UNIVERSAL CAPITAL BANK AD,
PODGORICA

SEPARATE FINANCIAL STATEMENTS FOR
THE YEAR ENDED DECEMBER 31, 2017

CONTENTS

Društvo za reviziju CH BDM d.o.o. Podgorica
Žiro račun: 520-34559-91; **Reg. broj:** 5-0803037/1 **PIB:** 03152324; **PDV**: 30/31-17725-0
Vučedolska 7, 81 000 Podgorica

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Universal Capital Bank AD Podgorica

We have audited the accompanying separate financial statements of Universal Capital Bank AD, Podgorica (hereinafter: "the Bank"), which comprise the separate balance sheet as at 31 December 2017, 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.
Smatramo da su revizorski dokazi koje smo prikupili dovoljni i odgovarajući da obezbijede osnovu za izražavanje našeg mišljenja.

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.

Opinion

In our opinion, separate financial statements present truly and objectively unconsolidated financial position of the Bank as at 31 December 2017, 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.

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INDEPENDENT AUDITOR'S REPORT (continued)

To the Shareholders of Universal Capital Bank AD Podgorica (continued)

Other Matter

The financial statements of the Bank as at and for the year ended December 31, 2016 were audited by another auditor, who expressed in his report dated 31 May, 2017 a positive opinion on these financial statements.

Report on other legal and law requirements

We have reviewed the Annual Management Report. Management is responsible for the preparation and presentation of the Annual Management Report in accordance with applicable regulations in Montenegro.

Our responsibility is to evaluate whether the Annual Management Report is consistent with the annual financial statements for the same business year and whether the Management Report has been prepared in accordance with the Law on Accounting of Montenegro.

Our opinion on the financial statements does not cover the Annual Management Report and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the Annual Management Report and, in doing so, consider whether the Annual Management Report is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

In accordance with the requirements of the Law on Accounting in Montenegro we considered whether the Annual Management Report has been prepared in accordance with the requirements of Articles 11, 12, 13 and 14 of that Law.

Based solely on the work required to be undertaken in the course of the audit of the financial statements and the procedure above, in our opinion:

- the information given in the Annual Management Report for the financial year for which the financial statements are prepared, is consistent with the financial statements;
- the Annual Management Report has been prepared in accordance with the requirements of Articles 11, 12, 13 and 14 of the Law on Accounting in Montenegro.

In addition, in light of the knowledge and understanding of the Bank and its environment obtained in the course of the audit, we are also required to report if we have identified material misstatements in the Annual Management Report. We have nothing to report in this respect.

CH BDM d.o.o. Podgorica

October 31, 2018

DRUŠTVO ZA REVIZIJU "CH BDM" PODGORICA

Đorđe Dimić; Certified Auditor

Licence no. 072 issued 9 March 2017

This is a translation of the original Independent Auditor's 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 financial statements.

SEPARATE INCOME STATEMENT
In the period from January 1 to December 31, 2017
(in thousands EUR)

	Notes	2017.	2016.
Interest income and similar income	3.1, 5a	3,412	2,779
Interest expense and similar expenses	3.1, 5b	(923)	(913)
NET INTEREST INCOME		**2,489**	**1,866**
Impairment losses	3.7, 6a	(395)	(280)
Provision charges	6b	(3)	2
Fee and commission income	3.1, 7a	1.703	877
Fee and commission expenses	3.1, 7b	(1,359)	(761)
NET FEE INCOME		**344**	**116**
Net losses from financial assets held for trading	8	(27)	(789)
Net gains from investment securities		412	479
Foreign exchange gains, net	3.2	222	1,072
Staff costs	3.15, 9	(1,286)	(1,164)
General and administrative costs	10	(1,143)	(711)
Depreciation/amortization charge	3.11, 10a	(292)	(248)
Other expenses		(67)	(25)
Other income	11	176	57
OPERATING PROFIT		**430**	**375**
Income tax	3.4, 12	(66)	(51)
NET PROFIT		**364**	**324**

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

SEPARATE BALANCE SHEET
As at December 31, 2017 (in thousands EUR)

	Notes	December 31, 2017.	December 31, 2016.
ASSETS			
Cash and deposit accounts held with central banks	3.5, 13	108,046	14,309
Loans and receivables from banks	3.6, 14	26,070	17,875
Loans and receivables from customers	3.6, 15	61,898	62,335
Investment securities			
- available for sale	3.8, 16	13,305	10,132
- held to maturity	3.8, 16	8,795	1,750
Investments in subsidiaries	3.9, 17	580	730
Property, plant and equipment	3.11, 3.12, 18	3,464	3,359
Intangible assets	3.11, 3.12, 19	591	374
Other financial receivables	20	1,564	751
Other operating receivables	3.14, 21	4,347	4,556
TOTAL ASSETS		**228,660**	**116,171**
LIABILITIES			
Deposits from Banks	22	206	-
Deposits from clients		207,235	98,172
Borrowings from banks	23	9	8
Borrowings from clients	24	7,780	6,890
Derivative financial liabilities as hedging instrument		84	757
Reserves		13	11
Current tax liabilities		37	45
Deferred tax liabilities	25	65	24
Other liabilities	26	727	238
Subordinated debt		2,997	1,002
TOTAL LIABILITIES		**219,153**	**107,147**
EQUITY	27		
Share capital		8,098	16,002
Accumulated Loss			(7,904)
Profit for the year		364	324
Other reserves		1,045	602
TOTAL EQUITY		**9,507**	**9,024**
TOTAL EQUITY AND LIABILITIES		**228,660**	**116,171**
OFF-BALANCE SHEET ITEMS	29	**129,239**	**98,058**

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TRANSLATION NOTE: This is a translation of the original document 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.

SEPARATE STATEMENT OF CHANGES IN EQUITY
In the period from January 1 to December 31, 2017
(in thousands EUR)

	Share Capital	Accumulated Loss	Profit for the year	Other reserves	Total
Balance, as at January 1, 2016	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	-	-	-	33	33
Balance, as at December 31, 2016	**16,002**	**(7,904)**	**324**	**602**	**9,023**
Distribution previous year profit	-	-	(324)	324	-
Profit for the year	-	-	364	-	364
Coverage of losses in previous years	(7,904)	7,904	-	-	-
Effects of valuation of securities available for sale	-	-	-	119	119
Balance, as at December 31, 2017	**8,098**	**-**	**364**	**1,045**	**9,507**

SEPARATE STATEMENT OF CASH FLOW
In the period from January 1 to December 31, 2017

(In thousand EUR)

	2017.	**2016.**
CASH FLOWS FROM OPERATING ACTIVITIES		
Inflows from interest and similar income	3,207	2,611
Outflows from interest and similar expense	(1,013)	(887)
Inflows from fees and commissions	1,683	896
Outflows from fees and commissions	(1,359)	(761)
Cash paid to employees and suppliers	(2,313)	(2,127)
Increase in loans and other assets	(541)	(38,089)
Inflows from deposits	108,468	27,059
Other inflows	-	328
Net cash (outflow)/inflow from operating activities	**108,132**	**(10,970)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(275)	(132)
Purchase of intangible assets	(338)	(161)
Treasury bills and treasury bonds	(9,391)	(250)
Income from sale of tangible and fixed assets	(7)	27
Net cash outflow from investing activities	**(10,011)**	**(516)**
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in borrowings	960	1,757
Net cash (outflow)/inflow from financing activities	**960**	**1,757**
Effects of foreign exchange in cash and cash equivalents	194	284
Net (decrease)/increase in cash and cash equivalents	**99,275**	**(9,445)**
Cash and cash equivalents, beginning of year	**32,196**	**41,641**
Cash and cash equivalents, end of year (note 13b)	**131,471**	**32,196**

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, 2017, the Bank comprised a Central Office located in Podgorica a branch office in Milocer, at hotel Maestral and in Podgorica street Petra Cetinjskog no 129. as well as representative office in Dubai. The Bank has 55 employees (December 31, 2016: 51 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, 2017, the Members of the Board of Directors were the following:

Name and surname	Position
Velibor Milosevic	President of the Board of Directors
Georgios Lychnos	Member of the Board of Directors
Djordje Djurdjic	Member of the Board of Directors
Jurij Daneu	Member of the Board of Directors
Bozo Milatovic	Member of the Board of Directors

As at December 31, 2017, the Executive Directors were as follows:

Name and surname	Position
Djordje Djurdjic	Chief Executive Officer
Milos Pavlovic	Executive Director

1. FOUNDATION AND BUSINESS ACTIVITY OF THE BANK (continued)

As at December 31, 2017, the Members of the Board for Auditing were as follows:

Name and surname	Position
Goran Bencun	President
Sonja Burzan	Deputy President
Lazar Misurovic	Member

As at December 31, 2017, the Members of the Committee for Management of Assets, Equity and Liabilities were as follows

Name and surname	Position
Djordje Djurdjic	Chief Executive Officer
Milos Pavlović	Executive Director
Mirza Redzepagic	Head of the Funds Management Department
Vesna Durkovic	Head of the Department for supervising, management and risk reporting
Vanja Bojanovic	Head of Sales Department - Corporate

As at December 31, 2017, the internal auditor of the Bank was Edin Sehovic.

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, 40/11 and 73/17) 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, 18/13 and 24/18).

The accompanying financial statements are individual in terms of including unconsolidated position of receivables, liabilities, the results of operating business, changes in equity and cash flow of the Bank without including a subsidiary – Universal Capital Development DOO, which is 100% in the ownership of the Bank. The Bank is in accordance with regulations from article 134. Low of Banks (Official Gazette of Montenegro, no 078/08, 044/10, 040/11 and 073/17) exempted from preparing consolidated financial statements where is defined that subordinated members of banking group whose balance sheet is less than 1% of the balance sheet of superior member of the group exempted from consolidation. The Bank applies the cost method i.e. cost while evaluating the participation. The total assets of the subsidiary make 0.29% of the total assets as at December 31, 2017.

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, 2017.

In accordance with the Law on Accounting of Montenegro the legal entities are preparing financial statements according to IAS i.e. 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.

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

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

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 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, 2017 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 which are detailed explained in Note 3, 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.

2.4. Comparative data in these financial statements represent data of financial statements of the Bank for 2016.

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.

3.1. 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.

3.2. 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.

3.3. 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.4. Taxes and Contributions (continued)

Income Taxes

Current income taxes

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.

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), cash at treasury (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, as well as other highly liquid assets with maturity up to three months.

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, 57/13, 44/17 and 82/17) 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.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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, 57/13, 44/17 and 82/17) 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.

When assessing the value of impairment of financial assets, the Bank complies with accounting regulations applied in Montenegro as 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;

Accounting polices applied in Montenegro 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.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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 recognized, 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.

<u>Corporate loans (including SMEs)</u>

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).

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 favour 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.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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.

<u>Retail loans</u>

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.

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, 57/13, 44/17 and 82/17), the Bank is obligated, depending on the probability of loss, to classify asset items into the following categories:

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

- 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

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 policies of Montenegro.

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 reserve 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.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

In accordance with the Decision on Minimum Standards for Credit Risk Management in Banks ("Off. Gazette of Montenegro", 22/12, 55/12, 57/13, 44/17 and 82/17), 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 proceeding 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.

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. 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 2021.

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 „Official Gazette of Montenegro“, 038/11, 055/12 and 082/17).

3.9. Investments in subsidiaries

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.

3.10. Derecognition of financial asset

Recognition of financial asset is terminated when the Bank has no more right on cash inflow from financial asset i.e. when the Bank transfer all the risks and benefits from ownership over the assets.

Recognition of financial liability is terminated when the obligation is completed i.e. when the dept is paid, cancelled or expired.
If the conditions for excluding receivables from balance sheet are completed the Bank is obligated to write off this receivable and to keep it in their internal records at written off amount until finalizing the collection process.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.11. Property, Plant, Equipment and Intangible Assets

Property, Plant, Equipment and Intangible Assets on December 31, 2017 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 %
	2017	**2016**
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%.

3.12. 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 recognized 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 recognized for the asset in prior years.

Management of Bank believes that the total value of tangible and intangible assets as at 31 December 2017 is not overrated.

3.13. Provisions

Provisions are recognized 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.

3.14 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, 16/15 and 82/17), the total investment of the Bank in real estate and fixed assets shall not be greater than share equity of the Bank's own funds.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.14. Acquired Assets (Continued)

Exceptionally, the Bank may have investments in real estate and fixed assets even above the level of the equity, if the following conditions are met:

1) the amount of investment in real estate and fixed assets exceeding the amount of share equity calculated in accordance with paragraph 1 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.

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.

3.15 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, in accordance with IAS 19 these financial statements do not comprise provisions based on the above employee benefits.

3.16. Financial Liabilities – Borrowings

Borrowings are initially recognized 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.

3.17. Fair Value

Accountant policies applied in Montenegro 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.17. Fair Value (continued)

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 by accountant policies applied in Montenegro. 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 recognized 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 risk, 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 risk which is reported to the Committee on asset and liability management and the Board of Directors on a monthly basis.

4.2. Credit risk

Bank 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.

4. RISK MANAGEMENT (continued)

4.2. Credit risk (continued)

4.2.1. Credit risk management (continued)

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 accountant policies of Montenegro

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.

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

(In thousand EUR)

Balance sheet items	**2017.**	**2016.**
Loans and receivables from banks	26,070	17,875
Loans and receivables from clients	61,898	62,335
Securities – available for sale	13,305	10,132
Securities – held to maturity	8,795	1,750
Other financial receivables	1,564	751
	111,632	**92,843**
Off-balance sheet items -Payment guarantees	1,284	2,216
Performance guarantees	282	99
The customs guarantee	1,070	676
The tender guarantees	8	6
Letters of credit	94	20
Undrawn credit facilities	14,534	1,114
	17,272	**4,131**
Total exposure to credit risk Balance sheet items	**128,904**	**96,974**

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.

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 (continued)

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, 2017	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)	6,091	-	5,019	11.110	50	-	50	11.060
Purchase of fixed assets	15,464	-	1,984	17.448	252	-	252	17.196
Overdraft	15,000	-	2,426	17.426	28	-	28	17.398
Preparation of tourist season	34	-	639	673	107	-	107	566
Housing loans	65	1	768	834	56	-	56	778
Other	5,141	1	3,041	8.183	99	-	99	8.084
Cash loans(general purpose)	236	9	2,529	2.774	238	24	262	2.512
Refinancing of liabilities towards to other banks	-	-	3,985	3.985	90	-	90	3.895
Interest receivables and Prepayments	147	7	394	548	139	-	139	409
	42,178	**18**	**20,785**	**62.981**	**1.059**	**24**	**1.083**	**61.898**

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**

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 thousand EUR)

	Past due up 30 days	Past due 31-90 days	Past due 91-270 days	Past due 270-365 days	Over 365 days	Total
December 31, 2017						
Loans to legal entities	4	-	-	-	-	4
Loans to entrepreneurs	3	9	-	-	-	12
Loans to individuals –residents	1	1	-	-	-	2
Loans to individuals - non-residents						
	8	**10**	**-**	**-**	**-**	**18**
December 31, 2016						
Loans to individuals –residents	27	25	-	-	-	52
Loans to individuals - non-residents	-	-	-	-	-	-
	27	**25**	**-**	**-**	**-**	**52**

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4. RISK MANAGEMENT (Continued)

4.2. Credit risk (Continued)

4.2.4. Loans and Advances (Continued)

b) 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 2017, the Bank restructured loans in the amount of EUR 8,751 thousand, out of which the amount of EUR 7,656 thousand related to legal entities (2016: 1,475 thousand) and EUR 1,095 thousand to individuals (2016: EUR 502 thousand).

c) Geographic Concentration

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

(In thousand EUR)

	Montenegro	European Union	Other countries in Europe	Other	Total
Loans and receivables from banks	-	10,299	12,626	3,145	26,070
Loans and receivables from clients	61,172	132	-	594	61,898
Securities held to maturity	8,795	-	-	-	8,795
Securities available for sale	13,305	-	-	-	13,305
Other financial receivables	1,564	-	-	-	1,564
December 31, 2017	**84,836**	**10,431**	**12,626**	**3,739**	**111,632**
December 31, 2016	**73,213**	**11,551**	**-**	**8,079**	**92,843**

NOTES TO THE SEPARATE FINANCIAL STATEMENTS
Year Ended December 31, 2017

4. RISK MANAGEMENT (Continued)

4.2. Credit risk (Continued)

4.2.4. Loans and Advances (Continued)

d) Industry Concentration

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

	Financies	Transportation, traffic and telecomunication	Services, tourism and hospitality	Trade	Building and construction	Mining	Administration	Professional, scientific and technological activities	Agriculture, hunting and fishing	Manufacturing	Other	Individuals	Total
Loans for receivables	26,070	-	-	-	-	-	-	-	-	-	-	-	26,070
Loans and receivables from customers	5,000	1,304	20,925	5,159	16,427	851	1,066	5,489	99	-	1,222	4,356	61,898
Securities available for sale	13,305	-	-	-	-	-	-	-	-	-	-	-	13,305
Securities held to maturity	8,795	-	-	-	-	-	-	-	-	-	-	-	8,795
Other financial receivables	-	-	409	-	-	-	-	-	-	-	1,155	-	1,564
December 31, 2017	**53,170**	**1,304**	**21,334**	**5,159**	**16,427**	**851**	**1,066**	**5,489**	**99**	-	2,377	4,356	111,632
December 31, 2016	**34,914**	**1,456**	**16,064**	**4,368**	**16,199**	**1,079**	**1,018**	**5,157**	**106**	**1,318**	**4,082**	**7,082**	**92,843**

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 thousand EUR)

	Undrown Loan Facilities	Guarantees	Uncovered Letters of Credit	Total
December 31, 2017				
Up to one year	12,237	1,328	94	13,659
From 1 to 5 years	2,297	1,316	-	3,613
	14,534	**2,644**	**94**	**17,272**

(In thousand EUR)

	Undrown 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**

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, 2017 is shown in the following table:

(In thousand EUR)	USD	GBP	CHF	Other	Total
Assets in foreign currencies	8,674	12,250	114	1,989	23,027
Liabilities in foreign currencies	8,737	12,238	74	2,223	23,272
Net open position:					
- December 31, 2017	(63)	12	40	(234)	(245)
- December 31, 2016	(31)	16	63	7	55
% of share capital:					
- December 31, 2017	(1,01%)	0,19%	0,64%	(3,77%)	
- December 31, 2016	(0,59%)	0,30%	1,20%	0,13%	
Aggregate open position:					
- December 31, 2017	(245)				
- December 31, 2016	55				
-% of share capital:					
- December 31, 2017	(3,95)%				
- December 31,2016	1,04%				

4. RISK MANAGEMENT (Continued)

4.3. Market Risk (continued)

4.3.1. Foreign Exchange Risk (Continued)

U thousand EUR

	GBP	Other currencies	Total Foreign currencies	Local Currency (EUR)	Total
FINANCIAL ASSETS					
Cash and deposits with the central banks	26	261	287	107,759	108,046
Loans and receivables from banks	4,187	10,764	14,951	11,119	26,070
Loans and advances to customers	-	-	-	61,898	61,898
Securities available for sale	-	-	-	13,305	13,305
Securities held to maturity	-	-	-	8,795	8,795
Other financial receivables	-	-	-	1,564	1.564
Total financial assets	**4,213**	**11,025**	**15,238**	**204,440**	**219,678**
FINANCIAL LIABILITIES					
Deposits due to Banks				206	206
Deposits due to clients	11,675	11,037	22,712	184,522	207,235
Borrowings from Bank				9	9
Borrowings from other clients	564	-	564	7,216	7,780
Derivative financial liabilities as a protection instrument	-	-	-	84	84
Subordinated debt	-	-	-	2,997	2,997
Total financial liabilities	**12,239**	**11,037**	**23,276**	**195,034**	**218,311**
Net foreign exchange exposure:					
December 31, 2017	**(8,026)**	**(12)**	**(8,038)**	**9,406**	**1,367**
December 31, 2016	**(9,176)**	**77**	**(9,099)**	**10,179**	**1,080**

4. RISK MANAGEMENT (Continued)

4.3. Market Risk (continued)

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, 2017:

(In thousand EUR)

	Interest bearing	Non – interest bearing	Total
FINANCIAL ASSETS			
Cash balances and deposits with central banks	7,081	100,965	108,046
Loans and receivables from banks	4,105	21,965	26,070
Loans and receivables from clients	61,898	-	61,898
Held-to-maturity securities	13,305	-	13,305
Available for sale securities	8,795	-	8,795
Other financial receivables	409	1,155	1,564
Total financial assets	**95,593**	**124,085**	**219,678**
FINANCIAL LIABILITIES			
Deposits due to Banks	-	206	206
Deposits due to clients	28,284	178,951	207,235
Borrowings from banks	9	-	9
Borrowings from other clients	7,780	-	7,780
Derivative financial liabilities as a hedging instrument	-	84	84
Subordinated debt	2,997	-	2,997
Total financial liabilities	**39,070**	**179,241**	**218,311**
Interest rate risk exposure:			
- December 31, 2017	**56,523**	**(55,156)**	**1,367**
- December 31, 2016	**26,700**	**(26,377)**	**323**

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 2017 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%

Deposit interest rates which were applicable on deposits of legal entities during 2017 were as follows:

Deposit type	**Interest rate**
Short-term deposits	0.10%-0.75%
Long-term deposits	0.75%-1.75%

Deposit interest rates which were applicable on deposits of individuals during 2017 were as follows:

Deposit type	**Interest rate**
Deposits on demand	
- EUR	
Term deposits in EUR:	0,10%
- from 1 to 3 months	0,50%
- from 3 to 6 months	0,75%
- from 7 to 12 months	1,25%
- from 13 to 24 months	1,75%
- from 24 to 36 months	
Term deposits in foreign currencies:	0,10%
- from 1 to 6	0,25%
- from 9 to 12	0,50%

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

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

4. RISK MANAGEMENT (Continued)

4.4. Liquidity Risk (continued)

4.4.1. Liquidity Risk Management

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, 2017 were as follows:

(In thousand 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	100,238	-	-	-	7,808	-	108,046
Loans and receivables from banks	25,344	466	-	-	260	-	26,070
Loans and receivables from clients	672	1,200	3,884	13,824	18,822	23,496	61,898
Securities held to maturity	8,795	-	-	-	-	-	8,795
Securities available for sale	-	-	-	-	13,305	-	13,305
Other financial receivables	-	948	-	92	115	409	1,564
	135,049	**2,614**	**3,884**	**13,916**	**40,310**	**23,905**	**219,678**
Financial liabilities							
Deposits due to banks	206	-	-	-	-	-	206
Deposits due to clients	34,632	8,869	9,153	28,056	118,617	7,908	207,235
Borrowings from banks	9	-	-	-	-	-	9
Borrowings from clients	49	244	198	1,191	4,043	2,055	7,780
Derivative financial liabilities as hedging instrument	-	84	-	-	-	-	84
Subordinated debt	-	-	-	-	-	2,997	2,997
	34,896	**9,197**	**9,351**	**29,247**	**122,660**	**12,960**	**218,311**
Maturity gap							
December 31, 2017	100,153	(6,583)	(5,467)	(15,331)	(82,350)	10,945	1,367
Cumulative Gap	100,153	93,570	88,103	72,772	(9,578)	1,367	346,387
% of the total source of financing	**45,9%**	**42,9%**	**40,4%**	**33,4%**	**(4,4%)**	**0,6%**	**-**
December 31, 2016	(26,979)	6,094	3,450	2,614	14,900	1,758	1,837
Cumulative Gap	(26,979)	(20,885)	(17,435)	(14,821)	79	1,837	(78,204)
% of the total source of financing	**(25,4%)**	**(19,7%)**	**(16,4%)**	**(14,7%)**	**(0,6%)**	**1,0%**	**-**

4. RISK MANAGEMENT (Continued)

4.4. Liquidity Risk (continued)

4.4. Liquidity Risk Management (continued)

As at December 31, 2017, the structure of assets and liabilities indicates the existence of non-conformities of remaining period of maturity of assets and liabilities within the maturity from 16 days up to over 5 years. 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 caused a high level of demand deposits on one side, approved loans and purchased securities on longer terms, on the other side. The Bank is ready to take the risk of incompatibility exclusively thanks to the fact that for all securities from the portfolio there is a developed second – hand market and therefore the purchased securities have the treatment of secondary liquidity reserve. In the past the Bank did not have the negative outflow of mentioned deposits in the short intervals. Also, the Bank based on experiential method in 2017 has developed the methodology for determining stable level of demand deposits i.e. it performed more adequate rearrangement of demand deposits where the cumulative GAP covers all negative GAP's in other time intervals.

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

(In thousand EUR)

	On demand	Up to one months	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
December 31, 2017							
FINANCIAL LIABILITIES							
Liabilities to banks	9	-	-	-	-	-	9
Liabilities to other customers	49	-	244	1,387	4,043	2,057	7,780
Deposits of banks	206	-	-	-	-	-	206
Deposits of clients	18,924	17,608	8,994	36,909	116,892	7,908	207,235
Derivative financial liabilities as a protection instrument	-	-	84	-	-	-	84
Subordinated debt	-	-	-	-	-	2,997	2,997
	19,188	**17,608**	**9,322**	**38,296**	**120,935**	**12,962**	**218,311**

(In thousand EUR)

	On demand	Up to 1 months	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 Banks	8	-	-	-	-	-	8
Liabilities to other costumers	67	-	304	950	4,282	1,287	6,890
Deposits of Banks	56,261	557	199	8,253	29,041	3,861	98,172
Deposits of clients	-	-	-	757	-	-	757
Derivative financial liabilities as hedging instrument	-	-	-	-	1,002	-	1,002
	56,336	**557**	**503**	**9,960**	**34,325**	**5,148**	**106,829**

3. RISK MANAGEMENT (Continued)

4.5 Fair Value of Financial Assets and Liabilities

(In thousand EUR)

	Carrying Amount		Fair Value	
	2017.	2016.	2017.	2016.
Financial assets				
Cash balances and deposit accounts with central banks	108,046	14,309	108,046	14,309
Loans and receivables from banks	26,070	17,875	26,070	17,875
Loans and receivables from clients	61,898	62,335	61,898	62,335
Securities available for sale	13,305	10,132	13,305	10,132
Securities held-to-maturity	8,795	1,750	8,795	1,750
Investments in subsidiaries	580	730	580	730
Other financial liabilities	1,564	751	1,564	751
Total assets:	**220,258**	**107,882**	**220,258**	**107,882**
Financial liabilities				
Deposits of banks	206	-	206	-
Deposits of clients	207,235	98,172	207,235	98,172
Borrowed funds from other clients	7,780	6,890	7,780	6,890
Borrowed funds from banks	9	8	9	8
Derivative financial liabilities as a protection instrument	84	757	84	757
Subordinated debt	2,997	1,002	2,997	1,002
Total Liabilities:	**218,311**	**106,829**	**218,311**	**106,829**

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.

4.5 Fair Value of Financial Assets and Liabilities (continued)

c) Available for sale securities

Securities held for sale are valued at fair value based on market prices. As at December 31, 2017 market prices valued at fair value were available. They relate to bonds issued by the Ministry of Finance of Montenegro which mature 2019, 2020 and 2021.

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 instrument.

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.

g) Fair value hierarchy

Accountant policies applied in Montenegro 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.

h) Cash balances and deposit accounts with central banks

Cash balances and deposit accounts with central banks include cash and cash equivalents at the treasury of the bank and on the accounts at Central bank of Montenegro.

Fair value of these financial assets is approximately equal to the carrying value of financial assets at the balance sheet day.

4.6 Fair Value of Financial Assets and Liabilities (continued)

i) Other financial liabilities

Other financial liabilities include trade receivables, receivables from card operations, temporary accounts and other financial liabilities.

Fair value of these financial assets is approximately equal to the carrying value of financial assets at the balance sheet day.

Fair value hierarchy of financial instruments valuated at fair value

Estimated fair value of financial instruments, according to fair value were as follows:

December 31, 2017.	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets held for trade	13,305	-	-	13,305
Total assets	**13,305**	**-**	**-**	**13,305**
Derivative financial liabilities as hedging instrument	-	84	-	84
Total liabilities	**-**	**84**	**-**	**84**

December 31, 2016	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets held for trade	10,132	-	-	10,132
Total assets	**10,132**	**-**	**-**	**10,132**
Derivative financial liabilities as hedging instrument	-	757	-	757
Total liabilities	**-**	**757**	**-**	**757**

Fair value hierarchy of financial instruments valuated at fair value

Estimated fair value of financial instruments, according to fair value were as follows:

December 31, 2017	**Level 1**	**Level 2**	**Level 3**	**Total**	**Carrying value**
Cash balances and deposit accounts with central bank	-	108,046		108,046	108,046
Loans and bank receivables	-	-	26,070	26,070	26,070
Loans and client receivables	-	-	61,898	61,898	61,898
Securities held to maturity	-	8,795		8,795	8,795
Investments in subsidiaries	-	-	580	580	580
Other financial receivables	-	-	1,564	1,564	1,564
Total assets	**-**	**116,841**	**90,112**	**206,953**	**206,953**
Bank deposits	-	-	206	206	206
Client deposits	-	-	207,235	207235	207,235
Borrowings from banks	-	-	7,780	7,780	7,780
Borrowings from other clients	-	-	9	9	9
Subordinated dept	-	-	2,997	2,997	2,997
Total liabilities	**-**	**-**	**218,227**	**218,227**	**218,227**

4. RISK MANAGEMENT (Continued)

4.5 Fair Value of Financial Assets and Liabilities (continued)

December 31, 2016	Level 1	Level 2	Level 3	Total	Carrying value
Cash balances and deposit accounts with central bank	-	14,309		14,309	14,309
Loans and bank receivables	-	-	17,875	17,875	17,875
Loans and client receivables	-	-	62,335	62,335	62,335
Securities held to maturity	-	1,750	-	1,750	1,750
Investments in subsidiaries	-	-	730	730	730
Other financial receivables	-	-	751	751	751
Total assets		**16,059**	**81,691**	**97,750**	**97,750**
Bank deposits	-	-	98,172	98,172	98,172
Client deposits	-	-	6,890	6,890	6,890
Borrowings from banks	-	-	8	8	8
Borrowings from other clients	-	-	1,002	1,002	1,002
Subordinated dept	**-**	**-**	**106,072**	**106,072**	**106,072**

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, 55/12 and 82/17). 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) unrealized 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.

4. RISK MANAGEMENT (Continued)

4.6. Capital Management (continued)

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 Central Bank of Montenegro Decision on capital adequacy;
5) hybrid instruments meeting the requirements set out in the Central Bank of Montenegro Decision on capital adequacy;
6) revaluation reserves for real estate property owned by a bank.

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 2017, the solvency ratio calculated by the Bank amounted to 17.60% (2016: 12.77%). The Bank's compliance with regulatory indicators is given in Note 28.

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 thousand EUR)

		2017.	Change in exchange rate	
	Total	Amount in foreign currency	10%	-10%
Financial assets				
Cash balances and deposit accounts with central bank	108,046	287	29	(29)
Loans and advances to banks	26,070	14,951	1,495	(1,495)
Off-balance sheet - Contracts for the purchase of foreign currency	7,789	7,789	779	(779)
Total financial assets	**141,905**	**23,027**	**2,303**	**(2,303)**
Financial liabilities				
Bank deposits	206	-	-	-
Client deposits	207,235	22,712	2,271	(2,271)
Borrowings from and banks	9	-	-	-
Borrowings from clients	7,780	564	56	(56)
Derivative financial liabilities as hedging instrument	84	-		
Total financial liabilities	**215,314**	**23,276**	**2,327**	**(2,327)**
Net exposure to foreign exchange risk:				
December 31, 2017			**(24)**	**24**
December 31, 2016			**(52)**	**52**

4. RISK MANAGEMENT (Continued)

4.7. Sensitivity analysis

4.7.1. Sensitivity analysis (Foreign Exchange Risk) (continued)

As at December 31, 2017, 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 53 thousand (December 31, 2016: decrease, i.e., increase by EUR 52 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.

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 thousand EUR)

		Net effect movements in interest rates	
	2017.	**+0.4 b.p. EUR KS**	**-0.4 b.p. EUR KS**
Financial assets			
Cash and deposits with central banks	108,046	-	-
Loans and receivables from banks	26,070	-	-
Loans and receivables from clients	61,898	248	(248)
Securities available for sale	13,305	53	(53)
Securities held to maturity	8,795	35	(35)
Other financial receivable	1,564	-	-
	219,678	**336**	**(336)**
Financial liabilities			
Bank deposits	206	-	-
Client and bank deposits	207,235	829	(829)
Borrowings from banks	9	-	-
Borrowings from other clients	7,780	31	(31)
Derivative financial liabilities as hedging ins	84	-	-
Subordinated debt	2,997	12	(12)
	218,311	**872**	**(872)**
Net exposure to the interest rate risk:			
- **December 31, 2017**		**(536)**	**536**
- **December 31, 2016**		**(127)**	**127**

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 537 thousand.

5. INTEREST INCOME AND EXPENSE

a) Interest Income

(In thousand EUR)	2017.	2016.
Deposits with:		
- foreign banks	11	3
Loans:		
- corporate	2,455	1,879
- retail	448	682
	2,914	2,564
Securities available for sale	459	252
Securities held to maturities	125	10
	3,498	2,823
Allowances for interest receivables	(86)	(47)
	3,412	**2,779**

b) Interest Expense

(In thousand EUR)	2017.	2016.
Deposits with:		
- government	70	1
- corporate	439	486
- retail	263	230
Loans and other borrowings	151	196
	923	**913**

6. IMPAIRMENT LOSSES AND PROVISIONS

a) Impairment losses

(In thousand EUR)	2017.	2016.
Impairment of loans	245	280
Impairment of investment in subsidiaries	150	-
	395	**280**

b) Provisions expenses

(In thousand EUR)	2017.	2016.
Net (decrease)/ increase in provisions in respect of:		
- off-balance sheet items	**3**	**(2)**

6. IMPAIRMENT LOSSES AND PROVISIONS (continued)

c) Changes in allowance for impairment 2017

(In thousands EUR)	Loans (note 15)	Investments in subsidiaries (note 17)	Interest and other (note 15)	Provision for off-balance items	Total
Opening balance	726	-	74	11	811
Charge for the year	245	150	86	3	484
Transfer to off-balance sheet	(27)	-	(21)	(1)	(49)
Balance at the end of the year	**944**	**150**	**139**	**13**	**1,246**

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

7. FEE AND COMMISSION INCOME AND EXPENSE

a) Fees and Commissions Income

(In thousands of EUR)	2017.	2016.
Fees and commissions for foreign payments	758	404
Fees for opening and maintaining the account	141	125
Fees on credit card business	177	113
Fees and commissions income from transactions payments and e- banking	113	85
Fees from loans	143	73
Fees income from off-balance-sheet operations	78	-
Other fees and commissions income	119	-
Fees from off-sheet operations	51	51
Other fees and provisions	123	26
	1,703	**877**

7. FEE AND COMMISSION INCOME AND EXPENSE (Continued)

b) Fees and Commissions Expense

(In thousands of EUR)	2017.	2016.
Deposit insurance premium fees	617	370
Fees of the Central Bank	304	155
Visa and Master card fees	122	92
International bank charges fees	137	52
Fees for electronic banking	75	47
Other fees and commissions	104	45
	1,359	**761**

8. NET LOSSES FROM FINANCIAL INSTRUMENTS HELD FOR TRADING

Net losses on financial instruments as at December 31, 2017 amounted to EUR 27 thousand (as at December 31, 2016 amounted to 789 thousand) and were created by reducing Swap transaction at fair value. Namely, Swap has classified as financial assets as hedging instrument as financial liability carried 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)	2017.	2016.
Net salaries	641	575
Taxes, surtaxes and contributions	451	438
Remunerations to members of the Board of Directors	116	50
Travel expenses and per diems	32	39
Retirement benefits and jubilee awards	3	29
Fees for temporary jobs	26	27
Employees trainings	8	4
Other net payments to employees	9	-
Provisions for pensions	-	2
	1,286	**1,164**

10. GENERAL AND ADMINISTRATIVE EXPENSES

(In thousands of EUR)	2017.	2016.
Professional fees	379	206
Computer and other equipment maintenance	134	121
Rentals	68	88
Communications networks	53	57
Security	63	56
Electricity and fuel	39	39
Audit	29	31
Telecommunication expenses	35	28
Membership fees and contributions	66	22
Office supplies expenses	13	17
Insurance	38	15
Miscellaneous expenses	88	13
Utilities	5	5
Representation expenses	30	5
Advertising and marketing	57	3
Postage	2	3
Court expenses	4	2
Consulting fees	40	-
	1,143	**711**

10a. DEPRECIATION EXPENSES

(In thousands of EUR)	2017.	2016.
Property, plant and equipment (Note 18)	171	169
Intangible assets (Note 19)	121	79
	292	**248**

11. OTHER INCOME

(In thousands of EUR)	2017.	2016.
Capital gain	-	23
Collection from written-off loans	7	15
Other extraordinary income	-	10
Correction from the previous year	165	6
Lease income	4	3
	176	**57**

12. INCOME TAXES

a) Components of Income Taxes

(In thousands of EUR)	2017.	2016.
Current taxes	36	45
Deferred taxes	30	6
	66	**51**

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

(In thousands of EUR)	2017.	2016.
Result in income statement before tax	430	375
Depreciation expenses in income statement	292	248
Depreciation expenses for tax purposes	(502)	(407)
Other	30	9
Total	**250**	**225**
Capital gains	(412)	(502)
Capital loss	7	-
Loss for tax balance sheet	(155)	(277)
Total capital gains for the year - tax base	**405**	**502**
Tax on capital gains	36	45
Tax from the tax registration	36	45
Effective tax rate	**8%**	**12%**

12. INCOME TAXES (continued)

c) Deferred tax

Generated in	Expires in	In thousands of EUR
2012	2017	136
2013	2018	277
		413

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

It was recognized the amount of deferred taxes of EUR 30 thousand as 9% of the difference between current carrying value and tax basis of fixed assets that were incurred as consequence of the difference between calculated accounting and tax depreciation of fixed assets for 2017.

13. CASH AND DEPOSIT ACCOUNTS HELD WITH CENTRAL BANKS

(In thousands of EUR)	December 31, 2017.	December 31, 2016.
Cash in hand:		
- in EUR	82	24
- in foreign currency	1	1
Cash at treasury		
-in EUR	4,504	250
-in foreign currency	286	92
Cash at ATM	-	127
Gyro account	89,012	6,391
Obligatory reserves with the Central Bank of Montenegro	14,161	7,424
	108,046	**14,309**

The Bank’s obligatory reserves as at December 31, 2017 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, 7/15 and 70/17) (hereinafter: the Decision), which prescribes that Bank’s allocate the obligatory reserve by applying rate of:

- 7.5% on deposits base which is consisted of demand deposits and deposits with agreed maturity up to one year, or up to 365 days and
- 6.5% on deposit base which is consisted of deposits with agreed maturity over one year, or over 365 days.

In thousand EUR	2017.	2016.
Cash in hand:		
- in EUR	82	24
- in foreign currency	1	1
Cash at treasury		
-in EUR	4,504	250
-in foreign currency	286	92
Cash at ATM	-	127
Gyro account	89,012	6,391
Obligatory reserves with the Central Bank of Montenegro	14,161	7,424
Assets at CDA	-	12
Correspondent accounts at foreign banks	23,425	17,875
Total	**131,471**	**32,196**

13. CASH AND DEPOSIT ACCOUNTS HELD WITH CENTRAL BANKS (continued)

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, 2017:

- For the amount of 50% of the obligatory reserve of the set aside requirement, the Central Bank pays monthly fee up to eight in the month for previous month, calculated fee 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, 2017.	December 31, 2016.
Correspondent accounts held at foreign banks	26,070	17,875
	26,070	**17,875**

As at December 31, 2017, the Bank has exposure to one bank in the amount exceeding 25% of regulatory capital, (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 28.

15. LOANS AND RECEIVABLES FROM CLIENTS

(In thousands of EUR)	December 31, 2017.	December 31, 2016.
Loans:		
- privately-owned companies	58,086	56,861
- retail	4,348	5,365
- other – entrepreneurs and non-governmental organizations	175	211
- public service	-	349
	62,609	**62,786**
Comprising of:		
Short-term loans:		
- privately-owned companies	7,311	14,087
- retail	58	76
	7,369	**14,163**
Long-term loans:		
- privately-owned companies	50,775	42,774
- retail	4,290	5,289
- other – entrepreneurs and non-governmental organizations	175	211
- public service	-	349
	55,240	**48,623**
Interest receivables:		
- loans	388	403
Accruals:		
- interest on loans	160	171
- loan origination fees	(176)	(225)
	62,981	**63,135**
Less:		
Allowance of impairment of loans	(944)	(726)
Allowance of impairment of interest	(139)	(74)
	(1,083)	(800)
	61,898	**62,335**

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.

15. LOANS AND RECEIVABLES FROM CLIENTS (continued)

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

(In thousands of EUR)	December 31, 2017.	December 31, 2016.
Construction	16,427	17,067
Retail	4,356	5,365
Art and entertainment activities	7,281	3,938
Transport and storage	1,284	1,427
Trade	5,159	4,368
Manufacturing	1,654	1,158
Restaurant and accommodation services	13,500	15,891
State administration and mandatory social insurance	5,000	5,000
Supply of electrical energy	158	160
Mining	851	1,079
Health and social care	931	1,018
Professional, scientific and technical activities	5,489	5,967
Agriculture, forestry and fishing	99	106
Administrative and support service activities	135	40
Information and communication	20	29
Other service activities	265	173
	62,609	**62,786**

16. INVESTMENT SECURITIES

Securities available for sale

As at 31 December 2017 Securities available for sale amounted to EUR 13,305 thousand (as at December 31, 2016 amounted to EUR 10,132) and refer to comprised bonds issued by the Ministry of Finance of Montenegro issued with interest rates from 3.875% to 5.75% and a maturity from May 2019 to March 2021.

Securities held to maturity

As at December 31, 2017, securities held to maturity amounted to EUR 8,795 thousand (2016: EUR 1,750 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 June 2017 with maturity date in January 2018, with annual interest rates from 1.00% to 1.95%.

17. INVESTMENTS IN SUBSIDIARIES

The basic capital of Universal Capital Development DOO amounted to EUR 580 thousand (2016: 730 thousand), entirely in cash.
The bank is during 2017 performed impairment of investments in subsidiaries in the amount of EUR 150 thousand (note 6).

18. PROPERTY, PLANT AND EQUIPMENT

Movements in property, plant, equipment and other assets for 2017 and 2016 are presented as follows:

(In thousands of EUR)	Buildings	Equipment and other Assets	Investments in progress	Total
Cost				
Balance, January 1, 2016	2,823	1,512	190	4,525
Additions	16	13	196	225
Transfers to intangible assets	-	-	(248)	(248)
Transfers	-	52	(52)	-
Balance, December 31, 2016	**2,839**	**1,577**	**86**	**4,502**
Additions	-	17	598	615
Transfers to intangible assets	-	-	(338)	(338)
Transfers	-	274	(274)	-
Balance, December 31, 2017	**2,839**	**1,868**	**72**	**4,779**
Accumulated depreciation				
Balance, January 1, 2016	(23)	(968)	-	(991)
Depreciation (Note 10a)	(28)	(141)	-	(169)
Disposals	-	17	-	17
Balance, December 31, 2017	**(51)**	**(1,092)**	**-**	**(1,143)**
Depreciation (Note 10a)	(28)	(143)	-	(171)
Disposals	-	-	-	-
Balance, December 31, 2017	**(79)**	**(1,235)**	**-**	**(1,314)**
Carrying value:				
December 31, 2017	**2,760**	**633**	**72**	**3,465**
December 31, 2016	**2,788**	**485**	**86**	**3,359**

As at December 31, 2017, 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 2017 and 2016 were as follows:

(In thousands of EUR)	**2017.**	**2016.**
Cost		
Balance, January 1	1,099	851
Transfer from property, plants and equipment	338	248
	1,437	**1,099**
Balance, December 31		
	725	646
Allowance for impairment		
Balance, January 1	121	79
Depreciation (Note 10a)	**846**	**725**
The carrying value as at December 31	**591**	**374**

20. OTHER FINANCIAL LIABILITIES

Other financial liabilities refer to:

(In thousand EUR)	**2017.**	**2016.**
Trade receivables	446	513
Receivables for card operations	827	157
Temporary account	121	-
Other financial liabilities	170	82
	1,564	**752**

21. OTHER OPERATING RECEIVABLES

Other operating receivables in amount of EUR 4,347 thousand (December 31, 2016: EUR 4,556 thousand) mostly relate to assets acquired through collecting receivables, which are owned by the Bank in the amount EUR 4,189 thousand (December 31, 2016: EUR 4,278 thousand). The acquired assets are recorded at the lower of the total amount of receivable and the estimated value of the asset.

22. DEPOSITS FROM CLIENTS

(In thousands of EUR)	December 31, 2017.	December 31, 2016.
Demand deposits:		
- privately-owned companies	77,398	33,570
- state owned companies	35	4
- funds	393	106
- regulatory agencies	134	33
- entrepreneurs	4	84
- retail customers	89,771	22,388
- non-profit organizations	9	52
- other	5,020	24
	172,764	**56,261**
Short-term deposits:		
- privately-owned companies	6,636	5,262
- regulatory agencies	-	100
- retail customers	327	1,932
	6,963	**7,294**
Long-term deposits:		
- privately-owned companies	18,424	16,400
- retail customers	8,876	17,984
	27,300	**34,384**
Deposits interest	208	233
	207,235	**98,172**

23. BORROWINGS FROM OTHER CLIENTS

(In thousands of EUR)	2017.	2016.
European Investment Bank	947	1,444
Accrued interest	5	76
	952	**1,520**
Investment-Development Fund	6,263	4,785
	6,263	**4,785**
Wellrock Ventures Limited	564	584
Accrued interest	1	1
	565	**585**
Total	**7,780**	**6,890**

As at December 31, 2017, borrowings in the amount of EUR 952 thousand (December 31, 2016: EUR 1,520 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, 2017, borrowings in the amount of EUR 6,263 thousand (December 31, 2016: EUR 4,785 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, 2017, borrowings in the amount of EUR 565 thousand relate to the liabilities to Wellrock Ventures Limited with maturity up to March 31, 2020 with the annual interest rate of 0.1%.

23. BORROWINGS FROM OTHER CLIENTS (continued)

Maturity upon years is presented in the following tables:

European Investment Bank:

(In thousands of EUR)	2017.	2016.
Up to 1 year	346	497
Up to 2 years	320	346
Up to 3 years	219	320
Up to 4 years	62	219
Up to 5 years	-	62
	947	**1,444**

Investment-Development Fund:

(In thousands of EUR)	2017.	2016.
Up to 1 year	726	807
Up to 2 years	817	756
Up to 3 years	763	713
Up to 4 years	870	634
Up to 5 years	869	644
Over 5 years	2,218	1,231
	6,263	**4,785**

24. DERIVATIVE FINANCIAL LIABILITIES AS HEDGING INSTRUMENT

In 2017, the Bank has extended Swop arrangement at correspondent banks SberBank and Intesa Sanpaolo, Bosnia and Hercegovina and the Bank sold GBP 6,9 and bought EUR 8 million for the period of one month, where the Bank protected itself from fluctuations in exchange rates EUR/GBP. Available assets in EUR the Bank invested in debt bonds with maturity up to 2021, until when the Swap jobs will be prolonged.

Swap is classified as a financial asset at fair value through income statement within the position Derivative Financial Liabilities used as hedging instrument and at 31 December 2017 amounted to EUR 84 thousand net (December 31, 2016: EUR 757 thousand), 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).

25. OTHER LIABILITIES

(In thousand EUR)	December 31, 2017.	December 31, 2016.
Suppliers	117	45
Foundation capital placement	11	11
Advances received	103	42
Liabilities at custody operations	388	-
Broker operations liabilities	55	10
Temporary account	46	126
Other liabilities	6	4
	727	**238**

26. SUBORDINATED DEBT

As at 31 December 2017, the Bank has a subordinated debt in amount of EUR 1,001 thousand (31 December 2016 in the amount of EUR 1,002 thousand) related to funds received from SDS Management DMCC where there is one amount of EUR 751 thousand, with an interest rate of 0.05 % and maturity of 24 August 2023 and second one NER Holding LTD in the amount of EUR 250 thousand with an interest rate of 0.05% and maturity Jun 3, 2023.

At Shareholder Assembly held on August 14, 2017 the Decision about issuing convertible bonds were made at in advance known exchange rate SDS Management DCC Dubai in the total amount of EUR 2,000. Based on the Decision of the commission for securities from October 27, 2017 the Bank has successfully issued convertible bonds in the amount of EUR 2,000 with maturity up to 5 years and 6 months and at fixed rate of 1% yearly. As at December 31, the amount of these bonds amounts EUR 1,996 which represent the other part of total subordinated debt which as at December 31, 2017 amounts EUR 2,997 thousand (31, December 2016 EUR 1,002 thousand).

27. SHARE CAPITAL

As at December 31, 2017, the Bank's share capital consists of 16,002 ordinary shares (December 31, 2016:16,002 ordinary shares), of individual nominal value of EUR 0.50605821 (December 31, 2016 of individual nominal value EUR 1.00).

The Law on Banks (Official Gazette of Montenegro, No. 17/08, 44/10, 40/11 and 73/17) defines the minimum amount of initial capital of Bank in the amount of EUR 5 million.

At a shareholder Assembly held on March 3, 2017 (no. 1631/17-3) the Bank made a Decision of reducing share capital by decreasing nominal value of the shares to cover accumulated loss of the Bank in the amount of EUR 7,904 thousand. As at December 31, 2017 the equity of the Bank amounts EUR 8,098 thousand (December 31, 2016 EUR 16,002).

The ownership structure of the Bank's equity as at December 31, 2017 and 2016 was as follows:

	2017.			2016.		
Shareholder name	**Number of shares**	**(In thousand EUR)**	**% share**	**Number of share**	**(In thousand EUR)**	**% share**
Sigma Delta Holdings	10,067	5,095	62,91%	8,663	8,663	54,13%
Ner Holding LTD	3,131	1,585	19,57%	3,986	3,986	24,90%
Sigma Delta Investments	2,288	1,158	14,30%	2,288	2,288	14,30%
UCB-collective custody account no.1	-	-	-	550	550	3,44%
Pairaktaridis Emmanouil	455	230	2,84%	455	455	2,84%
Seriatos Gerasimos	20	10	0,12%	20	20	0,12%
Others	41	20	0,26%	40	40	0,29%
	16,002	**8,098**	**100,00%**	**16,002**	**16,002**	**100,00%**

28. 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 realised indicators of business performance	
(In thousand EUR)	**2017.**	**2016.**
Foundation capital (minimum amount of EUR 5 million)	8.098	16.002
Regulatory capital of the Bank (minimum amount of EUR 5 million)	9.193	6.144
The solvency ratio (the minimum amount of 10%)	17,60%	12,77%
Daily liquidity ratio as at December 31 (minimum coefficient of 0.9)	2,29%	1,64%
Decade liquidity ratios for the decade ending as at December 31 (minimum coefficient of 1)	2,24%	1,69%
The Bank's exposure to a single entity or group of related entities (limit 25% of regulatory capital of the Bank)	34,21%	53,17%
The sum of large exposures (limit 800% of regulatory capital of the Bank)	392,82%	476,39%
The total exposure to related parties of the Bank (limit 200% of regulatory capital of the Bank)	9,76%	15,40%
The total exposure to an employee of the Bank (limit 1% of regulatory capital of the Bank)	0,61%	0,94%
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)	0,12%	0.11%
Total exposure to a shareholder who have a qualified participation in thebank, including exposure to legal entities which are controlled by such shareholder (limit 20% of regulatory capital of the Bank)	5,70%	8,27%
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)	0,15%	0,31%

As at December 31, 2017, the Bank has exposure to one entity or group related 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 53.17%, amounted at 31 December 2016, to 34.21%, amounted 31 December 2017.

29. OFF-BALANCE SHEET ITEMS

	December 31, 2017.	December 31, 2016.
Irrevocable commitments for loan approval	14,534	1,114
Irrevocable letters of credit issued for payments abroad	94	20
Issued payable guarantees	2,644	2,997
Off-balance sheet assets that are classified (gross)	**17,272**	**4,131**
Provisions for losses on off-balance sheet assets	**(16)**	**(9)**
Off-balance sheet assets that are classified (net)	**17,256**	**4,122**
Forward foreign currency sales	(84)	(757)
Other off-balance sheet items exposure of banks	24,407	3,384
Collaterals securing receivables	87,645	91,300
Off-balance sheet assets that are not classified	**111,968**	**93,927**
Total off-balance sheet items	**129,240**	**98,058**
Provision for losses at off-balance sheet	**(16)**	**(9)**
Total off-balance sheet (net)	**129,223**	**98,049**

30. RELATED PARTY TRANSACTIONS

Law on Banks ("Off. Gazette of Montenegro" no. 17/08, 44/10, 40/11 and 73/17) 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 thousand EUR)	**December 31, 2017.**	**December 31, 2016.**
Loans and receivables		
- individuals	480	481
- legal entities:		
-Monte Rock d.o.o. Podgorica	15,000	15,000
-Adriatic Properties d.o.o Budva	10,000	12,507
-Golden Estate d.o.o Podgorica	4,400	4,400
-Maestral Hotels and Casinos d.o.o. Budva	6,322	2,600
-SDS Menagement DMCC Dubai	393	850
-Epidaurus Hoteli d.o.o. Zagreb	-	398
-Nova Pobjeda d.o.o Podgorica	55	4
-Adriatic Yachting Servises d.o.o. Budva	10	-
-Portal Press d.o.o. Podgorica	8	-
-Media-Nea d.o.o. Podgorica	1	-
Total loans and receivables	**36,669**	**36,240**
Deposits:		
- individuals	4,338	313
- legal entities:		
-Golden Estate d.o.o. Podgorica	82	3,478
-SDS Management DMCC Dubai	13,483	3,232
-Adriatic Properties d.o.o. Budva	655	1,404
-Peneseda d.o.o. Podgorica	12	672
-Maestral Hotels and Casinos d.o.o. Budva	38	432
-Monte Rock d.o.o. Podgorica	2,426	255
-Sigma Delta Holdings d.o.o. Podgorica	82	87
-Nova Pobjeda d.o.o. Podgorica	52	79
-Adriatic Yachting services d.o.o. Budva	101	41
-Sigma Delta Investments d.o.o. Podgorica	33	38
-Universal Capital Development	2	25
-First Financial Holdings d.o.o. Podgorica	2	15
-Epidaurus hotel d.o.o. Zagreb	5	6
-Vires d.o.o. Podgorica	183	-
- Adriatic Procurement d.o.o. Budva	46	-
-Novine d.o.o. Podgorica	10	-
-Portal Press d.o.o. Podgorica	9	-
-Dnevne novine d.o.o. Podgorica	5	-
-Media – Nea d.o.o. Podgorica	1	-
Total deposits	**21,565**	**10,077**
Loans/(Deposits), net	**15,104**	**26,163**
Other receivables:		
-Nova Pobjeda d.o.o. Podgorica	409	444
	409	**444**
Interest income:		
- individuals	15	19
- legal entities:		
-Monte Rock d.o.o. Podgorica	591	591
-Adriatic Properties d.o.o.Budva	249	140
-SDS management DMCC Dubai	45	20
-Maestral Hotels and Casinos d.o.o. Budva	137	11
-Golden Estate d.o.o.Podgorica	87	10
-Nova Pobjeda d.o.o. Podgorica	1	-
	1,125	**791**

30. RELATED PARTY TRANSACTIONS (Continued)

Fee income:		
- legal entities:		
-Adriatic Properties d.o.o. Budva	64	5
-Monte Rock d.o.o. Podgorica	6	5
-Epidaurus hotel d.o.o. Zagreb	-	3
-Maestral Hotels and Casinos d.o.o.Budva	85	2
-SDS Management DMCC Dubai	13	-
-Golden Estate d.o.o. Podgorica	5	-
-Adriatic Yachting Servises d.o.o. Budva	1	-
-Portal Press d.o.o. Podgorica	1	-
-Nova Pobjeda d.o.o. Podgorica	4	-
-Novine d.o.o. Podgorica	1	-
-Adriatic Procurement d.o.o. Budva	1	-
-Vires d.o.o. Podgorica	1	-
	182	15
Total income	**1,307**	**806**
Interest and fees expenses:		
- individuals	1	-
SDS Menagement DMCC Dubai	3	1
Total expenses	**4**	**1**
Net income	**1,303**	**805**

Top management and board of directors gross wages and compensations in 2017 amounted to EUR 282 thousand (2016: EUR 143 thousand).

31. LITIGATIONS

As at December 31, 2017, 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, 2017, the total amount of claims against the Bank amounted to EUR 395 thousand (2016: EUR 867 thousand).

The Bank makes provision when exist high probability of cash outflows on the basis of litigation. As at 31 December 2017, 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 1,460 thousand (2016: EUR 1,960 thousand).

32. 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, 2017 and 2016 were as follows:

	December 31, 2017.	December 31, 2016.
USD	0.8338	0.9486
CHF	0.8545	0.9311
GBP	1.1271	1.1679

33. SUBSEQUENT EVENTS

33.1. First-time adoption of IFRS 9 - *Financial Instruments*

The Bank will apply IFRS 9 Financial instrument published as at July 2014, initially starting at January 2018.

IFRS 9 “Financial Instruments” is the replacement of IAS 39 “Financial Instrument – recognition and Measurement” for the financial statements starting as at or after January 1, 2018. The Standard introduces new requirements regarding the classification, recognition and measurement of financial instruments, impairments, derecognition and general hedge accounting.

Classification and Measurement

The concept of IFRS 9 is based on a new approach to the classification and measurement of financial instruments that reflects the business model that manages assets and the characteristics of contractual cash flows.

In accordance with IFRS 9, financial assets will be classified into the following four categories:
- Financial assets measured at amortized cost (AC);
- Financial assets measured at fair value through other comprehensive income (FVOCI);
- Financial assets measured at fair value through profit and loss (mandatory under FVTPL)
- Financial assets optionally measured at fair value through profit and loss (optionally FVTPL).

The financial assets will be measured at amortized cost if both of the following conditions are met and the assets are not designated as FVTPL:
- The objective of the business model is the collection of contractual cash flows;
- The contract terms provide a basis for collection at specified cash flow dates, which are solely payments of principal and interest on the remaining principal.

A financial asset is classified as FVOCI if it belongs to a business model whose objectives are also the collection of contractual cash flows and the sale of financial assets; and the contractual terms of a financial asset give rise to the collection of cash flows on specified dates, whereby the cash flows relate exclusively to the principal and interest payments on the remaining portion of the principal.

All other financial assets means i.e. financial assets that do not meet the classification criteria that involve subsequently measured at amortized cost or FVOCI are classified as financial assets that are subsequently measured at fair value through the recognition of a change in fair value in the income statement. In addition, the Bank has the option to identify this financial asset as FVTPL when initially recognizing a financial asset, if it eliminates or significantly reduces the inconsistency in valuation and recognition - i.e. "Accounting mismatch" - which would otherwise arise from the valuation of assets and liabilities, or the recognition of gains and losses on another basis.

The financial asset will be classified into one of the above categories at initial recognition.

Preliminary analyses of business models and contractual cash flows in the Bank's significant portfolios were carried out with the aim of determining the financial instruments that would be measured at amortized cost, at fair value through profit and loss or at fair value through other comprehensive income

Impairment

Measurement of expected loan losses implies determination of objective and with probability weighted value through analyse of various possible outcomes which includes time value of the money, and it is based on reasonable and documented information on past events, current conditions and future economic conditions, which are available at acceptable cost and efforts on reporting date.

33. SUBSEQUENT EVENTS (continued)

33.1. First-time adoption of IFRS 9 - *Financial Instruments (continued)*

IFRS 9 prescribes a three-way depreciation model of impairment based on changes of loan quality comparing to initially recognition. This model demands for financial instrument which is not impaired at initial recognition to be classified at Level (hereinafter: level) 1 and to be constantly monitored. If a significant increasement of credit risk is identified comparing to initial recognition, financial instrument is transferring at Level 2, but it is not yet considered impaired. If financial instrument is impaired, then it is transferred at Level 3.

Expected credit losses for financial instrument at Level 1 are calculated in the amount equal to the part of expected credit losses which can result in default in next 12 months. Expected credit losses for financial instrument at Level 2 or 3 are calculated based on expected credit losses during the entire period of duration of financial instrument i.e. its lifetime. According to IFRS 9 during the measurement of credit losses it is necessary to consider information which refers to future. Purchased or placed credit-impaired financial instruments represent those financial assets which are credit-impaired during the initial recognition and their expected credit loss is always calculated based on expected credit losses for the entire period of duration of financial instrument (Level 3)

The Bank performed preliminary assessment of the impact of the first implementation of IFRS 9 on impairment of financial instrument, but the following should be considered:

- A new standard requires the Bank to review its processes and internal controls, and these changes have not yet been fully implemented;
- Based on gap analysis and changes in methodology the main principles of IT solutions form implementation of IFRS 9 are defined. The preliminary specifications are prepared and process of implementation is ongoing;
- The Bank is currently testing and evaluating controls over the new IT system solutions.
- Systems and controls established in accordance with new requirements were not operational during the entire reporting period;
- In the forthcoming period, the Bank will work on the development and adoption of new policies and procedures, assumptions, judgments and valuation techniques.

33.2. The Bank is planning to issue subordinates bonds in the amount of EUR 2,000 with maturity up to 5 and 6 months at fixed interest rate of 1% yearly. Issuing these bonds, the Bank will increase Tier 2 – additional capital and solvency coefficient.

Besides, above mentioned event the management of the Bank considers that there is no other significant events after the reporting date that would affect separate financial statements for 2017.