Universal Capital Bank

Universal Capital Bank a.d. Podgorica
Separate financial statements for the year ended 31 December 2020
and
Independent Auditor's Report

CONTENT

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This is an English translation of Independent Auditor's Report originally issued in the Montenegrin language

INDEPENDENT AUDITOR'S REPORT

To the shareholders of Universal Capital Bank AD, Podgorica

Report on the Audit of the Separate Financial Statements

Opinion

We have audited the accompanying separate financial statements of "Universal Capital Bank" a.d. Podgorica (hereinafter "the Bank"), which comprise the separate balance sheet as of 31 December 2020 and the separate income statement, the separate statement of comprehensive income, separate statement of changes in equity and separate statement of cash flows for the year then ended, and the notes to the separate financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying separate financial statements present fairly, in all material respects, the unconsolidated financial position of the Bank as of 31 December 2020, and its unconsolidated financial performance and its unconsolidated cash flows for the year then ended in accordance with the accounting regulations prevailing in Montenegro and the regulations of the Central Bank of Montenegro governing the financial reporting of banks.

Basis for opinion

We conducted our audit in accordance with the Law on Audit ("Official Gazette of Montenegro", no. 001/17) and International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with the *International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants* (IESBA Code) together with the ethical requirements that are relevant to our audit of the separate financial statements in Montenegro, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the separate financial statements of the current period. These matters were addressed in the context of our audit of the separate financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

INDEPENDENT AUDITOR'S REPORT

To the shareholders of Universal Capital Bank AD, Podgorica (Continued)

Report on the Audit of the Separate Financial Statements (Continued)

Key Audit Matters (Continued)

Key audit matter	Audit procedures applied
1. **Adequacy of the impairment of loans and off-balance sheet items Notes 3.8.8, 5.2, 15, 18.2 and 29 to the separate financial statements**	
The measurement of costs of the impairment of loans and provisions for off-balance sheet items is deemed to be a key audit matter since the determination of assumptions for expected credit losses requires a significant level of professional judgement by the Bank's management. Receivables for loans and placements to borrowers as of 31 December 2020 amounted to EUR 106,755 thousand (EUR 92,563 thousand as of 31 December 2019), while the total amount of the allowance for impairment of these receivables amounted to EUR 5,226 thousand as of 31 December 2020 (EUR 2,970 thousand as of 31 December 2019). These provisions for losses constitute the best management's estimate of expected credit losses for the credit portfolio on the balance sheet date. Key areas of judgement include the interpretation of impairment requirements in accordance with International Financial Reporting Standard 9: Financial Instruments, which is reflected in the Bank's expected credit loss model, the identification of exposures where there has been a significant increase in credit risk (for which the expected credit loss is calculated over the useful life of a financial instrument), the parameters and assumptions used in the expected credit loss model, such as the counterparty's financial position and expected future cash flows, as disclosed in Notes 3.8.8, 5.2, 15, 18.2 and 29, as well as estimates and assumptions of expected outcomes in impairment scenarios for individually assessed placements. Possible outcomes are based on discounted cash flows for individually assessed placements and include estimates and other complex areas, such as impairment indicators, probabilities of relevant scenarios for expected future cash flows and cash flow forecasts, including the foreclosure of collaterals. The Bank's management disclosed additional information in Notes 3.8.8, 5.2, 15, 18.2 and 29 to the separate financial statements.	Based on our risk assessment and knowledge of the banking sector operations, we examined the costs of impairment of loans and provisions for off-balance sheet items and we estimated the applied methodology, as well as the assumptions used, in accordance with the description of the key audit matter. Our audit procedures included the following: • An estimate of key controls related to the assumptions used in expected credit loss (ECL) models to assess credit risk associated with the exposure and expected future cash flows of the customer; • Collection and detailed testing of evidence corroborating the assumptions used in ECL models applied in a stage allocation, assumptions applied to obtain twelve-month and lifetime probability of default (PD) and methods used to obtain the probability of loss given default (LGD); • Collection and detailed testing of evidence corroborating appropriate determination of assumptions related to impairment costs of loans and provisions for off-balance sheet exposures, including the measurement of collaterals and assumptions of future cash flows for individually assessed exposures on loan impairment; • An estimate of key movements in a high-risk portfolio from the prior period in relation to industry standards and historical data; • An estimate of adequacy of certain management's decisions in comparison to certain macro projections applied in ECL models; • An evaluation of applied methodologies using our knowledge and experience of the industry; • An assessment of accuracy and completeness of disclosures in the separate financial statements. Based on the audit procedures applied, we did not identify any significant findings in terms of the adequacy of the impairment of loan placements and provisions for off-balance sheet exposures as of 31 December 2020.

INDEPENDENT AUDITOR'S REPORT

To the shareholders of Universal Capital Bank AD, Podgorica (Continued)

Report on the Audit of the Separate Financial Statements (Continued)

Other Matters

The separate financial statements of the Bank as of and for the year ended 31 December 2019 were audited by another auditor, who expressed an unqualified opinion on these separate financial statements in its report dated 28 May 2020.

Responsibilities of Management and Those Charged with Governance for the Separate Financial Statements

Management is responsible for the preparation and fair presentation of the separate financial statements in accordance with the accounting regulations prevailing in Montenegro, which are based on the Law on Accounting ("Official Gazette of Montenegro", no. 52/2016), and regulations of the Central Bank of Montenegro governing financial reporting of banks, 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.

In preparing the separate financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditor's Responsibilities for the Audit of the Separate Financial Statements

Our objectives are to obtain reasonable assurance about whether the separate financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these separate financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

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

INDEPENDENT AUDITOR'S REPORT

To the shareholders of Universal Capital Bank AD, Podgorica (Continued)

Report on the Audit of the Separate Financial Statements (Continued)

Auditor's Responsibilities for the Audit of the Separate Financial Statements (Continued)

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the separate financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the separate financial statements, including the disclosures, and whether the separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the separate financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

INDEPENDENT AUDITOR'S REPORT

To the shareholders of Universal Capital Bank AD, Podgorica (Continued)

Report on the Audit of the Separate Financial Statements (Continued)

Report on Other Legal and Regulatory Requirements

Management of the Bank is responsible for the preparation and fair presentation of the accompanying Annual Management Report in accordance with the requirements of the Law on Accounting. Pursuant to the Law on Audit, our responsibility is to express an opinion on the consistency of the Bank's Annual Management Report for the year ended 31 December 2020 with the audited separate financial statements for the same year. Our procedures in this regard were only limited to the assessment of the consistency of financial information disclosed in the Annual Management Report with the audited separate financial statements.

In our opinion, financial information disclosed in the Bank's Annual Management Report for the year ended 31 December 2020 is consistent, in all material respects, with the audited separate financial statements of the Bank as of and for the year ended 31 December 2020 and prepared in accordance with the Law on Accounting.

The engagement partner on the audit resulting in this independent auditor's report is Milovan Popovic.

Podgorica, 27 April 2021

Društvo za reviziju BDO d.o.o. Podgorica

Milovan Popovic
Certified Auditor

SEPARATE INCOME STATEMENT
For te year ended 31 December 2020

in thousand EUR	Note	2020	2019
Interest and similar income	3.1, 6.1.	5,610	4,570
Interest income on impaired placements	3.1, 6.2.	200	-
Interest and similar expenses	3.1, 6.3.	(1,213)	(1,165)
Net interest income		**4,597**	**3,405**
Fee and commission income	3.2, 7.1.	5,124	7,097
Fee and commission expenses	3.2, 7.2.	(2,397)	(2,579)
Net fee and commission income		**2,727**	**4,518**
Net gain on derecognition of financial instruments not measured at fair value through income statement	8	81	30
Net loss on financial instruments, held for trade	3.3, 9	(67)	(36)
Net foreign exchange gains	3.4, 10	1,035	2,323
Net loss on derecognition of other assets		(1)	(32)
Other income	11	13	88
Staff costs	12	(1,746)	(1,644)
Depreciation/amortization charge	13	(473)	(398)
General and administrative costs	14	(1,329)	(1,506)
Net expenses from changes in impairment of financial instruments not measured at fair value through income statement	15	(2,562)	(3,155)
Other expenses		(35)	(56)
Profit before tax		**2,240**	**3,537**
Income tax	16	(195)	(296)
NET PROFIT		**2,045**	**3,241**

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

Signed on behalf of Universal Capital bank AD, Podgorica, on 30 March 2021:

Danijela Jović
CEO

Miloš Pavlović
Executive Director

Lana Kalezić
Lana Kalezić
Head of Finance and Accounting

SEPARATE BALANCE SHEET
as at 31 December 2020

In thousand EUR	Note	31 December 2020	31 December 2019
ASSETS			
Cash and assets held with the central banks	17	78,179	91,764
Financial assets at amortized cost			
Loans and receivables from banks	18.1.	25,305	13,725
Loans and receivables from clients	18.2.	101,529	89,593
Securities	18.3.	48,570	-
Other financial assets		37	12
Financial assets at fair value through other comprehensive income			
Securities	19	41,670	109,703
Financial assets held for trade			
Securities	20	551	272
Hedge derivatives		11	54
Investment property	21	187	159
Property, Plant and Equipment	22	3,932	3,259
Intangible assets	23	418	502
Deferred tax assets	16	151	150
Other assets	24	9,192	7,984
Total assets		**309,732**	**317,177**
LIABILITIES			
Financial liabilities at amortized cost			
Deposits due to clients	25.1.	282,873	285,395
Borrowings from clients other than banks	25.2.	3,072	3,882
Hedge derivative financial liabilities		-	275
Reserves		402	330
Current tax liabilities		192	404
Deferred tax liabilities	16	112	212
Other liabilities	26	3,010	7,480
Subordinated debt	27	1,002	1,002
Total liabilities		**290,663**	**298,980**
EQUITY			
Share capital	28	12,122	12,122
Retained earnings		4,902	1,661
Profit for the current year		2,045	3,241
Other reserves		-	1,173
Total equity		**19,069**	**18,197**
Total equity and liabilities		**309,732**	**317,177**
Off-balance sheet items	29	**320,760**	**293,342**

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Signed on behalf of Universal Capital bank AD, Podgorica, on 30 March 2021:

Universal Capital Bank AD
UCB
PODGORICA 1

Lana Kalezić

Danijela Jović
CEO

Miloš Pavlović
Executive Director

Lana Kalezić
Head of Finance and Accounting

SEPARATE STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2020

in thousand EUR	**Share capital**	**Retained earnings**	**Other reserves**	**Total**
Balance, as at 1 January 2019	8,098	1,661	(292)	9,467
Share issue (Note 28)	4,024	-	-	4,024
Result of the period	-	3,241	-	3,241
Effects of changes in fair value of securities measured through other comprehensive income, net	-	-	1,465	1,465
Balance as at 31 December 2019	**12,122**	**4,902**	**1,173**	**18,197**
Result of the period	-	2,045	-	2,045
Reclassification of debt instruments measured at fair value through other comprehensive income on amortized cost (Note 18.3)	-	-	1,089	1,089
Net amount reclassified to the income statement on the sale of securities measured through other comprehensive income	-	-	(86)	(86)
Net change in provisions for expected credit losses of debt instruments measured through other comprehensive income	-	-	241	241
Effects of changes in fair value of securities measured through other comprehensive income, net	-	-	(2,417)	(2,417)
Balance as at 31 December 2020	**12,122**	**6,947**	-	**19,069**

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

Signed on behalf of Universal Capital bank AD, Podgorica, on 30 March 2021:

Danijela Jović
CEO

Miloš Pavlović
Executive Director

Lana Kalezić
Head of Finance and Accounting

SEPARATE STATEMENT OF OTHER COMPREHENSIVE INCOME

For the year ended 31 December 2020

in thousand EUR	2020	2019
PROFIT FOR THE PERIOD	**2,045**	**3,241**
Items that will not be subsequently reclassified to profit or loss		
Effects of changes in value of debt securities valued at fair value through other comprehensive income	(20)	-
Items that will or may be subsequently reclassified to profit or loss		
Effects of changes in value of debt securities valued at fair value through other comprehensive income	(1,269)	1,610
Tax related to other comprehensive income	116	(145)
Total other comprehensive income	**(1,173)**	**1,465**
TOTAL COMPREHENSIVE INCOME OF THE PERIOD	**872**	**4,706**

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

Signed on behalf of Universal Capital bank AD, Podgorica, on 30 March 2021:

Danijela Jović
CEO

Miloš Pavlović
Executive Director

Lana Kalezić
Lana Kalezić
Head of Finance and Accounting

SEPARATE CASH FLOW STATEMENT
For the year ended 31 December 2020

in thousand EUR	31 December 2020	31 December 2019
CASH FLOWS FROM OPERATING ACTIVITIES		
Interest and similar receipts	7,033	4,394
Interest and similar outflows	(1,179)	(1,080)
Fee and commission receipts	4,562	6,863
Fees and commissions paid	(2,397)	(2,579)
Payments to employees and suppliers	(3,254)	(3,073)
Outflows from increases in loans and other assets	(14,942)	(2,052)
(Outflows) / inflows from deposits and other liabilities	(7,806)	46,536
Tax paid	(403)	(43)
Other inflows/(outflows)	114	(77)
Net cash from/(used in) operating activities	**(18,272)**	**48,889**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(402)	(171)
Purchase of intangible assets	(43)	(71)
Securities	16,478	(54,430)
Income from sale of tangible and fixed assets	-	-
Net cash used in investing activities	**16,033**	**(54,672)**
CASH FLOWS FROM FINANCING ACTIVITIES		
Decrease in borrowings	(808)	(1,291)
Net cash used in financing activities	**(808)**	**(1,291)**
Effects of foreign exchange in cash and cash equivalents	1,036	2,323
Net decrease in cash and cash equivalents	**(2,011)**	**(4,751)**
Cash and cash equivalents, beginning of year	**105,071**	**109,822**
Cash and cash equivalents, end of year (note 17)	**103,060**	**105,071**

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

Signed on behalf of Universal Capital bank AD, Podgorica, on 30 March 2021:

Danijela Jović
CEO

Universal Capital Bank AD
UCB
PODGORICA

Miloš Pavlović
Executive Director

Lana Kalezić
Lana Kalezić
Head of Finance and Accounting

NOTES TO THE SEPARATE FINANCIAL STATEMENTS
31 December 2020

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 18 October 2007. The Decision of the Shareholders Assembly of the Bank's name change was adopted at the session held on 30 May 2014, and the new name was official changed on 4 June 2014.

The Bank's headquarters are in Podgorica, Stanka Dragojevića Street bb.

The Bank has obtained a permit from the Central Bank of Montenegro (Decision No. 0101-2933/3-2 dated 12 July 2007). The Bank is inscribed in the Register of the issuers of securities maintained by the Securities Commission under number 472 (Decision No. 02/3-33/2-07 dated 31 October 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) Finance lease;
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 31 December 2020, the Bank included a Central Office located in Podgorica, a branch office in Milocer and Podgorica, as well as representative office in Dubai. The Bank has 70 employees (31 December 2019: 70 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 31 December 2020, the Members of the Board of Directors were the following:

Name and surname	Position
Božo Milatović	President of the Board of Directors
Alfredo Longo	Member of the Board of Directors
Ronald K. Noble	Member of the Board of Directors
Miloš Pavlović	Member of the Board of Directors
Goran Bencun	Member of the Board of Directors

As at 31 December 2020, the Executive Directors were as follows:

Name and surname	Position
Danijela Jović	Chief Executive Officer
Miloš Pavlović	Executive Director

As at 31 December 2020, the Members of the Audit Committee were as follows:

Name and surname	Position
Mina Jovanović	President
Miljan Marković	Member
Lazar Mišurović	Member

The Bank's internal auditor as at 31 December 2020 is Sonja Burzan.

The Bank's head office is in Podgorica, Stanka Dragojevića bb.

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

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

The 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).

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 31 December 2020.

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.

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 represent the separate financial statements of the Bank. In accordance with Article 134 of the Law on Banks of Montenegro ("Official Gazette of Montenegro" No. 17/08, 44/10, 40/11, 73/17), the consolidated financial statements of the banking group do not include subordinate members of the banking group whose balance sheet is less than 1% of the balance sheet of the parent group member. Since the Bank has, as of 31 December 2020, the control over one subordinate entity, and fulfils the condition from Article 134 of the Law on Banks, the Bank does not compile consolidated financial statements, using the right to exemption from consolidation.

In preparing these financial statements, the Bank has applied the accounting policies disclosed in Note 3.

2.2. Rules of estimates

The financial statements are prepared based on historical cost, except for the following positions measured at fair values:

- Financial instruments at fair value through profit or loss,
- Financial instruments at fair value through other comprehensive income,
- Financial liabilities at fair value through profit or loss.

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

2.3. Functional and presentation currency

The Bank's financial statements are stated in thousands of euros (EUR) which is the official reporting currency in Montenegro. Except if stated otherwise all amounts are presented in thousands of EUR.

2.4. 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 reporting 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 estimates as well as the assumptions on the basis of which the estimates are made are subject of regular controls.

If the control determines that there has been a change in the estimated value of assets and liabilities, the identified effects are recognized in the financial statements in the period when the change in the estimate occurred, if the change in the estimate affects only that accounting period, or in the period when there has been a change in the estimate in subsequent accounting periods, if the change in the estimate affects the current and future accounting periods.

Note 4 provides information about the areas where the level of assessment is the largest and may have the most significant effect on the amounts recognized in financial statements of the Bank.

2.5. Changes in accounting policy and disclosures

New and amended standards and interpretations

Except for the amendments mentioned below, the accounting policies have been consistently applied in all accounting periods presented in these financial statements.

- **Conceptual framework of IFRS**

The IASB issued a revised Financial Reporting Conceptual Framework on 29 March 2018. The Conceptual Framework sets out a comprehensive framework of financial reporting concepts, setting standards, guidelines for preparing consistent accounting policies, and assisting others in their efforts to understand and interpret standards. The IASB has also issued a separate accompanying document, Amendments to the References to the IFRS Conceptual Framework, which sets out amendments to the standards that have been affected by the revisions of the Framework. The aim is to support the transition to a revised Conceptual Framework for companies using the Conceptual Framework in the event that there is no applicable IFRS for a particular transaction, and is effective for annual periods beginning on or after 1 January 2020.

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

2.5. Changes in accounting policy and disclosures (continued)

- **IFRS 3: Business Combinations (Amendments)**

The IASB has issued amendments to the definition of operations that aim to address difficulties that arise when an entity determines whether an acquisition is acquired or a group of assets. The amendment is applicable for all periods beginning after 1 January 2020 for business combinations for which the acquisition date is in the first annual period after that date, or for the acquisition of assets occurring on or after that date. Earlier application is allowed. The amendments have not yet been adopted by the EU. The Bank's management does not expect material implementation effects on the Bank's financial statements.

- **IAS 1: Presentation of Financial Statements and IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors: Definition of Material Significance (Amendments)**

The amendments are applicable from 1 January 2020, with earlier adoption permitted. The definition of material significance and its manner of application are clarified. The new definition states that "information is material if it is reasonable to expect that its omission, misrepresentation or concealment would affect the decisions of the primary users of general-purpose financial statements when making decisions based on financial statements that provide financial information about a particular reporting entity." Additionally, the explanations that accompany the definition have been improved. The amendments also ensure consistent application of the definition of materiality across all IFRS standards. The Bank's management does not expect material implementation effects on the Bank's financial statements.

- **Interest rate benchmark reform - IFRS 9, IAS 39 and IFRS 7 (Amendments)**

In September 2019, the IASB issued amendments to IFRS 9, IAS 39 and IFRS 7, which are the conclusion of the first phase of work on responding to the effects of the IBOR (Interbank Offered Rates) reform on financial reporting. The published amendments address issues affecting financial reporting in the period before the replacement of the existing benchmark interest rate with an alternative interest rate and address the implications for the specific hedge accounting requirements in IFRS 9 Financial Instruments that require forward-looking analysis. The amendments provide temporary relief, applicable to all hedge accounting relationships that are directly affected by the interest rate benchmark reform, allowing the hedge accounting to continue in the period of uncertainty before replacing the existing interest rate with an alternative near-risk-free rate. In addition, amendments to IFRS 7 Financial Instruments: Additional disclosures around uncertainty arising from the interest rate benchmark reform are effective for annual periods beginning on or after 1 January 2020 and must be applied retrospectively. The second phase will focus on issues that could affect financial reporting when the existing benchmark interest rate is replaced by a risk-free interest rate (RFR). The Bank's management does not expect material effects on the Bank's financial statements.

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

2.5. Changes in accounting policy and disclosures (continued)

Standards issued but not yet in force and not early adopted

- **Amendments to IFRS 10 Consolidated Financial Statements and IAS 28 Long-Term Investments in Subsidiaries and Joint Ventures: Sale or Contribution to Assets between the Investor and its Subsidiaries or Joint Ventures**

The amendments relate to the identified inconsistency between the requirements of IFRS 10 and the requirements of IAS 28 in the treatment of sales or contributions to assets between an investor and its subsidiaries or joint ventures. The main consequence of the amendment is that the full amount of profit or loss is recognized when the transaction involves business (whether it takes place in a subsidiary or not). Partial gain or loss is recognized when the transaction involves non-operating assets, even if the assets belong to a subsidiary. In December 2015, the IASB moved the effective date of the amendment indefinitely, depending on the capital accounting research project. The Bank's management does not expect material implementation effects on the Bank's financial statements.

- **IAS 1 Presentation of Financial Statements: Classification of Liabilities as Short-Term or Long-Term (Amendments)**

The amendments are effective for annual reporting periods beginning on or after 1 January 2022, with earlier adoption permitted. The International Accounting Standards Board has issued a proposal to postpone the date of entry into force of these amendments until 1 January 2023. The aim is to promote consistency in the application of requirements by assisting companies in determining whether, in the balance sheet, debt and other liabilities with an indefinite maturity date should be classified as short-term or long-term. The amendments affect the presentation of liabilities in the balance sheet and do not alter existing requirements regarding the measurement or immediate recognition of any asset, liability, income or expense, or the disclosure of information about those items. Also, the amendments clarify the classification requirements for debt that can be converted into equity by issuing its own equity instruments. The amendments have not yet been adopted by the EU. The Bank's management does not expect material implementation effects on the Bank's financial statements.

- **IFRS 3: Business Combinations; IAS 16: Property, Plant and Equipment; MRS 37: Provisions, Contingent Liabilities and Contingent Assets, and Annual improvements to IFRS Standards "2018-2020 Cycle" (amendments)**

The amendments are effective for annual reporting periods beginning on or after 1 January 2022, with earlier adoption permitted. The International Accounting Standards Board has issued amendments to the narrow-scope IFRS as follows:

  - **IFRS 3 Business Combinations (amendments)** updates the reference in IFRS 3 Conceptual Framework for Financial Reporting without changing the accounting requirements for business combinations.

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

2.5. Changes in accounting policy and disclosures (continued)

Standards issued but not yet in force and not early adopted (continued)

- **IAS 16 Property, Plant and Equipment (amendments)** prohibits a company from deducting from the cost of property, plant and equipment amounts received from the sale of items produced while the company is preparing an asset for its use. Instead, the Company will recognize such sales revenue and related expenses in the income statement.
- **IAS 37 Provisions, Contingent Liabilities and Contingent Assets (amendments)** specifies which costs an entity includes in determining the cost of performing a contract to assess whether the contract is onerous.
- **Annual improvements to IFRS Standards "2018-2020 Cycle" –** amendments to IFRS 1: First-time Adoption of International Financial Reporting Standards, IFRS 9: Financial Instruments, IAS 41: Agriculture and Illustrative Examples for IFRS 16 Leasing.

These amendments have not yet been adopted by the EU. The Bank's management does not expect material effects on the Bank's financial statements with respect thereto.

- **IFRS 16: Leases – Covid-19-Related Rent Concessions**

The amendment is effective for annual reporting periods beginning on or after 1 June 2020, retrospectively. Earlier adoption is permitted, including in financial statements not yet authorized for issue on 28 May 2020. The International Accounting Standards Board amended the standard to provide relief to lessees from the application of IFRS 16 Guidelines for Accounting for Modifications to Lease Agreements for Concessions which occur as a direct consequence of the Covid-19 pandemic. This amendment provides a practical exception to the accounting treatment of leases in books, when accepting any changes in rents resulting from the Covid-19 pandemic concessions, by allowing coverage in the same way as any change under IFRS 16, if the change there was no modification of the lease, only if all the following conditions were met:

- Changes in lease payments lead to a change in the lease that is substantially the same or less than the rent immediately before the change occurs.
- Any reduction in lease payments only affects payments that were originally due on or before 30 June 2021.
- There are no substantial changes to other lease terms.

The Bank's management does not expect material effects on the Bank's financial statements.

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

2.5. Changes in accounting policy and disclosures (continued)

Standards issued but not yet in force and not early adopted (continued)

- **Interest Rate Benchmark Reform – Phase 2 – IFRS 9, MSFI 7, IFRS 4 and IFRS 16 (amendments)**

In August 2020, the IASB announced the Interest Rate Benchmark Reform - Phase 2, Amendments to IFRS 9, IFRS 7, IFRS 4 and IFRS 16, concluding its work in response to the reform of the IBOR. The amendments provide temporary relief that addresses the effects of financial reporting when the Interbank Offered Rate (IBOR) is replaced by an alternative near risk-free interest rate (RFR). In particular, the amendments provide for a practical exception when calculating changes in the basis for determining the contractual cash flows of financial assets and liabilities, in order to require an adjustment of the effective interest rate equivalent to the movement of the market interest rate. The amendments also introduce reliefs for termination of a hedging relationship, including a temporary exemption from the need to meet a separately identifiable requirement when an RFR instrument is designated for a hedging risk component. Further, the amendments to IFRS 4 are designed to enable insurance companies that still apply IAS 39 to receive the same benefits as those provided for in the amendments to IFRS 9. Amendments to IFRS 7 Financial Instruments: Disclosures that allow users to understand the nature and extent of risks arising from the IBOR reform to which the entity is exposed to and how the entity manages those risks. The amendments are effective for annual periods beginning on or after 1 January 2021, with the possibility of earlier adoption. When the application is retrospective, the entity is not required to modify data from prior periods.

2.6. 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 of time in the foreseeable future.

2.7. Reconciliation of receivables and liabilities

In accordance with the applicable legal regulations the Bank has performed reconciliation of receivables and liabilities with creditors and debtors of the Bank as at 31 December 2020.

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

2.8. Covid-19 pandemic

Following the outbreak of the Covid-19 coronavirus pandemic (hereinafter: coronavirus) worldwide in late 2019 and early 2020, the Bank, as a responsible legal entity, has taken all necessary measures to protect its employees, customers and business partners. Measures have been taken in order to ensure safe working conditions for the Bank, respecting the recommendations of the Institute of Public Health of Montenegro as well as measures of the Government of Montenegro that enable uninterrupted performance of the Bank's business activities.

The accompanying effects of the pandemic (closing borders, slowing down international trade, increasing uncertainty in international markets, drastic impact on certain industries) had multiple negative impacts on the economic environment in Montenegro, as well as on the Bank's operations. The most affected industries are tourism and hospitality, which make up a significant part of Montenegro's gross domestic product. According to the latest available data, the decline of Montenegrin GDP in 2020 is estimated at around 15%.

The coronavirus itself, as well as its consequences and side effects, carry a great deal of uncertainty, so it is a great challenge for the Bank to anticipate all the implications for economic and business performance. This may result in estimates and assumptions that will require revision. In addition, the uncertainty relates to a set of nation-wide government measures to combat the spread of the coronavirus, which have already been taken and will be taken in the future. The measures may have an impact on the operations of the entire economy and consequently on the operations of the Bank.

According to the Bank's management, the new pandemic could in this case affect the expected level of revenue realization on the one hand and potential cost growth on the other, loan distribution, quality of loan portfolio, value of collateral, amount of expected credit losses, especially in industries that are most affected by the pandemic. Despite all the above, the Bank's liquidity is at a high level and stable, and capital adequacy is significantly above the regulatory minimum.

In accordance with the Decision on Temporary Measures for Mitigating the Negative Impacts of the New Coronavirus on the Financial System (Official Gazette of Montenegro No. 19/20) of the Central Bank of Montenegro (CBM) of 31 March 2020, the Bank offered its clients a delay in the repayment of liabilities (moratorium) on the basis of loans and related products for a period of at least 90 days, starting from 24 March 2020.

After the expiration of the conditions from the moratorium, which referred to the delay in the repayment of clients' obligations, the Bank continued with the activities of regular loan collection. The accrued interest was credited to the principal debt with an extension of the repayment period for the number of annuities covered by the moratorium. Activities related to the conditions on the continuation of calculation and collection of loans were performed by the Bank in accordance with the Decision of the CBM.

Considering that the moratorium on the part of the borrower was on a voluntary basis, as well as the characteristics of the Bank's portfolio, the effect of the moratorium on the Bank's liquidity was limited. In addition, by the Decision on Amendments to the Decision on Reserve Requirements of Banks (Official Gazette of Montenegro No. 43/20) with the CBM of 11 May 2020, the CBM reduced the mandatory reserve requirements from 7.5% and 6.5% to 5.5% and 4.5%, which created the preconditions for the smooth preservation of credit activity. In addition, the Bank obtained a credit line in the event of liquidity losses in the amount of EUR 5 million (Note 25.2).

In accordance with the Amendments to the Decision on Temporary Measures for Mitigating the Negative Impacts of the Covid-19 Infectious Disease Epidemic on the Financial System (Official Gazette of Montenegro 80/20) of the CBM of 4 August 2020, the Bank offered its clients relief in the form of an additional moratorium for loan clients from the tourism sector and from the agriculture, forestry and fisheries sectors in the period from 1 September 2020 until 31 August 2021, if as of 31 December 2019 the client did not have a delay in repayment of the loan for more than 90 days, and the loan on that day was not classified in the category of non-performing assets. Also, in accordance with the aforementioned Decision, the Bank offered restructuring options to clients from the tourism sector and from the agriculture, forestry and fisheries sectors, if as of 31 December 2019 the client did not have a delay in repayment of the loan for more than 90 days, and the loan on that day was not classified in the category of non-performing assets. The impact of this second wave of the moratorium on the Bank's liquidity is minor.

Furthermore, pursuant to the Amendments to the Decision on Temporary Measures for Mitigating the Negative Impacts of the Covid-19 Infectious Disease Epidemic on the Financial System (Official Gazette of Montenegro No. 105/20) of the CBM dated 29 October 2020, in accordance with the Decision, the Bank offered to loan clients relief in the form of an additional moratorium for a period of six months upon fulfilment of the conditions specified in the Decision, as well as options for restructuring liabilities upon fulfilment of conditions specified in the Decision.

At the time of preparing these financial statements, the CBM Decision is still in place regarding the possibility of an additional moratorium and restructuring of the Bank's debtors' liabilities. Until the date of preparation of these financial statements, the last Decision on amendments to the Decision on temporary measures to mitigate the negative effects of the epidemic of infectious diseases Covid-19 on the financial system from 1 March 2021, brings extensions in the field of client activities.

These events did not affect the Bank's ability to continue as a going concern in the foreseeable future, therefore the Bank continues to use the going concern principle in preparing and presenting its financial statements.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic accounting policies applicable when compiling the financial statements for 2020 are listed below.

3.1. Interest Income and Expense

Interest income and expense are recognized in the income statement using the effective interest method. The effective interest rate represents the rate that discounts future inflows and outflows during the expected deadline of financial instrument:

- Gross book value of a financial asset or
- Amortised amount of the financial liabilities.

When calculating the effective interest rate for financial instruments, except for purchased or originated as credit-impaired (POCI) assets, the Bank when estimating future cash flows takes into account all agreed terms but not for ECL. For POCI assets the credit – adjusted effective interest rate is calculated taking into account expected cash flows including ECL.

When calculating effective interest rate the transaction cost and all unpaid or paid fees are considered, which are part of the effective interest rate. The transaction costs are incremental costs which can be directly attributed to the issuance or disposal of some financial assets or financial liabilities.

Amortized amount of the financial asset or financial liability represents the amount by which the financial asset or financial liability are valuated in the moment of initial recognition less for repayment of principal and increased or decreased for cumulative depreciation calculated using effective interest rate, the difference between initial amount and the amount of the maturity and for financial assets, corrected for expected credit loss.

Gross book amount of financial asset is the amortized amount of financial asset before the impairment for expected credit loss.

The effective interest rate for financial assets and financial liabilities is calculated at initial recognition of the financial asset or liability. When calculating the interest income and expense the effective interest rate is applied on gross carrying amount of the assets (if the amount is not credit – impaired) or amortized value of liability. For the financial instruments with variable interest rate the effective interest rate is fluctuated due to periodic estimation of cash flow to reflect market interest rate trend.

For financial assets which became credit – impaired after initial recognition the interest income is calculated by applying the effective interest rate method on amortized value of financial asset. If the financial assets are no longer credit – impaired the calculation of the income is calculated again on a gross basis i.e., the interest is calculated applying effective interest rate on gross carrying amount of the financial asset of the financial asset.

For financial assets which are credit - impaired at the time of initial recognition the interest income is calculated by applying credit – adjusted interest rate on the amortized amount of financial asset. The calculation of interest income does not return to gross basis not even when the credit risk is improved.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1. Interest Income and Expense (continued)

Fee income and expenses which are part of the effective interest rate of the financial asset or financial liability are included in the calculation of the income and expenses from interest by applying effective interest rate method.

Penalty interest and other income and other expenses related to interest-bearing assets, i.e., interest-bearing liabilities, are calculated according to the principle of causality of income and expenses.

3.2. Interest and commission income and expense

Fee and commission income include fees that the Bank calculates and charges for performance of payment services in the country and abroad, guarantees and letters of credit, as well as other services. Fee and commission income are recognized at the time when the correspondent service is done.

Fee and commission expenses generally relate to fees for domestic and foreign payment operations and other services which are recognized as an expense in the moment when the service is provided.

3.3. Net profit / (loss) based on financial instruments held for trade

Net profit / (loss) based on financial instruments held for trade includes profit less losses based on financial assets and financial liabilities held for trade, including all realized and unrealized changes in fair value.

3.4. Foreign exchange translation

Transactions denominated in foreign currencies are translated into EUR at the date of transaction. Assets and liabilities denominated in a foreign currency are translated into EUR by applying the official exchange rate, as determined on the exchange rate list from Central bank of Montenegro valid on day given. For currencies that are not on this list, the exchange rate from the Interbank foreign exchange market is used. The treatment of assumed and contingent liabilities in foreign currency is identical.

Net foreign exchange gains or losses arising upon the translation of transactions, and the assets and liabilities denominated in foreign currencies are credited or charged to the statement of comprehensive income as gains or losses based on foreign exchange.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.5. Leases

At the date of establishing the contract, the Bank assesses whether it constitutes a lease, i.e., whether the contract transfers the right to control the use of the determined property during a certain period of time in exchange for compensation.

3.5.1. Bank as a lessee

The Bank applies a single recognition and measurement approach to all leases, except for short-term contracts or low-value assets. The Bank recognizes lease liabilities and assets - rights to use.

The Bank recognizes assets on the basis of the right to use them on the day of the beginning of the lease agreement, i.e., the date of obtaining the right to use the property. Subsequent measurement is performed at amortized cost, with adjustments based on compliance with lease obligations. Initial direct costs and advances paid less benefits received are included in the value of the asset at the date of initial recognition. Depreciation is calculated on a straight-line basis over the term of the contract. For contracts without a term, the Bank applies a period of 5 years.

Right-of-use assets are presented in Note 22 – Property, plant and equipment.

At the date of commencement of the lease agreement, the Bank recognizes a lease liability measured at the net present value of future payments under the lease agreement until the expiration of the contract. For contracts without a term, the Bank applies a period of 5 years. The Bank has no variable elements of future payments or built-in options in the contracts.

3.5.2. Bank as a lessor

Leases under which the Bank does not transfer substantial risks and rewards of ownership are classified as operating leases. Lease income is recognized on a straight-line basis over the term of the contract. Initial costs related to the asset, such as negotiation costs and asset preparation costs, are included in the carrying amount of the asset and depreciated in accordance with the recognition of rental income.

3.6. Taxes and Contributions

3.6.1. Income tax

Current Income Tax

Income taxes are calculated and paid in accordance with the Law on Corporate Income Tax ("Official Gazette of Montenegro", No. 80/2004, 40/2008, 86/2009, 14/2012, 61/2013 and 55/2016). The income tax rate is proportional and amounts to 9% of the tax base.

Capital losses may be offset against capital gains realized in the same year. Where, upon offsetting capital loss against capital gains realized in the same year capital loss remains, the taxpayer may carry it forward and set against the next gains over a five-year period.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.6. Taxes and Contributions (Continued)

3.6.1. Income tax (Continued)

Current Income Tax (Continued)

The Montenegrin tax regulations do not envisage the possibility of using the current period tax loss as a basis for the recovery of tax paid in prior periods. However, current period losses presented in the tax balance sheet may be used to reduce the future tax base for up to 5 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.

3.7. Cash and Cash Equivalents

Cash and cash equivalents are comprised of 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.

Cash and cash equivalents are valued at amortized value in the balance sheet.

3.8. Financial instruments

3.8.1. Initial Recognition

Purchase or sale of a financial asset or liability is recorded using an accounting coverage at the balance sheet date of the transaction.

Financial instruments are initially measured at fair value plus transaction costs for all financial assets or liabilities other than those measured at fair value through income statement. Financial assets at fair value, whose effect of changes in fair value are recognized in the income statement are initially recognized at fair value and transaction costs are charged to operating expenses in the income statement.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial instruments (continued)

3.8.2. Classification and measurement

The Bank classifies all its financial assets based on the business model for asset management and contractual provisions of the asset (identification of SPPI criteria).

The Bank classifies financial assets 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 mandatorily measured at fair value through profit and loss (mandatory FVTPL) and
- Financial assets optionally measured at fair value through profit and loss (optional FVTPL).

Financial liabilities are measured at amortized cost, except for liabilities held for trading or derivative instruments, where the determination of fair value is applied. In this case, changes in fair value are recorded in the income statement.

3.8.2.1. Business model assessment

The Bank determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's key management personnel
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected)
- The expected frequency, value and timing of sales are also important aspects of the Bank's assessment.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realized in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial instruments (continued)

3.8.2. Classification and measurement (continued)

3.8.2.2. SPPI test

The second step in the classification process is that the Bank assesses contractual terms of funding to identify whether they meet the SPPI test.

'Principal' for the purposes of this test is defined as the fair value of a financial asset on initial recognition and may change over the lifetime of the financial asset (for example, if there are principal repayments or premium / discount depreciation). The most important elements of the interest for loan arrangement are usually taking into account the time value of the money and credit risk. In order to implement the SPPI rating, the Bank applies assessment and considers relevant factors such as currency in which is denominated financial asset and the period for which the interest rate is determined.

In contrast, contractual terms that introduce a more than *de minimis* exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

3.8.3. Financial assets and liabilities

3.8.3.1. Loans and receivables from banks and clients, securities and other financial assets at amortized cost

The Bank measures loans and receivables from banks, loans and receivables from customers, debt securities and other financial assets at amortized cost if both of the following conditions are met:

- The financial asset is held within the business model with the aim of holding the financial asset for the purpose of collecting contracted cash flows;
- The contractual terms of the financial asset give cash flows on certain dates that are solely payments of principal and interest (SPPI) on the amount of outstanding principal.

Loans and receivables

Loans approved from the Bank are recorded in the business books in the moment of the transfer of the assets to the loan beneficiary.

Loans are stated in the balance sheet in the amount of approved placement increased by the amount of interest due less repaid principal and paid interest and impairment of the value based on the assessment of the identified risk for individual placements and risk for which the experience indicates that they are contained in credit portfolio.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial instruments (continued)

3.8.3. Financial assets and liabilities (continued)

3.8.3.1. Loans and receivables from banks and clients, securities and other financial assets at amortized cost (continued))

Financial guarantees, letters of credit and undrawn loan commitments

Financial guarantees are initially recognized in the financial statements (as part of the provision) at fair value, with a premium received. After initial recognition, the Bank's liability for each guarantee is measured as greater than the initial amount recognized less cumulative depreciation recognized in the income statement, and in accordance with IFRS 9 - ECL Provisions as set out in Note 3.8.8. The premium received is recognized in the income statement in net income from fees and commissions proportionately over the life of the guarantee.

Unused loan liabilities and letters of credit are liabilities under which, during the term of the liability, the Bank is obliged to provide the client with a loan with predetermined conditions. Similar to contracts, and for financial guarantees, provisions are created in the case of an onerous contract, but as of 1 January 2018, these contracts are within the requirements of the ECL.

3.8.3.2. Debt instruments valued at FVOCI

The Bank applies the new category under IFRS 9 of debt instruments measured at FVOCI when both of the following conditions are met:

- The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets
- The contractual terms of the financial asset meet the SPPI test

FVOCI debt instruments are subsequently measured at fair value with gains and losses arising due to changes in fair value recognized in OCI. Interest income and foreign exchange gains and losses are recognized in profit or loss in the same manner as for financial assets measured at amortized cost. On derecognition, cumulative gains or losses previously recognized in OCI are reclassified from OCI to profit or loss.

3.8.3.3. Equity instruments at FVOCI

On initial recognition, the Bank may choose to irrevocably classify some of equity instruments as equity instruments at FVOCI when they meet the definition of definition of Equity under IAS 32 *Financial Instruments:* Presentation and are not held for trading. Such classification is determined on an instrument-by instrument basis.

Gains and losses on these equity instruments are never reclassified to profit. Dividends are recognized in profit or loss as other operating income when the right of the payment has been established, except when the Bank benefits from such proceeds as a recovery of part of the cost of the instrument, in which case, such gains are recorded in OCI. Equity instruments at FVOCI are not subject to an impairment assessment.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial instruments (continued)

3.8.3. Financial assets and liabilities (continued)

3.8.3.4. Financial assets and liabilities at fair value through profit or loss

Financial assets and financial liabilities in this category are those that are held for trading and have been either designated by management upon initial recognition or are mandatory required to be measured at fair value under IFRS 9. Such designation is determined when one of the following conditions are met:

- The designation eliminates, or significantly reduces, the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognizing gains or losses on them on a different basis or
- The liabilities are part of a group of financial liabilities, which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy
- The liabilities containing one or more embedded derivatives, unless they do not significantly modify the cash flows that would otherwise be required by the contract, or it is clear with little or no analysis when a similar instrument is first considered that separation of the embedded derivative(s) is prohibited.

Financial assets and financial liabilities at FVPL are recorded in the statement of financial position at fair value. Changes in fair value are recorded in profit and loss with the exception of movements in fair value of liabilities designated at FVPL due to changes in the Bank's own credit risk. Such changes in fair value are recorded in the Own credit reserve through OCI and do not get recycled to the profit or loss. Interest earned or incurred on instruments designated at FVPL is accrued in interest income or interest expense, respectively, using the EIR, taking into account any discount/ premium and qualifying transaction costs being an integral part of instrument. Dividend income from equity instruments measured at FVPL is recorded in profit or loss as other operating income when the right to the payment has been established.

Hedge derivatives

The effects of reducing the fair value of derivative financial instruments are recognized in the income statement at the reporting date.

3.8.4. Reclassification of financial assets and liabilities

The Bank reclassifies its financial assets after their initial recognition, in cases of changes in the business model, and in exceptional circumstances when the Bank acquires, disposes of or terminates the business line. Financial liabilities are never reclassified. Reclassification of financial assets is performed from the date of reclassification, without restatement of previously recognized profit, loss (including expected credit losses) or interest.

If the Bank reclassifies financial assets from the measurement category at amortized cost to the measurement category at fair value through profit or loss, its fair value is measured at the date of reclassification. All gains or losses arising as the difference between the amortized cost of financial assets and fair value are recognized in the income statement.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial instruments (continued)

3.8.4. Reclassification of financial assets and liabilities

If the Bank reclassifies a financial asset from the fair value through profit or loss category to at amortized cost category, its fair value at the date of reclassification becomes its new gross carrying amount. Based on the above, the effective interest rate is adjusted on the reclassification date, which is considered the new date of initial recognition for the purpose of measuring expected credit losses.

If the Bank reclassifies financial assets from the measurement category at amortized cost to the measurement category at fair value through other comprehensive income, its fair value is measured at the date of reclassification. All gains or losses arising as the difference between the amortized cost of financial assets and fair value are recognized in other comprehensive income. Effective interest rate and measurement of expected credit losses are not adjusted due to reclassification.

If the Bank reclassifies financial assets from measurement at fair value through other comprehensive income to measurement at amortized cost, the financial asset is reclassified at its fair value at the date of reclassification. However, the cumulative gain or loss previously recognized in other comprehensive income is removed from equity and carried at fair value at the date of reclassification. Consequently, financial assets are measured at the reclassification date as if they were always measured at amortized cost. This adjustment affects other comprehensive income, but does not affect the income statement, and is therefore not a reclassification adjustment in accordance with IAS 1: Presentation of Financial Statements. Effective interest rate and measurement of expected credit losses are not adjusted due to reclassification.

If the Bank reclassifies financial assets from the fair value measurement through profit or loss to the fair value measurement category to other comprehensive income, the financial assets are still measured at fair value. The reclassification date is considered to be the new date of initial recognition for the purpose of measuring expected credit losses.

If the Bank reclassifies financial assets from the fair value through other comprehensive income to the fair value through profit or loss category, the financial assets are still measured at fair value. Cumulative gain or loss previously recognized in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment in accordance with IAS: 1 Presentation of Financial Statements at the Date of Reclassification.

As disclosed in Note 18.3, in 2020 the Bank reclassified part of the securities portfolio from the measurement at fair value through other comprehensive income to the measurement at amortized cost. The corresponding effects are presented in the Statement of Changes in Equity and Note 18.3.

3.8.5. Derecognition of financial assets and liabilities

The Bank derecognizes a financial asset, such as a loan to a customer, when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new loan, with the difference recognized as a derecognition gain or loss, to the extent that an impairment loss has not already been recorded. The newly recognized loans are classified as Stage 1 for ECL measurement purposes, unless the new loan is deemed to be POCI).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial instruments (continued)

3.8.5. Derecognition of financial assets and liabilities (continued)

When assessing whether or not to derecognize a loan to a customer, among others, the Bank considers the following factors:

- Change in currency of the loan
- Introduction of an equity feature
- Change in counterparty
- If the modification is such that the instrument would no longer meet the SPPI criterion.

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Bank records a modification gain or loss, to the extent that an impairment loss has not already been recorded.

Recognition of financial liability terminates when the liability is met i.e., when the debt is paid, cancelled or expired.

3.8.6. Write offs

The financial assets are written off partly or in total only if the Bank has no reasonable expectation of recovery of the financial asset. Thus, a write off represents a derecognition event. If the amount that should be written off is greater than accumulated provision for credit losses the difference is initially calculated as additional provision which conflicts with gross carrying amount. Any other additional collection is recognized as extraordinary income within the balance sheet item – other income.

Write-offs may relate to the financial asset in whole or in part. Indicators of lack of reasonable expectation of recovery of financial assets are: death of the client and / or guarantor, complete loss of communication and access to the client, partial or complete legal nullity of the contract, exhaustion of legal collection possibilities (termination of litigation and enforcement proceedings) from debtor's assets, final non-recognition of claims in the bankruptcy estate of the debtor. The existence of any of the indicators (or more of them) is a necessary but not a sufficient condition for the write-off of financial assets. The decision on write-off is made by the Board of Directors, while the responsibility for materially insignificant amounts is delegated to the Credit Committee.

During 2020, the Bank wrote off financial assets with a total gross carrying amount of EUR 5 thousand. Collection of previously written off financial assets during 2020 amounted to EUR 4 thousand.

3.8.7. Forborne and modified loans

The Bank sometimes makes concessions or modifications to the original terms of loans as a response to the borrower's financial difficulties, rather than taking possession or to otherwise enforce collection of collateral. The Bank considers a loan forborne when such concessions or modifications are provided as a result of the borrower's present or expected financial difficulties and the Bank would not have agreed to them if the borrower had been financially healthy. Financial difficulty indicators include outstanding liabilities to covenants, or significant concerns from the Credit Risk Department. Forbearance may involve extending the payment arrangements and the agreement of new loan conditions.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial instruments (continued)

3.8.7. Forborne and modified loans (continued)

Once the terms have been renegotiated, any impairment is measured using the original EIR as calculated before the modification of terms. It is the Bank's policy to monitor forborne loans to help ensure that future payments continue to be likely occuring. Derecognition decisions resulting in classification in POCI or between Stage 2 and Stage 3 are determined on a case-by-case basis. If these procedures identify a loss in relation to a loan, it is disclosed and managed as an impaired Stage 3 forborne asset until it is collected or written off.

Once an asset has been classified as forborne, it will remain forborne for a minimum 24-month probation period. In order for the loan to be reclassified out of the forborne category, the customer has to meet all of the following criteria:

- All of its facilities have to be considered performing
- The probation period of two years has passed from the date the forborne contract was considered performing
- Regular payments of more than an insignificant amount of principal or interest have been made during at least half of the probation period
- The customer does not have any contract that is more than 30 days past due.

An overview of the development of restructured loans during 2020 is presented in Note 5.

3.8.8. Impairment of financial assets

In accordance with the valid Decision on minimum standards for credit risks management in banks (Official Gazette of Montenegro, no. 22/12, 55/12, 57/13, 44/17 and 82/17), the Bank is obliged to assess the quality of assets at least quarterly, determine whether there is objective evidence of impairment of balance sheet assets, or probable loss on the basis of off-balance sheet items and to calculate the adequate amount of such impairment, or probable loss, and to classify these items in the appropriate classification group, in accordance with the mentioned Decision.

For the purposes of assessing impairment of financial assets and calculation of impairment, the Bank applies the Methodology for impairment and expected loss assessment according to IFRS 9.

In accordance with IFRS 9, impairment of financial assets (i.e., expected credit losses, ECL) is considered for all financial assets except those classified at fair value through profit or loss and equity instruments at fair value through other comprehensive income.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial instruments (continued)

3.8.8. Impairment of financial assets and provision (continued)

3.8.8.1. Basic principle of the implementation of IFRS 9

When assessing the impairment of financial assets, the Bank starts from the requirements of IFRS 9 standard, as follows:

- An impairment assessment is based on expected losses.
- The expected losses are made at the 12-month level (or lifetime, depending on stage) and contain the probability-weighted assessments;
- Impairment is recognized both individually and on a group (portfolio) basis;
- Calculation of impairment for clients in default is based on an assessment of the expected future cash flows of a financial asset;
- Cash flows from a financial asset that are measured at amortized cost are discounted using the contractual effective interest rate (EIR), except for POCI assets, where credit risk adjusted EIR is used;
- Probability-weighted scenarios for calculating the expected loss - means that at all stages of calculating the expected losses probability-weighted scenarios must be incorporated and ECLs are calculated in at least two different scenarios;
- Necessary adequate modelling of risk parameters (EAD exposure, PD - probability of default, LGD - loss by default, CCF - credit conversion factor);
- Necessary modelling of forward-looking expectations - while determining the risk parameters, it is also necessary to consider forward-looking information which enable the adjustment of historical data towards future expectations;
- Calculation of interest income on non – performing assets is performed at amortized (net) value.

Forward-looking information

According to the requirements of IFRS 9, in the first step the Bank is required to assess, at reasonable cost and effort, at which point in the economic cycle it is currently and in relation to its exposures and how future events may affect the level of expected credit losses. The very concept of expected credit losses (as opposed to the previous concept of incurred losses) requires the use of forward-looking information. The most common method of including these informations is to find a significant relationship between the components in the expected credit loss model and macroeconomic variables and then, use the estimated movements of macroeconomic variables to predict the future values of the expected credit loss model components (risk parameters).

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial instruments (continued)

3.8.8. Impairment of financial assets and provision (continued)

3.8.8.1. Basic principle of the implementation of IFRS 9 (continued)

Forward-looking information (continued)

However, starting from the following assumptions:

- Since the first quarter of 2020, a pandemic of a new coronavirus (Covid-19) has broken out in the world with still unforeseeable consequences for the population and the economy;
- The pandemic has had a negative impact on indicators in various industries, especially tourism and hospitality (significant industries in Montenegro);
- As a result of the above, a significant decline in GDP and an increase in the unemployment rate in Montenegro is expected;
- There is still great uncertainty about the magnitude of the negative effects on the Montenegrin economy and it is currently impossible to accurately estimate the recovery period;

We come to the conclusion that the so-called black swan has occurred and that the use of standard statistical methods to examine the interdependence between macroeconomic variables (e.g., linear regression) would be inadequate in every respect.

Instead, the Bank opted for an expert assessment of the correction factor (for forward-looking approach), by examining the historical PD and its movement by years (separately for the retail and corporate segments). In this way, the maximum increase in PD over a period of 12 months was identified. By indexing this increase, a corrective factor was obtained.

Individually significant receivables

Individually significant receivables are considered as total gross exposure of the Bank to the one party or a group of related parties which is greater than EUR 50 000 in the segment of operations with legal entities, individuals and entrepreneurs.

Default status

Default status is the status which is assigned to the receivables if one of the following criteria is met:

- There is a delay in repayment more than 90 days;
- There are other qualitative factors which indicates on objective proof of impairment – the assessment of uncertainty for debtor fulfilling the obligations;
- financial problems of the debtor;
- restructuring which is designated as non - performing;
- bankruptcy or liquidation;
- Lack of client cooperation and terminated contracts;
- Write off of receivables.

The default status client has if the credit rating is D and E i.e., all exposures that are classified in Stage 3.

6. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial instruments (continued)

3.8.8. Impairment of financial assets (continued)

3.8.8.1. *Basic principle of the implementation of IFRS 9* (continued)

Exposures of low credit risk

In accordance with the provisions of IFRS 9, credit risk of financial instrument is considered low if there is a low risk of default of financial instrument, i.e. the debtor is totally capable in short-term to fulfil all its contractual liabilities in respect of cash flow, and if unfavourable changes in the economic and business conditions can in the long term, but not necessarily, decrease the ability of the debtor to fulfil his contractual liabilities in respect of cash flow.

Financial instruments are not considered as instrument of the low credit risk when the risk from loss on those instruments is considered low only because of the collateral value. Financial instruments do not need to obtain an external rating to be considered as instruments of the low credit risk from a market participants' perspective considering all the terms of financial instruments.

3.8.8.2. Impairment calculation

Staging

During the initial recognition, all financial assets that fall within the scope of IFRS 9 (except POCI assets) are allocated in Stage 1 and require the calculation of 12-month expected credit losses.

A significant increase in credit risk in relation to initial recognition for exposures that are not part of the low credit risk portfolio leads to the transition to Stage 2 according to the criteria of client creditworthiness and delay of legal entities and individuals. Exiting from Stage 2 i.e., return to phase 1 for corporate, individuals and S.M.E. (in which the staging is conditioned by the days of delay) it is possible for clients classified as A, B or C if the client at the end of the accounting period meets the condition for being in Stage 1. An exception from the preceding paragraph relates to the restructured performing exposures that require the cooling period of 12 months from the date of restructuring, provided that at the end of the reporting periods in the cooling period there is no delay of more than 30 days. The Bank may also classify certain exposures in Stage 2 based on individual decision and assessment of credit risk increase.

7. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial instruments (continued)

3.8.8. Impairment of financial assets (continued)

3.8.8.2. Impairment calculation (continued)

Staging (continued)

Indicators of a significant increase in credit risk since initial recognition are:

- Financial condition of the debtor shows a deterioration compared to the initially assessed condition, which is accompanied by a change in the initial creditworthiness from good to low quality (with the restriction that the newly assigned is not lower than the category belonging to the classification group C);
- Fact that there is information about the breach of contractual obligations;
- Delays in settling due liabilities for 31-90 days;
- Significant change in the terms of loan repayment compared to the originally agreed, assuming that at the time of concluding the restructuring the client is up to 90 days in arrears (so-called performing - restructuring);
- Information from external sources suggests a negative development of the client's creditworthiness (e.g., litigations and lawsuits are filed against the client, account blockade, loss of significant customers or suppliers, etc.);
- Available information from the credit register shows that the client is in a significant delay in repaying the loan with other banks, etc. (excluding situations in which the Bank's loan is clearly separable from other loans granted to the same borrower by its characteristics or sources of repayment);
- Bad historical experience;
- Unfavourable change in the regulatory or technological environment of the debtor;
- Significant change in the value of collateral to the extent that reduces the debtor's incentive to continue with regular repayment of contractual obligations, etc.);
- Disappearance of the active market for financial instruments of debtors;
- Expected significant reduction in customer turnover and loss of a large customer. A decline in turnover is defined as significant if it is not the result of "one-off" events or events related to the specificity of the industry, i.e., seasonality but is the result of regular business activity.

For securities, the transition to Stage 2 represents a decline in the issuer's rating (according to the scales of Moody's, S&P, Fitch), which leads to an increase in the lifetime of PD higher than 200% compared to PD at the time of recognition of the financial instrument. Exposures with a rating lower than C or exposures with a default event are considered Stage 3.

Criteria for client allocation in Stage 3 are objective evidence of impairment, and by definition they are:

- there is a delay in repayment for more than 90 days,
- there are other qualitative factors that are pointing to objective proof of impairment - assessment of uncertainty for fulfilment of obligations of the debtor,
- restructuring designated as non-performing,
- terminated contracts, bankruptcy or liquidation, POCI
- clients with current rating D or E.

8. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial instruments (continued)

3.8.8. Impairment of financial assets (continued)

3.8.8.2. Impairment calculation (continued)

Staging (*continued*)

The transition of exposure from Stage 3 to Stage 2 and from Stage 2 to Stage 1 is only possible in stages:

- the condition for the transition from Stage 3 to Stage 2 is possible after the expiration of a period of 3 months in condition that at the end of the reporting periods during the cooling period there are no delays of more than 90, if the condition for Stage 3 was a delay of more than 90 days, i.e., that the conditions of being in Stage 2 have been fulfilled;
- Exiting from Stage 2 i.e., the return to Stage 1 for legal entities, individuals and S.M.E. (in which the shifting is conditioned by the days of delay) is for clients A, B and C is possible if the client at the end of the accounting period meets the condition for being in Stage 1.

The exception to the above applies to non-performing loans that require a cooling period of 12 months from the date of restructuring, provided that at the end of the reporting period there is no delay of more than 90 days, with an additional 12 months in Stage 2, provided that at the end of the reporting periods during that cooling period no delays of more than 30 days were recorded, after which the condition for transition to Stage 1 is met.

Stage for client with a larger number of individual exposures is determined by the exposure with the largest delay in repayment. The Bank is obliged to take into account the relations within the group of related legal entities by classifying the dominant debtor from the group of related parties in Stage 2/Stage 3 and other entities from that group in that category. Clients with ICL (Intensive Care List) checklist are treated under Stage 2 and Stage 3, respectively.

POCI assets

Financial assets that are recognized as impaired at the time of initial recognition are considered POCI assets (Purchased or Originated as Credit Impaired).

For POCI assets, expected credit losses are always assessed at lifetime level, and cannot be assessed at the level of twelve-month expected losses. Credit risk-adjusted EIR is used to discount expected future cash flows.

Impairment principles of balance sheet and off – balance sheet items

The Bank identifies the items of balance sheet assets and the expected loss on the basis of off-balance sheet items subject to credit risk and calculates the appropriate amount of that impairment i.e., expected loss on:

- Individual basis of material significant receivables;
- Group basis (group assessment for receivables which are not individually significant in default);
- Group basis (group assessment of individually significant items which are not in default).

The assessment of expected credit losses is performed quarterly.

9. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial instruments (continued)

3.8.8. Impairment of financial assets (continued)

3.8.8.2. Impairment calculation (continued)

Individual basis of the assessment of ECL

Assessment of expected credit losses on an individual basis relates to exposures to clients whose exposure exceeds the materiality threshold and are in the default status. An assessment of expected losses on an individual basis is based on an assessment of the expected cash flows from the loan repayment or from collateral. Expected scenarios are represented by three scenarios with different probabilities. The amount of impairment represents the discounted value of collected cash flows through scenarios weighted by their probability. The scenarios use estimates of expected future cash flows from ordinary activities (continued loan repayment) or from the foreclosure of collateral.

The assessment of cash flows from the continuation of loan repayment is based on the assessment for each client individually in accordance with the expectation of cash flows (whether based on assumptions from the previous period or oral / written agreement with the client). The expected cash flows are the result of the probability of a weighted outcome as explained in this Methodology - part of the inclusion of forward-looking information.

In accordance with the Bank's policy on the acceptability and effective value of collateral, the assessment of cash flows expected to be realized by collateral is also based on the probability of weighted results. The expected effective value of the collateral is considered through the scenario of expected collection and discounted at the original effective interest rate on the reporting date. The impairment calculation is considered on the net principle.

The assessment of expected losses on a group basis is for all other financial assets that are not the subject of an individual assessment and for which the impairment is not established. Estimation of expected losses on a group basis is done according to the phases defined by this Methodology as follows:

- for Stage 1 at the level of twelve months of losses;
- for Stage 2 and Stage 3 at the level of expected lifetime losses.

Group assessment of ECL

Group assessment of expected losses are made according to groups with similar credit risk characteristics, and considering the current size and structure of the Bank's loan portfolio.

Risk parameters in the calculation of expected losses:

- PD - *Probability of Default* (12-month or in duration) which indicates the probability of occurrence of default status;
- LGD - *Loss Given at Default* which indicates the amount of loss on default;
- EAD – *Exposure at Default* which indicates the Bank's exposure to credit losses;
- CCF – *Credit Conversion Factor* which indicates the probability of converting off-balance sheet exposures to on-balance sheet exposures.

10. 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)
3.8. Financial instruments (continued)

3.8.8. Impairment of financial assets (continued)

3.8.8.2. Impairment calculation (continued)

Group assessment of ECL (continued)

The PD is directly calculated from the migration matrix (which contains the probability of transition between two statuses in a specific time period) by monitoring in all segments for exposures that are not in default for twelve months and reflecting the percentage of exposure that has passed into default status during that period. The obtained PD values will be used as the basis for the calculation for all segments of the portfolio.

The probability of default can vary in different life stages of the loan, so in terms of the probability of migration, it is important to consider all stages of the loan's duration. Changes in the time periods for PD calculation can be determined by multiplying the matrix with the corresponding path number in order to assess the appropriate time horizon. PD for a period of 12 months is obtained by calculating the number of migrations at the beginning and at the end of the period.

Based on days of delay the Bank will classifies the following groups (buckets:

Bucket	Credit balance	Days of delay
1	Impairment before default	0 - 30 days
2	Impairment before default	31 - 60 days
3	Impairment before default	61 - 90 days
4	Impairment after default	90+ days

Twelve months parameter of the PD risk is and, in that status, and the year is defined as:

$$PD_i(t) = \frac{N_{[t-1,\, t)}^{i \to default}}{N_{t-1}^{i}}$$

where:

$N_{[t-1,\, t)}^{i \to default}$ - the number or transition from state "i" to the state "default" for the time period [t-1, t)

N_{t-1}^{i} – number of placements and in that state measured in the year (t-1).

For PD calculation for retail portfolio, migration matrices are based on the facility level. Corporate portfolio migration matrices are based on client level.

For the calculation of twelve months of losses, a PD will be used based on twelve months matrices adjusted by macroeconomic adjustment weighted by the probability as described in the introduction - the inclusion of forward-looking information.

When calculating the lifetime values of the PD, the same matrix format used to calculate the 12-month PD values will be used.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial instruments (continued)

3.8.8. Impairment of financial assets (continued)

3.8.8.2. Impairment calculation (continued)

Group assessment of ECL (continued)

Step 1:

Starting from the value of the PD at the twelve-month level according to the matrix of migration, the Bank will multiply the matrix by calculating the cumulative probability of a PD for maturity up to 5 years, from where further to the maximum maturity of financial instruments in the portfolio implies constant values of cumulative probability per bucket.

The multiplication of migration matrices is based on the access of Markov chain and is calculated using the formula:

$T_t = T_{t-1} \text{ x } T = \ldots = T^t$,

where:

T - one – year migration matrix.

* Note: The multiplication of the matrix does not have commutative characteristic and is marked as 'x'.

Step 2:

Based on the obtained cumulative values of PD for different maturities and buckets, the Bank will calculate probabilities of PD for the same maturities and buckets (assuming that certain exposure has passed to default in year n, assuming that it has "survived" up to the year n-1). Transfer from cumulative to conditional probability is obtained by Bayes approach:

$$PD_{conditional}(t) = \frac{PD_{cumulative}(t) - PD_{cumulative}(t-1)}{1 - PD_{cumulative}(t-1)}$$

Step 3:

Based on the obtained conditional probability of the PD, the Bank will calculate from the same matrices the marginal values of the PD, which marks the default exactly in year n for all maturities and buckets. For the marginal value of the PD from the 5th year, the Bank will use a constant simple weighted average of marginal value of the PD until that year. The Bank calculates the marginal probability using the formula:

$$PD_{marginal}(t) = PD_{conditional}(t) \cdot (1 - PD_{cumulative}(t-1))$$

*Marginal, cumulative and conditional PD in the first year (t=1) are equal, therefore it is the same which one is used during the calculation of twelve months credit losses. In lifetime loans only marginal PD is used. For the further consistency, for the parameter valuation of the PD risk we are considering the valuation of marginal probability of PD.

Step 4:

Obtained marginal values of the PD for all maturities and buckets the Bank will use macroeconomic adjustments as described in introduction – the inclusion of forward-looking information.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

a. 3.8. Financial instruments (continued)

3.8.8. Impairment of financial assets (continued)

3.8.8.2. Impairment calculation (continued)

Group assessment of ECL)

The PD parameter for securities is used according to the values of Moody's rating or S&P and according to the expectation of the changes of rating in the following year the macroeconomic adjustment of the weighted probability is done, as described in introduction – inclusion of the forward-looking information.

The LGD parameter is used for securities according to the values and rating scale of Moody's, or S&P.

To calculate the LGD in the segment of corporate-legal entity as well as in the segment of Retail-individuals, the following formula will be used:

$$LGD = (1\text{-}CR) * \left(\frac{EAD - \max\{0, \text{effective value of collateral}\}}{EAD}\right)$$

where:

LGD – Loss Given Default,

CR – Cure Rate, obtained from migration matrices on the twelve months level (for stage 3 amounts 0)

In the case where the effective value of the collateral equals or its greater than amount of EAD, and with the aim for LGD not to be equal to zero, in the formula $\left(\frac{EAD - \max\{0, \text{effective value of collateral}\}}{EAD}\right)$ fixed value of 5% is used. The percentage is determined by experts, by taking into account the high value of collateral, and on the other hand takes into account the provision of IFRS 9 that the assessment of expected credit losses should always reflect the possibility of credit losses even if the absence of credit loss (IFRS 9, 5.5.41) is most likely.

The LGD parameter is not macro-economically adjusted, since the adjustment is at PD level, and is taken into account by multiplying in the impairment formula.

For the calculation of impairment within the homogeneous groups Corporate with first class collateral and Retail with first class collateral, the Bank will apply a fixed percentage of 0.1% in relation to EAD.

For the amount of exposure for the purpose of expected credit losses on a twelve months lifetime level it is considered the amount of the exposure according to the definition in the introduction, and according to the depreciation plan. For off-balance sheet exposures as a basis for impairment calculation, the amount of off-balance sheet exposure is used together with the credit conversion factor as defined by this Methodology (i.e., as a product of off-balance sheet exposure and credit conversion factors).

As defined in Article 13 of the Capital Adequacy Decision, the values of the credit conversion factor (CCF) for different types of off-balance sheet exposures are used.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8. Financial instruments (continued)

3.8.8. Impairment of financial assets (continued)

3.8.8.2. Impairment calculation (continued)

Impairment calculation on a group basis (continued)

The calculation of impairment for placements on a group basis is done according to the formulas below for all segments, and for those clients, where there is no objective evidence of impairment if they are materially significant clients or clients with evidence of impairment, but whose exposure is not material.

For exposures that are classified in Stage 1 and for which the expected credit loss at the twelve-month level is calculated on a group basis, the following formula is used:

$$12EL = PD_s \cdot LGD_s \cdot EAD_s$$

12EL	Twelve months expected credit losses
EADs	Exposure at the time of the reporting date
PDs	The probability of entering the default status adjusted for future expectations
LGDs	Loss in the default status i.e., the recovery rate which indicates on that which the part (percentage) of the contract that were in a default status of the obligation came out in a natural way (considering the value of collateral for individual contracts) during a given time period

For exposures classified in Stage 2 and 3 and for which the calculation of expected lifetime credit losses is done on a group basis the following formula is used:

a) *For nondefault exposures*

$$LEL = \sum_{t=1}^{Maturity} EAD_s[t] \cdot mPD_s[t] \cdot LGD_s[t]$$

where:

LEL	Lifetime expected credit loss
mPDs[t]	For macroeconomic expectations through the probability weighted scenarios adjusted vector of PD
LGDs[t]	Vector LGD
EADs[t]	Vector of the exposure to the credit risk

b) *for default exposures*

The same formula as in the previous part is used, PD vector=1 for all the point of the curves.

11. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

b. Financial instruments (continued)

3.8.8. Impairment of financial assets (continued)

3.8.8.2. Impairment calculation (continued)

ECL calculation on an individual basis

After selecting individual significant placements and establishing the existence of one or more objective evidence of impairment of receivables, the impairment is assessed on an individual basis.

The amount of impairment in accordance with IFRS is calculated as the difference between the carrying amount of the assets and the present value by the probability of the weighted scenarios of the estimated cash flows discounted to the present value i.e., value on the reporting date.

Impairment (P*ind*) is calculated on an individual basis as:

$P_{ind} = CA - RA$

where:

CA	Carrying amount of financial assets
RA	The amount that the Bank expects to collect at individual impaired asset through probability weighted scenarios. RA is defined as present value of the future cash flows CFt.

RA calculation is presented in the following mathematic formula:

$$RA = \sum_{0}^{t} \frac{CF_t}{(1+r)^t},$$

where:

t	The expected collection period of the receivables from the Bank. Cash flows are added monthly.

An assessment of the amount that the Bank expects to collect on an individually impaired asset is in accordance with the probability of weighted assumptions, so that the bank assesses it in two different scenarios to which is assigned the probability and amount of the collection, and the final amount of RA is the sum of the collection amount according to the probability scenario weighted with its probability.

The discount factor r presents the initially agreed effective interest rate calculated for a certain loan if it is the loan that is classified in the Stage 3, i.e., credit adjusted effective interest rate if it is about POCI assets.

The Bank considers the following relation between annual EIR and monthly EIR: $EKS_{p.m.} = (1 + EKS_{p.a.})^{1/12} - 1$

The assessment of the client consists of the assessment of the future cash flow. The expected future cash flows include:

- Future cash flows from the loan collection; and
- Future cash flows from the collateral collection.

12. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

c. Financial instruments (continued)

3.8.8. Impairment of financial assets (continued)

3.8.8.2. Impairment calculation (continued)

ECL calculation on an individual basis (continued)

For the discounting of the cash flow the effective interest rate or credit adjusted effective interest rate (expressed on a monthly level) is used, depending on the type of the assets. For the impairment calculation on the off – balance sheet items and discounting of the future cash flows the effective interest rate can be used on one of the following ways:

- With approved and unused loans – there is an effective interest rate;
- With guarantees, letters of credit and other off – balance sheet liabilities the Bank will use the interest rate of 10%.

In addition, maturity from 12-24 months is taken into account, as it is considered that the contingent off – balance sheet item would transfer to loan, if it was called upon, , with maturity from 12-24 months and possibly with all other conditions that would affect the effective interest rate.

The following parameters are considered significant:

- The agreed effective interest rate;
- The date of improvement and the date of maturity of the placements;
- Expected collection of the cash flows (principal, interest, fee) from original repayment plan or corrected in accordance with delay or experience;
- Expected collection of the collateral, if the collection is not expected from cash flows. Collateral is entered reduced by the corresponding haircut, defined by the procedure.

Considering the provision of IFRS 9 that the assessment of the expected credit losses should always reflect the possibility of credit losses, even if it is most likely that that the credit loss will not occur, the Bank will define the percentage of 0.1% as a minimum amount of impairment at individual party.

3.8.8.3. Presentation

Impairment for ECL in the income statement is recognized as follows:

- For financial assets valued at amortized cost, impairment decreases the gross carrying amount of the financial asset;
- For off – balance sheet exposures (irrevocable commitments for undrawn loans and financial guarantees) impairment is recognized as reserve in the liabilities of the balance sheet;
- For partially withdrawn loan facilities where the Bank cannot separately identify the ECL, the expected credit losses should be recognized together as a deductible item of gross carrying value of withdrawn credit parties. Provision is recorded to the extent where the combined ECL exceeds the gross carrying value of the assets;

For debt instruments classified as FVOCI the impairment is not recognized in the balance sheet, due to the carrying amount of these assets must be equal to their fair value.

13. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

d. Financial instruments (continued)

3.8.8. Impairment of financial assets and provision (continued)

3.8.7.4. Provisions

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 obliged, depending on the probability of loss, to classify asset items into the following categories:

- A category ("Good Assets") - including loans and other receivables for which there are firm documentary evidences that will be collected in full and as agreed
- B category ("Special Note") - with B1 and B2 subcategories - including loan for which there is remote probability of loss, but which, require special attention of the Bank, 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 ("Suspicious assets") including loan of which the full collection 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 performed on a monthly basis. On a 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	% of provision	Days of delay
A	0.5	<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 IFRS 9.

The positive difference between the calculated provisions for potential losses and the sum of allowances for items of balance sheet assets and provisions for off-balance sheet items, represent a deductible item from the Bank's own funds (Tier 1 + Tier 2 capital).

14. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.9. Property, Plant, Equipment and Intangible Assets

Property, Plant, Equipment and Intangible Assets on 31 December 2020 are recorded at cost less accumulated depreciation, i.e., amortisation. Cost is the value at the invoice of supplier increased by attributable expenses based on procurement and preparation of assets for functioning.

Depreciation., i.e., amortisation is calculated on a straight-line basis on cost 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 (%)	
	2020	2019
Buildings	1	1
Computers and computer equipment	20	20
Furniture and other equipment	11	11
Vehicles	15	15
Leasehold improvements	15	15
Intangible assets	20	20

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 the applicable rate is of 5%, while the remaining fixed assets, equipment and software, are arranged in groups II to V, for which applicable rates are in the range from 15% to 30%.

3.10. Investment property

Investments in property are tangible assets that are not used directly for the performance of activities, but are acquired for the lease or sales purposes.

Investment property is initially recognized at cost, which consists of cost and transaction costs of acquisition. Subsequent measurement is based on a fair value model based on market value. Gains and losses on subsequent measurement are recognized in the income statement.

15. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.11. 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.

An impairment loss is recognized as an expense of the current period and is recorded under other operating expenses. If subsequently there is a situation that the loss recognized in previous years does not exist or is reduced, the value of the asset is increased up to the revised estimate of its recoverable value, but in way that increased value at which the asset is managed does not exceed the value at which the asset would be managed if in the previous years was not recognized loss due to impairment of assets.

The Bank's management believes that the total value of tangible and intangible assets as at 31 December 2020 is not overstated.

3.12. Repossessed assets

Repossessed assets are assets acquired by the Bank on foreclosure of receivables for placements collateralised by the above mentioned property. The Bank recognizes repossessed assets at the lower of the gross carrying value of receivables or market value of 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 Tier 1 capital. 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:

- the amount of investment in real estate and fixed assets exceeding the amount of Tier 1 capital 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 (Tier 1 + Tier 2 capital);
- 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 tangible 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:

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

16. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.13. Provisions

Provisions are recognized when:

- the Bank has a present legal or derived obligation as a result of past events;
- when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation;
- When a reliable estimate of the amount of the obligation can be made.

Provisions are measured at the present value of the expenditures required to settle the liability.

Provisions are reassessed at each balance sheet date and adjusted to reflect the best current estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the liability, the provision is reversed through the income statement.

3.14. Employee Benefits

3.14.1. 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 obliged 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.

3.14.2. 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 accounting policies applicable in Montenegro, provisions are made based on mentioned employee benefits, using the actuarial calculation.

3.15. 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.

3.16. Commission activities

The Bank performs commission activities according to the principle of the Business Cooperation Agreement, which is concluded with the Client on the one hand and with the Borrower on the other hand. Under this type of work, the Bank undertakes to receive funds from the Client and to conclude a Commission Loan Agreement with the Borrower on its own behalf and on its behalf, and to make these funds available to the Client in all amount. The Borrower pays interest according to the commission loan agreement in accordance with the repayment plan, while the Bank charges a commission as a fee for conducting commission operations. Commission transactions differ from credit transactions due to the fact that the Bank does not bear the credit risk, which is entirely on the side of the Borrower. Considering this reason, the Bank records these transactions in the off-balance sheet, while fee income is recorded in the income statement within the item Fee and commission income during the period of commission activities.

4. ACCOUNTING POLICIES AND ASSUMPTIONS

The management performs assessments and makes assumptions which affect the value of assets and liabilities in the following financial year. Accounting policies and assumptions are continuously valued and based on historical experience and other factors, including expectations of the future events for which it is believed that they will be reasonable in the given circumstances.

The resulting accounting assumptions will by the definition rarely be equal with the achived results. The most significant uses of estimates and judgments are as follows:

4.1. Impairment of loans

The Bank monitors and checks the quality of the loan portfolio on a monthly basis, both on an individual and collective basis, with the aim of ongoing assessment of the required amount of impairment. In determining the amount of impairment on an individual basis, the Bank estimates the value of future cash flows, including from collateral, using a certain degree of impairment of collateral (hair-cuts) and a certain collection period.

Management uses historical loss estimates for assets with similar credit risk characteristics to assess the level of impairment of collateral and the period of collection. The methodology and assumptions used in estimating the amounts and periods of future cash flows are reviewed regularly to eliminate any differences between estimated losses and actual experience.

Stress testing for credit risk predicts the impact of adverse macroeconomic conditions on non-collection and loss rates. Based on historical experience, the relationship between macroeconomic and risk factors is assessed and a benchmark for existing exposures is applied to assess the additional default rate and the provision required to respond to the identified risk. The assumption in these scenarios is that the exposure does not change over the course of one year.

Low-risk loans and lower-exposure loans are reviewed collectively.

4.2. Impairment of securities

To assess the impairment of securities, the Bank uses the rating system of internationally recognized rating agencies (Moody's, S&P, Fitch), as well as their research on government and corporate debt.

In the part of PD parameters (Probability of Default), data from the above mentioned researches are used directly, where the influence of estimates and assumptions is low. The estimation of the LGD parameter (Loss Given at Default) for government debt is based on the information from the above research for default economies, which are most similar to the economies of issuers whose securities the Bank has in its portfolio. Average values are used for corporate debt.

The most significant assumptions relate to forward-looking information, with the Bank, guided by the precautionary principle in times of heightened uncertainty, using moderately pessimistic scenarios in modelling.

4.3. Fair value of financial instruments

The fair value of financial instruments traded in an active market is obtained based on the published market price on the valuation date.

Determining the fair value of financial assets and liabilities for which there is no observable market price requires the use of various valuation techniques. Although valuation techniques reflect market conditions to a good extent on the day of measurement, they may still differ from market conditions before and after that day.

For financial instruments that are not traded frequently and have low price transparency, fair value is less objective and requires some degree of valuation variation depending on liquidity, concentration, uncertainty of market factors, price assumptions and other risks affecting a particular instrument. A change in the estimates of these factors could affect the fair value of the financial instruments shown.

4.4. Long-term employee benefits

The cost of long-term employee benefits is determined on the basis of actuarial calculation, using actuarial assumptions: discount rate, future wage growth in line with inflation and promotion rates, and wage growth based on past work, as well as changes in the number of employees entitled to compensation. Given the long-term nature of these plans, estimates are subject to significant uncertainty. Actuarial calculation is performed by an independent actuary.

4.5. Lifetime of intangible assets, properties, plants and equipment

Determining the lifetime of intangible assets, properties, plants and equipment is based on previous experience with similar assets as well as anticipated technical development and changes that are influenced by a large number of economic and industrial factors. The adequacy of a certain useful lifetime is reconsidered at an annual level or whenever there is an indication that there has been a significant change of the factors which presented the basis for determining the lifetime.

4.6. Litigation

The Bank's management estimates the amount of provisions for outflows based on litigation based on an assessment of the probability that the outflow of resources will actually occur under a contractual or legal obligation from prior periods.

4. ACCOUNTING POLICIES AND ASSUMPTIONS (CONTINUED)

4.7. Lease assessments

4.7.1. Assessment of the indefinite lease term

The Bank has lease agreements for business premises in which it performs activities concluded for an indefinite period of time. The Bank's management estimates the expected duration of the contract based on available information. Estimates are revised at each reporting period or if there are significant changes in contractual terms.

4.7.2. Estimation of incremental borrowing rate (discount rate)

The Bank is not able to determine the implicit leasing rate, therefore it uses an incremental borrowing rate in measuring the lease liability. The incremental borrowing rate reflects the rate at which the Bank could borrow funds necessary to purchase the leased assets, in similar economic circumstances.

5. RISK MANAGEMENT

5.1. Introduction

Bank is exposed to various risks in its business operations, including the most important:

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

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

The Department for Risk Monitoring, Management and Reporting is responsible for monitoring the Bank's exposure to certain risks, which is reported to the Asset and Liability Management Committee and the Board of Directors on a monthly basis.

5.2. Credit risk

The Bank is exposed to credit risk which is a risk that customers will be unable to pay their liabilities to the Bank in full and on time. Credit risk is perceived as the most important in the Bank. The Bank makes provisions for expected credit losses as defined by the Methodology for the Assessment of Impairment and Expected Loss according to IFRS 9 (Note 3.3.8). Significant changes in the economic environment or certain industries included in the Bank's loan portfolio might result in losses that are different from the losses provided for as of the balance sheet date. Therefore, the Bank's management carefully manages Bank's credit risk exposure.

5.2.1. Credit risk management

A credit risk exposure is a risk of a financial loss resulting from the borrower's inability to meet all their contractual obligations towards the Bank. The Bank's strategic commitment is aimed at ensuring optimal diversification of risks and income sources in order to increase cost-effectiveness and the segment of providing existing products and services, as well as promoting and affirming new ones. The Bank manages the credit risk 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 management is performed by a regular analysis of the ability of the borrower and potential borrowers to repay their liabilities for interest and principal.

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.1. Credit risk management (Continued)

Loan 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 Bank's irrevocable undertakings that it will make payments in the event that a customer cannot meet its obligations to third parties, and therefore they carry the same credit risk as loans.

5.2.2. Provisions for credit losses on impairment in accordance with accounting regulations prevailing in Montenegro

The Bank makes an impairment assessment (for balance sheet items), i.e. an estimate of a probable loss (for off-balance sheet items) regarding all balance sheet and off-balance sheet items that are exposed to credit risk. According to the methodology, the Bank has classified all financial assets into groups (portfolios) with similar credit risk characteristics, and taking into consideration the current size and structure of the loan portfolio, they are divided into: placements to corporate customers and entrepreneurs and placements to retail customers. As of the reporting date, the Bank establishes if financial assets were impaired. Objective impairment evidence is explained in Note 3.8.8.

5.2.3. Maximum credit risk exposure

An overview of financial assets and off-balance sheet exposures to credit risk (the amounts contain all receivables, including interest and accruals and deferrals) is presented below:

In EUR thousand	**31 December 2020**		**31 December 2019**	
I Overview of assets	**Gross**	**Net**	**Gross**	**Net**
Cash and deposit accounts with central banks	78,179	78,179	91,764	91,764
Loans and advances to banks	25,323	25,305	13,737	13,725
Loans and advances to customers	106,755	101,529	92,563	89,593
Securities	91,396	90,446	109,975	109,483
Other financial assets	65	37	34	12
Other assets	6,748	6,645	5,556	5,459
	308,473	**302,141**	**313,629**	**310,036**
II Off-balance sheet items				
Irrevocable commitments	4,039	3,987	8,438	8,318
Payment guarantees	9,052	8,769	4,588	4,398
Performance guarantees	2,647	2,582	1,679	1,661
	15,738	**15,338**	**14,705**	**14,377**
Total (I+II)	**324,211**	**317,479**	**328,334**	**324,413**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.3. Maximum credit risk exposure (Continued)

Types of collaterals are as follows:

- deposits;
- pledges on industrial machinery, securities, inventories and vehicles;
- property mortgages and fiduciary ownership transfer;
- promissory notes;
- authorisations;
- garnishments and injunctions;
- endorsers and
- insurance policies.

The catalogue of eligible collaterals defines collateral types (security instruments for Bank's loan repayments) and establishes which objects and rights are treated as collaterals, i.e. which objects and rights and under what conditions the Bank takes into account when analysing and assessing borrower’s credit risk. Credit risk management is partially controlled in this way.

Taking into consideration the collateral value risk when estimating cash flows from collaterals, the Bank applies a haircut of at least 30% up to 100% to all immovable property depending on the type of collateral and location, whereas a 90% haircut is applied to a collateral in the form of a pledge on movable property.

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers

Loans and advances to banks and customers - staging

An overview of gross exposures and the calculated impairment of advances' principal (ECL – expected credit losses) by stages for loans and advances to banks and customers is provided below:

In EUR thousand

31 December 2020	Gross S1	Gross S2	Gross S3	**Total**	ECL S1	ECL S2	ECL S3	**Total ECL**	**Net**
Cash loans	1,555	78	483	**2,116**	46	18	442	**506**	**1,610**
Housing loans	409	275	28	**712**	3	32	28	**63**	**649**
Credit cards	619	13	7	**639**	4	3	6	**13**	**626**
Other	1,168	21	322	**1,511**	7	-	322	**329**	**1,182**
Loans to retail customers	**3,751**	**387**	**840**	**4,978**	**60**	**53**	**798**	**911**	**4,067**
Large and medium-sized enterprises	55,559	23,567	6,816	**85,942**	408	1,103	2,198	**3,709**	**82,233**
State	15,000	-	-	**15,000**	83	-	-	**83**	**14,917**
Other	89	-	-	**89**	-	-	-	**-**	**89**
Loans to corporate customers	**70,648**	**23,567**	**6,816**	**101,031**	**491**	**1,103**	**2,198**	**3,792**	**97,239**
Total loans to customers	**74,399**	**23,954**	**7,656**	**106,009**	**551**	**1,156**	**2,996**	**4,703**	**101,306**
Loans to banks	**25,323**	**-**	**-**	**25,323**	**18**	**-**	**-**	**18**	**25,305**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

Loans and advances to banks and customers - staging

In EUR thousand

31 December 2019	Gross S1	Gross S2	Gross S3	**Total**	ECL S1	ECL S2	ECL S3	**Total ECL**	**Net**
Cash loans	2,040	107	478	**2,625**	38	12	415	**465**	**2,160**
Housing loans	500	264	30	**794**	3	23	30	**56**	**738**
Credit cards	464	11	10	**485**	3	1	7	**11**	**474**
Other	635	48	322	**1,005**	1	-	322	**323**	**682**
Loans to retail customers	**3,639**	**430**	**840**	**4,909**	**45**	**36**	**774**	**855**	**4,054**
Large and medium-sized enterprises	76,173	5,664	3,260	**85,097**	602	474	758	**1,834**	**83,263**
State	2,000	-	-	**2,000**	11	-	-	**11**	**1,989**
Other	119	-	2	**121**	-	-	2	**2**	**119**
Loans to corporate customers	**78,292**	**5,664**	**3,262**	**87,218**	**613**	**474**	**760**	**1,847**	**85,371**
Total loans to customers	**81,931**	**6,094**	**4,102**	**92,127**	**658**	**510**	**1,534**	**2,702**	**89,425**
Loans to banks	**13,737**	**-**	**-**	**13,737**	**12**	**-**	**-**	**12**	**13,725**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

An overview of the data on the credit risk exposure of advances' principal by sectors and categories of advances, stage and the number of days in arrears on the repayment of past due liabilities is provided below:

Advances to customers and banks – Stage 1

In EUR thousand

31 December 2020	Not in arrears	Up to 30 days in arrears	From 31 to 60 days	From 61 to 90 days	Over 90 days	**Total**
Cash loans	1,133	423	-	-	-	**1,556**
Housing loans	320	88	-	-	-	**408**
Credit cards	-	619	-	-	-	**619**
Other	1,168	-	-	-	-	**1,168**
Loans to retail customers	**2,621**	**1,130**	**-**	**-**	**-**	**3,751**
Large and medium-sized enterprises	55,500	59	-	-	-	**55,559**
State	15,000	-	-	-	-	**15,000**
Other	36	53	-	-	-	**89**
Loans to corporate customers	**70,536**	**112**	**-**	**-**	**-**	**70,648**
Total loans to customers, out of which:	**73,157**	**1,242**	**-**	**-**	**-**	**74,399**
Restructured	**19,757**	**-**	**-**	**-**	**-**	**19,757**
Loans to banks	**25,323**	**-**	**-**	**-**	**-**	**25,323**

31 December 2019	Not in arrears	Up to 30 days in arrears	From 31 to 60 days	From 61 to 90 days	Over 90 days	**Total**
Cash loans	1,286	754	-	-	-	**2,040**
Housing loans	198	302	-	-	-	**500**
Credit cards	5	441	18	-	-	**464**
Other	607	28	-	-	-	**635**
Loans to retail customers	**2,096**	**1,525**	**18**	**-**	**-**	**3,639**
Large and medium-sized enterprises	54,493	21,670	10	-	-	**76,173**
State	2,000	-	-	-	-	**2,000**
Other	62	57	-	-	-	**119**
Loans to corporate customers	**56,555**	**21,727**	**10**	**-**	**-**	**78,292**
Total loans to customers, out of which:	**58,651**	**23,252**	**28**	**-**	**-**	**81,931**
Restructured	**20,004**	**4,453**	**-**	**-**	**-**	**24,457**
Loans to banks	**13,737**	**-**	**-**	**-**	**-**	**13,737**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

Advances to customers and banks – Stage 2

In EUR thousand

31 December 2020	Not in arrears	Up to 30 days in arrears	From 31 to 60 days	From 61 to 90 days	Over 90 days	**Total**
Cash loans	12	44	16	6	-	**78**
Housing loans	10	6	195	64	-	**275**
Credit cards	-	9	3	1	-	**13**
Other	-	21	-	-	-	**21**
Loans to retail customers	**22**	**80**	**214**	**71**	**-**	**387**
Large and medium-sized enterprises	20,123	3,414	-	30	-	**23,567**
State	-	-	-	-	-	**-**
Other	-	-	-	-	-	**-**
Loans to corporate customers	**20,123**	**3,414**	**-**	**30**	**-**	**23,567**
Total loans to customers, out of which:	**20,145**	**3,494**	**214**	**101**	**-**	**23,954**
Restructured	**5,252**	**926**	**195**	**-**	**-**	**6,373**
Loans to banks	**-**	**-**	**-**	**-**	**-**	**-**

31 December 2019	Not in arrears	Up to 30 days in arrears	From 31 to 60 days	From 61 to 90 days	Over 90 days	**Total**
Cash loans	20	30	47	10	-	**107**
Housing loans	-	264	-	-	-	**264**
Credit cards	-	3	8	-	-	**11**
Other	-	-	48	-	-	**48**
Loans to retail customers	**20**	**297**	**103**	**10**	**-**	**430**
Large and medium-sized enterprises	1,431	2,209	24	2,000	-	**5,664**
State	-	-	-	-	-	**-**
Other	-	-	-	-	-	**-**
Loans to corporate customers	**1,431**	**2,209**	**24**	**2,000**	**-**	**5,664**
Total loans to customers, out of which:	**1,451**	**2,506**	**127**	**2,010**	**-**	**6,094**
Restructured	**867**	**205**	**4**	**2,000**	**-**	**3,076**
Loans to banks	**-**	**-**	**-**	**-**	**-**	**-**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

Advances to customers and banks – Stage 3

In EUR thousand

31 December 2020	Not in arrears	Up to 30 days in arrears	From 31 to 60 days	From 61 to 90 days	Over 90 days	**Total**
Cash loans	13	11	2	-	457	**483**
Housing loans	-	-	-	-	28	**28**
Credit cards	-	-	-	-	7	**7**
Other	-	-	-	-	322	**322**
Loans to retail customers	**13**	**11**	**2**	**-**	**814**	**840**
Large and medium-sized enterprises	2,372	2,890	-	19	1,535	**6,816**
State	-	-	-	-	-	**-**
Other	-	-	-	-	-	**-**
Loans to corporate customers	**2,372**	**2,890**	**-**	**19**	**1,535**	**6,816**
Total loans to customers, out of which:	**2,385**	**2,901**	**2**	**19**	**2,349**	**7,656**
Restructured	**1,987**	**1,059**	**-**	**-**	**1,267**	**4,313**
Loans to banks	**-**	**-**	**-**	**-**	**-**	**-**

31 December 2019	Not in arrears	Up to 30 days in arrears	From 31 to 60 days	From 61 to 90 days	Over 90 days	**Total**
Cash loans	6	1	-	2	469	**478**
Housing loans	-	-	-	-	30	**30**
Credit cards	-	-	-	-	10	**10**
Other	-	-	-	-	322	**322**
Loans to retail customers	**6**	**1**	**-**	**2**	**831**	**840**
Large and medium-sized enterprises	794	415	1,059	581	411	**3,260**
State	-	-	-	-	2	**2**
Other	-	-	-	-	-	**-**
Loans to corporate customers	**794**	**415**	**1,059**	**581**	**413**	**3,262**
Total loans to customers, out of which:	**800**	**416**	**1,059**	**583**	**1,244**	**4,102**
Restructured	**577**	**15**	**1,059**	**581**	**703**	**2,935**
Loans to banks	**-**	**-**	**-**	**-**	**-**	**-**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

An overview of the data on impaired advances by days in arrears (advances' principal and the appropriate amount of expected credit losses) is provided below:

Advances to customers and banks – Stage 3

In EUR thousand

31 December 2020	Gross loan	Impairment	Stage 3	Restructured Stage 3	Impairment Stage 3	Share Stage 3	Collateral for Stage 3
Cash loans	2,116	506	483	237	442	22.83%	1,364
Housing loans	712	63	28	25	28	3.93%	-
Credit cards	639	13	7	-	6	1.10%	51
Other	1,511	329	322	322	322	21.31%	903
Loans to retail customers	**4,978**	**911**	**840**	**584**	**798**	**16.87%**	**2,318**
Large and medium-sized enterprises	85,942	3,709	6,816	3,729	2,198	7.93%	**8,319**
State	15,000	83	-	-	-	0.00%	**-**
Other	89	-	-	-	-	0.00%	**-**
Loans to corporate customers	**101,031**	**3,792**	**6,816**	**3,729**	**2,198**	**6.75%**	**8,319**
Total loans to customers	**106,009**	**4,703**	**7,656**	**4,313**	**2,996**	**7.22%**	**10,637**
Loans to banks	**25,323**	**18**	**-**	**-**	**-**	**0.00%**	**-**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

Advances to customers and banks – Stage 3

In EUR thousand

31 December 2019	Gross loan	Impairment	Stage 3	Restructured Stage 3	Impairment Stage 3	Share Stage 3	Collateral for Stage 3
Cash loans	2,625	465	478	228	415	18.21%	1,382
Housing loans	794	56	30	-	30	3.78%	-
Credit cards	485	11	10	-	7	2.06%	5
Other	1,005	323	322	349	322	32.04%	903
Loans to retail customers	**4,909**	**855**	**840**	**577**	**774**	**17.11%**	**2,290**
Large and medium-sized enterprises	85,097	1,834	3,260	2,358	758	3.83%	**6,160**
State	2,000	11	-	-	-	0.00%	**-**
Other	121	2	2	-	2	1.65%	**-**
Loans to corporate customers	**87,218**	**1,847**	**3,262**	**2,358**	**760**	**3.74%**	**6,160**
Total loans to customers	**92,127**	**2,702**	**4,102**	**2,935**	**1,534**	**4.45%**	**8,450**
Loans to banks	**13,737**	**12**	**-**	**-**	**-**	**0.00%**	**-**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

An overview of movements in loans and advances to customers by stages in 2020 for the principal amounts of advances and expected credit losses is presented below:

In EUR thousand	Stage 1	Stage 2	Stage 3	Total
Balance as of 31 December 2019	81,931	6,094	4,102	**92,127**
New advances	32,858	4,518	886	**38,262**
Reduction / Advance repayment	(20,942)	(2,686)	(752)	**(24,380)**
Transition to Stage 1	50	(45)	(5)	**-**
Transition to Stage 2	(19,418)	19,477	(59)	**-**
Transition to Stage 3	(80)	(3,404)	3,484	**-**
Balance as of 31 December 2020	**74,399**	**23,954**	**7,656**	**106,009**

In EUR thousand	Stage 1	Stage 2	Stage 3	Total
Balance as of 31 December 2019	659	510	1,533	**2,702**
New advances	278	598	142	**1,018**
Reduction / Advance repayment	(311)	(104)	(7)	**(422)**
Impairment during the year	84	317	1004	**1,405**
Transition to Stage 1	6	(5)	(1)	**-**
Transition to Stage 2	(164)	166	(2)	**-**
Transition to Stage 3	(2)	(326)	328	**-**
Balance as of 31 December 2020	**550**	**1,156**	**2,997**	**4,703**

Restructured loans and advances

The Bank has restructured a borrower's loan if it did the following due to the deterioration of the borrower's creditworthiness:

- extended the repayment period for principal or interest,
- reduced the interest rate on the approved loan,
- assumed the borrower's claims against a third party for the purpose of the loan repayment either in full or in part;
- reduced the amount of debt, principal or interest;
- capitalized interest on the loan approved to the borrower;
- replaced the existing loan or existing loans with a new loan (loan renewal);
- provided other similar benefits that facilitate the borrower's financial position.

During the loan restructuring, the Bank performs financial due diligence of the borrower and assesses the borrower's ability, after the loan restructuring, to generate cash flows that will be sufficient to repay the loan principal and interest. In 2020 the Bank restructured loans in the amount of EUR 6,842 thousand, out of which the amount of EUR 6,777 thousand (2019: EUR 19,951 thousand) is related to corporate customers and EUR 65 thousand (2019: EUR 547 thousand) relates to retail customers.

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

Data on restructured loans and advances are presented below:

Restructured loans and advances

In EUR thousand

31 December 2020	Restructured advances	S1	S2	S3	ECL restructured advances	ECL S1	ECL S2	ECL S3	Share of restructured advances	Collateral for restructured advances
Cash loans	257	-	19	237	231	-	3	229	12.10%	527
Housing loans	235	-	211	25	45	-	21	25	33.01%	289
Credit cards	-	-	-	-	-	-	-	-	0.00%	-
Other	343	-	21	322	323	-	-	322	22.70%	1,156
Loans to retail customers	**835**	**-**	**251**	**584**	**599**	**-**	**24**	**576**	**16.75%**	**1,972**
Large and medium-sized enterprises	29,608	19,757	6,122	3,729	1,316	20	258	1,038	34.45%	37,635
State	-	-	-	-	-	-	-	-	0.00%	-
Other	-	-	-	-	-	-	-	-	0.00%	-
Loans to corporate customers	**29,608**	**19,757**	**6,122**	**3,729**	**1,316**	**20**	**258**	**1,038**	**29.30%**	**37,635**
Total loans to customers	**30,443**	**19,757**	**6,373**	**4,313**	**1,915**	**20**	**282**	**1,614**	**28.72%**	**39,607**
Loans to banks	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**0.00%**	**-**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

Restructured loans and advances (Continued)

In EUR thousand

31 December 2019	Restructured advances	S1	S2	S3	ECL restructured advances	ECL S1	ECL S2	ECL S3	Share of restructured advances	Collateral for restructured advances
Cash loans	266	28	10	228	228	-	-	228	10.13%	588
Housing loans	244	19	198	27	39	-	12	27	30.73%	301
Credit cards	-	-	-	-	-	-	-	-	0.00%	-
Other	345	23	-	322	322	-	-	322	34.33%	1,007
Loans to retail customers	**855**	**70**	**208**	**577**	**589**	**-**	**12**	**577**	**17.42%**	**1,896**
Large and medium-sized enterprises	29,612	24,387	2,867	2,358	547	38	236	273	34.80%	36,044
State	-	-	-	-	-	-	-	-	0.00%	-
Other	-	-	-	-	-	-	-	-	0.00%	-
Loans to corporate customers	**29,612**	**24,387**	**2,867**	**2,358**	**547**	**38**	**236**	**273**	**33.95%**	**36,044**
Total loans to customers	**30,467**	**24,457**	**3,075**	**2,935**	**1,136**	**38**	**248**	**850**	**33.07%**	**37,940**
Loans to banks	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**0.00%**	**-**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

Restructured loans and advances (Continued)

The data on movements in 2020 in restructured loans classified under Stage 1 are provided below:

In EUR thousand	Balance as of 31 December 2019	New restructured S1 advances	Reduction in existing S1 advances	Transition to S2	Transition to S3	Balance as of 31 December 2020
Cash loans	28	-	(9)	(15)	(4)	-
Housing loans	20	-	(4)	(16)	-	-
Credit cards	-	-	-	-	-	-
Other	22	-	(1)	(21)	-	-
Loans to retail customers	**70**	**-**	**(14)**	**(52)**	**(4)**	**-**
Large and medium-sized enterprises	24,387	-	(202)	(4,428)	-	19,757
State	-	-	-	-	-	-
Other	-	-	-	-	-	-
Loans to corporate customers	**24,387**	**-**	**(202)**	**(4,428)**	**-**	**19,757**
Total loans to customers	**24,457**	**-**	**(216)**	**(4,480)**	**(4)**	**19,757**
Loans to banks	**-**	**-**	**-**	**-**	**-**	**-**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

Restructured loans and advances (Continued)

The data on movements in 2020 in restructured loans classified under Stage 2 are provided below:

In EUR thousand	Balance as of 31 December 2019	New restructured S2 advances	Reduction in existing S2 advances	Transition to S1	Transition to S3	Balance as of 31 December 2020
Cash loans	10	19	(5)	-	(5)	19
Housing loans	198	16	(3)	-	-	211
Credit cards	-	-	-	-	-	-
Other	-	21	-	-	-	21
Loans to retail customers	**208**	**56**	**(8)**	**-**	**(5)**	**251**
Large and medium-sized enterprises	2,867	5,277	(522)	-	(1,500)	6,122
State	-	-	-	-	-	-
Other	-	-	-	-	-	-
Loans to corporate customers	**2,867**	**5,277**	**(522)**	**-**	**(1,500)**	**6,122**
Total loans to customers	**3,075**	**5,333**	**(530)**	**-**	**(1,505)**	**6,373**
Loans to banks	**-**	**-**	**-**	**-**	**-**	**-**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

Restructured loans and advances (Continued)

The data on movements in 2020 in restructured loans classified under Stage 3 are provided below:

In EUR thousand	Balance as of 31 December 2019	New restructured S3 advances	Reduction in existing S3 advances	Transition to S1	Transition to S2	Balance as of 31 December 2020
Cash loans	228	9	-	-	-	237
Housing loans	27	-	(2)	-	-	25
Credit cards	-	-	-	-	-	-
Other	322	-	-	-	-	322
Loans to retail customers	**577**	**9**	**(2)**	**-**	**-**	**584**
Large and medium-sized enterprises	2,358	1,500	(75)	-	(54)	3,729
State	-	-	-	-	-	-
Other	-	-	-	-	-	-
Loans to corporate customers	**2,358**	**1,500**	**(75)**	**-**	**(54)**	**3,729**
Total loans to customers	**2,935**	**1,509**	**(77)**	**-**	**(54)**	**4,313**
Loans to banks	**-**	**-**	**-**	**-**	**-**	**-**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

Geographic concentration

The geographic concentration of the Bank's credit risk exposure is as follows:

In EUR thousand

	Stage 1 and Stage 2					*Stage 3*				
31 December 2020	Montenegro	EU	Europe - other	Other	**Total**	Montenegro	EU	Europe - other	Other	**Total**
Retail customers	**2,470**	**716**	**700**	**252**	**4,138**	**834**	**2**	**3**	**1**	**840**
Cash loans	1,607	-	26	-	**1,633**	480	-	3	-	**483**
Housing loans	600	84	-	-	**684**	28		-	-	**28**
Credit cards	168	50	162	252	**632**	4	2	-	1	**7**
Other	95	582	512	-	**1,189**	322	-	-	-	**322**
Corporate customers	**65,353**	**-**	**520**	**28,342**	**94,215**	**5,316**	**1,500**	**-**	**-**	**6,816**
Professional, scientific and technical activities	4,854	-	520	16,590	**21,964**	14	1,500	-	-	**1,514**
Accommodation and food services	20,000	-	-	-	**20,000**	808	-	-	-	**808**
Public administration, defence and mandatory social insurance	17,911	-	-	-	**17,911**	-	-	-	-	**-**
Wholesale, retail trade and repair of motor vehicles and motorcycles	3,832	-	-	11,752	**15,584**	1,412	-	-	-	**1,412**
Artistic, entertainment and recreational activities	5,506	-	-	-	**5,506**	487	-	-	-	**487**
Construction	5,539	-	-	-	**5,539**	3	-	-	-	**3**
Information and communication	3,414	-	-	-	**3,414**	-	-	-	-	**-**
Other	4,297	-	-	-	**4,297**	2,592	-	-	-	**2,592**
Loans to banks	**-**	**14,041**	**5,692**	**5,590**	**25,323**	**-**	**-**	**-**	**-**	**-**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

Geographic concentration (Continued)

In EUR thousand

	Stage 1 and Stage 2					*Stage 3*				
31 December 2019	Montene gro	EU	Europe - other	Other	**Total**	Montene gro	EU	Europe - other	Other	**Total**
Retail customers	**2,913**	**722**	**266**	**168**	**4,069**	**831**	**3**	**6**	**-**	**840**
Cash loans	2,034	1	112	-	**2,147**	476	-	2	-	**478**
Housing loans	676	88	-	-	**764**	30	-	-	-	**30**
Credit cards	117	36	154	168	**475**	3	3	4	-	**10**
Other	86	597	-	-	**683**	322	-	-	-	**322**
Corporate customers	**57,254**	**2,000**	**690**	**24,012**	**83,956**	**3,262**	**-**	**-**	**-**	**3,262**
Professional, scientific and technical activities	4,882	2,00 0	600	12,252	**19,734**	14	-	-	-	**14**
Accommodation and food services	31,302	-	-	-	**31,302**	37	-	-	-	**37**
Public administration, defence and mandatory social insurance	2,000	-	-	-	**2,000**	-	-	-	-	**-**
Wholesale, retail trade and repair of motor vehicles and motorcycles	7,392	-	-	11,760	**19,152**	75	-	-	-	**75**
Artistic, entertainment and recreational activities	3,567	-	-	-	**3,567**	535	-	-	-	**535**
Construction	2,436	-	90	-	**2,526**	10	-	-	-	**10**
Information and communication	2,815	-	-	-	**2,815**	-	-	-	-	**-**
Other	2,860	-	-	-	**2,860**	2,591	-	-	-	**2,591**
Loans to banks	**-**	**4,882**	**7,042**	**1,811**	**13,735**	**-**	**-**	**-**	**-**	**-**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

Concentration per industry

The Concentration per industry of the Bank's credit risk exposure is as follows:

In EUR thousand

31 December 2020	State, public administration and local self-government	Banks and financial activities	Professional, scientific and technical activities	Service activity	Trade	Artistic, entertainment and recreational activities	Construction	Information and communication	Mining	Traffic and logistics	Other	Retail customers	**Total**
Financial assets at amortized cost													
Loans and advances to banks	-	25,323	-	-	-	-	-	-	-	-	-	-	**25,323**
Loans and advances to customers	17,912	581	23,478	22,802	16,997	5,993	5,541	3,414	1,036	1,507	1,770	4,978	**106,009**
Securities	45,523	-	3,652	-	-	-	-	-	-	-	-	-	**49,175**
Other financial assets	-	-	-	-	-	-	-	-	-	-	65	-	**65**
Financial assets at FVOCI													
Securities	40,552	923	-	-	-	-	-	-	-	-	195	-	**41,670**
Financial assets at FVPL													
Securities	102	-	-	449	-	-	-	-	-	-	-	-	**551**
Other assets	-	-	-	-	-	-	-	-	-	-	6,755	-	**6,755**
Total	**104,089**	**26,827**	**27,130**	**23,251**	**16,997**	**5,993**	**5,541**	**3,414**	**1,036**	**1,507**	**8,785**	**4,978**	**229,548**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

Concentration per industry (Continued)

In EUR thousand

31 December 2019	State, public administration and local self-government	Banks and financial activities	Professional, scientific and technical activities	Service activity	Trade	Artistic, entertainment and recreational activities	Construction	Information and communication	Mining	Traffic and logistics	Other	Retail customers	**Total**
Financial assets at amortized cost													
Loans and advances to banks	-	13,737	-	-	-	-	-	-	-	-	-	-	**13,737**
Loans and advances to customers	2,000	302	19,748	33,048	19,226	4,104	2,535	2,815	581	995	1,864	4,909	**92,127**
Securities	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Other financial assets	-	-	-	-	-	-	-	-	-	-	34	-	**34**
Financial assets at FVOCI													
Securities	109,488	-	-	-	-	-	-	-	-	-	-	-	**109,488**
Financial assets at FVPL													
Securities	-	-	-	272	-	-	-	-	-	-	-	-	**272**
Other assets	-	-	-	-	-	-	-	-	-	-	5,556	-	**5,556**
Total	**111,488**	**14,039**	**19,748**	**33,320**	**19,226**	**4,104**	**2,535**	**2,815**	**581**	**995**	**7,454**	**4,909**	**221,214**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

Loans secured by collateral

Loans and advances to banks and customers secured by collaterals (only secured amounts) are provided below:

In EUR thousand

	Stage 1				Stage 2				Stage 3			
31/12/2020	Property	Deposits	Other collaterals	**Total**	Property	Deposits	Other collaterals	**Total**	Property	Deposits	Other collaterals	**Total**
Cash loans	109	14	-	**123**	26	-	-	**26**	371	-	14	**385**
Housing loans	245	84	-	**329**	266	-	-	**266**	-	-	-	**-**
Credit cards	-	520		**520**	-	-	-	**-**	-	-	1	**1**
Other	538	582	-	**1,120**	21	-	-	**21**	322	-	-	**322**
Loans to retail customers	**892**	**1,200**	**-**	**2,092**	**313**	**-**	**-**	**313**	**693**	**-**	**15**	**708**
Large and medium-sized enterprises	4,779	41,089	37	**45,905**	8,152	12,500	-	**20,652**	3,837	-	-	**3,837**
State	-	-	-	**-**	-	-	-	**-**	-	-	-	**-**
Other	89	-	-	**89**	-	-	-	**-**	-	-	-	**-**
Loans to corporate customers	**4,868**	**41,089**	**37**	**45,994**	**8,152**	**12,500**	**-**	**20,652**	**3,837**	**-**	**-**	**3,837**
Total loans to customers	**5,760**	**42,289**	**37**	**48,086**	**8,465**	**12,500**	**-**	**20,965**	**4,530**	**-**	**15**	**4,545**
Loans to banks	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.4. Loans and advances to banks and customers (Continued)

Loans secured by collateral (Continued)

In EUR thousand

	Stage 1				Stage 2				Stage 3			
31/12/2019	Property	Deposits	Other collaterals	**Total**	Property	Deposits	Other collaterals	**Total**	Property	Deposits	Other collaterals	**Total**
Cash loans	274	33	-	**307**	55	-	-	**55**	407	-	14	**421**
Housing loans	316	88	-	**404**	264	-	-	**264**	-	-	-	**-**
Credit cards	-	357	-	**357**	-	-	-	**-**	-	-	4	**4**
Other	37	597	-	**634**	48	-	-	**48**	322	-	-	**322**
Loans to retail customers	**627**	**1,075**	**-**	**1,702**	**367**	**-**	**-**	**367**	**729**	**-**	**18**	**747**
Large and medium-sized enterprises	6,190	47,126	17	**53,333**	3,045	-	247	**3,292**	2,745	-	-	**2,745**
State	-	-	-	**-**	-	-	-	**-**	-	-	-	**-**
Other	119	-	-	**119**	-	-	-	**-**	-	-	-	**-**
Loans to corporate customers	**6,309**	**47,126**	**17**	**53,452**	**3,045**	**-**	**247**	**3,292**	**2,745**	**-**	**-**	**2,745**
Total loans to customers	**6,936**	**48,201**	**17**	**55,154**	**3,412**	**-**	**247**	**3,659**	**3,474**	**-**	**18**	**3,492**
Loans to banks	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.5. Off-balance sheet items

In EUR thousand

31 December 2020	Undrawn credit facilities	Guarantees	Uncovered letters of credit	Total
Up to 1 year	238	2,008	-	2,246
From 1 to 5 years	3,801	9,691	-	13,492
Total	**4,039**	**11,699**	**-**	**15,738**

31 December 2019	Undrawn credit facilities	Guarantees	Uncovered letters of credit	Total
Up to 1 year	7,831	2,863	13	10,707
From 1 to 5 years	594	3,404	-	3,998
Total	**8,425**	**6,267**	**13**	**14,705**

Exposures and provisions for off-balance sheet items by stage are presented below:

31 December 2020	Undrawn credit facilities	Guarantees	Uncovered letters of credit	Total
Exposure				
Stage 1	3,906	10,502	-	14,408
Stage 2	82	868	-	950
Stage 3	51	329	-	380
Total	**4,039**	**11,699**	**-**	**15,738**
Provision for off-balance				
Stage 1	43	111	-	154
Stage 2	7	172	-	179
Stage 3	2	65	-	67
Total	**52**	**348**	**-**	**400**
Net	**3,987**	**11,352**	**-**	**15,339**

5. RISK MANAGEMENT (Continued)

5.2. Credit risk (Continued)

5.2.5. Off-balance sheet items (Continued)

31 December 2019	Undrawn credit facilities	Guarantees	Uncovered letters of credit	Total
Exposure				
Stage 1	8,399	5,551	13	13,963
Stage 2	25	594	-	619
Stage 3	1	122	-	123
Total	**8,425**	**6,267**	**13**	**14,705**
Provision for off-balance				
Stage 1	116	128	-	244
Stage 2	3	38	-	41
Stage 3	-	43	-	43
Total	**119**	**209**	**-**	**328**
Net	**8,306**	**6,058**	**13**	**14,377**

5.3. Market risk

The Bank is exposed to market risks. Market risks arise in the case of open positions due to changes in interest rates. changes in exchange rates and changes in the prices of securities that change in accordance with market fluctuations. Limits for the market risk exposure are internally prescribed and harmonized with the limits prescribed by the Central Bank of Montenegro.

5.3.1. Foreign exchange risk

The Bank's financial position and cash flows are exposed to the effects of changes in foreign exchange rates. Exposure to foreign exchange risk is regularly monitored through compliance with the limits prescribed by the Central Bank of Montenegro. The exposure to foreign exchange risk as of 31 December 2020 is presented below:

In EUR thousand	USD	GBP	CHF	Other	**Total**
Foreign currency assets	845	5,467	92	10,560	**16,964**
Foreign currency liabilities	848	5,468	90	10,513	**16,919**
Net open position					
31 December 2020	**(3)**	**(1)**	**2**	**47**	**45**
31 December 2019	667	-131	19	85	**640**
% of stake capital					
31 December 2020	-0.02%	-0.01%	0.01%	0.31%	**0.30%**
31 December 2019	5.86%	-1.15%	0.17%	0.75%	**5.62%**

5. RISK MANAGEMENT (Continued)

5.3. Market risk (Continued)

5.3.1. Foreign exchange risk (Continued)

Bank's assets and liabilities in major currencies as of 31 December 2020 are provided below:

In EUR thousand	USD	GBP	CHF	Other currencies	Total foreign currencies	Local currency (EUR)	**Total**
Cash and deposit accounts with central banks	215	22	44	6	287	77,892	**78,179**
Financial assets at amortised cost							
Loans and advances to banks	503	3,784	48	6,123	10,458	14,847	**25,305**
Loans and advances to customers	-	-	-	-	-	101,529	**101,529**
Securities	-	-	-	-	-	48,570	**48,570**
Financial assets at FVOCI							
Securities	-	-	-	-	-	41670	**41,670**
Financial assets held for trading							
Securities for trading	-	-	-	-	-	551	**551**
Derivatives held for risk protection	-	1,661	-	-	1,661	(1,650)	**11**
Other assets	127	-	-	4,431	4,558	2,087	**6,645**
Total financial assets	**845**	**5,467**	**92**	**10,560**	**16,964**	**285,496**	**302,460**
Financial liabilities at amortised cost							
Customer deposits	765	5,468	90	10,513	16,836	266,037	**282,873**
Loans to non-bank customers	-	-	-	-	-	3,072	**3,072**
Derivative financial liabilities as a hedging instrument	-	-	-	-	-	-	**-**
Other liabilities	83	-	-	-	83	2,927	**3,010**
Subordinated debt	-	-	-	-	-	1,002	**1,002**
Total financial liabilities	**848**	**5,468**	**90**	**10,513**	**16,919**	**273,038**	**289,957**
Net foreign exchange exposure:							
31 December 2020	**(3)**	**(1)**	**2**	**47**	**45**		
31 December 2019	**667**	**(131)**	**19**	**85**	**640**		

5. RISK MANAGEMENT (Continued)

5.3. Market risk (Continued)

5.3.2. Interest rate risk

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate due to fluctuating market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate due to fluctuating market interest rates. The Bank is exposed to the effects of changes in current interest rates on the market based on the risk of changes in interest rates on cash flows. As a result of such changes, interest margins may increase. However, they may reduce profit or result in a loss in the event of unexpected movements. Interest rates are based on market rates so that the Bank regularly re-sets prices.

The following table shows the Bank's interest-bearing and non-interest-bearing assets and liabilities as at 31 December 2020:

In EUR thousand	Interest-bearing	Non-interest-bearing	**Total**
Cash and deposit accounts with central banks	6,796	71,383	78,179
Financial assets at amortised cost			-
Loans and advances to banks	-	25,305	25,305
Loans and advances to customers	101,529	-	101,529
Securities	48,570	-	48,570
Other financial assets	-	37	37
Financial assets at FVOCI			-
Securities	41,670	-	41,670
Financial assets held for trading			-
Securities for trading	102	449	551
Derivatives held for risk protection	-	11	11
Other assets	-	6,645	6,645
Total financial assets	**198,667**	**103,830**	**302,497**
Financial liabilities at amortised cost			
Customer deposits	76,044	206,829	282,873
Loans to non-bank customers	3,072	-	3,072
Derivative financial liabilities as a hedging instrument	-	-	-
Other liabilities	-	3,010	3,010
Subordinated debt	1,002	-	1,002
Total financial liabilities	**80,118**	**209,839**	**289,957**
Interest rate risk exposure:			
31 December 2020	**118,549**	**(106,009)**	**12,540**
31 December 2019	**147,973**	**(135,413)**	**12,560**

5. RISK MANAGEMENT (Continued)

5.3. Market risk (Continued)

5.3.2. Interest rate risk (Continued)

The Bank is financed and it grants placements at fixed interest rate. Loans to corporate customers are granted at the following interest rates:

- Short-term loans at a fixed interest rate: 2.50% - 8.00%
- Long-term loans at a fixed interest rate: 4.00% - 10.00%

Lending interest rates applied to loans to individuals in 2020 are as follows:

Loan type	**Interest rate**
Cash loans	5.50% - 11.00%
Student loans	7.50%
Loans for tourism development	7.50%
Micro loans	13.00%
Loans to pensioners	6.50% - 9.50%
Special-purpose car loans	9.90%

Passive interest rates applied to the deposits of corporate customers in 2020 were as follows:

Deposit type	**Interest rate**
Short-term deposits	0.25% - 1.00%
Long-term deposits	1.25% - 2.00%

Passive interest rates applied to the deposits of retail customers in 2020 were as follows:

Deposit type	**Interest rate**
Demand deposits	-
Time deposits in EUR:	
- 3 months	0.40% - 0.60%
- 6 months	0.80% - 1.00%
- 12 months	1.30% - 1.50%
- 24 months	1.80% - 2.00%
- 36 months	2.10% - 2.50%
Time deposits in foreign currencies:	
- 6 months	0.20%
- 12 months	0.40%
- 24 months	0.60%

5. RISK MANAGEMENT (Continued)

5.4. Liquidity risk

Liquidity risk is the risk of the Bank being unable to provide cash to settle liabilities upon maturity, or the risk that the Bank will have to obtain funds at reasonable prices and in a timely manner to be able to settle its matured liabilities.

The matching and controlled mismatching between the maturities and interest rates of assets and of liabilities are fundamental to the management of the Bank. It is uncommon for banks to have completed matching since business transactions are often made for indefinite term and are of different types. A mismatched position potentially enhances profitability, but also increases the risk of losses.

The maturities of assets and liabilities and the ability of the Bank to obtain sources of funding upon maturity of liabilities at an acceptable cost are an important factor in assessing the liquidity of the Bank and its exposure to changes in interest rates and foreign exchange rates. Liquidity requirements to support calls on guarantees, i.e. active letters of credit, are considerably less than the amount of the commitments because the Bank does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments for approved loans with extended maturities 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 have to maintain the cash resources level in order to meet all potential requirements, estimating that the minimum level of reinvestments of maturing funds can be reliably predicted.

The structure of assets and liabilities as of 31 December 2020 indicates a maturity mismatch of the remaining maturity period of assets and liabilities within a maturity period between one and five years. Bank's liquidity as its ability to settle due liabilities in a timely manner depends on the balance sheet structure, on one hand, and on the compliance between asset inflows and outflows, on the other hand.

The resulting negative GAPs are predominantly the result of a high level of demand deposits, on one hand, and granted loans and purchased securities for longer terms, on the other hand. The Bank is prepared to assume such a gap risk only due to the fact that there is a developed secondary market for all securities in the Bank's portfolio. Thus, purchased securities are treated as secondary liquidity reserves.

As disclosed in Note 25.2, the Bank concluded in 2020 a Contract on the Limit for Using Borrowings in case of Endangered Liquidity Position in the amount of EUR 5 million, with a maturity date of up to one year from the date of funds' disbursement. The Contract is an additional level of the liquidity reserve in case of the endangered liquidity position.

5. RISK MANAGEMENT (Continued)

5.4. Liquidity risk (Continued)

The remaining expected maturity matching of financial assets and liabilities as of 31 December 2020 is as follows.

In EUR thousand	Up to 1 month	From 1 to 3 months	From 3 to 6 months	From6 to 12 months	From 1 to 5 years	Over 5 years	Total
Cash and deposit accounts with central banks	71,383	-	-	-	6,796	-	**78,179**
Financial assets at amortised cost							**-**
Loans and advances to banks	24,863	-	-	-	442	-	**25,305**
Loans and advances to customers	4,585	12,433	13,110	20,617	41,786	8,998	**101,529**
Securities	-	212	-	-	26,431	21,927	**48,570**
Other financial assets	37	-	-	-	-	-	**37**
Financial assets at FVOCI							**-**
Securities	7,704	10,069	7,451	7,068	7,027	2,351	**41,670**
Financial assets held for trading							**-**
Securities for trading	-	-	-	-	551	-	**551**
Derivatives held for risk protection	11	-	-	-	-	-	**11**
Other assets	5,086	376	930	153	100	-	**6.645**
Total financial assets	**113,669**	**23,090**	**21,491**	**27,838**	**83,133**	**33,276**	**302,497**
Financial liabilities at amortized cost							
Deposits of customers	41,108	18,139	36,735	26,649	156,125	4,117	**282,873**
Loans to non-bank customers	-	21	15	142	1,768	1,126	**3,072**
Derivative financial liabilities as a hedging instrument	-	-	-	-	-	-	**-**
Other liabilities	2,216	36	119	37	602	-	**3,010**
Subordinated debt	-	-	-	-	-	1,002	**1,002**
Total financial liabilities	**43,324**	**18,196**	**36,869**	**26,828**	**158,495**	**6,245**	**289,957**
Maturity GAP							
31 December 2020	70,345	4,894	(15,378)	1,010	(75,362)	27,031	12,540
Cumulative GAP	70,345	75,239	59,861	60,871	(14,491)	12,540	
% of the total source of assets	**24.3%**	**25.9%**	**20.6%**	**21.0%**	**-5.0%**	**4.3%**	
31 December 2019	64,274	25,850	3,202	(7,781)	(154,635)	85,013	15,923
Cumulative GAP	64,274	90,124	93,326	85,545	(69,090)	15,923	
% of the total source of assets	**20.5%**	**28.7%**	**29.7%**	**27.2%**	**-22.0%**	**5.1%**	

5. RISK MANAGEMENT (Continued)

5.4. Liquidity risk (Continued)

Based on the empirical method in previous years, the Bank designed Methodology for Determining the Stable Level of Demand Deposits, i.e. it performed a more adequate redistribution of demand deposits, according to which the cumulative GAP covers all negative GAPs in other time intervals. Maturities of financial liabilities according to the remaining maturity (undiscounted cash flows) are as follows:

In EUR thousand 31 December 2020	On demand	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
Financial liabilities at *amortized cost*							
Customers' deposits	206,988	8,736	19	37,273	25,740	4,117	**282,873**
Loans to non-bank customers	-	-	21	157	1,768	1,126	**3,072**
Derivative financial liabilities as a hedging instrument	-	-	-	-	-	-	**-**
Other liabilities	1,954	262	36	156	602	-	**3,010**
Subordinated debt	-	-	-	-	-	1,002	**1,002**
Total financial liabilities	**208,942**	**8,998**	**76**	**37,586**	**28,110**	**6,245**	**289,957**

31 December 2019	On demand	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
Financial liabilities at *amortized cost*							
Customers' deposits	227,942	-	800	24,091	28,118	4,444	**285,395**
Loans to non-bank customers	7	156	213	503	2,160	843	**3,882**
Derivative financial liabilities as a hedging instrument	275	-	-	-	-	-	**275**
Other liabilities	7,065	403	11	1	-	-	**7,480**
Subordinated debt	-	-	-	2	-	1,000	**1,002**
Total financial liabilities	**235,289**	**559**	**1,024**	**24,597**	**30,278**	**6,287**	**298.034**

5. RISK MANAGEMENT (Continued)

5.5. Fair value of financial assets and liabilities

Comparison between the fair and carrying values of financial assets

	Carrying value		Fair value	
In EUR thousand	2020	2019	2020	2019
Cash and deposit accounts with central banks	78,179	91,764	78,179	91,764
Financial assets at amortized cost				
Loans and advances to banks	25,305	13,725	25,305	13,725
Loans and advances to customers	101,529	89,593	101,529	89,593
Securities				
Other financial assets	37	12	37	12
Financial assets at FVOCI				
Securities	41,651	108,543	41,670	109,703
Financial assets held for trading				
Securities for trading	674	325	551	272
Derivatives held for risk protection	11	54	11	54
Other assets	6,645	5,459	6,645	5,459
Total financial assets	**254,031**	**309,475**	**253,927**	**310,582**
Financial liabilities at *amortized cost*				
Customers' deposits	282,873	285,395	282,873	285,395
Loans to non-bank customers	3,072	3,882	3,072	3,882
Derivative financial liabilities as a hedging instrument	-	275	-	275
Other liabilities	3,010	7,480	3,010	7,480
Subordinated debt	1,002	1,002	1,002	1,002
Total financial liabilities	**289,957**	**298,034**	**289,957**	**298,034**

There are no available market prices for a certain part of the Bank's financial instruments. In circumstances when no market prices are available, the fair value is estimated using cash flow discounting models or other models. Changes in the assumptions underlying the estimates, including discount rates and estimated cash flows, significantly affect the estimates. Therefore, the estimated fair values may differ from those obtained during the actual sale of a financial instrument.

In estimating the fair value of financial instruments for which such a value can be determined, the following methods and assumptions have been applied:

Loans and advances to banks

Advances to other banks include interbank placements and positions in the collection process. The fair value of fixed interest rate placements and overnight deposits approximates the carrying amount of these financial assets stated at the balance sheet date.

5. RISK MANAGEMENT (Continued)

5.5. Fair value of financial assets and liabilities (Continued)

Loans and advances to customers

In order to determine the fair value of loans and advances to customers with a fixed interest rate measured at amortized cost, the Bank compared its interest rates on loans and advances to clients to the available information on the current market interest rates in the banking sector of Montenegro, i.e. weighted average market rates by business activities.

The Bank's management believes that the Bank's interest rates do not deviate significantly from the prevailing market interest rates in the banking sector of Montenegro and accordingly, the fair value of loans is calculated for clients as the present value of future cash flows discounted by applying current market rates, i.e. weighted average interest rates for the banking sector, and it does not deviate significantly from the stated carrying amounts of loans at the balance sheet date. According to the management, the amounts in the financial statements reflect a realistic value that is the most reliable and useful for the purposes of financial reporting in the given circumstances.

Securities

Bonds are valued at fair value based on market prices. As of 31 December 2020, the market prices of bonds measured at fair value in the Bank's portfolio were available.

Treasury bills are issued by the Ministry of Finance of Montenegro with a maturity of 182 days (matured in February/March 2020). Given the maturity of these bonds, the Bank's management is of the opinion that the carrying amount of these financial instruments reflects their fair value at the balance sheet date.

Financial liabilities

As regards demand deposits, as well as deposits with a remaining maturity of less than one year, it is assumed that the estimated fair value does not deviate significantly from the book values. According to the management, the Bank's interest rates are adjusted to current market interest rates and accordingly, the amounts in the financial statements reflect the realistic value which in the given circumstances most accurately reflects the fair value of fixed interest rate deposits with a remaining maturity of more than one year.

The fair value of variable interest rate borrowings is assumed to be approximate to the carrying amount of these liabilities at the reporting date.

5.5.1. Fair value hierarchy

The applicable accounting regulations in Montenegro, as well as the application of IFRS 13, require the disclosure of fair value measurements according to the following hierarchical levels:

- quoted prices (unadjusted) on an active market for the same assets or the same liabilities (level 1);
- information other than quoted prices included in level 1, which is based on available market data for assets or liabilities, either directly (i.e. prices) or indirectly (i.e. derived from prices) (level 2),
- information on an asset or a liability that is not based on available market data (level 3).

5. RISK MANAGEMENT (Continued)

5.5. Fair value of financial assets and liabilities (Continued)

5.5.1. Fair value hierarchy (Continued)

The fair value of financial instruments traded in an active market is based on quoted market prices at the balance sheet date. The fair value of financial instruments that are not traded in an active market is determined using various evaluation techniques. The Bank applies various methods and makes assumptions based on market conditions prevailing at the balance sheet date. These methods include quoted market prices or quoted prices for similar instruments and estimated discounted cash flow values.

In EUR thousand

31 December 2020	Stage 1	Stage 2	Stage 3	**Total**
Financial assets at fair value through other comprehensive income				
Securities	41,670	-	-	**41,670**
Financial assets held for trading				
Securities for trading	551	-	-	**551**
Derivatives held as a hedging instrument	-	11	-	**11**
Total assets	**42,221**	**11**	**-**	**42,232**
Derivative financial liabilities as a hedging instrument	-	-	-	**-**
Total liabilities	**-**	**-**	**-**	**-**

31 December 2019	Stage 1	Stage 2	Stage 3	**Total**
Financial assets at fair value through other comprehensive income				
Securities	75,498	33,989	216	**109,703**
Financial assets held for trading				
Securities for trading	272	-	-	**272**
Derivatives held as a hedging instrument	-	55	-	**55**
Total assets	**75,770**	**34,044**	**216**	**110,030**
Derivative financial liabilities as a hedging instrument	-	276	-	**276**
Total liabilities	**-**	**276**	**-**	**276**

5. RISK MANAGEMENT (Continued)

5.6. Capital management

The capital management objective is:

- compliance with regulatory regulations,
- protection of the Bank's ability to continue as a going concern in order to be able to provide shareholder payments and compensations to other owners. And
- provision of capital to support Bank's further development.

The Bank's management controls capital adequacy using the methodology and limits prescribed by the Central Bank of Montenegro according to 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 position and structure to the Central Bank of Montenegro. The Bank's own funds consist of stake capital and supplementary capital. The sum of the main elements of own funds, less the sum of deductible items, represents the Tier 1 capital of the Bank.

The main elements of the Bank's own funds:

- paid-in share capital at nominal value, excluding cumulative preference shares;
- collected issuance premiums;
- reserves for estimated losses upon regulatory requirement, allocated in accordance with the decision prescribing minimum standards for credit risk management in banks;
- reserves made and charged to profit after tax (legal. statutory and other reserves);
- retained earnings from previous years;
- the amount of profit in the current year if the General Meeting of Shareholders has made a decision to be included in the stake capital of the Bank.

Deductible items in the calculation of the Bank's Tier 1 capital:

- losses from previous years;
- loss from the current year;
- intangible assets in the form of goodwill. licenses. patents. trademarks and concessions;
- a nominal amount of acquired own shares, excluding cumulative preference shares;
- unrealised loss from value adjustments of financial assets available for sale, at fair value;
- a positive difference between the amount of accrued provisions for potential losses and the sum of the impairment allowance for balance sheet assets and provisions for off-balance sheet items;
- the amount of the exceeded investment limit in property and fixed assets, determined by a separate regulation of the Central Bank.

A sum of number additional elements of own funds, less the sum of deductible items, represents Bank's supplementary capital.

Additional elements of own funds that are included in Bank's supplementary capital (Tier 2):

- a nominal amount of paid-in preference cumulative shares;
- collected issuance premiums based on cumulative priority shares;
- the amount of general reserves of up to 1.25% of total risk-weighted assets;
- subordinated debt for which the conditions from the CBM Decision on Capital Adequacy are met;
- hybrid instruments for which the conditions from the CBM Decision on capital adequacy are met;
- revaluation reserves for property owned by the Bank.

5. RISK MANAGEMENT (Continued)

5.6. Capital management (Continued)

Deductible items in the calculation of supplementary capital (Tier 2):

- acquired own preference cumulative shares;
- receivables and contingent liabilities secured by hybrid instruments or a subordinated debt of the Bank up to the amount in which these instruments are included in supplementary capital.

In accordance with the regulations of the Central Bank of Montenegro, the Bank is obliged to maintain a minimum capital adequacy ratio of 10%. The Bank is obliged to harmonize the scope of its operations with the prescribed indicators, i.e. to harmonize the scope and structure of its risk-weighted placements with the Law on Banks and the regulations of the Central Bank of Montenegro. As of 31 December 2020, the solvency ratio calculated by the Bank amounted to 21.57% (2019: 20.08%). The Bank 's compliance with regulatory indicators is provided in Note 30.

5. RISK MANAGEMENT (Continued)

5.7. Sensitivity analyses

5.7.1. Foreign exchange risk sensitivity analysis

Apart from an analysis of Bank's foreign currency receivables and payables, the foreign exchange risk management also includes a foreign exchange risk sensitivity analysis. A scenario of exchange rate changes ranging from +10% to -10% in comparison to EUR is provided below:

In EUR thousand	Total	Foreign currency amount	10%	-10%
Cash and deposit accounts with central banks	78,179	287	29	(29)
Financial assets at amortized cost				
Loans and advances to banks	25,305	10,458	1,046	(1,046)
Loans and advances to customers	101,529	-	-	-
Securities	48,570	-	-	-
Other financial assets	37	-	-	-
Financial assets at FVOCI				
Securities	41,670	-	-	-
Financial assets held for trading				
Securities for trading	551	-	-	-
Derivatives held for risk protection	11	1,661	166	(166)
Other assets	6,645	4,558	456	(456)
Total financial assets	**302,497**	**16,964**	**1,697**	**(1,697)**
Financial liabilities carried at amortised cost				
Customers' deposits	282,873	16,836	1,684	(1,684)
Loans to non-bank customers	3,072	-	-	-
Derivative financial liabilities as a hedging instrument	-	-	-	-
Other liabilities	3,010	83	8	(8)
Subordinated debt	1,002	-	-	-
Total financial liabilities	**289,957**	**16,919**	**1,692**	**(1,692)**
Net foreign currency exposure:				
31 December 2020			**5**	**(5)**
31 December 2019			**64**	**(64)**

As of 31 December 2020, provided that all other parameters remain unchanged by the change in the EUR exchange rate against other currencies by + 10% and -10%, Bank's profit would decrease or increase by EUR 5 thousand (31 December 2019: EUR 64 thousand). The reason for the Bank's low exposure to changes in foreign exchange rates is the fact that the largest amount of Bank's receivables and payables are denominated in EUR, and that Bank's exposure (open position) to foreign exchange risk is reduced through derivatives used for hedging against foreign exchange risk. The open position is monitored and closed on a daily basis.

5. RISK MANAGEMENT (Continued)

5.7. Sensitivity analyses (Continued)

5.7.2. Interest rate risk sensitivity analysis

During the interest rate risk management, the Bank performs sensitivity analysis of changes in receivables and payables with variable interest rates. The effects of changes in variable interest rates on receivables and payables denominated in EUR ranging from +0.4% p.p. to -0.4% p.p. are presented below:

In EUR thousand	Total	Interest bearing	+ 0.4%	- 0.4%
Cash and deposit accounts with central banks	78,179	6,796	27	(27)
Financial assets at amortized cost				
Loans and advances to banks	25,305	-	-	-
Loans and advances to customers	101,529	101,529	406	(406)
Securities	48,570	48,570	194	(194)
Other financial assets	37	-	-	-
Financial assets at FVOCI				
Securities	41,670	41,670	167	(167)
Financial assets held for trading				
Securities for trading	551	102	-	-
Derivatives held for risk protection	11	-	-	-
Total financial assets	**302,497**	**198,667**	**794**	**(794)**
Financial liabilities carried at amortised cost				
Customers' deposits	282,873	76,044	304	(304)
Loans to non-bank customers	3,072	3,072	12	(12)
Derivative financial liabilities as a hedging instrument	-	-	-	-
Other liabilities	3,010	-	-	-
Subordinated debt	1,002	1,002	4	(4)
Total financial liabilities	**289,957**	**80,118**	**320**	**(320)**
Interest rate risk exposure:				
31 December 2020			**474**	**(474)**
31 December 2019			**(364)**	**364**

Provided that all other parameters are unchanged, an increase or a decrease in the variable interest rate on receivables and payables denominated in EUR by 0.4 p.p. would result in an increase and/or a decrease in Bank's profit by EUR 474 thousand.

6. INTEREST INCOME AND EXPENSES

6.1. Interest income and similar income

In EUR thousand	2020	2019
Deposits with foreign banks	12	89
Loans to:		
state	59	95
companies	3,108	2,882
Individuals	260	306
	3,427	**3,283**
Securities		
at amortised cost	1,161	-
at fair value through other comprehensive income	870	1,062
at fair value through profit or loss	8	-
	2,039	**1,062**
Loan fee income	132	136
Total	**5,610**	**4,570**

6.2. Income from interest on impaired placements

In EUR thousand	2020	2019
Loans		
impaired placements to companies	190	-
impaired placements to individuals	10	-
Total	**200**	**-**

6.3. Interest expenses and similar expenses

In EUR thousand	2020	2019
Deposits of:		
foreign banks	73	75
companies	899	779
individuals	168	185
	1,140	**1,039**
Loans and other borrowings	57	79
Subordinated debt	5	47
Expenses from interest on leased assets	11	-
Total	**1,213**	**1,165**

7. FEE AND COMMISSION INCOME AND EXPENSES

7.1. Fee and Commission Income

In EUR thousand	2020	2019
International payment transactions	2,581	4,461
Commission activities	1,384	1,431
VISA and MC card operations	378	618
Domestic payment transactions	257	275
Custody and brokerage operations	127	124
E-banking	116	95
Fees for issued guarantees	142	64
Other fees and commissions	139	29
Total	**5,124**	**7,097**

7.2. Fee and Commission Expenses

In EUR thousand	2020	2019
Deposit insurance premium fees	1,257	1,378
Fees and commissions payable to the Central Bank	396	418
VISA and MC card operations	249	367
International payment transactions	299	222
Custody and brokerage operations	17	22
Expenses for securities	51	49
E-banking	99	93
Other fees and commissions	29	30
Total	**2,397**	**2,579**

8. NET INCOME FROM DERECOGNITION OF FINANCIAL INSTRUMENTS NOT MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS

In EUR thousand	2020	2019
Securities at FVOCI	31	30
Financial instruments at amortised cost	50	-
Total	**81**	**30**

9. NET LOSSES ON FINANCIAL INSTRUMENTS HELD FOR TRADING

In EUR thousand	2020	2019
Equity instruments	(74)	(36)
Debt instruments	7	-
Total	**(67)**	**(36)**

10. NET GAINS FROM FOREIGN EXCHANGE DIFFERENCES

In EUR thousand	2020	2019
Realised foreign exchange differences – operations with customers	1,241	2,273
Value adjustment between assets and liabilities	(206)	50
Total	**1,035**	**2,323**

11. OTHER INCOME

In EUR thousand	2020	2019
Income from collection of written-off loans	4	4
Sundry income	1	75
Rental income	8	9
Total	**13**	**88**

12. EMPLOYEE BENEFITS

In EUR thousand	2020	2019
Net salaries	972	912
Payroll taxes, surtaxes and contributions	667	595
Remunerations to members of the Board of Directors	71	65
Travel and subsistence expenses	7	35
Fees for occasional jobs	25	20
Employee training	4	17
Total	**1,746**	**1,644**

13. DEPRECIATION AND AMORTISATION CHARGES

In EUR thousand	2020	2019
Property, plant and equipment (Note 22)	175	206
Leased assets (Note 22)	113	-
Leased assets – investment property (Note 21)	14	-
Intangible assets (Note 23)	171	192
Total	**473**	**398**

14. GENERAL AND ADMINISTRATIVE COSTS

In EUR thousand	2020	2019
Representative office costs - Dubai	284	352
Marketing and sponsorships	68	207
Maintenance of IT equipment	214	184
Lease and maintenance of business premises	73	147
Intellectual services	185	95
Entertainment	9	91
Telecommunications	95	79
Security	58	59
Other	39	65
Water supply, electricity, fuel and utilities	52	54
Insurance	38	49
Membership fees	54	46
Travel and accommodation expenses	11	30
Legal fees and court expenses	121	14
Money transportation	10	12
Other taxes	11	11
Office material	7	11
Total	**1,329**	**1,506**

15. IMPAIRMENT EXPENSES OF FINANCIAL INSTRUMENTS NOT MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS

In EUR thousand	2020	2019
Loans and advances to banks	6	6
Loans and advances to customers	1,989	1,253
Securities at amortised cost	340	-
Securities at FVOCI	118	416
Off-balance sheet items exposed to credit risk	71	194
Other assets	38	1,286
Total	**2,562**	**3,155**

15. IMPAIRMENT EXPENSES OF FINANCIAL INSTRUMENTS NOT MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS (Continued)

Movements in impairment and provision accounts

The accounts of impairment allowances include all items of financial and non-financial assets, other than intangible assets, property, plant, equipment and investment property (disclosed in Notes 22-24), as items of calculated provisions for potential losses and long-term employee benefits. The calculation of the impairment of financial assets and off-balance sheet items exposed to credit risk is based on IFRS 9: *Financial instruments*, of other assets on IAS 36: *Impairment of Assets*, whereas provisions for long-term employee benefits are based on IAS 19: *Employee Benefits.* The Bank did not have provisions based on IAS 37: *Provisions, Contingent Liabilities and Contingent Assets* as of 31 December 2020 and 31 December 2019.

Movements on accounts of impairment and provisions during 2020 were as follows:

	Loans and advances to banks	Loans and advances to customers	Securities - AC	Securities - FVOCI	Off-balance sheet items	Other assets	Provisions for retirement benefits	**Total**
Balance as of 31 December 2019	**12**	**2,970**	**-**	**493**	**329**	**1,323**	**2**	**5,129**
Charge for the year	26	13,222	444	334	1,693	285	-	**16,004**
Reversal during the year	(20)	(11,232)	(105)	(216)	(1,622)	(247)	-	**(13,442)**
Interest income reduction on impaired placements	-	266	-	-	-	-	-	**266**
Reclassification	-	-	266	(266)	-	-	-	**-**
Balance as of 31 December 2020	**18**	**5,226**	**605**	**345**	**400**	**1,361**	**2**	**7,957**

16. INCOME TAXES

16.1. Income tax components

In EUR thousand	**2020**	**2019**
Calculated current income tax	180	410
Calculated deferred income tax	15	(114)
Total	**195**	**296**

16.2. Numerical Reconciliation of Income Tax Recognised in the Income Statement and Profit for the Year Before Tax Multiplied by the Statutory Income Tax Rate

In EUR thousand	**2020**	**2019**
Result in the income statement before tax	2,240	3,537
Interest rate (9%)	202	318
Decrease in the tax liability arising from timely payment	(12)	(26)
Permanent differences – non-deductible expenses	2	2
Permanent differences – tax effects of not recognising equipment whose value is lower than EUR 300	1	1
Other	2	1
	195	**296**
Effective tax rate	**8.71%**	**8.37%**

16. INCOME TAXES (Continued)

16.3. Deferred income tax

Movements on accounts of deferred income taxes in 2020 are provided below:

In EUR thousand	Deferred tax assets – equity securities at FVOCI	Deferred tax assets – acquired assets	Deferred tax assets – temporary differences arising from the expense recognition for tax purposes	Deferred tax liabilities - temporary differences arising from depreciation calculation	Deferred tax liabilities - equity securities at FVOCI
Balance as of 31 December 2019	33	111	6	(64)	(149)
Deferred tax income / (expense) for the period	-	-	(1)	(14)	-
Deferred other tax result for the period	2	-	-	-	114
Balance as of 31 December 2020	**35**	**111**	**5**	**(78)**	**(35)**

Deferred tax liabilities are income taxes payable in future periods against taxable temporary differences. Deferred tax assets are income taxes recoverable in future periods, which are related to: a) deductible temporary differences; b) unused tax losses carried forward to the next period; c) unused tax credit carried forward to the next period.

Temporary differences are differences between the carrying amount of an asset or a liability stated in the balance sheet and their tax base. They can be:

- *Taxable temporary differences* – their result will be taxable amounts during the determination of taxable profit (or tax loss) of future periods when the carrying amount of an asset or a liability is recovered or settled;
- *Deductible temporary differences* – their result will be amounts that can be deducted during the determination of taxable profit (or tax loss) when the carrying amount of an asset or a liability is recovered or settled.

The Bank does not have unused tax losses or tax credit carried forward to the next period.

17. CASH AND DEPOSIT ACCOUNTS WITH CENTRAL BANKS

In EUR thousand	31/12/2020	31/12/2019
Cash on hand:		
- in EUR	105	105
- in foreign currency	-	-
Cash in vault:		
- in EUR	11,479	12,485
- in foreign currency	288	777
Cash at ATMs		-
Gyro account	52,716	58,198
Reserve requirement with the Central Bank of Montenegro	13,591	20,199
Total	**78,179**	**91,764**

For the purpose of compiling the Separate Statement of Cash Flows, the table below includes cash and deposit accounts with central banks and funds on correspondent accounts with foreign banks:

	31/12/2020	31/12/2019
Cash on hand:		
- in EUR	105	105
- in foreign currency	-	-
Cash in vault:		
- in EUR	11,479	12,485
- in foreign currency	288	777
Cash at ATMs	-	-
Gyro account	52,716	58,198
Reserve requirement with the Central Bank of Montenegro	13,591	20,199
Loans and advances to banks (Note 18.1)	24,881	13,307
Total cash and cash equivalents	**103,060**	**105,071**

As of 31 December 2020, the Bank's obligatory reserves were set aside in accordance with the Decision of the Central Bank of Montenegro on Obligatory Reserves of Banks to be held with the Central Bank of Montenegro ("Official Gazette of Montenegro", no. 88/17, 43/20) (hereinafter "the Decision"), stipulating that banks calculate the obligatory reserve applying the following rates:

- 5.5% to the base comprised of demand deposits and deposits maturing within a year i.e. 365 days and
- 4.5% to the base comprised of deposits with maturities of over a year i.e. 365 days.

On 11 May 2020 the Central Bank of Montenegro passed a Decision on Amendments to the Decision of the Central Bank of Montenegro on Obligatory Reserves of Banks to be held with the Central Bank of Montenegro, based on which the rates of the required reserve have been reduced from 7.5% and 6.5% to 5.5% and 4.5%. The Bank sets aside calculated required reserve to the account of the required reserve in the county and/or accounts of the Central Bank of Montenegro abroad. The required reserve is set aside in EUR.

As of 31 December 2020, the Central Bank pays to the Bank on a monthly basis, up to the eighth day of the month for the preceding month, a fee on 50% of the funds of the required reserve calculated at the EONIA rate minus 10 basis points per annum, whereas the rate cannot be less than zero.

17. CASH AND DEPOSIT ACCOUNTS WITH CENTRAL BANKS (Continued)

The Bank may use up to 50% of allocated reserve requirements to maintain daily liquidity. The Bank does not pay a fee for the used amount of the required reserve that is returned on the same day. The Bank is obliged to pay a monthly fee on the amount of required reserve funds that it does not return on the same day at the rate determined by a special regulation of the Central Bank of Montenegro. In 2020 the Bank did not use the required reserve to maintain daily liquidity.

18. FINANCIAL ASSETS AT AMORTIZED COST

18.1. Loans and advances to banks

In EUR thousand	**31/12/2020**	**31/12/2019**
Correspondent accounts with foreign banks	24,881	9,535
Term funds with foreign banks	442	4,202
	25,323	**13,737**
Impairment (Note 15)	(18)	(12)
Total	**25,305**	**13,725**

Gross balances on accounts with foreign banks:

31/12/2020	**12m PD**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Credit rating					
Aaa - Aa	0%-0.22%	2,873	-	-	2,873
A	0.06%	4,776	-	-	4,776
Baa	0.17%	11,510	-	-	11,510
Ba	0.86%	3,296	-	-	3,296
B	3.24%	2,811	-	-	2,811
Caa	9.61%	47	-	-	47
Individually observed		10	-	-	10
Total		**25,323**	**-**	**-**	**25,323**

31/12/2019	**12m PD**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Credit rating					
Aaa - Aa	0%-0.2%	2,202	-	-	2,202
A	0.06%	3,120	-	-	3,120
Baa	0.18%	5,471	-	-	5,471
Ba	0.91%	2,934	-	-	2,934
B	3.44%	-	-	-	-
Caa	10.14%	-	-	-	-
Individually observed		10	-	-	10
Total		**13,737**	**-**	**-**	**13,737**

18. FINANCIAL ASSETS AT AMORTIZED COST (Continued)

18.2. Loans and advances to customers

In EUR thousand	**31/12/2020**	**31/12/2019**
Loans		
- Government of Montenegro	15,000	2,000
- privately owned companies	85,794	85,056
- individuals	4,978	4,909
- other - entrepreneurs and non-governmental organizations	237	162
	106,009	**92,127**
Interest receivables		
Accruals and deferrals		
- loan interest	1,078	760
- loan fees	(332)	(324)
Impairment		
- Impairment of loans (Note 15)	(4,703)	(2,702)
- Impairment of interest (Note 15)	(523)	(268)
Total loans and advances to customers	**101,529**	**89,593**

Short-term loans to companies are mostly granted for working capital with a term of one month to 12 months, while long-term loans are approved for a period of 12 to 240 months and mainly relate to companies from hotel management, trade, mining and quarrying, energy, service and other sectors.

Retail loans include cash loans, housing loans, tourism loans, pensioner loans and micro loans approved for a period of 12 to 240 months.

Detailed information on the Bank's loan portfolio is disclosed in Note 5.2.4.

18.3. Securities

	31/12/2020	**31/12/2019**
Debt securities		
Government bonds of Montenegro	40,662	-
Bonds of foreign governments	4,861	-
Corporate bonds	3,652	-
Impairments of debt securities (Note 15)	(605)	-
Total	**48,570**	**-**

18. FINANCIAL ASSETS AT AMORTIZED COST (Continued)

18.3. Securities (Continued)

As disclosed in Note 3.8.4, in 2020 the Bank reclassified a portion of its portfolio of securities at FVOCI to the portfolio of securities at amortised cost.

On 29 February 2020, bonds whose gross carrying amount is EUR 21,003 thousand were reclassified. The market value of the reclassified bonds at the time of reclassification amounted to EUR 20,836 thousand. On 31 March 2020, bonds whose gross carrying amount is EUR 27,660 thousand were reclassified. The market value of the reclassified bonds at the time of reclassification amounted to EUR 26,306 thousand. The said reclassifications did not affect the measurement of expected credit losses, but they did have an impact on their presentation (reclassification form other reserves under equity to the item under assets).

Reclassification effects on other comprehensive income are presented separately under the Cash Flow Statement.

19. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

19.1. Securities

In EUR thousand	**31/12/2020**	**31/12/2019**
Debt securities		
Government bonds of Montenegro	38,964	71,534
Bonds of foreign governments	1,588	3,965
Corporate bonds	923	-
Treasury bills	-	33,989
	41,475	**109,488**
Equity securities (FVOCI)		
Equity investment in subsidiaries	195	215
Total	**41,670**	**109,703**
Impairments of debt securities (Note 15)	(345)	(492)

All bonds in the Bank's portfolio are related to fixed interest rate Eurobonds. The maturities of government bonds are from April 2023 to October 2029.

Bonds whose nominal value is EUR 17,736 thousand and treasury bills of a nominal value of EUR 34,000 thousand, issued by the Ministry of Finance of Montenegro, which the Bank had in its portfolio as of 31 December 2019, were due and recovered in February and March 2020.

20. FINANCIAL ASSETS HELD FOR TRADING

20.1. Securities

In EUR thousand	**31/12/2020**	**31/12/2019**
Debt securities	102	-
Equity securities	449	272
Total	**551**	**272**

21. INVESTMENT PROPERTY

	2020	**2019**
Cost		
Balance as of 1 January	159	165
Effects of IFRS 16 application as 1 January 2020	42	-
Balance as of 31 December	**201**	**165**
Allowance for impairment		
Balance as of 1 January	-	-
Depreciation (Note 13)	14	6
Balance as of 31 December	**14**	**6**
Carrying value as of 31 December	**187**	**159**

22. PROPERTY. PLANT AND EQUIPMENT

			Right to use assets			
In EUR thousand	**Buildings**	**Equipment and other assets**	**Buildings – business premises**	**cars**	**Construction in progress**	**Total**
Cost						
Balance as of 1 January 2019	2,839	1,426	-	-	16	4,281
Additions	-	77	-	-	241	318
Transfers to intangible assets	-	-	-	-	(71)	(71)
Transfers	-	-	-	-	-	-
Decrease-write-offs	-	(31)	-	-	(84)	(115)
Balance as of 31 December 2019	**2,839**	**1,472**	**-**	**-**	**102**	**4,413**
Application effect of IFRS 16 as of *1 January 2020*	-	-	228	19	-	247
Additions	-	445	391	-	442	1,278
Transfers to intangible assets	-	-	-	-	(87)	(87)
Decrease-write-offs	-	(51)	(30)	-	-	(81)
Transfers	-	-	-	-	(445)	(478)
Balance as of 31 December 2020	**2,839**	**1,866**	**589**	**19**	**12**	**5,325**
Accumulated depreciation						
Balance as of 1 January 2019	(108)	(852)	-	-	-	(960)
Depreciation (Note 13)	(28)	(178)	-	-	-	(206)
Write-off and disposal	-	12	-	-	-	12
Balance as of 31 December 2019	**(136)**	**(1,018)**	**-**	**-**	**-**	**(1,154)**
Depreciation (Note 13)	(28)	(147)	(107)	(6)	-	(288)
Write-off and disposal	-	49	-	-	-	49
Balance as of 31 December 2020	**(164)**	**(1,116)**	**(107)**	**(6)**	**-**	**(1,393)**
Net book value as of:						
- 31 December 2020	**2,675**	**750**	**482**	**13**	**12**	**3,932**
- 31 December 2019	**2,703**	**454**	**-**	**-**	**102**	**3,259**

As of 31 December 2020, the Bank has no pledged assets that serve as an instrument to secure the repayment of loans and other liabilities.

23. INTANGIBLE ASSETS

Intangible assets mainly include licenses and software. The following overview shows movements on intangible assets during 2020 and 2019:

In EUR thousand	**2020**	**2019**
Cost		
Balance as of 1 January	1,363	1,435
Transfers from property, plant and equipment	87	71
Write-off	-	(143)
Balance as of 31 December	**1,450**	**1,363**
Accumulated amortization		
Balance as of 1 January	861	750
Amortization (Note 13)	171	192
Write-off	-	(81)
Balance as of 31 December	**1,032**	**861**
Carrying value as of 31 December	**418**	**502**

24. OTHER ASSETS

	31/12/2020	**31/12/2019**
Repossessed assets	2,547	2,525
Trade receivables	46	401
Receivables for card operations	935	907
Unallocated payments	4,429	3,562
Prepaid expenses	377	229
Receivables for commission activities	672	217
Other receivables	186	143
Total	**9,192**	**7,984**

25. FINANCIAL LIABILITIES MEASURED AT AMORTISED COST

25.1. Customer deposits

In EUR thousand	**31/12/2020**	**31/12/2019**
Demand deposits		
- privately owned companies	131,111	169,579
- other financial institutions that are not banks	227	603
- other: regulatory agencies, non-profit organisations and entrepreneurs	155	258
- individuals	75,336	57,182
	206,829	**227,622**
Short-term deposits		
- privately owned companies	13,752	661
- other financial institutions that are not banks	-	-
- other: regulatory agencies, non-profit organisations and entrepreneurs	-	-
- individuals	717	4,800
	14,469	**5,461**
Long-term deposits		
- privately owned companies	41,633	39,866
- other financial institutions that are not banks	-	-
- other: regulatory agencies, non-profit organisations and entrepreneurs	-	-
- individuals	19,603	12,132
	61,236	**51,998**
Interest on deposits	339	314
Total	**282,873**	**285,395**

25.2. Loans to non-bank customers

	31/12/2020	**31/12/2019**
European Investment Bank	-	282
Investment and Development Fund A.D. Podgorica	3,072	3,600
	3,072	**3,882**
Maturity by year		
Up to 1 year	178	940
Up to 2 years	505	667
Up to 3 years	452	663
Up to 4 years	427	419
Up to 5 years	384	350
Over 5 years	1,126	843
Total	**3,072**	**3,882**

25. FINANCIAL LIABILITIES MEASURED AT AMORTISED COST (Continued)

25.2. Loans to non-bank customers (Continued)

Liabilities for loans and borrowings as of 31 December 2020 in the amount of EUR 3,072 thousand (31 December 2019: EUR 3,600 thousand) are related to liabilities to the Investment and Development Fund of Montenegro a.d. Podgorica for several long-term loans. The interest rate ranges from 1% to 4%. The maturity is from 5 to 14 years. The Bank has no obligation to meet financial indicators for these loans.

In order to secure additional sources in case of endangered liquidity, the Bank signed a Contract on the Limit for Using Borrowings in case of Endangered Bank's Liquidity with Alta banka a.d. Belgrade on 1 September 2020 in the amount of EUR 5 million and with a maturity of up to one year from the date of funds disbursement. As of 31 December 2020, the Bank did not withdraw proceeds from this credit facility.

26. OTHER LIABILITIES

In EUR thousand	**31/12/2020**	**31/12/2019**
Custody operations	1,476	5,970
Lease liabilities - IFRS 16	531	-
Trade payables	150	172
Brokerage operations	75	54
Advances received	25	97
Liabilities from unallocated payments	1	1,083
Liabilities for commission activities	546	-
Other liabilities	206	104
Total	**3,010**	**7,480**

27. SUBORDINATED DEBT

As of 31 December 2020, a portion of the Bank's subordinated debt in the amount of EUR 1,002 thousand (31 December 2019: EUR 1,002 thousand) relates to funds received from SDS Management DMCC, where one amount is EUR 751 thousand at an interest rate of 0.50% and a maturity date of 24 August 2026 and another amount of EUR 251 thousand at an interest rate of 0.50% and a maturity date of 3 June 2026 (assumed from NER Holding LTD pursuant to the Assignment Agreement).

28. SHARE CAPITAL

As of 31 December 2020, the Bank's share capital consists of 23.954 thousand of ordinary shares (31 December 2019: 23,954 ordinary shares) of a nominal value of EUR 0,50605821 (31 December 2019: EUR 0.50605821). The Law on Banks ("Official Gazette of Montenegro" no. 17/08, 44/10, 40/11 and 73/17) stipulates a minimum amount of Bank's cash capital in the amount of EUR 5 million.

The ownership structure of the Bank as at 31 December 2020 and 2019 was as follows:

Shareholder	No. of shares	In EUR thousand	No. of shares	In EUR thousand
Sigma Delta Holdings doo	21,606,260	10,934	21,606,260	10,934
Sigma Delta Investments doo	2,288,200	1,158	2,288,200	1,158
Seriatos Gerasimos	20,000	10	20,000	10
Saveljić Tijana	15,000	8	15,000	8
Aleksić Milutin	8,000	4	8,000	4
Others	16,654	8	16,654	8
Total	**23,954,114**	**12,122**	**23,954,114**	**12,122**

At its extraordinary session held on 10 October 2019, the General Meeting of Shareholders of the Bank adopted a Decision on Capital Increase by Issuing Shares based on a Conversion of Convertible Bonds (hybrid instrument) into Shares in the amount of EUR 4,024 thousand. The changes were registered in the Central Register of Business Entities on 20 November 2019.

29. OFF-BALANCE SHEET ITEMS

In EUR thousand	**31/12/2020**	**31/12/2019**
Off-balance sheet items exposed to credit risk		
Irrevocable loan liabilities – undrawn credit facilities	4,039	8,425
Irrevocable documentary letters of credit issued for payment abroad	-	13
Issued payment guarantees	9,052	4,588
Issued performance guarantees	2,647	1,679
	15,738	**14,705**
Other off-balance sheet items		
Custody assets	103,181	93,261
Collateral for receivables	115,452	105,928
Commission activities	84,076	79,064
Other	2,313	384
	305,022	**293,342**
Total	**320,760**	**293,342**
Provisions for expected credit losses on off-balance sheet items (Note 15)	**(400)**	**(328)**

30. COMPLIANCE WITH REGULATIONS OF CENTRAL BANK OF MONTENEGRO

In accordance with the regulations of the Central Bank of Montenegro, the Bank is required to maintain a minimum capital adequacy ratio of 10%. The Bank is required to comply its operations within the prescribed parameters, i.e. to comply the volume and structure of risk-weighted placements with the Law on Banks and the regulations of the Central Bank of Montenegro.

Indicator	2020	2019	Regulatory limit
Stake capital	12,122	12,122	≥ 5,000
Bank's own funds	16,076	12,381	≥ 5,000
Bank's solvency ratio	21.57%	20.08%	≥ 10%
Daily liquidity ratio as of 31 December	2.43	1.41	≥ 0.9
Decade liquidity ratio as of 31 December	2.52	1.38	≥ 1
The Bank's exposure to a single person or group of related parties	23.02%	11.92%	≤ 25% SSB
Sum of large exposures	244.92%	190.22%	≤ 800% SSB
Total exposure to persons related to the Bank	6.42%	16.34%	≤ 200% SSB
Total exposure to a Bank's employee	0.30%	0.41%	≤ 1% SSB
Total exposure to a member of the Board of Directors, Audit Committee or Executive Officer	0.54%	0.24%	≤ 2% SSB
Total exposure to shareholders that have qualified interest in the Bank, including the exposure to legal entities controlled by these shareholders	0.47%	1.47%	≤ 20% SSB
Total exposure to shareholders that do not have qualified interest in the Bank, including the exposure to legal entities controlled by these shareholders	2.39%	0.02%	≤ 10% SSB

On 22 October 2020, the Central Bank of Montenegro adopted a *Decision on Amendments to the Decision on Temporary Measures for Mitigating Negative Effects of the Covid-19 Epidemic on the Financial System, which* allows banks to include 20%, instead of 30%, of demand deposits when calculating due liabilities according to the Decision on Liquidity Risk Management Minimum Standards in Banks. Consequently, banks are enabled to use their funds in a more efficient manner.

The aforesaid resulted in an increase in daily and decade liquidity ratios. According to the calculation method applied as of 31 December 2019, the daily liquidity ratio as of 31 December 2020 would amount to 1.63.

31. RELATED PARTY TRANSACTIONS

The Law on Banks ("Official Gazette of Montenegro" no. 17/08, br. 44/10, 40/11 and 73/17) stipulates that persons that appoint at least one representative in the Board of Directors or a similar body have a significant influence on the Bank's operations either through ownership of shares, based on shareholders' consent, or in any other manner. In accordance with the Law on Banks. transactions with related parties are shown in the following tables:

31. RELATED PARTY TRANSACTIONS (Continued)

Loans and advances to customers	**31/12/2020**	**31/12/2019**
retail	361	502
corporate:		
Golden Estate doo Podgorica	4,400	4,400
Adriatic Properties doo Budva	-	10,500
Nova Pobjeda doo Podgorica	-	145
Adriatic Yachting Servises doo Budva	-	10
Portal Press doo Podgorica	-	10
Monterock Internacional limited UAE	4,340	-
Innovative Recycling S.A. Switzerland	-	414
	10,101	**15,981**
Other receivables		
Nova Pobjeda doo Podgorica	-	348
Total loans and advances to customers	**10,101**	**16,329**

Customer deposits	**31/12/2020**	**31/12/2019**
retail	886	1,507
corporate:		
Sigma Delta Holdings doo Podgorica	52	73
Golden Estate doo Podgorica	27	20
First Financial Holdings doo Podgorica	1	127
Adriatic Properties doo Budva	2,154	1,005
Nova Pobjeda doo Podgorica	247	187
Epidaurus Hoteli and SPA D.O.O.	5	5
Universal Capital Development	10	6
Sigma Delta Investments doo	141	43
SDS Management DMCC Dubai	207	9,435
SDS Gulf limited	52	524
Adriatic Yachting Servises doo Budva	63	200
Portal Press doo Podgorica	4	6
Media - Nea doo Podgorica	1	9
Dnevne novine doo Podgorica	9	14
Novine doo Podgorica	-	1
Adriatic Procurement doo Budva	-	9
Vires doo Podgorica	190	203
Novi Tender Oglasi doo	29	9
Monterock Internacional limited UAE	13,374	178
Ebenus Events Managements LLC	68	68
RMR Europe Investments LTD Cyprus	4	6
Benaturayou Limited Gibraltar	7	7
Nightsapphire Resorts LTD Cyprus	-	2
Pure Angel doo Budva	111	181
Seven Hills Holdings Limited	-	11
RMR Innovative Recycling Internacional	395	-
Kalerosi services LTD	46	-
RMR Blue Essence Investment LTD Cyprus	1	5
Mystic Quartz resorts LTD Cyprus	50	1
Innovative Recycling S.A. Switzerland	3	-
Monte London limited UK	1	-
Total customer deposits	**18,138**	**13,842**

Subordinated debt		
SDS Management DMCC Dubai	1,002	1,002

31. RELATED PARTY TRANSACTIONS (Continued)

Guarantees	**31/12/2020**	**31/12/2019**
corporate:		
Adriatic Properties doo Budva	7	500
Nova Pobjeda doo Podgorica	10	10
Adriatic Yachting Servises doo Budva	10	10
Innovative Recycling S.A. Switzerland	450	414
Total guarantees	**477**	**934**

Unused loan amount	**31/12/2020**	**31/12/2019**
corporate:		
Nova Pobjeda doo Podgorica	50	50
Total unused loan amount	**50**	**50**

Commission activities	**31/12/2020**	**31/12/2019**
corporate:		
Monterock Internacional limited UAE	9,950	-
Nightsapphire Resorts LTD Cyprus	7,299	7,048
RMR Innovative Recycling Internacional	100	100
Ocean Jasper resorts LTD Cyprus	3,459	1,607
RMR Star Bright Investment LTD Cyprus	1,006	506
RMR Blue Essence Investment LTD Cyprus	6,077	2,193
Mystic Quartz resorts LTD Cyprus	110	110
Pure Larimar resorts LTD Cyprus	5,606	601
Tiger Eye resorts LTD Cyprus	2,980	2,980
Total Commission activities	**36,587**	**15,145**

Interest income	**2020**	**2019**
individuals	15	24
legal entities:		
Golden Estate doo Podgorica	87	87
Adriatic Properties doo Budva	205	250
Nova Pobjeda doo Podgorica	12	16
Monterock Internacional limited UAE	12	-
	331	**377**

31. RELATED PARTY TRANSACTIONS (Continued)

Fee income	**2020**	**2019**
individuals	-	1
legal entities:		
Golden Estate doo Podgorica	5	4
Adriatic Properties doo Budva	60	8
Nova Pobjeda doo Podgorica	1	-
Innovative Recycling S.A. Switzerland	2	1
	68	**14**

Commission activities	**2020**	**2019**
individuals	-	-
legal entities:		
Adriatic Properties doo Budva	171	80
Nightsapphire Resorts LTD Cyprus	76	11
RMR Innovative Recycling Internacional	1	1
Ocean Jasper resorts LTD Cyprus	27	14
RMR Star Bright Investment LTD Cyprus	6	-
RMR Blue Essence Investment LTD Cyprus	53	17
Mystic Quartz resorts LTD Cyprus	1	1
Pure Larimar resorts LTD Cyprus	53	2
Tiger Eye resorts LTD Cyprus	31	30
	419	**156**

Total income from interest, fees and commissions	**818**	**547**

Interest and fee expenses:	**2020**	**2019**
individuals		-
legal entities:		
SDS Management DMCC Dubai	5	47
	5	**47**

Net income	**813**	**500**

Remunerations to the management and the Board of Directors for gross salaries and compensations in 2020 amount to EUR 297 thousand (2019: EUR 255 thousand).

32. EARNINGS PER SHARE

Basic and diluted earnings per share are calculated by dividing the annual net profit of Bank's shareholders by the weighted average number of ordinary shares that were outstanding during the period.

	2020	2019
Net profit for the year (*in EUR thousand*)	2,045	3,241
No. of ordinary shares at year's end	23,954,114	23,954,114
Weighted average number of shares at year's end	23,954,114	16,895,251
Basic earnings per share in EUR	**0.0854**	**0.1353**
Diluted earnings per share in EUR	**0.0854**	**0.1918**

33. LITIGATIONS

As of 31 December 2020, the Bank participates as a defendant in several lawsuits instituted by natural persons, demanding invalidation or admission and/or execution. Therefore, they are not focused on compensation for damages and accordingly, no amount of the claim has been determined (2019: EUR no amount of the claim was determined).

As of 31 December 2020, the Bank's management deems that no negative outcomes will arise from the said disputes and thus, the Bank has not provided for them.

In addition, the Bank participates as a plaintiff in several litigations against legal and natural persons for the purpose of collecting receivables in the total amount of EUR 2,242 thousand (2019: EUR 2,333 thousand).

34. EXCHANGE RATES

The official exchange rates used in the translation of the balance sheet components denominated in foreign currencies into EUR as of 31 December 2020 and 2019 were as follows:

Currency	31 December 2020	31 December 2019
USD	1.22810	1.11890
CHF	1.08570	1.08710
GBP	0.90307	0.85208
CAD	1.57010	1.46210
HKD	9.52100	8.71330
CNY	8.01340	7.81750
HRK	7.54600	7.44850
AED	4.51345	4.11409

35. EVENTS AFTER THE REPORTING DATE

As disclosed in Note 2.8, during the preparation of the financial statements the *Decision on Temporary Measures for Mitigating Negative Effects of the Covid-19 Epidemic on the Financial System* passed by the Central bank of Montenegro was still effective in terms of having the possibility of using an additional moratorium and restructuring the liabilities of Bank's borrowers. Until the preparation of these financial statements, the most recent *Decision on Amendments to the Decision on Temporary Measures for Mitigating Negative Effects of the Covid-19 Epidemic on the Financial System* of 1 March 2021 brings extensions with regard to the business activities of customers that may use moratorium and restructuring.

The said events did not affect the Bank's ability to continue as a going concern in the foreseeable future. Therefore, the Bank continues to use a going concern principle in the preparation and presentation of the financial statements.

Additionally, the Bank's management deems that there were no other significant events after the reporting date that would affect the separate financial statements for the year ended 31 December 2020.

Signed on behalf of Universal Capital Bank A.D. Podgorica on 30 March 2021:

Danijela Jovic CEO	Milos Pavlovic Executve officer	Lana Kalezic Head of the Finance and Accounting Department