CRNOGORSKA KOMERCIJALNA BANKA AD, PODGORICA

Financial Statements
For the Year Ended December 31, 2019
and Independent Auditors' Report

CONTENTS

Deloitte.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Shareholders of Crnogorska komercijalna banka AD, Podgorica Member of OTP Group

Opinion

We have audited the stand alone financial statements (pages 5 to 82) of Crnogorska komercijalna banka AD, Podgorica, Member of OTP Group (the Bank), which comprise the unconsolidated balance sheet as at December 31, 2019, and the unconsolidated income statement, unconsolidated statement of changes in equity and unconsolidated cash flow statement for the year then ended, and notes to the unconsolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying unconsolidated financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2019, and its financial performance and its cash flows for the year then ended in accordance International Financial Reporting Standards.

Basis for Opinion

We conducted our audit in accordance with the International Standards on Auditing, Law on Auditing of Montenegro and Law on Accounting of Montenegro. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the unconsolidated 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 unconsolidated financial statements in Montenegro, and we have fulfilled our other ethical responsibilities in accordance with these requirements. 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 unconsolidated financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

(Continued)

To the Board of Directors and Shareholders of "Crnogorska komercijalna banka AD", Podgorica (Continued)

Key audit matter	How our audit addressed the key audit matter
Expected credit losses on loans and provisions under guarantees	
Loan receivables and accounts receivable amounted to EUR 500.406 thousand as at December 31, 2019 (EUR 429.728 thousand as at December 31, 2018), while the total amount of the Bank's allowance for impairment was EUR 22.625 thousand as at December 31, 2019 (EUR 34.633 thousand as at December 31, 2018). Measuring the costs of loan impairment and provisions for guarantees is considered a key audit matter, since determining the assumptions for expected credit losses is subjective because of the significant level of professional judgment exercised by the Management. The most significant judgements refer to: • Assumptions used in models of expected credit loss to estimate the credit risk associated with exposure and the client's expected future cash flows. • Timely identification of exposures with a significant increase in credit risk exposure and credit impairment. • Measurement of collateral and assumptions of future cash flows on individually estimated credit exposures. The Management disclosed additional information on costs of loan impairment and provisions for guarantees in the Notes 2, 3.6, 11, 16 and 28 to the unconsolidated financial statements.	Based on our risk assessment and industry knowledge, we have examined the costs of loan impairment and provisions, and assessed the methodology applied, as well as the assumptions used, in accordance with the description of the key audit matter. Our procedures included the following elements: • Assessment of key controls over assumptions used in expected credit loss models to estimate credit risk associated with exposure and the client's expected future cash flows. • Detailed testing on the sample basis of evidences that support the assumptions used in the expected credit loss models applied in allocating the stages, assumptions applied to obtain the twelve-month and lifelong probability of default (PD) and the methods used to obtain the probability of losses arising from the inability to collect a receivable. • Assessment of key controls and testing their effectiveness on the sample basis over the timely identification of exposures with a significant increase in credit risk and the timely identification of loan impairment exposures. • Detailed sample testing of evidences of timely identification of exposures with a significant increase in credit risk and timely identification of exposures based on loan impairment. • Detailed sample testing of evidences that support the appropriate identification of assumptions for loan impairment expenses and provisions for guarantees, including the valuation of collateral and assumptions of future cash flows for individually assessed loan impairment exposures. • Assessment of key changes in high-risk portfolios from prior period in relation to industry standards and historical data. • Assessment of adequacy of the various identified management decisions compared to certain macro forecasts applied in models of expected credit loss. • Evaluation of applied methodologies made with use of our industry knowledge and experience. • We have engaged our IT and Credit Risk Specialists in areas that required specific expertise.

(Continued)

INDEPENDENT AUDITOR'S REPORT (Continued)

To the Board of Directors and Shareholders of Crnogorska komercijalna banka AD, Podgorica Member of OTP Group (Continued)

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

Management is responsible for the preparation and fair presentation of the unconsolidated financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of unconsolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the unconsolidated 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 Company 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 Unconsolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the unconsolidated 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 International Standards on Auditing, Law on Auditing of Montenegro and Law on Accounting of Montenegro 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 unconsolidated financial statements.

As part of an audit in accordance with International Standards on Auditing, Law on Auditing of Montenegro and Law on Accounting of Montenegro, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the unconsolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to this 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 omission, misrepresentation or the override of internal controls,

(Continued)

INDEPENDENT AUDITOR'S REPORT (Continued)

To the Board of Directors and Shareholders of Crnogorska komercijalna banka AD, Podgorica Member of OTP Group (Continued)

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

- Obtain an understanding of internal controls 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 controls,
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of the management's use of 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 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 unconsolidated 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 unconsolidated financial statements including the disclosures, and whether the unconsolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charges 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 the audit.

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

Deloitte d.o.o.

Deloitte d.o.o. Podgorica	Katarina Bulatović, Certified Auditor
March 24, 2020	(License number 067 issued on March 31, 2015)

UNCONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
Year Ended December 31, 2019
(thousands of EUR)

	Notes	2019	2018
Interest and similar income	6a	25.988	24.742
Interest expense and similar charges	6b	(281)	(274)
Net interest income		25.707	**24.468**
Fee and commission income	7a	18.017	15.120
Fee and commission expense	7b	(6.961)	(5.192)
Net fee and commission income		**11.056**	**9.928**
Net foreign exchange gains	8	886	844
Other operating income	9	512	661
Operating expenses	10	(35.670)	(24.771)
Losses on impairment and provisions	11	1.584	(2.725)
		(32.688)	(25.991)
INCOME BEFORE TAX		**4.075**	**8.405**
Income taxes	12	(457)	(1.024)
INCOME FOR THE YEAR		**3.618**	**7.381**

The accompanying notes on the following pages 10 to 82 form an integral part of these financial statements.

These unconsolidated financial statements were approved by the management of Crnogorska komercijalna banka AD, Podgorica.

Podgorica, March 24, 2020

Signed on behalf of Crnogorska komercijalna banka AD, Podgorica by:

Pal Jozsef Kovacs	Maja Krstić	Srđan Janković
Chief Executive Officer	Executive director for Finance and Bank operation	Director of Accounting & Controlling Directorate

CRNOGORSKA KOMERCIJALNA BANKA A.D.
Member of OTP Group
PODGORICA

UNCONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME
Year Ended December 31, 2019
(Thousands of RSD)

	2019	2018
RESULT FOR THE YEAR - PROFIT	**3.618**	**7.381**
Components of other comprehensive income that cannot be reclassified to the profit or loss:		
Actuarial gains/(losses)	(148)	-
Components of other comprehensive income that can be reclassified to the profit or loss:		
Positive effects of changes in fair value of securities measured at fair value through other comprehensive income (FVtOCI)	(445)	1.340
Tax losses relating to other comprehensive income for the year	-	-
Total other comprehensive income for the year	(593)	1,340
TOTAL POSITIVE COMPREHENSIVE INCOME FOR THE YEAR	**3.025**	**8.721**

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CRNOGORSKA KOMERCIJALNA BANKA A.D.
Member of OTP group
PODGORICA

UNCONSOLIDATED STATEMENT OF FINANCIAL POSITION
As of December 31, 2019
(thousands of EUR)

	Notes	December 31, 2019	December 31, 2018
ASSETS			
Cash and balances with the Central Bank	14	160.024	135.251
Loans and advances to banks at amortized cost	15	39.201	57.689
Loans and advances to customers at amortized cost	16	477.781	395.095
Securities at fair value through other comprehensive income	17	520	6.992
Securities at amortized cost	18	79.566	79.278
Forfeiting	20	1.241	1.221
Shares and equity investments	19	41.810	335
Intangible assets	21	3.616	3.563
Property and equipment	22	14.742	13.279
Deferred tax assets	13.c	603	53
Other assets	23	2.435	1.813
Total assets		**821.539**	**694.569**
LIABILITIES			
Deposits from banks	24	10.982	7.022
Due to customers	25	606.963	555.517
Other borrowed funds	26	13.913	2.733
Other liabilities	27	15.112	5.498
Provisions	28	3.035	3.227
Deferred income tax liabilities	13.c	238	568
Employee benefits	29	1.409	1.181
Total liabilities		**651.652**	**575.746**
EQUITY			
Share capital	30	181.876	136.876
Other reserves		773	3.207
Accumulated losses		(12.762)	(21.260)
Total equity		**169.887**	**118.823**
Total liabilities and equity		**821.539**	**694.569**
OFF-BALANCE SHEET ITEMS	31	**93.765**	**79.132**

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Podgorica, March 24, 2020

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CRNOGORSKA KOMERCIJALNA BANKA A.D. PODGORICA

UNCONSOLIDATED STATEMENT OF CHANGES IN EQUITY
Year Ended December 31, 2019
(thousands of EUR)

	Share Capital	Other Reserves	Accumulated Losses	Total
Total comprehensive income				
Balance at January 1, 2018	136.876	1.867	(28.641)	110.102
Profit for the year	-	-	7.381	7.381
Total other comprehensive income for the year	-	1.340	-	1.340
Balance at December 31, 2018	**136.876**	**3.207**	**(21.260)**	**118.823**
Total comprehensive income				
Balance at January 1, 2019	136.876	3.207	(21.260)	118.823
Increase of Share Capital	45.000	-	-	45.000
Profit for the year	-	-	3.618	3.618
Increase in fair value of securities at fair value through other comprehensive income	-	2.594	-	2.594
Decrease in revaluation reserves due to sale of securities	-	(4.880)	4.880	-
Total other comprehensive income for the year	-	(593)	-	(593)
Other	-	445	-	445
Balance at December 31, 2019	**181.876**	**773**	**(12.762)**	**169.887**

The accompanying notes on the following pages 10 to 82 form an integral part of these financial statements.

These unconsolidated financial statements were approved by the management of Crnogorska komercijalna banka AD, Podgorica.

Podgorica, March 24, 2020

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CRNOGORSKA KOMERCIJALNA BANKA A.D. Member of OTP group PODGORICA

UNCONSOLIDATED STATEMENT OF CASH FLOWS
Year Ended December 31, 2019
(thousands of EUR)

	2019	2018
Cash flows from operating activities		
Interest and similar income received	27.435	26.136
Interest and similar charges paid	(191)	(420)
Fee and commission received	18.069	14.956
Fee and commission paid	(10.027)	(7.895)
Other income	437	420
Taxes paid	(21.005)	(680)
Cash payments to employees and suppliers	(1.705)	(18.520)
Net cash inflows from operating activities before changes in operating assets and liabilities	13.013	13.997
Changes in operating assets and liabilities		
Net (decrease)/increase in obligatory reserve	(6.280)	(2.208)
Net decrease in loans and advances to banks and customers	(81.630)	(93.485)
Net decrease in forfeiting	56	966
Net increase in other assets	(572)	463
Net increase/(decrease) in deposits from banks	(296)	(912)
Net increase in customer deposits	55.688	62.939
Net increase/(decrease) in other liabilities	(480)	904
Net cash provided by operating activities	(20.501)	(17.336)
Cash flows from investing activities		
Net increase/ (decrease) in securities	8.640	45
Subsidiary purchase	(41.475)	(335)
Purchase of property and equipment	(2.143)	(1.440)
Purchase of intangible assets	(1.140)	(1.119)
Treasury bills	-	6.300
Net increase securities at amortized cost	12	-
Net cash used in investing activities	(36.106)	3.451
Cash flows from financing activities		
Net decrease in other borrowed funds	11.181	(529)
Issue of common shares	45.000	-
Net cash used in financing activities	56.181	(529)
Effect of exchange rate changes	370	539
Net (decrease)/increase in cash and cash equivalents	(56)	(13.875)
Cash and cash equivalents at beginning of year	151.785	165.660
Cash and cash equivalents at end of year (Note 33)	**151.729**	**151.785**

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Podgorica, March 24, 2020

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CRNOGORSKA KOMERCIJALNA BANKA A.D. Member of OTP group PODGORICA

1. GENERAL INFORMATION

Crnogorska komercijalna banka AD, Podgorica (hereinafter: the "Bank") was established as an independent bank and registered with the Commercial Court in Podgorica on January 15, 1997.

OTP Bank Plc. Budapest holds 100 percent equity interest in the Bank's equity.

The Bank is registered as a shareholding company. The Bank's registration number in the Central Register of the Commercial Court is 4-0001633/49.

The Bank obtained the operating license from the Central Bank based on the Decision number 0101-72/1-2002 dated February 18, 2002.

The Bank is registered with the Securities Exchange Commission and entered into the Register of Security Issuers under number 51 (Decision number 02/3-47/2-01 as of July 12, 2001).

Pursuant to the Law on Banks, Founding Decision and Statute, the Bank is engaged in the business of keeping deposits and other assets of private individuals and legal entities and it approves loans and makes other advances from these funds entirely, or in part, for its own account.

In addition to these operations, the Bank is also registered to perform the following activities:

- to issue guarantees and undertake other off-balance sheet commitments;
- to purchase, sell and collect receivables;
- to issue, process and record payment instruments;
- to perform payment transactions domestically and abroad;
- to perform finance lease operations;
- to trade in its own name for its own account or for the account of a customer with foreign payment instruments and financial derivatives;
- to prepare analysis and provide information and advice on the company and entrepreneur creditworthiness;
- depositary operations;
- safekeeping of assets and securities and
- other operations as in accordance with the approval of the Central Bank of Montenegro.

The Bank is headquartered at Moskovska Street, no number.

As at September 27, 2018 the Bank bought 100% shares of OTP Debt Collection, doo Podgorica. The Bank as the new owner of OTP Debt Collection, doo Podgorica was officially registered in the Central Registry of Commercial Entities on December 17, 2018.

On July 16, 2019, the Bank became the owner of 90,56% of the share capital of Societe Generale Montenegro AD Podgorica, Montenegrin branch of Societe Generale Group.
On December 20, 2019, by purchasing the remaining 9.44% of shares from minority shareholders, the Bank becomes 100% owner of Podgoricka Bank shares.

On December 31, 2019, the Bank consisted of its Head Office in Podgorica, twenty four branches, and five counters located on the territory of Montenegro.

As of December 31, 2019, the Bank had 457 employees (December 31, 2018: 452 employees).

The members of the Board of Directors of the Bank are as follows:

First name and surname	Position
Dr. Németh Miklós	President
Dr. Barna Zsolt	Member
Gergely Gozon	Member
Nyitrai Győző József	Member
Kovács Pál József	Member
Krizsanovich Péter	Member
Olchvary Balazs	Member

1. GENERAL INFORMATION (Continued)

The members of the Audit Committee of the Bank are as follows:

First name and surname	Position
Mr. Peter Krizsanovich	President
Mr. Attila Kozsik	Member
Mr. Andreas Szalay	Member

Executive directors of the Bank as of 31 December 2019 were:

Name and surname	**Key area**
Mr. Pal Kovacs	Chief Executive Officer
Mr. Viktor Vorobej	Executive Director for Credit Approval and Risc Management Division
Mrs. Maja Krstić	Executive Director for Finance and Bank Operations
Mrs Sandra Kordić	Executive Director for Retail Banking Division
Mr. Milan Sztepanov	Executive Director for Compliance and Security Division
Mrs Branislava Vukčević	Director of CEO Cabinet and HR Directorate
Mr. Ivan Vučinić	Director of IT and Logistic Directorate

As of December 31, 2019, Head of Compliance Department was Dora Dragović.

As of December 31, 2019, Internal Auditor was Alenka Mugoša.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS

These financial statements are general purpose financial statements prepared in accordance with International Financial Reporting Standards ("IFRS"). The Bank also prepares financial statements according to statutory accounting rules that differ materially from IFRS.

2.1. Statement on Compliance

These financial statements have been prepared in accordance with IFRS adopted by the International Accounting Standards Board (IASB).

The preparation of financial statements in conformity with IFRS requires from the Bank's management to use certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Bank's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 2 (d).

The IFRS accounting policies provided below have been consistently applied by the Bank to all periods presented in these financial statements.
Decrease in fair value of securities at fair value through other comprehensive income.

2.2. Basis of Preparation

These financial statements have been prepared under the historical cost convention, as modified by the fair value changes for financial assets measured at fair value through other comprehensive income or fair value through profit or loss, financial assets and financial liabilities (included derivate financial instruments) measured at fair value through profit or loss, under the going concern assumption.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS

2.3. Going Concern

The Bank's financial statements have been prepared on a going concern basis, which entails that the Bank will continue to operate in the foreseeable future.

2.4. Functional and Reporting Currency

The financial statements are stated in EUR, which is the Bank's functional currency. Unless otherwise is stated, all financial information is presented in EUR rounded to the nearest thousand.

2.5. Use of Estimates and Judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods. Information about significant areas of estimation uncertainty and critical estimates in applying accounting policies that have the most significant effect on the amount recognized in the financial statements are described in Note 5 to the financial statements.

A summary of the principal accounting policies applied in preparing the IFRS financial statements are set out within Note 3 to the financial statements.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS

2.6. Adoption of the New Standards and Revised/Amended Standards Effective for the Current Year

In 2019, the Bank has adopted and applied the following new standards and amendments to the existing standards that are effective for annual periods beginning on or after January 1, 2019:

- IFRS 16 "Leases";
- Amendments to IFRS 9 "Financial Instruments" - Prepayment Features with Negative Compensation;
- Amendments to IAS 19 "Employee Benefits" - Plan Amendment, Curtailment or Settlement;
- Amendments to IAS 28 "Investments in Associates and Joint Ventures" - Long-term Interests in Associates and Joint Ventures ;
- Amendments to various standards due to "Improvements to IFRSs - Cycle 2015-2017 (IFRS 3 "Business Combinations", IFRS 11 "Joint Arrangements", IAS 12 "Income Taxes" and IAS 23 "Borrowing Costs"; and
- IFRIC 23 "Uncertainty over Income Tax Treatments".

The adoption of these new standards, amendments to the existing standards and interpretation has not led to any material changes in the Bank's unconsolidated financial statements, except for the effects of IFRS 16 implementation, as disclosed in greater detail further in this Note to the unconsolidated financial statements.

(i) First-Time Adoption of IFRS 16 "Leases"

IFRS 16 sets out the main principles of recognition, presentation and the disclosure of lease contracts for the counterparties, i.e., the lessee and lessor. IFRS 16 is effective for accounting periods beginning on or after January 1, 2019 and supersedes the previous lease guidance including IAS 17 'Leases' and related interpretations: IFRIC 4 'Determining Whether an Arrangement Contains a Lease', SIC 15 'Operating Leases – Incentives' and SIC 27 'Evaluating the Substance of Transactions in the Legal Form of a Lease'.

IFRS 16 provides a new definition of a lease. The essential element differentiating the definition of a lease under IAS 17 and under IFRS 16 is the concept of control. Under IFRS 16, an agreement is a lease or contains a lease if it conveys the right to control the use of an identified asset for a given period in exchange for compensation. Control is considered to exist, or to have been conveyed, if the lessee has the right to obtain substantially all of the economic benefits from the use of an identified asset, and the right to direct the use of that asset.

The lessee accounting for the leases is changed under IFRS 16 and stipulates recognition of a right-of-use asset for all leases. A right-of-use asset is a right to use the asset leased while at the same time the lessee recognizes a liability for future lease payments defined by the lease contract (a lease liability). On initial application of IFRS 16, the right-of-use asset is initially measured based on the contractual cash flows defined by the lease contract. Subsequently, the right-of use asset will be measured under the rules for measurement of asset set forth by IAS 16, IAS 38 or IAS 40, using the cost model, i.e., at cost net of accumulated depreciation and aggregate impairment losses, if any, or using the revaluation model or fair value model, as appropriate. The accounting treatment of lease contracts for lessors under IFRS 16 has remained substantially unaltered in comparison to IAS 17. The lessors will continue to classify all lease contracts as either operating or finance leases.

The date of initial application of IFRS 16 for the Bank was January 1, 2019. The Bank elected to use the modified retrospective transition approach.

The Bank implemented activities of developing rules, principles and software solutions for appropriate assessment of the new assets and liabilities and subsequent calculation of the related performance to ensure adequate initial application of the standard. The Bank assessed all its lease contracts to identify those that will be in the scope of the new standard's first-time adoption given the new definition of a lease.. The Bank has applied the new definition of a lease set out in IFRS 16 to all lease contracts effective on January 1, 2019 or entered into or modified after January 1, 2019.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS

2.6. Adoption of the New Standards and Revised/Amended Standards Effective for the Current Year (Continued)

(i) First-Time Adoption of IFRS 16 "Leases" (Continued)

As permitted by the standard, the Bank decided not apply provisions of IFRS 16 to the leases of intangible assets, short-term leases (with lease terms of up to 12 months from the first-time adoption of the standard) and leases with low-value assets leased (such as printers, POS terminals, tablets, computers, telephones, water dispensers and smaller office furniture items). In the aforesaid cases, the Bank applies the same accounting treatments as in prior years, i.e., recognizes lease costs on a straight-line basis within the income statement's line item of other expenses.

Upon first-time adoption of IFRS 16, the Bank did not restate the comparative figures for 2018, but recognized the right-of-use asset in the amount equal to that of the lease liability adjusted by the amount of any prepaid or accrued lease payments before or on the date of the lease commencement date. In addition, the future cash flows were determined based on the contractual provisions, excluding VAT since the obligation to pay VAT is established at the moment of invoice issuance and not on the lease commencement date. On initial application of IFRS 16, the Bank initially measured the lease liability using its average incremental borrowing interest rate ranging 3.12%.

As of January 1, 2019, the Bank recognized the right-of-use (ROU) asset in the total amount of EUR 3.723 thousand (Note 32), while at the same time the corresponding lease liability was recognized in the amount of EUR 3.723 thousand.
The effects of the first-time adoption of IFRS 16 on the Bank's statement of financial position items are presented below:

	ROU assets (Note 22)	Prepaid lease liabilities and deposits	Lease liabilities (Note 32)
Business premises	3.723	-	3.723
Balance at January 1, 2019	**3.723**	**3.723**	**3.723**

The accounting policies for lease recognition and measurement are presented in more detail in Note 3.3.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS

2.7. New Standards and Amendments to the Existing Standards in Issue not yet Adopted

At the date of approval of these unconsolidated financial statements the following new standards, amendments to the existing standards and new interpretations were in issue but not yet effective:

- IFRS 17 "Insurance Contracts" (effective for annual periods beginning on or after January 1, 2021);
- Amendments to IFRS 3 "Business Combinations" - Definition of a Business (effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020 and to asset acquisitions that occur on or after the beginning of that period);
- Amendments to IAS 1 "Presentation of Financial Statements" and IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" - Definition of Material (effective for annual periods beginning on or after 1 January 2020);
- Amendments to References to the Conceptual Framework in IFRS Standards (effective for annual periods beginning on or after 1 January 2020); and
- Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures" - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date deferred indefinitely until the research project on the equity method has been concluded.

The Bank's management has elected not to adopt these new standards, amendments to existing standards and new interpretations in advance of their effective dates. The management anticipates that the adoption of these standards, amendments to existing standards and new interpretations will have no material impact on the unconsolidated financial statements of the Bank in the period of initial application.

2.8. Comparative Information

The Bank's accounting policies and estimates relating to the recognition and measurement of the assets and liabilities used upon preparation of the accompanying unconsolidated financial statements are consistent with the accounting policies and estimates used in preparation of the Bank's unconsolidated financial statements for FY 2018, except for the changes in the accounting policies resulting from the adoption of IFRS16. The Bank applied the allowed exemption option not to adjust the comparative figures for prior years in respect of the changes relating to the classification and measurement of the financial assets and financial liabilities and impairment. Consequently, the presented comparative figures for 2018 do not reflect the requirements of IFRS 16 and are not comparable to the figures presented for 2019.

2.9. Key Accounting Estimates and Assumptions

Preparation of the unconsolidated financial statements in accordance with IFRS requires the Bank's management to make the best possible estimates and reasonable assumptions that affect the application of the accounting policies and the reported amounts of assets and liabilities, as well as income and expenses arising during the accounting period.

These estimations and assumptions are based on information available, as of the date of preparation of the financial statements. Actual results may vary from these estimates. Estimates and assumptions are subject to constant review and when adjustments become necessary they are stated within the income statement for periods in which they became known.

The critical estimates and judgements as the key sources of estimate uncertainty that pose a significant risk of causing material adjustments to the carrying amounts of assets and liabilities within the next financial year are described below.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS

2.9. Key Accounting Estimates and Assumptions (continued)

(a) Impairment of Financial Assets

The estimation of impairment losses in the Bank's credit-risk exposed portfolio represents the major source of estimation uncertainty.

The Bank recognizes provisions for expected credit losses (ECL) per financial assets measured at amortized cost (AC) and debt instruments, i.e., financial assets measured at fair value through other comprehensive income (FVtOCI) as well as per borrowings and issued guarantees. The carrying values of the financial assets measured at AC are reduced by the amount of provisions for expected credit losses.

(b) Impairment of Non-Financial Assets

At each reporting date, the Bank's management reviews the carrying amounts of the Bank's intangible assets, property and equipment. If there is any indication that such assets have been impaired, the recoverable amount of each asset is estimated in order to determine the extent of the impairment loss. If the recoverable amount of the asset is estimated to be below its carrying value, the carrying amount of the asset is reduced to its recoverable amount. Impairment assessment requires the management to make subjective judgments in respect to the cash flows, growth rates and discounting rates for cash-generating units subject to assessment.

(c) Useful Life of Intangible Assets, Property, Plant and Equipment

Determining the useful life of intangible assets, property and equipment is based on historical experience with similar assets, as well as the anticipated technical development and changes affected by numerous economic and industrial factors (Note 3.9).

Adequacy of useful lives of assets is reviewed annually or whenever there are indications of significant changes in the factors underlying the estimates of useful lives.

(d) Provisions

Provisions are reviewed at each reporting date and adjusted to reflect the best possible estimation. If it is no longer likely that an outflow of funds representing economic benefits will be required to settle the obligation, the provisions are reversed through unconsolidated statement of comprehensive income. Provisions are recognized when it is expected that the Bank, as a result of past events, will have a current legal or derived obligation that can be reliably determined and the settlement of which is expected to result in an outflow of resources that represent economic benefit to the Bank.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS

2.9. Key Accounting Estimates and Assumptions (Continued)

(e) Fair Value of Financial Instruments

The Bank applies models consistently from one period to another, thus ensuring comparability and continuity of valuation during time. However, fair value assessment inevitably entails significant extent of judgement. Therefore, the management sets up valuation adjustments to cover the differences relating to the estimates of unobservable parameters and assumptions within the models.

Although in some instances substantial judgement is required for fair value assessment, the management believes that the unconsolidated statement of financial position and changes in the fair values reported in the unconsolidated statement of comprehensive income are prudent and reflect the actual economic conditions, based on the executed controls and protection procedures.

Valuation methods, assumptions and techniques used in fair value assessment are explained in Note 4.5.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1. Income and Expense Recognition

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

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

Fees and commissions are generally recognized on an accrual basis once the service is rendered. Loan approval fees are charged as onetime fee, deferred and recognized in income as an adjustment of the effective interest rate on the loan. Fee and commission income, also, includes transfer payments in foreign currency, domestic payments transactions, loan administration, guarantee, letter of credit business and other banking services.

3.2. Foreign Exchange Translation

Transactions denominated in foreign currencies are translated into Euros at the official middle exchange rates, at the date of each transaction.

Assets and liabilities denominated in foreign currencies are translated into Euros by applying the official middle exchange rates, prevailing at the statement of financial position date. 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.

Commitments and contingent liabilities denominated in foreign currencies are translated into Euros by applying the official middle exchange rates, at the statement of financial position date.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.3. Leasing

(a) *The Bank as lessee*

At inception of a contract, the Bank shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

At the commencement of the lease term, Bank recognises a right-of-use asset and a lease liability in their Statements of Financial Position. Exemption are:

- Short term leases, and
- Leases, where the underlying asset is low value (individual asset with a value of $5,000 or less when new).

The Bank recognises the lease payments associated with the exemption as an expense on either a straight-line bases over the lease term or another systematic basis if that basis is more representative of the pattern of the lessee's benefit.

At the commencement date, the right-of-use asset is measured at cost. The cost of the right-of-use asset comprises:

- The amount of the initial measurement of the lease liability;
- Any lease payments made at or before the commencement date, less any lease incentives received;
- Any initial direct costs incurred by the lessee; and
- An estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories.

At the commencement date, the lease liability is measured at the present value of the lease payments that are not paid at that date.

At the commencement date, the lease liability is measured at the present value of the lease payments that are not paid at that date. The discount rate applied to calculate the present value – unless the contract has other provisions – is the incremental borrowing rate determined which is based on government securities zero coupon yield curves increased by the spread reflecting the risk of the Bank. OTP Bank defined methodology for Calculation of discount rates.

At the commencement date, the lease payments included in the measurement of the lease liability comprise:

- Fixed payments (including in-substance fixed payments), less any lease incentives receivable;
- Amounts expected to be payable by the lessee under residual value guarantees;
- The exercise price of a purchase option if the lessee is reasonably certain to exercise that option;
- Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

The Bank always separates the non-lease components of the lease contracts (e.g. insurance fee, utility bills) and accounts them as an expense.

Lease payments must be included in the measurement of the lease liability without value added taxes. Non-deductible VAT is recognised as other expense.

The non-cancellable period of the lease is the enforceable period of the contract. The lease is no longer enforceable when the lessee and the lessor each have the right to terminate the lease without permission from the other party with no more than an insignificant penalty.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.3. Leasing (Continued)

(a) *The Bank as lessee (Continued)*

In case of contracts with definite term:

- If the lessee does not have any extension or termination option according to the contract, the lease term is the contractual term;
- If the lessee has termination or extension option, and it is reasonably certain that the lessee will exercise that option, the lease term is the contractual term, extended or shortened with the period based on the option.

Contracts with indefinite term usually contain termination options. If the lessee and the lessor have also right to terminate the contract at any time during the lease term with no more than an insignificant penalty, the lease term that can be considered enforceable is the notice period, so the lease term is equal to the notice period of the contract in case of intercompany and also third party contracts.

The lease liability is accounted in the contractual currency. When determining the contractual currency, substance is over form, i.e. if the lease payment is determined in the currency in which the payment should be performed, but the lease payment is variable depending on the rate of another currency, the latter currency is considered to be the currency of the contract.

(b) *The Bank as a lessor*

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Amounts due from lessees under finance leases are recorded as other receivables at the amount of the net investment in the lease of the Bank. Finance lease income is allocated to accounting periods so as to reflect a constant rate of return on the net investment outstanding of the Group in respect of the leases. Direct costs such as commissions are included in the initial measurement of the finance lease receivables.

Rental income from operating leases is recognized on a straight-line basis over the term of the relevant lease.

(c) *First application of IFRS 16 "Leases"*

The published standard, IFRS 16 "Leases", is effective for annual periods beginning on or after 1 January 2019 and has been adopted by the European Union. It supersedes the previous standard IAS 17 – Leases, interpretation IFRIC 4 - Determining Whether an Arrangement Contains a Lease, SIC 15 - Operating Leases – Incentives and SIC 27 - Evaluating the Substance of Transactions in the Legal Form of a Lease.

The purpose of the standard IFRS 16 "Leases" is to ease the comparability of the financial statements, presenting both financial and operating leases in the statement of financial position, and providing corresponding information to the users of the financial statements about the risks associated with the agreements. The essential element differentiating the definition of a lease from IAS 17 and from IFRS 16 is the requirement to have control over the used, specific asset, indicated directly or indirectly in the agreement.

The essential element differentiating the definition of a lease from IAS 17 and from IFRS 16 is the requirement to have control over the used, specific asset, indicated directly or indirectly in the agreement.

Expenses related to the use of lease assets, the majority of which were previously recognised in external services costs, will be currently classified as depreciation/amortisation and interest costs. Usufruct rights are depreciated using a straight line method, while lease liabilities are settled using an effective discount rate.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.3. Leasing (Continued)

(c) *First application of IFRS 16 "Leases" (Continued)*

In the cash flow statement cash flows from the principal of the lease liability are classified as cash flows from financing activities, while lease payments for short-term leases, lease payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability are classified as cash-flows from operating activities. The interest payments regarding the lease liability are classified according to the IAS 7 standard.

For the lessors the recognition and measurement requirements of IFRS 16 are similar, as they were stated in IAS 17. The leases shall be classified as finance and operating leases according to IFRS 16 as well. Compared to IAS 17, IFRS 16 requires the lessors to disclose more information about than earlier, however the main characteristic of the accounting treatment is unchanged.

(i) Transition

The Bank applies the following practical expedients available:

- Apply a single discount rate to a portfolio of leases with reasonably similar characteristics.
- Adjust the right-of-use asset at the date of initial application by the amount of any provision for onerous leases in the statement of financial position.
- Apply a simplified method for contracts mature within 12 months for the date of initial application.
- Exclude initial direct costs from the measurement of the right-of-use asset at the date of initial application.
- Use hindsight such as in determining the lease term if the contract contains options to extend or terminate the lease.

(ii) IFRS 16 Project

The project to implement IFRS 16 (project), which was commenced in the fourth quarter of 2017, was performed in three stages:

Stage I – Analysis of contracts, data collection

During the analysis of all executed agreements the classification was made, whether it is a purchase of services, or a lease. The analysis covered all the relevant agreements despite their current classification. Furthermore to calculate the value of the right-of-use assets and lease liabilities the collection of all the relevant information was performed.

The Bank presents the following types of right-of-use assets in the statement of financial position:

- Office building
- Branch office

The average life of the lease (useful life of the presented right-of-use assets):

- Office building 5,67 years
- Branch office 5.20 years

3.3. Leasing (Continued)

(c) *First application of IFRS 16 "Leases" (Continued)*

Stage II – Evaluation of contracts, Calculations

In accordance with the application of IFRS 16 the analysis was prepared, which included:

- The effect on the statement of financial position at the date of initial application as of January 1, 2019.
- The effect of lease agreements recognized and measured in accordance with IFRS 16 on the statement of financial position and on the statement of profit and loss (including the future effects)

Applying a leasing calculation tool, the value of the right-of-use assets and lease liabilities were determined.

Stage III - Implementation of IFRS 16 based on the developed concept, Developing accounting policy and disclosures

The OTP Group applies IFRS 16 with modified retrospective approach, recognising the accumulated effect of the initial application on January 1, 2019. The Bank has adopt this approach.

In case of leases previously classified as operating lease (applying IAS 17) , on January 1, 2019. the Bank recognises:

- The Lease liability,
  - as the present value of the remaining lease payments,
  - discounted using the Groups incremental borrowing rate at the date of initial applications
- The right-of –use-assets,
  - at an amount equal to the lease liability,
  - Adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before January 1, 2019. excluding initial direct cost from the measurement.

The Bank accounts leases for which the lease term ends by December 31, 2019 as short term leases.

In accordance with developed concept, the Bank will use the application which OTP Group developed for these purpose.

(iii) Recognition of lease liabilities

Following the adoption of IFRS 16, the Bank has recognised lease liabilities related to leases which were previously classified as "operating leases" in accordance with IAS 17 Leases. These liabilities is measured at the present value of lease payments receivable as at the date of commencement of the application of IFRS 16. Lease payments shall be discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the incremental borrowing rate. Interest rate applied by the Bank: weighted average lessee's incremental borrowing rate: 3.12%

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.3. Leasing (Continued)

(c) *First application of IFRS 16 "Leases" (Continued)*

At their date of initial recognition, lease payments contained in the measurement of lease liabilities comprise the following types of payments for the right to use the underlying asset for the life of the lease:

- fixed lease payments less any lease incentives,
- Variable lease payments which are dependent on market indices,
- Amounts expected to be payable by the lessee under residual value guarantees,
- The strike price of a purchase option, if it is reasonably certain that the option will be exercised, and
- Payment of contractual penalties for terminating the lease, if the lease period reflects that the lessee used the option of terminating the lease.

The Bank makes use of expedients with respect to short-term leases (less than 12 months) as well as in the case of leases in respect of which the underlying asset has a low value (less than USD 5.000) and for which agreements it will not recognise financial liabilities or any respective right-to-use assets. These types of lease payments will be recognised as costs using the straight-line method during the life of the lease.

(iv) Recognition of right-to-use assets

Right-to-use assets are initially measured at cost.

The cost of a right-of-use asset comprises:

- The initial estimate of lease liabilities,
- Any lease payments paid at the commencement date or earlier, less any lease incentives receivable,
- Initial costs directly incurred by the lessee as a result of entering into a lease agreement,
- Estimates of costs which are to be incurred by the lessee as a result of an obligation to disassemble and remove an underlying asset or to carry out renovation/restoration.

(v) Application of estimates

The implementation of IFRS 16 requires the making of certain estimates and calculations which effect the measurement of financial lease liabilities and of right-to-use assets. These include among others:

- determining which agreements are subject to IFRS 16,
- determining the life of such agreements (including for agreements with unspecified lives or which may be prolonged),
- determining the interest rates to be applied for the purpose of discounting future cash flows,
- Determining depreciation rates.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.4. Taxes and Contributions

Income Taxes

Current Income Taxes

Income taxes are calculated and paid in conformity with the income tax regulations defined under the Montenegro Corporate Income Tax Law, Article 28 (Official Gazette of Montenegro, no. 65/01, 80/04, 40/08, 86/09, 14/12, 61/13 and 55/16) as per the effective proportional tax rate of 9 percent on taxable income.

A taxpaying entity's taxable income is determined based upon the income stated in its statutory statement of comprehensive income following certain adjustments to its income and expenses performed in accordance with the Montenegro Corporate Income Tax Law.

The capital gain is considered as income generated by the sale of land, buildings, property rights and securities. Capital losses may be offset against capital gains realized in the same period. If after such offsetting capital loss is incurred, the taxpayer may carry forward the capital loss to the future periods against capital gains within the ensuing five years.

Montenegro tax regulations do not envisage that any tax losses of the current period be used to recover taxes paid within a specific carry back period. However, any current year losses reported in the annual corporate income tax returns may be carried forward and used to reduce or eliminate taxes to be paid in future accounting periods, but only for an ensuing period of a maximum of five years.

Deferred Income Taxes

Deferred income tax is determined using the statement of financial position liability method, for the temporary differences arising between the tax bases of assets and liabilities, and their carrying values in the financial statements. The currently enacted tax rates at the statement of financial position 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.4. Taxes and Contributions (Continued)

Income Taxes (Continued)

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 and contributions paid pursuant to state and municipal regulations.

3.5. Cash and Cash Equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with less than a three month maturity from the date of acquisition including: cash on hand, non-restricted balances with the Central Bank of Montenegro and other banks.

3.6. Financial instruments

The Bank recognises a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes a party to the contractual provisions of the financial instrument.

The Bank classifies its financial assets in the following categories: financial assets measured at amortised cost, financial asset measured at fair value through other comprehensive income and financial asset at fair value through profit or loss, on the bases of both: business model for managing the financial assets and the contractual cash flow characteristics of the financial asset. Management determines the classification of financial assets at initial recognition in accordance of the adopted Business Model and result of SPPI tool prepared according Solely Payments of Principal and Interest Procedures.

(a) Business model

The business models reflect how groups of financial assets are managed together to achieve a particular business objectives. The business models are not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation. The Bank's business model refers to how the Bank manages its financial assets in order to generate cash flows. The Bank's cash flows will result from collecting contractual cash flows, selling financial assets or both. If cash flows are realised in a way that is different from the expectations at the date that the Bank assessed the business model, that does not give rise to a prior error in the Bank's financial statements nor does it change the classification of the remaining financial assets held in that business model.
The business model is determined by the Bank's key management.

(i) Business model: collecting contractual cash flows

In determining whether cash flows are going to be realised by collecting the financial assets' contractual cash flows, the Bank considers the frequency, value and timing of sales prior periods, the reasons for those sales and expectations about future sales activity. The Bank considers information about past sales within the context of the reasons for those sales and the conditions that existed at that time as compared to current conditions. Although the objective of this business model may be to hold financial assets in order to collect contractual cash flows, the Bank need not hold all of these instruments until maturity. The business model may be to hold assets to collect contractual cash flows even if the Bank sells financial assets when there is an increase in the assets' credit risk. Irrespective of their frequency and value, sales due to an increase in the assets' credit risk are not inconsistent with a business model whose objective is to hold financial assets to collect contractual cash flows. Credit risk management activities that are aimed at minimizing potential credit losses due to credit deterioration are integral to such a business model.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.6. Financial instruments (Continued)

(a) Business model (Continued)

(ii) Business model: Collecting contractual cash flows and selling financial assets

The Bank may hold financial assets in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. In this type of business model, the Bank’s key management have made a decision that both collecting contractual cash flows and selling financial assets are integral to achieving the objective of the business model. Compared to a business model whose objective is to hold financial assets to collect contractual cash flows, this business model will typically involve greater frequency and value of sales.

(iii) Other business models

Financial assets are measured at fair value through profit or loss if they are not held within a business model whose objective is to hold assets to collect contractual cash flows or within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.
A portfolio of financial assets that meets the definition of held for trading is not held to collect contractual cash flows or held both to collect contractual cash flows and to sell financial assets. For such portfolios, the collection of contractual cash flows is only incidental to achieving the business model’s objective.

(b) Contractual cash flow characteristics of financial assets

Classification of a financial asset is based on the characteristics of its contractual cash flows if the financial asset is held within a business model whose objective is to hold assets to collect contractual cash flows or within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

The Bank should determine whether the asset’s contractual cash flows are solely payments of principal and interest on the principal amount outstanding.

For the purpose of applying these paragraphs:

- principal is the fair value of the financial asset at initial recognition
- interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as a profit margin.

Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are consistent with a basic lending arrangement. Contractual terms that introduce exposure to risks or volatility in the contractual cash flows that is unrelated to a basic lending arrangement, such as exposure to changes in equity prices or commodity prices, do not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

The Bank assess whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding for the currency in which the financial asset is denominated.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.6. Financial instruments (Continued)

(b) Contractual cash flow characteristics of financial assets

Time value of money is the element of interest that provides consideration for only the passage of time. However, in some cases, the time value of money element may be modified. In such cases, the Bank assesses the modification to determine whether the contractual cash flows represent solely payments of principal and interest on the principal amount outstanding. When assessing a modified time value of money element, the objective is to determine how different the undiscounted contractual cash flows could be from undiscounted cash flows that would arise if the time value of money element was not modified (the benchmark cash flows). The benchmark instrument can be an actual or a hypothetical financial asset. If the undiscounted contractual cash flows significantly – above 2% – differ from the undiscounted benchmark cash flows, the financial asset should be subsequently measured at fair value through profit or loss.

The Bank will consider the possible effect of the contractual cash flow characteristic in each reporting period and cumulatively over the life of the financial asset.

(c) Measurement of financial instruments

The Bank at initial recognition measures a financial asset or financial liability at transaction price which represents the market (fair) value plus or minus – in the case of a financial asset or financial liability not at fair value through profit or loss – transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

The Bank uses settlement date i.e. when the asset was delivered to the relevant party, accounting for financial instruments, both in case of recognition and derecognition.

For the purpose of measuring a financial asset after initial recognition, the Bank classifies financial assets into these categories:

- Financial assets at fair value through profit or loss
- Financial assets at fair value in other comprehensive income
- Securities at amortised cost using the effective interest method
- Loans and receivable at amortised cost using the effective interest method

After initial recognition, the Bank measures financial assets, at their fair values, without any deduction for transaction costs it may incur on sale or other disposal, except for the following financial assets:

- loans and receivables, which shall be measured at amortised cost using the effective interest method;
- securities, which shall be measured at amortised cost using the effective interest method; and
- investments in equity instruments that do not have a quoted price in an active market and whose fair value cannot be reliably measured, which shall be measured at cost.

All financial assets except those measured at fair value through profit or loss are subject to review for impairment.

The Bank subsequently measures all financial liability at amortised cost, except financial liabilities at fair value through profit or loss.

The Bank can irrevocably designate at initial recognition a financial liability as measured at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency.

3.6. Financial instruments (Continued)

(c) *Financial asset or financial liability at fair value through profit or loss*

(i) Trading financial assets at fair value through profit or loss

The Bank requires that only those instruments and group of instruments can be classified into this category, at which trading generally reflects active and frequent buying and selling, and when financial instruments generally are used with the objective of generating a profit from short-term fluctuations in price or dealer's margin.

Financial instruments are also classified in this category, if those are part of a portfolio of identified financial instruments that are managed together and for which there is evidence a recent actual pattern of short-term profit-taking.

In the interpretation of Bank, a period of up to 12 months should be regarded as short-term in this connection. This term is, however, only an indication that the intention of the conclusion of the transaction was the short-term generation of a profit. The actual length of time held can depend on the development of the situation in the market and exceed the defined term.

(ii) Financial assets mandatorily at fair value through profit or loss

A financial asset shall be measured at fair value through profit or loss unless it is measured at amortised cost or at fair value through other comprehensive income.

The Bank shall measure investments in equity instruments at fair value through profit or loss. However the Bank can make an irrevocable election at initial recognition to present subsequent changes in fair value of investments in equity instruments in other comprehensive income.

(ii) Designated as at fair value through profit or loss upon initial recognition ('Fair Value Option')

The Bank may use this designation only in following cases:

- the classification eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases ('accounting mismatch').
- the group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel.

The use of the Fair Value Option is limited only to special situations, and it can be based only on direct decision of management of the Bank.

(d) *Financial assets at f*air value through other comprehensive income

The financial assets shall be measured at fair value through other comprehensive income if both of the following conditions are met:

- the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

At initial recognition, the Bank may make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument that is neither held for trading .

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.6. Financial instruments (Continued)

(e) *Financial instruments at amortised cost*

The financial assets shall be measured at amortised cost if both of the following conditions are met:

- the business model's objective is to hold financial assets in order to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

The Bank subsequently measures all financial liability at amortised cost, except financial liabilities at fair value through profit or loss.

(f) *Impairment of financial instruments*

The Bank requires to all financial assets, with the exception of those measured at fair value through profit or loss, the assessment for impairment in accordance with IFRS 9.

Pursuant to the IFRS9, upon the initial recognition and on the reporting dates (last calendar day of the reporting month) the financial assets must be allocated to one of the following three stages:

- Stage 1 – performing,
- Stage 2 – performing, but compared to the initial recognition it shows significant increase in credit risk,
- Stage 3 – non-performing.

At each reporting date, an entity shall assess whether the credit risk on a financial asset has increased significantly since initial recognition. When making the assessment an entity shall use the change in the risk of a default occurring over the expected life of the financial asset instead of the change in the amount of expected credit losses. To make that assessment, an entity shall compare the risk of a default occurring on the financial asset as at the reporting date with the risk of a default occurring on the financial asset as at the date of initial recognition.

The impairment of the receivables equals the difference of the receivable's gross book value on the valuation date and the present value of the receivable's expected cash flows discounted to the valuation date by the exposure's original effective interest rate (calculated at the initial recognition, or in the case of variable rate, recalculated due to the last interest rate change).

(g) *Partial write-off*

The Bank will implement the partial write-off when has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof. The amount of partial write-off is maximized up to maximum recoverable amount of credit claims. However this amount does not necessarily equals with the expected recovery used for provisioning purposes.

Credit claim is considered for partial write off:

- if the Bank possess the proofs on unsuccessful collection of receivables in a court, enforcement, bankruptcy or in liquidation procedure
- maturity period for receivable collection is over 365 days
- met the conditions for excluding a receivable from the Bank's balance sheet (Article 49b of the Decision on Minimum Standard for Credit Risk Management in Bank of Central Bank of Montenegro) as secured or unsecured receivables.

Based on the Bank's interpretation, all of financial assets are the subject to that investigation whether partial write-off shall be recorded or not. Based on this principle, this investigation shall be performed to all impaired portfolio regardless to the type and securitisation of loans. The Bank prepares and regularly updates supporting documentation to partial write-offs (presenting the nature of credit claims, reason and extent of being uncollectible, determining highest recovery, etc.).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.6. Financial instruments (Continued)

(h) *Partial write-off (Continued)*

The accounting write off entails write off and transfer of uncollectable receivables to the Banks off-balance sheet items and derecognition of loans and receivable or part of then from the Banks statement of financial position. The transfer to the Banks off-balance sheet items means that the Bank will continue with collection activities.

3.7. Investments in subsidiaries

The Bank initially recognizes the investment in the Balance Sheet when the Bank acquires the control over the investee. The date of obtaining of the control shall be the date of registration of the investment in the Central Registry of Commercial Entities unless written agreement provides specific date.The initially recognized value consists of the purchase value of the assets given and any other costs which can be directly attributable to the business acquisition.

The Bank assesses at each reporting date whether there is any indication that these assets may be impaired. If any such indication exists, the Bank shall estimate the recoverable amount of the asset An asset can be considered to be impaired when its carrying amount excesses its recoverable amount. The impairment loss is recognized by the Bank as expense in income statement.

3.8. Intangible Assets

Costs associated with maintaining computer software programs are recognized as an expense when they incur. Costs that are directly associated with identifiable and unique software products controlled by the Bank and will probably generate economic benefits exceeding costs beyond one year, are recognized as intangible assets. If the agreed period of using is less than eight years, depreciation is calculated in accordance with the period of use agreed in the contract. If the agreed period of use is longer than eight years, depreciation is calculated using the straight-line method, at a rate of 12,50%, in order to distribute the cost of licenses over their estimated useful lives use.

Costs include external software company development costs.

Amortization of intangible assets is charged on a straight-line basis over their estimated useful lives, which are as follows:

Intangible Assets	*Useful Life (in Years)*
License	8
Software	8

There were no changes in estimated useful lives of intangible assets compared to prior year.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Property and Equipment

All property, plant and equipment are stated at cost less depreciation and impairment losses, if any. The cost includes expenditure that is directly attributable to the acquisition of the items.

Depreciation on property, plant and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, remained the same as in previous years, and are as follows:

Major Categories of Property, Plant and Equipment	*2019 Useful Life (in Years)*	*2018 Useful Life (in Years)*
Buildings	40	50
Computers and computer equipment	4 - 5	8
Furniture and office equipment	4 - 10	4 - 10
Motor vehicles	8	8
ATM machines	7	8
Other equipment	8	8

Assets under construction are carried at cost. Depreciation of these assets, on the same basis as for other property, commences when the assets are ready for their intended use. Investments in property, plant and equipment based on current maintenance are recognized as operating expenses in the period in which they arise.

Investments in leased premises are depreciated in accordance with the period of use specified in the leasing agreement, if the agreed period is shorter than seven years, and proportionate to seven years if the agreed period of use is longer than seven years.

In 2019, the Bank made a change in accounting estimate, relating to the useful life of buildings, IT equipment and other electronic devices. Valuation involves judgment based on the latest available, reliable information. Changes in the useful life or expected timing of the future economic benefits embodied in depreciable assets affect the depreciation expense for the current period and for each future period over the remaining useful life of the asset. The effect of the change in accounting estimate is EUR 543 thousand, for which the depreciation costs would have been lower in 2019 had the Bank used the 2018 rates.

3.10. Impairment of Tangible and Intangible Assets

At each statement of financial position date, the Bank's management reviews the carrying amounts of the Bank's tangible and intangible assets. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying value, the carrying amount of the asset is reduced to its recoverable amount.

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

3.11. Acquired assets

Acquired assets are assets that became the property of the Bank based on collection of receivables that were secured by that property. The Bank records the received assets at the lower than gross carrying amount of receivables or market value of the collateral less costs of sale.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.12. Provisions

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

Provisions are measured at the present value of the estimated expenditure required to settle the present obligations. Provisions are re-examined at each statement of financial position date and adjusted so as to reflect the best present estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision is reversed and credited to the income statement.

The Bank does not recognize provisions against contingent liabilities until it has determined the existence of a present obligation which can result in an outflow of resources embodying economic benefits required to settle the obligation, or if a reliable estimate cannot be made of the amount of the obligation, in which case it is so disclosed.

3.13. Employee Benefits

Employee Taxes and Contributions for Social Security

In accordance with the regulations prevailing in Montenegro, the Bank has an obligation to pay contributions to various State Social Security Funds. These obligations involve the payment of contributions on behalf of the employee, by the employer in an amount calculated by applying the specific, legally prescribed rates. The Bank is also legally obligated to withhold contributions from gross salaries to employees, and on behalf of the employees, to transfer the withheld portions directly to government funds. These contributions payable on behalf of the employee and employer are charged to expenses in the period in which they arise.

Retirement Benefits and Other Long Term Employee Benefits

In accordance with the Collective Bargaining Agreement, the Bank has an obligation to disburse an employment retirement benefit to a retiree, in an amount equal to six average net salaries effective in the Bank in the month prior to the employee’s retirement. The Bank's financial statement as of December 31, 2019, include provisions calculated based on the estimated present value of retirement benefits to employees upon vesting in respective right by independent authorized actuary.

3.14. Transaction with related parties

The aim of International accounting standard 24 – Related-Party Disclosures", is to ensure that the financial statements of an entity include the disclosure, which will draw attention to possible impact of related parties on the financial position and profit or loss of the entity.

The related parties are:

- companies that directly, or indirectly, through one or more intermediaries, control the reporting company or are under its control, or that control the reporting entity jointly with other entities
- associated companies in which the Bank has significant influence and which are not a subsidiary or joint venture of the investor;
- natural persons who have, directly or indirectly, the voting right in the Bank, which gives them significant influence over the Bank, as well as any other entity which is expected to influence, or be influenced by that related person in their dealings with the Bank
- managers on key positions, or persons that have authority and responsibilities for planning, directing and controlling the activities of the Bank, including directors and key management

When observing any related party transaction, the attention should be paid to the essence of the relationship, not merely on the legal form.

4. FINANCIAL INSTRUMENTS

4.1. Risk Management

In its Strategy for Risk Assumption, the Bank has identified the following list of materially significant type of risks it is exposed to:

- Credit risk – defined as the risk of loss due to a client's failure to honour its obligations towards the Bank.
- Operational risk – defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk.
- Market risk - defined as the probability of incurring losses on bank balance sheet and off-balance sheet financial instruments arising from changes in interest rates, foreign exchange rates, prices, indices and/or other market factors impacting the value of financial instruments, as well as the risks related with the marketability of financial instruments.
- Country risk - represents a probability of incurring losses by the Bank stemming from inability of debtors headquartered outside of Montenegro to meet their payment obligations or original contract conditions due to reasons pertaining to political, social and economic environment of the country in which debtor has its head office or residence.
- Liquidity risk - is defined as the risk that the bank will not be able to provide a sufficient amount of cash to meet its obligations as they become due, or risk that the bank may obtain cash with significant expenses to meet the matured obligations.
- Reputational risk – represents the potential loss in reputational capital based on either real or perceived losses in reputational capital.

The Bank has organised the risk management process as an organic part of its governance structure which is embedded in all key processes from the product development to collection of problematic receivables.

The Bank's risk management has the following set of strategic goals:

- Balance risk and return
- Keep potential losses within the risk-bearing capacity and the risk appetite
- Measure, assess and ensure adequate coverage of all relevant risks
- Provide support to business lines in achieving their strategic goals

In order to fulfil its stated goals the risk management function is using the following set of tools:

- Identification of main risks inherent in its value creating processes
- Assessment of the level of risk based on historical data and estimation of future trends
- Risk control
- Risk mitigation techniques such as setting up exposure limits, collateral requirements, hedging, establishing control environment etc.

4. FINANCIAL INSTRUMENTS

4.2. Credit Risk

Credit risk represents a risk of loss due to a client's failure to honour its obligations towards the Bank.

The basic goal of credit risk management is to help the lines of business to achieve their growth targets without generating excessive losses in the process. In order to achieve this basic goal the Bank is seeking to develop and maintain a well-diversified portfolio able to sustain shocks in any particular industry, geographic region or a client group it is exposed to.

The following represent the main principles for the sound credit risk management:

- Primary source of repayment of loans should be a cash flow from a client's main activity/income
- All of the Bank's products and services need to build on sound credit risk management principles in order to ensure fulfilment of the Bank's credit policy

Credit risk management is implemented through credit policy and various operating procedures governing the process of risk identification, assessment, system of limits, decision-making and control.

The Bank is placing a special emphasis on development of analysis and modelling tools for credit risk management such as approval scorecards. The results of risk assessment are incorporated into product conditions in order to maintain the desired risk profile of the loan portfolio.

To ensure the risk profile stays within the defined risk appetite, the Bank is using the following credit risk control tools:

- credit approval and credit control procedures
- monitoring of compliance with the risk appetite
- monitoring introduction and implementation of policies and products
- portfolio management
- reporting
- control of the practical implementation of competences using sampling techniques

4.2.1. Credit Related Commitments and Contingent Liabilities

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

4.2.2. Provisions for Impairment Losses in Accordance with Requirements of IFRS 9

According to the requirements of the IFRS9 standard the Bank allocates the financial assets measured at amortized cost and at fair value through other comprehensive income into three stages:

- stage 1 – performing assets without significant increase in credit risk since initial recognition
- stage 2 – performing assets with significant increase in credit risk since initial recognition but not credit-impaired
- stage 3 – non-performing, credit-impaired assets

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.2. Provisions for Impairment Losses in Accordance with Requirements of IFRS 9 (Continued)

Performing (Stage 1) assets include all financial assets in the case of which the events and conditions specified in respect of stage 2 and stage 3 do not exist on the reporting date.

A client or loan must be qualified as default if from the following two conditions, one or both of them occurs:

- if the client delays more than 90 days. This is objective criterion.
- there is the possibility that the client won’t pay all of its obligation. This condition is examined on the basis of probability criterions of default.

The subject of default qualification is that exposure (on-balance and off-balance) which originates credit risk (so originated from loan commitments, risk-taking contracts).

A financial asset shows significant increase in credit risk, it is became allocated to stage 2, if in respect of which any of the following triggers exist on the reporting date, without fulfilling any of the conditions for the allocation to the non-performing stage (stage 3):

- the payment delay exceeds 30 days,
- it is classified as performing forborne,
- based on individual decision, its currency suffered a significant "shock" since the disbursement of the loan and no hedge position exists in respect thereof,
- monitoring classification of corporate and municipal clients above different thresholds defined on group level

A financial asset is non-performing, the asset is became allocated to stage 3 when any of the following events or conditions exists in respect thereof on the reporting date:

- defaulted (*default status* -based on the Bank default definition),
- it is classified as non-performing forborne (based on the Bank level forborne definition),
- the monitoring classification of corporate and municipal clients above different thresholds defined on Bank level

When loss allowance is calculated at exposures categorized into stages the following process is needed by stages:

- stage 1 (performing): loss allowance at an amount equal to 12-month expected credit loss should be recognized,
- stage 2 (significant increase in credit risk): loss allowance at an amount equal to lifetime expected credit loss should be recognized,
- stage 3 (non-performing): loss allowance at an amount equal to lifetime expected credit loss should be recognized.

For lifetime expected credit losses, an entity shall estimate the risk of a default occurring on the financial asset during its expected life. 12-month expected credit losses are a portion of the lifetime expected credit losses and represent the lifetime cash shortfalls that will result if a default occurs in the 12 months after the reporting date (or a shorter period if the expected life of a financial instrument is less than 12 months), weighted by the probability of that default occurring.

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.2. Provisions for Impairment Losses in Accordance with Requirements of IFRS 9 (Continued)

An entity shall measure expected credit losses of a financial asset in a way that reflects:

- an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes
- the time value of money and
- reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

(i) Defining the expected credit loss on individual and collective basis

The following exposures are subject to collective assessment:

- retail exposure irrespective of the amount,
- micro and small enterprise exposures irrespective of the amount,
- all other exposure which are insignificant on a stand-alone basis and not part of the workout management,
- exposure which are not in stage 3,
- exposure which are in stage 3, but not significant on a stand-alone basis
- purchased or originated credit-impaired assets which are in accordance with the conditions mentioned above

On individual basis:

Individually assessed are the non-retail or micro- and small enterprise exposure of significant amount on a stand-alone basis:
- exposure in stage 3,
- exposure in workout management, not related to the retail segment
- purchased or originated credit-impaired assets which are in accordance with the conditions mentioned above

The calculation of impairment must be prepared and approved by the risk management functional areas. The calculation, all relevant factors (amortised cost, original and current effective interest rate, contracted and expected cash flows (from business and/or collateral) for the individual periods of the entire lifecycle, other essential information enforced during the valuation) and the criteria thereof (including the factors underlying the classification as stage 3) must be documented individually, i.e. by receivables.

The impairment of the receivable equals the difference of the receivable's amortised cost (gross book value) on the valuation date and the present value of the receivable's expected cash flows discounted to the valuation date by the exposure's original effective interest rate (EIR) (calculated at the initial recognition, or in the case of variable rate, recalculated due to the last interest rate change).

The estimation of the expected future cash flows should be forward looking, it must also contain the effects of the possible change of macroeconomic outlook. At least two scenarios must be used for the estimation of the expected cash flow. Probability weights must be allocated to the individual scenarios. For the calculation of the impairment of the transaction, the present value calculated as the weighted average of the individual scenarios must be applied. The estimation must reflect the probability of the occurrence and non-occurrence of the credit loss, even if the most probable result is the non-occurrence of the loss.

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.2. Provisions for Impairment Losses in Accordance with Requirements of IFRS 9 (Continued)

(i) Defining the expected credit loss on individual and collective basis (Continued)

On collective basis:

In the collective provisioning methodology credit risk and the change of credit risk can be correctly captured by understanding the risk characteristics of the portfolio. In order to achieve this the main risk drivers shall be identified and used to form homogeneous segments having similar risk characteristics. The segmentation is expected to stay stable from month to month however a regular (at least yearly) revision of the segmentation process should be set up to capture the change of risk characteristics. The segmentation must be performed separately for each parameter, since in each case different factors may have relevance.

The Bank's Headquarter Group Reserve Committee stipulates the guidelines related to the collective impairment methodology at group level. In addition, it has right of agreement in respect of the risk parameters (PD -probability of default, LGD - loss given default, EAD – exposure at default) and segmentation criteria proposed by the Bank.

The review of the parameters must be performed at least annually and the results should be approved by the Group Reserve Committee.

At least on a yearly basis the provisioning parameters should be backtested as well.

In the case of performing (stage 1) exposures a 12-month probability of default (PD) is to be calculated. In the case of exposures showing significant increase in credit risk (stage 2) or non-performing (stage 3) exposures, lifetime PD must be used. The lifetime PD must be calculated by multiplying the transition matrices according to the remaining contractual maturity or the expected lifetime of the exposure. During the multiplication the same matrix should be used for the full lifetime, except when the "number of years elapsed since disbursement" is a segmentation factor; in this case, the matrices related to the various years of the remaining duration are different.

The migration matrix methodology applied in the Bank (which is applied on the Group level) is based, on the payment delay buckets, default flag, restructured flag and rating information (if available) but other segmentation parameters (LTV, etc.) may also be used.

The Bank uses two different methods for collectively assessed exposures:

- Retail mortgage loans and non-retail portfolios (MSE and Wholesale) that are significantly secured by mortgage: modified LGL (loss given loss) methodology based on the Asset Quality Review (AQR). The primary source of the data is the collateral itself, but cash recovery is also taken into account.
- Consumer loans, car finance and unsecured exposures: recovery based LGL methodology estimated from historical data.

It is important that PD -probability of default and LGD - loss given default parameters are consistent in terms of healing and cure rates.

The expected loss calculation should be forward looking, including forecasts of future economic conditions. This may be achieved by applying 3-5 different macroeconomic scenarios, which may be integrated in the PD -probability of default, LGD - loss given default and EAD – exposure at default parameters.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.3. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items

	In thousands of EUR 2019	2018
Balance sheet items		
Loans and advances to banks	39.201	57.689
Loans at amortized cost	477.781	395.095
Securities at fair value through other comprehensive income	520	6.992
Financial assets at fair value through profit or loss	-	-
Securities at amortized cost	79.566	79.278
Forfeiting	1.241	1.221
Shares and equity investments	41.810	335
Other financial assets	1.021	1.684
	641.140	542.294
Off-balance sheet items		
Payment guarantees	14.987	8.378
Performance bonds	17.379	8.316
Uncovered letters of credit	542	549
Undrawn credit facilities	40.148	41.603
Written off loans	20.709	20.286
	93.765	79.132
Total credit risk exposure	734.905	621.426

The exposure to credit risk is partially controlled by obtaining collaterals and guarantees issued by legal entities and private individuals.

Before approving loans and other placements, the Bank assesses the debtor's creditworthiness taking into account the criteria established by the internal regulation, and the legal validity of the appraised value of collateral. The collateral value is calculated as its net value, by which is meant the market value less any costs relating to the realization of collateral.

In addition, all private individuals must receive their salaries through the account held with the Bank, with a view to draw down the credit risk.

Types of collateral are as follows:

- Deposits;
- Pledges placed against industrial machines, securities, inventories and vehicles;
- Mortgages against property and fiduciary ownership transfer;
- Bills of exchange;
- Authorizations;
- Administrative injunctions;
- Guarantors and
- Insurance policies.

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.3. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items

Besides the valuation of balance and off-balance sheet items according to the International Accounting Standards, in accordance reqirements of Central Bank of Montenegro, the Bank classify balance sheet asset items into one of the following classification categories depending on their loss incurring probability:

1. group A - "pass"; loans and other receivables with solid documentary evidence that they will be fully collected in accordance with the contractual terms are classified into the classification category A
2. group B - "special mention", with subcategories „B1" and „B2"; loans with a small probability of incurring losses are classified into the classification category B (subcategories B1 and B2). However, such loans must be subject to special attention of the bank since their potential risk if inadequately monitored may result in poor perspective for its repayment.
3. group C - "substandard", with subcategories „C1" and „C2"; loans with high probability of incurring losses due to clearly disclosed weaknesses jeopardizing their repayment are classified into the classification category C.
4. group D - "doubtful"; loans with a low probability of full collection taking into consideration the debtor's credit capacity, value and possibility of collateral enforcement are classified into classification category D.
5. group E - "loss"; loans which are fully uncollectible or which will be collected in an insignificant amount are classified into classification category E.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019
4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.3. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items (Continued)

In thousands of EUR

		Gross carrying amount				Accumulated impairment			
December 31, 2019	**Total, net exposure**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans and advances to banks at amortized cost	39.201	39.202	-	-	39.202	(1)	-	-	(1)
- Housing loans	66.710	55.309	10.961	1.964	68.234	(130)	(129)	(1.265)	(1.524)
- Current account overdrafts	2.101	1.251	844	88	2.183	(4)	(4)	(74)	(82)
- Consumer loans	89.489	86.926	2.079	2.215	91.220	(207)	(54)	(1.470)	(1.731)
- Credit cards	2.728	2.145	549	809	3.503	(19)	(14)	(742)	(775)
- Special purpose loans	19	12	-	76	88	-	-	(69)	(69)
- Other loans to individuals - covered by mortgage	32.257	22.254	9.870	960	33.084	(47)	(95)	(685)	(827)
- Other loans	2.157	1.160	440	2.231	3.831	(8)	(21)	(1.645)	(1.674)
- Car loans	265	233	33	-	266	(1)	-	-	(1)
- Loans to micro and small entities	10.828	8.898	1.492	2.179	12.569	(28)	(27)	(1.686)	(1.741)
- Loans to medium and large entities	167.679	154.523	5.441	19.491	179.455	(2.348)	(635)	(8.793)	(11.776)
- Loans to Government and municipalities	99.956	102.300	-	17	102.317	(2.345)	-	(16)	(2.361)
- Treasury LOB	3.592	3.656	-	-	3.656	(64)	-	-	(64)
Loans and advances to customers at amortized cost	477.781	438.667	31.709	30.030	500.406	(5.201)	(979)	(16.445)	(22.625)
Securities at FVTOCI	520	520	-	-	520	-	-	-	-
Securities at amortized cost	79.566	80.002	-	-	80.002	(435)	-	-	(435)
Forfeiting	1.241	-		2.640	2.640	-	-	(1.399)	(1.399)
Shares and equity investments	41.810	41.810	-	-	41.810	-	-	-	-
Other financial assets	1.021	847	64	6.029	6.940	-	(8)	(5.912)	(5.920)
Total	**641.140**	**601.0487**	**31.773**	**38.699**	**671.519**	**(5.637)**	**(987)**	**(23.756)**	**(30.380)**
Loan commitments	39.749	39.401	692	55	40.148	(372)	(5)	(22)	(399)
Financial guarantees	32.648	32.745	163	-	32.908	(245)	(15)	-	(260)
	72.397	**72.146**	**855**	**55**	**73.056**	**(617)**	**(20)**	**(22)**	**(659)**

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.3. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items (Continued)

In thousands of EUR

		Gross carrying amount				Accumulated impairment			
December 31, 2018	**Total, net exposure**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans and advances to banks at amortized cost	57.689	57.690	-	-	57.690	(1)	-	-	(1)
- Housing loans	59.730	58.169	960	3.093	62.222	(296)	(72)	(2.124)	(2.492)
- Current account overdrafts	2.256	2.253	12	149	2.414	(24)	(3)	(131)	(158)
- Consumer loans	81.102	81.307	579	2.354	84.240	(1.100)	(137)	(1.901)	(3.138)
- Credit cards	2.423	2.365	149	1.316	3.830	(96)	(47)	(1.264)	(1.407)
- Special purpose loans	30	17	1	593	611	-	-	(581)	(581)
- Other loans to individuals covered by mortgage	27.948	27.233	555	1.090	28.878	(70)	(40)	(820)	(930)
- Other loans	1.890	1.772	282	3.131	5.185	(130)	(105)	(3.060)	(3.295)
- Car loans	102	104	-	-	104	(2)	-	-	(2)
- Loans to micro and small entities	20.051	18.907	126	5.968	25.001	(283)	(21)	(4.646)	(4.950)
- Loans to medium and large entities	126.330	110.199	6.536	26.610	143.345	(2.014)	(1.001)	(14.000)	(17.015)
- Loans to Government and municipalities	73.233	73.563	-	335	73.898	(646)	-	(19)	(665)
- Treasury LOB	-	-	-	-	-	-	-	-	-
Loans and advances to customers at amortized cost	395.095	375.889	9.200	44.639	429.728	(4.661)	(1.426)	(28.546)	(34.633)
Securities at FVTOCI	6.992	6.992	-	-	6.992	-	-	-	-
Securities at amortized cost	79.278	80.019	-	-	80.019	(741)	-	-	(741)
Forfeiting	1.221	-		2.697	2.697	-	-	(1.476)	(1.476)
Shares and equity investments	335	335	-	-	335				-
Other financial assets	1.684	1.684	-	15.699	17.383	-	-	(15.699)	(15.699)
Total	**542.294**	**522.609**	**9.200**	**63.035**	**594.844**	**(5.402)**	**(1.426)**	**(45.721)**	**(52.549)**
Loan commitments	40.879	41.275	42	286	41.603	(680)	(11)	(33)	(724)
Financial guarantees	17.090	17.232	6	5	17.243	(152)	-	(1)	(153)
	57.969	**58.507**	**48**	**291**	**58.846**	**(832)**	**(11)**	**(34)**	**(877)**

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.3. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items (Continued)

In thousands of EUR

	Neither Past due nor Impaired	Past Due but not Individually Impaired	Individually Impaired	Total, Gross	Individual Allowance for Impairment	Collective Allowance for Impair-ment	Total Allowance for Impairment	Total, net exposure
December 31, 2019								
Housing loans	67.375	859	-	68.234	-	(1.524)	(1.524)	66.710
Current account overdrafts	2.059	124	-	2.183	-	(82)	(82)	2.101
Consumer loans	90.118	1.102	-	91.220	-	(1.731)	(1.731)	89.489
Credit cards	2.789	221	493	3.503	(493)	(282)	(775)	2.728
Special purpose loans	12	76	-	88	-	(69)	(69)	19
Other loans to individuals covered by mortgage	32.504	580	-	33.084	-	(827)	(827)	32.257
Other loans	2.417	1.414	-	3.831	-	(1.674)	(1.674	2.157
Car loans	266	-	-	266	-	(1)	(1)	265
Loans to micro and small entities	10.419	912	1.238	12.569	(945)	(796)	(1.741)	10.828
Loans to medium and large entities	159.447	517	19.491	179.455	(8.795)	(2.981)	(11.776)	167.679
Loans to Government and municipalities	102.299	1	17	102.317	(17)	(2.344)	(2.361)	99.956
Treasury LOB	3.656	-	-	3.656	-	(64)	(64)	3.592
	473.361	**5.806**	**21.239**	**500.406**	**(10.250)**	**(12.375)**	**(22.625)**	**477.781**
Loans and advances to banks at amortized cost	39.201	-	-	39.201	-	-	-	-
	512.562	**5.806**	**21.239**	**539.607**	**(10.250)**	**(12.375)**	**(22.625)**	**477.781**

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.3. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items (Continued)

In thousands of EUR

	Neither Past due nor Impaired	Past Due but not Individually Impaired	Individually Impaired	Total, Gross	Individual Allowance for Impairment	Collective Allowance for Impair-ment	Total Allowance for Impairment	Total, net exposure
December 31, 2018								
Housing loans	60.527	1.695	-	62.222	-	(2.492)	(2.492)	59.730
Current account overdrafts	2.225	189	-	2.414	-	(158)	(158)	2.256
Consumer loans	82.961	1.279	-	84.240	-	(3.138)	(3.138)	81.102
Credit cards	2.716	629	485	3.830	(485)	(922)	(1.407)	2.423
Special purpose loans	68	543	-	611	-	(581)	(581)	30
Other loans to individuals covered by mortgage	28.081	797	-	28.878	-	(930)	(930)	27.948
Other loans	3.005	2.180	-	5.185	-	(3.295)	(3.295)	1.890
Car loans	104	-	-	104	-	(2)	(2)	102
Loans to micro and small entities	19.148	1.704	4.149	25.001	(3.243)	(1.707)	(4.950)	20.051
Loans to medium and large entities	116.484	251	26.610	143.345	(14.000)	(3.015)	(17.015)	126.330
Loans to Government and municipalities	73.549	14	335	73.898	(19)	(646)	(665)	73.233
	388.868	9.281	31.579	429.728	(17.747)	(16.886)	(34.633)	395.095
Loans and advances to banks at amortized cost	57.690	-	-	57.690	(1)	-	(1)	57.689
	446.558	9.281	31.579	487.418	(17.748)	(16.886)	(34.634)	452.784

Loans and advances past neither due nor impaired in FY 2019 and 2018 are all ranked under the satisfactory risk category.

4. FINANCIAL INSTRUMENTS (Continued)
4.2. Credit Risk (Continued)
4.2.3. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items (Continued)

In thousands of EUR

		Gross carrying amount				Accumulated impairment			
December 31, 2019	**Carrying amount**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans and advances to banks at amortized cost	39.201	39.202	-	-	39.202	(1)	-	-	(1)
- Category A	449.645	427.203	27.145	1.036	455.384	(5.033)	(282)	(424)	(5.739)
- Category B	23.107	11.356	4.434	10.542	26.332	(167)	(689)	(2.369)	(3.225)
- Category C	831	83	97	992	1.172	(1)	(7)	(333)	(341)
- Category D	98	-	-	192	192	-	-	(94)	(94)
- Category E	4.100	25	33	17.268	17.326	-	(1)	(13.225)	(13.226)
Loans and advances to customers at amortized cost	477.781	438.667	31.709	30.030	500.406	(5.201)	(979)	(16.445)	(22.625)
Category A - Securities at FVTOCI	520	520	-	-	520	-	-	-	-
Category A - Securities at amortized cost	79.566	80.001	-	-	80.001	(435)	-	-	(435)
Category E - Forfeiting	1.241	-	-	2.640	2.640	-	-	(1.399)	(1.399)
Category A - Shares and equity investments	41.810	41.810	-	-	41.810	-	-	-	-
- Category A	847	848	-	-	848	-	-	-	-
- Category B	55	-	64	-	64	-	(8)	-	(8)
- Category C	91	-	-	138	138	-	-	(48)	(48)
- Category D	29	-	-	48	48	-	-	(19)	(19)
- Category E	0	-	-	5.843	5.843	-	-	(5.845)	(5.845)
Other financial assets	1.021	848	64	6.029	6.941	-	(8)	(5.912)	(5.920)
Total	**641.140**	**601.048**	**31.773**	**38.699**	**671.520**	**(5.637)**	**(987)**	**(23.756)**	**(30.380)**
- Category A	37.461	37.123	671	26	37.820	(345)	(5)	(9)	(359)
- Category B	2.222	2.238	11	-	2.249	(27)	-	-	(27)
- Category C	2	1	-	1	2	-	-	-	-
- Category D	1	-	-	1	1	-	-	-	-
- Category E	64	40	10	27	77	-	-	(13)	(13)
Loan commitments	39.750	39.402	692	55	40.149	(372)	(5)	(22)	(399)
- Category A	30.930	31.104	63	-	31.167	(233)	(4)	-	(237)
- Category B	1.718	1.641	100	-	1.741	(12)	(11)	-	(27)
Financial guarantees	32.648	32.745	163	-	32.908	(245)	(15)	-	(260)
Total	**72.398**	**72.147**	**855**	**55**	**73.057**	**(617)**	**(20)**	**(22)**	**(659)**

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)
4.2. Credit Risk (Continued)
4.2.3. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items (Continued)

		Gross carrying amount				Accumulated impairment			
December 31, 2018	**Carrying amount**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Loans and advances to banks at amortized cost	57.689	57.690	-	-	57.690	(1)	-	-	(1)
- Category A	362.681	361.082	5.692	1.548	368.322	(4.386)	(643)	(612)	(5.641)
- Category B	25.767	14.542	3.317	11.758	29.617	(268)	(764)	(2.818)	(3.850)
- Category C	1.415	174	168	1.584	1.926	(3)	(10)	(498)	(511)
- Category D	67	-	-	369	369	-	-	(302)	(302)
- Category E	5.165	91	23	29.380	29.494	(4)	(9)	(24.316)	(24.329)
Loans and advances to customers at amortized cost	395.095	375.889	9.200	44.639	429.728	(4.661)	(1.426)	(28.546)	(34.633)
Category A Securities at FVTOCI	6.992	6.992	-	-	6.992	-	-	-	-
Category A Securities at amortized cost	79.278	80.019	-	-	80.019	(741)	-	-	(741)
- Category B	450	-	-	499	499	-	-	(49)	(49)
- Category E	771	-	-	2.198	2.198	-	-	(1.427)	(1.427)
Forfeiting	1.221	-	-	2.697	2.697			(1.476)	(1.476)
Category A - Shares and equity investments	335	335	-	-	335	-	-	-	-
- Category A	1.684	1.684	-	-	1.684	-	-	-	-
- Category E	-	-	-	15.699	15.699	-	-	(15.699)	(15.699)
Other financial assets	1.684	1.684	-	15.699	17.383	-	-	(15.699)	(15.699)
Total	**542.294**	**522.609**	**9.200**	**63.035**	**594.844**	**(5.403)**	**(1.426)**	**(45.721)**	**(52.550)**
- Category A	40.407	40.828	20	248	41.096	(672)	(3)	(13)	(688)
- Category B	410	405	13	2	420	(6)	(3)	-	(9)
- Category C	2	1	-	5	6	-	-	(4)	(4)
- Category D	6	-	-	12	12	-	-	(6)	(6)
- Category E	54	41	9	19	69	(2)	(5)	(10)	(17)
Loan commitments	40.879	41.275	42	286	41.603	(680)	(11)	(33)	(724)
- Category A	15.350	15.475	6	5	15.486	(135)	-	(1)	(136)
- Category B	1.740	1.757	-	-	1.757	(17)	-	-	(17)
Financial guarantees	17.090	17.232	6	5	17.243	(152)	-	(1)	(153)
Total	**57.969**	**58.507**	**48**	**291**	**58.846**	**(832)**	**(11)**	**(34)**	**(877)**

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.3. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items (Continued)

Loans and advances to customers at amortized cost	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Gross carrying amount on December 31st, 2018	375.889	9.200	44.639	429.728
Changes in gross book value				
- Transfer to stage 1	1.212	(1.091)	(121)	-
- Transfer to stage 2	(27.213)	27.427	(214)	-
- Transfer to stage 3	(775)	(350)	1.125	-
Payments of annuities during the year for placements active on January 1, 2019	(26.053)	(3.668)	(3.246)	(32.967)
Financial assets that have ceased to be recognized for placements active on January 1, 2019	(46.790)	(3.854)	(803)	(51.447)
Write-offs of exposures	(107)	(10)	(759)	(876)
Sold exposures during the year	-	-	(2.278)	(2.278)
Partial write-offs	-		(8.363)	(8.363)
New financial assets, as of December 31st, 2019	162.504	4.055	50	166.609
Gross carrying amount on December 31st, 2019	438.667	31.709	30.030	500.406
Accumulated impairment on December 31st, 2019	(5.201)	(979)	(16.445)	(22.625)
Net carrying amount on December 31st, 2019	**433.466**	**30.730**	**13.585**	**477.781**

Loans and advances to customers at amortized cost	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Accumulated impairment on December 31st, 2018	(4.661)	(1.426)	(28.546)	(34.633)
Changes in Accumulated impairment				
- Transfer to stage 1	(188)	164	24	-
- Transfer to stage 2	217	(310)	93	-
- Transfer to stage 3	12	81	(93)	-
Changes due to change in credit risk (net) for exposures active on January 1, 2019	687	285	914	1.886
Financial assets that have ceased to be recognized for placements active on January 1, 2019	628	535	534	1.697
Accumulated impairment for written-off exposures	43	9	526	578
Accumulated impairment for sold exposures during the year	-	-	1.763	1.763
Accumulated impairment for partial write-offs exposures	-	-	8.363	8.363
Accumulated impairment for new financial assets, as at December 31st, 2019	(1.939)	(317)	(23)	(2.279)
Gross carrying amount on December 31, 2019	**(5.201)**	**(979)**	**(16.445)**	**(22.625)**

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.3. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items (Continued)

Forfeiting	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Gross carrying amount on December 31st, 2018	-	-	2.697	2.697
Payments of annuities during the year for placements active on January 1, 2019	-	-	(57)	(57)
Write-offs of exposures	-	-	-	-
Gross carrying amount on December 31st, 2019	-	-	2.640	2.640
Accumulated impairment on December 31st, 2019	-	-	(1.399)	(1.399)
Net carrying amount on December 31st, 2019	-	-	**1.241**	**1.241**

Forfeiting	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Accumulated impairment on December 31st, 2018	-	-	(1.476)	(1.476)
Changes due to change in credit risk (net) for exposures active on January 1, 2019	-	-	77	77
Accumulated impairment for written-off exposures	-	-	-	-
Gross carrying amount on December 31st, 2018	**-**	**-**	**(1.399)**	**(1.399)**

Undrawn credit facilities, financial guarantees and Uncovered letters of credit	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Gross carrying amount on December 31st, 2018	58.507	48	291	58.846
Changes in gross book value				
- Transfer to stage 1	219	(1)	(218)	-
- Transfer to stage 2	(777)	777	-	-
- Transfer to stage 3	(10)	-	10	-
Financial assets that have ceased to be recognized for placements active on January 1, 2019	(22.029)	(14)	(31)	(22.074)
Changes of limit (net) for exposures active on January 1, 2019	(9.836)	(184)	2	(10.018)
New financial assets, as of December 31, 2019	46.072	229	1	46.302
Gross carrying amount on December 31st, 2019	72.146	855	55	73.056
Accumulated impairment on December 31, 2019	617	20	22	659
Net carrying amount on December 31, 2019	**72.763**	**875**	**77**	**73.715**

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.3. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items (Continued)

Undrawn credit facilities, financial guarantees and Uncovered letters of credit	**Stage 1**	**Stage 2**	**Stage 3**	**Total**
Accumulated impairment on December 31st, 2018	(832)	(11)	(34)	(877)
Changes in Accumulated impairment				
- Transfer to stage 1	-	-	-	-
- Transfer to stage 2	15	(15)	-	-
- Transfer to stage 3	-	-	-	-
Changes due to change in credit risk (net) for exposures active on January 1, 2019	140	17	-	157
Financial assets that have ceased to be recognized for placements ctive on January 1, 2019	443	1	12	456
Accumulated impairment for new financial assets, as at December 31, 2019	(383)	(12)	-	(395)
Gross carrying amount on December 31, 2019	(617)	(20)	(22)	(659)

Exposures based on loans and receivables from banks at amortized cost and securities at amortized cost are classified in Stage 1 as at December 1, 2019. During 2019, the Bank did not change the classification of these exposures.

b) Fair Value of Collateral up to the amount of collateralized exposure

	In thousands of EUR	
	December 31, 2019	**December 31, 2018**
Deposits	24.484	27.306
Securities	2.221	958
Pledge	4.146	6.354
Mortgages	262.443	220.986
Total	293.294	255.604

	In thousands of EUR	
There of- not individually impaired up to the value of receivables	**December 31, 2019**	**December 31, 2018**
Deposits	24.321	26.256
Securities	1.345	958
Pledge	3.745	4.791
Mortgages	217.686	190.894
Total	247.097	222.899

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.3. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items (Continued)

b) Fair Value of Collateral up to the amount of collateralized exposure (Continued)

There of - individually impaired up to the value of receivables	In thousands of EUR December 31, 2019	December 31, 2018
Deposits	163	1.050
Securities	876	-
Pledge	401	1.563
Mortgages	44.757	30.092
Total	46.197	32.705

As collateral, the Bank accepts mortgages against immovable, the fair value of which, pursuant to the certified appraiser's valuations, exceeds the minimum of 30 percent of LTV ratio. Properties used as collateral are housing premises, apartment buildings, business buildings and premises, as well as land depending on its location and future use.

When accepting pledge over securities as collateral, the Bank monitors the price of the security used as collateral on a daily basis. The market value of the pledge must exceed 50 percent of the placement's worth.

a) Restructured Loans and Advances

The Bank restructured a loan to the borrower due to a decline in the borrower's creditworthiness, if it has:

a. Extended the principal and interest maturity,
b. Decreased the interest rate on the loan approved,
c. Reduced the amount of debt, principal or interest or
d. Took over the debt,
e. Performed capitalization of interest;
f. Replaced the existing loan with a new loan;
g. Made other concessions which place the borrower in a better financial position

Upon restructuring of the loan, the Bank performs financial analysis of the borrower and assesses its capacitates to realize cash flows necessary for the repayment of the loan principal, as well as the corresponding interest once the loan is restructured.

During 2019, the Bank restructured loans in the amount of EUR 781 thousand which extended the repayment term, the amount of EUR 748 thousand in which the interest rate was reduced, the amount of EUR 635 thousand in which where the debt was taken over, the amount of EUR 538 thousand where the existing loan was replaced with new one, and the amount of EUR 14.951 thousand on which benefits were made to facilitate borrowers financial position (in 2018: total amount of restructured loans were EUR 21.277).

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.4. Loans and Advances (Continued)

d) Geographic Concentration

Geographic concentration of the Bank's exposure to the credit risk, exclusive of the allowance for impairment is as follows:

In thousands of EUR

	Montenegro	European Union	USA and Canada	Other	Total
Loans and advances to banks at amortized cost	-	37.237	1.389	575	39.201
Loans and advances to customers at amortized cost	472.048	212	26	5.495	477.781
Securities at fair value through other comprehensive income	471	49	-	-	520
Securities at amortized cost	79.566	-	-	-	79.566
Forfeiting	1.241	-	-	-	1.241
Shares and equity investments	48.810	-	-	-	48.810
Other financial assets	1.021	-	-	-	1.021
December 31, 2019	596.157	37.498	1.415	6.070	641.140
December 31, 2018	472.305	56.030	8.543	5.416	542.294

Country risk represents a probability of incurring losses stemming from inability of debtors headquartered outside of Montenegro to meet their payment obligations or original contract conditions due to reasons pertaining to political, social and economic environment of the country in which the debtor resides.

The Bank is identifying, assessing and controlling country risk based on principles set by the Central Bank of Montenegro and international standards.

Country risk management is based on the following three principles:

- Calculation of country rating
- Setting up exposure limits
- Monitoring

The Bank classifies all countries of residence of its debtors in the following risk categories:

1) risk-free countries;
2) low-risk countries;
3) medium-risk countries;
4) high-risk countries.

Based on calculated country rating The Bank is determining the capital required for country risk in line with the Central Bank's standards and is setting up appropriate exposure limits.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4 FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.4. Loans and Advances (Continued)

e) Industry Concentration

Industry concentration of the Bank's exposure to the credit risk, exclusive of the allowance for impairment is as follows:

In thousands of EUR

	Finance	Transportation,Telecommunication	Services, Tourism, Management	Trading	Civil Engineering	Electrica power industry	Mining	Administration	Real Estate	Agriculture Hunting and Fishing	Manufacturing	Other	Retail Customers	Total
Loans and advances to bank at amortized cost	39.201	-	-	-	-	-	-	-	-	-	-	-	-	39.201
Loans and advances to customers at amortized cost	5.020	7.757	57.787	70.075	20.946	28	43	100.117	5.326	6.191	5.053	1.175	198.263	477.781
Securities at fair value through other comprehensive income	296	-	-	-	-	206	-	-	-	-	-	18	-	520
Securities at amortized cost	-	-	-	-	-	-	-	79.566	-	-	-	-	-	79.566
Forfeiting	-	60	98	579	-	-	-	-	-	-	504	-	-	1.241
Shares and equity investments	41.810	-	-	-	-	-	-	-	-	-	-	-	-	41.810
Other financial assets	-	-	-	-	-	-	-	-	-	-	-	1.021	-	1.021
December 31, 2019	86.327	7.817	57.885	70.654	20.946	234	43	179.683	5.326	6.191	5.557	2.214	198.263	641.140
December 31, 2018	66.312	4.735	42.113	64.661	17.168	490	36	152.770	4.816	3.111	4.150	3.888	178.044	542.294

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.2. Credit Risk (Continued)

4.2.5. Off-Balance Sheet Items

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

In thousands of EUR

	Undrawn Loan Facilities	Guarantees	Uncovered Letters of Credit	Total
December 31, 2019				
Up to one year	30.495	32.216	542	63.252
From 1 to 5 years	9.653	151	-	9.804
	40.148	32.366	542	73.056

In thousands of EUR

	Undrawn Loan Facilities	Guarantees	Uncovered Letters of Credit	Total
December 31, 2018				
Up to one year	27.231	16.140	549	43.920
From 1 to 5 years	14.372	554	-	14.926
	41.603	16.694	549	58.846

4.3. Market Risk

Based on the Central Bank's standards the Bank is managing all types of market risk arising from its business activities, with a special attention to:

- Position risk (price and interest rate risk),
- Foreign exchange risk (hereafter: FX risk),
- Counterparty and settlement risk.

Considering its business model, size and complexity of operations, the Bank has been classified as "passive treasury" within OTP group, meaning that is shall not form a trading book or engage into any proprietary trading activities designed to profit from perceived arbitrage opportunities or market bets.

As a consequence of its business model, the main sources of interest rate and FX risk are commercial banking activities such as deposit taking and lending activity.

4.3.1. Foreign Exchange Risk

Foreign exchange risk represents the risk of loss due to fluctuation of market FX rates.

In order to mitigate the FX risk the Bank is setting up FX position limits in line with the Central Bank's standards and its business requirements.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.3. Market Risk (Continued)

4.3.1. Foreign Exchange Risk (Continued)

The exposure to foreign currency risk as of December 31, 2019 is presented in the following table.

In thousands of EUR

	USD	Other Currencies	Total Foreign Currencies	Local Currency (EUR)	Total
ASSETS					
Cash and balances with the Central Bank	322	1.794	2.116	157.908	160.024
Loans and advances to banks at amortized cost	22.991	2.761	25.752	13.449	39.201
Loans and advances to customers at amortized cost	-	-	-	477.781	477.781
Securities at fair value through other comprehensive income	-	-	-	520	520
Securities at amortized cost	-	-	-	79.566	79.566
Forfeiting	-	-	-	1.241	1.241
Shares and equity investments	-	-	-	41.810	41.810
Other financial assets	-	-	-	1.021	1.021
Total assets	23.313	4.555	27.868	773.296	801.164
LIABILITIES					
Deposits from banks	84	-	84	10.898	10.982
Due to customers	23.217	4.470	27.687	579.276	606.963
Other borrowed funds	-	-	-	13.913	13.913
Other financial liabilities	5	-	5	6.018	6.023
Total liabilities	23.306	4.470	27.776	610.105	637.881
Net Open Position:					
- December 31, 2019	7	85	92	163.191	154.283
- December 31, 2018	(48)	27	(21)	106.796	106.775

4.3.2. Operational risk

Operational risk represents the risk of losses as a result of inadequate internal systems, processes, controls, information technology, external events, fraud and outsourcing.

Operational risk management consist of identification, assessment, monitoring and implementation of mitigation measures.

Operational risk identification is performed through the process of risk controls self-assessment (RCSA) which is conducted once a year. To complement the RCSA the Bank performs a scenario analysis which is designed to identify low probability operational risks and assess its potential impact.

In order to evaluate identified operational risks the Bank is collecting historical data on realized losses from operational risk on a regular basis.

To mitigate significant operational risks the Bank is using several measures such as action plans for introduction of control measures, Business Continuity Planning, insurance against risk etc.

To ensure the risk level stays within the defined risk appetite, the Bank is regularly monitoring the level of operational risk exposures through analysis of trends in operational risk losses and key risk indicators.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.3. Market Risk (Continued)

4.3.3. Interest Rate Risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. The interest rates are based on market rates and the Bank regularly performs repricing.

The following table presents the Bank's interest bearing and non-interest bearing assets and liabilities as of December 31, 2019:

			In thousands of EUR
	Interest Bearing	Non-Interest Bearing	Total
ASSETS			
Cash and balances with the Central Bank	23.156	136.868	160.024
Loans and advances to banks at amortized cost	39.199	2	39.201
Loans and advances to customers at amortized cost	477.781	-	477.781
Securities at fair value through other comprehensive income	-	520	520
Securities at amortized cost	79.566	-	79.566
Forfeiting	1.241	-	1.241
Shares and equity investments	-	41.810	41.810
Other financial assets	-	1.021	1.021
Total assets	620.943	180.221	801.164
LIABILITIES			
Deposits from banks	10.210	771	10.781
Due to customers	468.814	138.150	606.964
Other borrowed funds	12.560	1.353	13.913
Other financial liabilities	-	6.023	6.023
Total liabilities	491.584	146.297	637.881
Interest Sensitive Gap:			
- December 31, 2019	129.359	33.924	163.283
- December 31, 2018	141.288	(34.513)	106.775

4.4. Liquidity Risk

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

4.4.1. Liquidity Risk Management

The matching and controlled mismatching between the maturities and interest rates of assets and of liabilities is fundamental to the management of the Bank. It is unusual for banks ever to be completely matched since business transacted is often of uncertain term and of different types. An unmatched position potentially enhances profitability, but also increases the risk of losses.

The maturities of assets and liabilities and the ability of the Bank to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest rates and exchange rates.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.4. Liquidity Risk (Continued)

4.4.1. Liquidity Risk Management (Continued)

Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Bank does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

The Assets and Liquidity Department monitors the Bank's exposure to liquidity risk on daily basis.

In order to determine the matching and mismatching of cash inflows and outflows, the Bank makes use of GAP analysis.

The table below analyses assets and liabilities of the Bank into relevant maturities based on the remaining period at statement of financial position date to the contractual maturity date.

In thousands of EUR

	Up to One Month	From One to 3 Months	From 3 to 12 Months	From 1 to 5 Years	Over 5 Years	Total
ASSETS						
Cash and balances with the Central Bank	113.711	-	-	46.313	-	160.024
Loans and advances to banks at amortized cost	37.932	-	-	1.269	-	39.201
Loans and advances to customers at amortized cost	12.089	15.315	58.745	240.178	151.454	477.781
Securities at fair value through other comprehensive income	-	-	-	-	520	520
Securities at amortized cost	-	35.056	17.210	27.300	-	79.566
Forfeiting	27	40	153	626	395	1.241
Shares and equity investments	-	-	-	-	41.810	41.810
Other financial assets	1.021	-	-	-	-	1.021
Total assets	164.780	50.411	76.108	315.686	194.179	801.164
LIABILITIES AND EQUITY						
Deposits from banks	780	372	415	9.415	-	10.982
Due to customers	43.906	20.962	23.365	518.730	-	606.963
Other borrowed funds	10.008	72	89	607	3.137	13.913
Other liabilities	6.023	-	-	-	-	6.023
Total liabilities and equity	60.716	21.406	23.869	528.752	3.137	637.881
Net Open Position:						
- December 31, 2019	104.064	29.005	52.239	(213.066)	191.042	163.283
- December 31, 2018	114.899	(9.041)	64.955	(208.731)	144.693	106.775

4. FINANCIAL INSTRUMENTS (Continued)

4.4. Liquidity Risk (Continued)

4.4.1. Liquidity Risk Management (Continued)

The structure of the Bank's financial assets and liabilities as classified into their relevant maturities as of December 31, 2019 indicates the existence of liquidity gap in one to five-year period (December 31, 2018: in one-month to three-month period and in one to five-year period). The main reason for this gap is that the short-term sources of funds with maturities up to one month, primarily demand deposits, were committed for a longer period of time. Bank has developed and apply Procedure for stress testing and Procedure for calculation of stable a vista deposit level that are used in aim of monitoring gap maturity match. Analyses which is used according to Procedure for calculation of stable deposits allows to Bank to use short term sources for placement of funds on longer period. In order to overcome the liquidity gap, the Bank plans following activities:

- The Bank gives priority to short-term placement of funds, up to one year.
- The Bank will contact clients whose deposits mature in the period from 31 to 365
- days in order to prepare the plan of potential significant outflows
- The Bank will withdraw funds from OTP Bank Plc. Budapest to overcome negative
- GAP, if needed.

The Bank did not have any liquidity issues in 2019. On December 31, 2019, liquidity ratio was 1.06% (December 31, 2018: 1,15%).

4.5. Fair Value of Financial Instruments

4.5.1 Fair Value of Financial Instruments Measured at Fair value

Fair value hierarchy for financial instruments measured at fair value

IFRS 13 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices (unadjusted) on active markets for identical assets or liabilities. This level includes listed equity securities.

- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for an asset or a liability, either directly (that is, as prices) or indirectly (that is, as derived from prices). The Bank does not have financial instruments measured at fair value included within Level 2.

- Level3 – inputs for an asset or a liability that are not based on observable market data (unobservable inputs). This level includes equity investments with Bank's market assumption (no observable market data available). The Bank does not have financial instruments measured at fair value included within Level 3.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.5. Fair Value of Financial Instruments (Continued)

4.5.1 Fair Value of Financial Instruments Measured at Fair value (Continued)

Fair value hierarchy for financial instruments measured at fair value (Continued)

This hierarchy requires the use of observable market data when available. The Bank considers relevant and observable market prices in its valuations where possible. As at December 31, 2019, for securities measured at fair value in Bank's portfolio, market prices were available.

December 31, 2019	**Level 1**	**Level 2**	**Level 3**	**Total**
Securities at fair value through other comprehensive income – equity instruments	520	-	-	520
Total assets	520	-	-	520

December 31, 2018	**Level 1**	**Level 2**	**Level 3**	**Total**
Securities at fair value through other comprehensive income – equity instruments	6.992	-	-	6.992
Total assets	6.992	-	-	6.992

Valuation techniques and inputs to valuation techniques for financial instruments measured at fair value

The fair value for securities is based on market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar characteristics. As at December 31, 2019, for securities measured at fair value in Bank's portfolio, market prices were available.

4.5.2 Fair Value of Financial Instruments Not Measured at Fair value

Fair value hierarchy for financial instruments not measured at fair value

Estimated fair value of financial instruments, based on fair value hierarchy is given as follows:

December 31, 2019	**Level 1**	**Level 2**	**Level 3**	**Total**	**Carrying Amount**
Cash and balances with the Central Bank	-	160.024	-	160.024	160.024
Loans and advances to banks at amortized cost	-	39.201	-	39.201	39.201
Loans and advances to customers at amortized cost	-	-	477.781	477.781	477.781
Securities at amortized cost	-	79.566	-	79.566	79.566
Forfeiting	-	-	1.241	1.241	1.241
Shares and equity investments			41.810	41.810	41.810
Other financial assets	-	-	1.021	1.021	1.021
Total assets	-	278.791	521.853	800.644	800.644
Deposits from banks	-	-	10.982	10.982	10.982
Due to customers	-	-	606.963	606.963	606.963
Other borrowed funds	-	-	13.913	13.913	13.913
Other liabilities	-	-	6.023	6.023	6.023
Total liabilities	-	-	637.881	637.881	637.881

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.5. Fair Value of Financial Instruments (Continued)

4.5.2 Fair Value of Financial Instruments Not Measured at Fair value (Continued)

Fair value hierarchy for financial instruments not measured at fair value (Continued)

December 31, 2018	Level 1	Level 2	Level 3	Total	Carrying Amount
Cash and balances with the Central Bank	-	135.251	-	135.251	135.251
Loans and advances to banks at amortized cost	-	57.689	-	57.689	57.689
Loans and advances to customers at amortized cost	-	-	395.095	395.095	395.095
Securities at amortized cost	-	79.278	-	79.278	79.278
Forfeiting	-	-	1.221	1.221	1.221
Shares and equity investments	-	-	335	335	335
Other financial assets	-	-	1.684	1.684	1.684
Total assets	-	272.218	398.335	670.553	670.553
Deposits from banks	-	-	7.022	7.022	7.022
Due to customers	-	-	555.517	555.517	555.517
Other borrowed funds	-	-	2.733	2.733	2.733
Other liabilities	-	-	5.498	5.498	5.498
Total liabilities	-	-	570.770	570.770	570.770

Valuation techniques and inputs to valuation techniques for financial instruments not measured at fair value

For financial assets and liabilities not measured at fair value, fair values are calculated only for disclosure purposes, and do not impact the statement of financial positions or income statement. In addition, since the instruments generally do not trade, there are significant management judgments required to determine their fair values.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions regardless of whether that price is directly observable or estimated using another valuation technique. However, no readily available market prices exist for a certain portion of the Bank's financial instruments, and those were accordingly classified into Level 2 and Level 3 based on fair value hierarchy. In this circumstances where the quoted market prices are not readily available, the fair value is estimated using discounted cash flow models or other pricing models as appropriate. Changes in underlying assumptions, including discount rates and estimated future cash flows, significantly affects the estimates. Therefore, the calculated fair market estimates cannot be realized in a current sale of the financial instrument.

The carrying amount represents a reasonable estimate of fair value for the following financial instruments which are predominately short-term:

- Cash and balances with the Central Bank;
- Securities at amortized cost (relate to treasury bonds maturing up to 6 months);
- Other liabilities.

In estimating the fair value of the Bank's financial instruments not measured at fair value and classified into Level 2 and Level 3, the following assumptions were used:

Loans and advances to banks

Loans and advances to banks include inter-bank placements and line items in the course of collection, linked with floating interest rates. Future anticipated cash flows are discounted to their present value using current interest rates. Due to the fact that floating interest rates are agreed, changes in those interest rates lead to changes in agreed interest rates, so the fair value of floating rate placements and overnight deposits approximates their carrying amount at the statement of financial position date.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.5. Fair Value of Financial Instruments (Continued)

4.5.2 Fair Value of Financial Instruments Not Measured at Fair value (Continued)

Valuation techniques and inputs to valuation techniques for financial instruments not measured at fair value (Continued)

Loans and advances to customers and Forfeiting

Fair value is determined using discounting cash flow models that include inputs for credit risk, interest rate risk, probability of default estimates, loss given default estimates, as appropriate. Given the fact that significant portion of the loan portfolio is extended at fixed interest rates, in order to determine the fair value of loans and advances to customers with fixed interest rate, the Bank has performed comparison of the Bank's interest rate on loans and advances to customers with available information on the current market interest rates in the banking sector of Montenegro (i.e. average weighted market rates by activities), as it is summarized in the following table:

- in percentages-	Annual Average Weighted Interest Rate	
Industry Sector	Bank	Banking Sector in Montenegro
Financial institutions	4,42	3,02
Corporate	4,94	4,91
Other nonfinancial institutions	7,20	5,49
General Government	3,41	3,59
Households	7,72	7,65
Other	7,92	4,08

According to the Bank's management, the fair value of loans and advances to customers calculated as the present value of discounted future cash flows, using current market rates (average weighted interest rates in the banking sector), does not materially differ from the carrying amount of loans at statement of financial position date. According to the Bank's management, carrying values as presented in the Bank's financial statements represent values that are believed to be the most valid under the circumstances and most useful for the purposes of financial reporting.

Deposits and borrowings

The estimated fair value of demand deposits and deposits with remaining contractual maturities less than one year approximates their carrying amount.
The estimated fair value of fixed interest bearing deposits with remaining contractual maturities over one year, without a quoted market price, is based on discounted cash flows using interest rates for new debts with similar remaining maturity. According to the Bank's management, Bank's interest rates are harmonized with the current market rates and the amounts stated in the financial statements represent the values that are believed under the circumstances, to approximate the fair value of these financial instruments.

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

4.6. Capital Management

The Bank's capital management objectives are:

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

The Bank's management controls capital adequacy by applying the methodologies and limits prescribed by the Central Bank of Montenegro (Official Gazette of Montenegro number 60/08, 41/09, 38/11, 55/12and 82/17). In accordance with the regulations, the Bank submits quarterly reports on the capital condition and structure to the Central Bank of Montenegro.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.6. Capital Management (Continued)

The Bank's capital is divided into two tiers:

- Tier 1 capital (paid-in share capital, retained earnings from prior years, profit for the year decreased for current year losses); and
- Tier 2 capital (reserves from profit after taxation: Bank's risk-weighted assets, legal reserves, subordinated loans).
- Both decreased for intangible assets, missing reserves, direct and indirect investments in other banks, credit or financial institution in amount more than 10% of capital of these institutions

Risk-weighted assets are comprised of items of assets and loan equivalents of off-balance sheet items exposed to risk. The loan equivalents of off-balance sheet assets are computed by multiplying the book value of off-balance sheet items with the prescribed conversion factors. Total risk-weighted assets are comprised of assets and loan equivalents of off-balance sheet items exposed to risk (the Bank's risk weighted assets) classified in four categories and multiplied by adequate prescribed risk weights.

In accordance with the requirements of the Central Bank of Montenegro, the Bank is under obligation to maintain a minimum capital adequacy ratio of 10%. The Bank is required to maintain certain minimum or maximum ratios with respect to its activities and composition of risk assets in compliance with the Law on Banks of the Montenegro and with the Central Bank of Montenegro Regulations. The Bank's solvency ratio amounted to 23,67% as of December 31, 2019, calculated on statutory financial statements.

4.7. Risk Exposure Analysis

4.7.1. Risk Exposure Analysis (Foreign Exchange Risk)

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

			In thousands of EUR	
		Amount in foreign	Change in Exchange Rate	
	Total	currencies	10%	-10%
ASSETS				
Cash and balances with the Central Bank	160.024	2.116	212	(212)
Loans and advances to banks at amortized cost	39.201	25.752	2.575	(2.575)
Securities at fair value through other comprehensive income	520	-	-	-
Other financial assets	1.021	-	-	-
Total assets	200.766	27.868	2.787	(2.787)
LIABILITIES				
Deposits from banks	10.982	84	8	(8)
Due to customers	606.963	27.687	2.769	(2.769)
Other borrowed funds	13.913	-	-	-
Other financial liabilities	6.023	5	1	(1)
Total liabilities	637.881	27.776	2.778	(2.778)
Net Open Position:				
- December 31, 2019			9	(9)
- December 31, 2018			(3)	3

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

4. FINANCIAL INSTRUMENTS (Continued)

4.7. Risk Exposure Analysis (Continued)

4.7.2. Risk Exposure Analysis (Interest Rate Risk)

As of December 31, 2019, under the assumption that all other parameters remain the same upon the change in the EUR exchange rate, as compared to other currencies, by +10%, i.e., -10%, the Bank's profit would decrease, i.e., increase by EUR 9 thousand (December 31, 2018: decrease, i.e., increase by EUR 3 thousand). The reason why the Bank's exposure to currency risk is small is rooted in the fact that the major portion of the Bank's assets and liabilities is denominated in EUR.

In the process of interest rate risk management, the Bank analyses the exposure of Bank's assets and liabilities to changes in interest rates. The following table shows the effect of fluctuations in interest rates on the Bank's assets and liabilities denominated in EUR and foreign currency in the range from +0.4 b.p. to - 0.4 b.p. respectively.

			In thousands of EUR
	Net effect of movements in interest rates		
	2019	+0.4 b.p. EUR IR/FX IR	-0.4 b.p. EUR IR/FX IR
ASSETS			
Cash and balances with the Central Bank	160.024	-	-
Loans and advances to banks	39.201	-	-
Loans at amortized cost	477.781	533	(533)
Securities at fair value through other comprehensive income	520	-	-
Securities at amortized cost	79.566	-	-
Forfeiting	1.241	-	-
Shares and equity investments	41.810		
Other financial assets	1.021		
	801.164	533	(533)
LIABILITIES			
Deposits from banks	10.982	-	-
Due to customers	606.963	-	-
Other borrowed funds	13.913	-	-
Other financial liabilities	6.023	-	-
	637.881	-	-
Net Interest Sensitive Gap:			
- December 31, 2019		533	(533)
- December 31, 2018		396	(396)

Under the assumption that all other parameters remain the same, the increase, or decrease in variable interest rates applied to assets and liabilities denominated in EUR and in foreign currency, by 0.4 percentage points, the Bank's profit would increase, or decrease, respectively by EUR 533 thousand (December 31, 2018: the respective decrease would amount to EUR 396 thousand).

The reason why the Bank's exposure to interest rate is small is rooted in the fact that the major portion of the Bank's assets and liabilities are linked to a fixed interest rate.

5. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS IN APPLYING ACCOUNTING POLICIES

The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

(a) Impairment losses on loans and advances

The Bank reviews its loan portfolios, to assess impairment, monthly at least. In determining whether an impairment loss should be recorded in the statement of comprehensive income, the Bank makes judgments as to whether there are any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a Bank, or national or local economic conditions that correlate with defaults on assets in the Bank. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

(b) Impairment of securities- equity investments and investments in associates

The Bank determines that investments in securities are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment. Impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance and operational and financing cash flows.

(c) Retirement benefits and other long-term employee benefits

The present value of liabilities for retirement benefits and other long-term employee benefits depends on a number of factors that are determined on an actuarial basis using a number of assumptions. Any changes in these assumptions will impact the carrying amount of employee benefits obligations. Key assumptions for retirement benefits and other long-term employee benefits are disclosed in Note 28.

(d) Taxation risks

Montenegro tax legislation is subject to different interpretations and changes that occur frequently. The interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Bank may not be in line with that of the management. As a result, tax authorities may challenge Bank’s transactions and the Bank may be assessed additional taxes, penalties and interest, which could be material. The Bank’s tax statements may be reviewed or audited for a period of five years from the filing date of such statements.

(e) Provisions

Provisions are re-examined at each statement of financial position date and adjusted to reflect the best present estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision is reversed and credited to the income statement.

The Bank does not recognize provisions against contingent liabilities until it has determined the existence of a present obligation that can result in an outflow of resources embodying economic benefits required to settle the obligation, or if a reliable estimate cannot be made of the amount of the obligation, in which case it is so disclosed.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

6. INTEREST INCOME AND EXPENSE AND SIMILAR INCOME AND EXPENSE

a) Interest and Similar Income

	In thousands of EUR Year Ended December 31, 2019	2018
Interest and similar income		
Loans and advances to customers	22.881	21.241
Placements to banks	361	376
Negative interest rate charged by Central Bank of Montenegro	(187)	(137)
Negative interest rate charged by another banks	(127)	(73)
Forfeiting	81	111
Securities at amortized cost	2.979	3.224
	25.988	24.742

b) Interest Expense and Similar Charges

	In thousands of EUR Year Ended December 31, 2019	2018
Interest and similar expenses		
Deposits from customers	92	203
Borrowed funds, from banks	46	50
Borrowed funds, from government	20	21
Interest expense due to IFRS 16	123	-
	281	274

7. FEE AND COMMISSION INCOME AND EXPENSE

a) Fee and Commission Income

	In thousands of EUR Year Ended December 31, 2019	2018
Fee and commission income arising from domestic and international payment transfers	8.679	7.765
Credit card related fees and commissions	8.108	6.294
Fee income from issued guarantees and other contingent liabilities	349	263
Other	881	798
	18.017	15.120

b) Fee and Commission Expense

	In thousands of EUR Year Ended December 31, 2019	2018
Fee and commission expense arising from domestic payment transfers	949	834
Fee and commission expense arising from international payment transfers	457	372
Commission expenses arising on guarantees and other contingent liabilities	21	28
Credit card related fees and commissions	5.463	3.876
Other	71	82
	6.961	5.192

Credit Card related fees and commissions expence are higher in 2019, in amount of EUR 1.587 thousand ,compared to 2018, are related to interbank expenses of fees and commissions.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

8. NET FOREIGN EXCHANGE GAINS

	In thousands of EUR Year Ended December 31, 2019	2018
Foreign exchange gains, realized	904	838
Foreign exchange gains/(losses), unrealized	(18)	6
	886	844

9. OTHER OPERATING INCOME

	In thousands of EUR Year Ended December 31, 2019	2018
Income from custody operations	210	164
Gains raised from forfeiting	15	219
Gains from sale fixed assets	23	57
Other	264	221
	512	661

10. OPERATING EXPENSES

	In thousands of EUR Year Ended December 31, 2019	2018
Staff costs	18.665	12.373
Administrative expenses	839	693
Depreciation of property, plant and equipment (Note 22)	2.957	1.579
Amortization of intangible assets (Note 21)	1.085	968
Impairments of real estate owned by the Bank	1.673	-
Impairments of equipment and other assets	77	-
Impairments of intangible assets	1	-
Rent	292	1.306
Software and hardware expenses	1.844	1.630
Maintenance of non IT property	363	305
Vehicle maintenance costs	52	46
Professional services	2.178	936
Deposit insurance premium	2.763	2.503
Insurance costs	279	184
Marketing, sponsorship, and entertainment	681	547
The cost of fuel and electricity	750	725
Telecommunications and postal services	533	537
The cost of travel and training	118	151
Tax expense due to IFRS 16	179	-
Other	341	288
	35.670	24.771

Rent expenses in 2019. are lover than in 2018 due to implementation of IFRS 16, in amount of EUR 1.014 thousand.
Expences for professional services at December 31, 2019 in the amount of EUR 2.178 thousand are mostly related to the engagement of consulting companies for the preparation of migration with Podgorička banka AD, Podgorica.

The Bank has determined that the recoverable amount of HQ Vektra – Podgorica and branches in Ulcilj, Bar, Mojkovac, Herceg Novi and Rožaje is less than its carrying amount, so the Bank recognized the impairment loss in the amount of EUR 1.673 thousand.

11. LOSSES ON IMPAIRMENT AND PROVISIONS

	In thousands of EUR Year Ended December 31, 2019	2018
Loans at amortized cost, net (Note 16)	(1.825)	1.776
(Release)/Provisions for forfeiting (Note 20)	(77)	(23)
(Release)/Provisions for securities at amortized cost (Note 19)	(306)	(45)
Provision for other assets, net (Note 23)	431	628
Provision for contingent liabilities, net (Note 28)	(218)	347
Provisions for potential litigation losses (Note 28)	305	77
Provisions for employee benefits, net (Note 29)	92	-
Other provisions (Note 28)	(7)	(35)
Provision for termination of contract (28)	21	-
	(1.584)	2.725

The Bank performed accounting estimations related to impairment of investment in branches and related equipment after the plan for new branch network has been adopted as part of integration proces with Podgorička banka.

According to performed accounting estimations the Bank recognised impairment:

- In leased premises and equipment in amount of EUR 77 thousand, of which impairment of leased premises was EUR 54 thousand and in equipment EUR 23 thousand,
- intangible assets EUR 1 thousand.

Also, based on Rent Contract in Capital Plaza, the Bank recognised additional provision for the penalty in amount of EUR 21 thousand.

During 2019, the Bank transfer in off-balance evidence, as partial write-off and interest recognition on Stage 3 credit exposure in amount of EUR 8.363 thousand (December 31, 2018: EUR 20.184 thousand). For these exposures the Bank has no reasonable expectations of recovering. The identification and decision of partial write-off has been done according Rulebook for the identification and qualification of the partial write off amount for Crnogorska Komercijalna Banka a.d. Podgorica. The Banks will continue with collection activities for these receivables.

In 2019, the Bank sold receivables in the amount of EUR 2.278 thousand for the price of EUR 1,166 thousand. The gross value of sold receivables was EUR 8.721 thousand, of which in off-balance evidence was EUR 6.443 thousand.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

12. INCOME TAXES

a) Components of income taxes

In thousands of EUR	2019	2018
Current income tax expenses	(1.123)	(1.013)
Deferred tax benefits	666	(11)
	(457)	(1.024)

b) Numerical Reconciliation between Tax Expense and the Product of Accounting Results Multiplied by the Applicable Tax Rate

	In thousands of EUR Year Ended December 31, 2019	2018
Profit before tax	4.075	8.404
Income tax (9%)	(367)	(748)
Income tax (9%) on capital losses	-	(8)
Expenses not recognized for tax purposes	(696)	(26)
Effects of changing of the legislation amendments	-	-
Capital tax losses carried forward, used for tax deduction	-	6
Effects of the reconciliations with the taxable base with the statutory financial statement	(120)	(243)
Other tax effects	60	6
Current income tax	(1.123)	(1.013)
The difference between the present value of tangible assets and intangible assets recognized in the financial statements and tax report	6	(28)
Salary costs that are recognized for tax purposes after disbursement	502	17
Impairment of assets that are not recognized for tax purposes	158	-
Deferred tax	666	(11)
Total tax expenses	(457)	(1.024)
Effective tax rate	*11.22%*	*12.18%*

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

13. INCOME TAXES (Continued)

c) Deferred tax assets and liabilities

Deferred tax liabilities at December 31, 2019 in the amount of EUR 216 thousand (December 31, 2018: EUR 380 thousand) are associated with the temporary differences arising between the tax bases of property and equipment and the carrying value of such assets.

	Year Ended December 31, 2019			Year Ended December 31, 2018		
	Deferred tax assets	Deferred tax liabilities	Deferred tax	Deferred tax assets	Deferred tax liabilities a	Deferre d tax
Depreciation of fixed assets	-	216	216	-	380	(380)
Salary costs that are recognized for tax purposes after disbursement	593	-	593	-	(91)	91
Actuarial losses on defined benefit pension plans	-	12	(12)	-	-	-
Change in fair value of securities at fair value through other comprehensive income	10	10	-	53	279	(226)
Deferred tax assets / (liabilities)	603	238	365	53	568	(515)

e) Taxes, Contributions and Other Duties Not Related to Operating Results

Taxes, contributions and other duties that are not related to the Bank's operating results, include property taxes, employer contributions on salaries, and various other taxes and contributions paid pursuant to state and municipal regulations.

14. CASH AND BALANCES WITH THE CENTRAL BANK

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Cash on hand in EUR	27.449	27.443
Cash on hand in foreign currencies	2.116	2.002
Cash in the course of collection	1.597	1.173
Gyro account	82.635	64.686
Included in cash and cash equivalents (Note 33)	113.797	95.304
Obligatory reserve held with the Central Bank	46.313	40.033
Less: Allowance for impairment	(86)	(86)
	160.024	135.251

The Bank's obligatory reserve at December 31, 2019 represents the minimum deposits set aside in accordance with the Central Bank of Montenegro Regulation with respect to "Decision on Bank Reserve Requirements To Be Held with The Central Bank of Montenegro" ("Official Gazette of the Montenegro," no. 35/11, 22/12, 61/12, 57/13, 52/14, 07/15 i 33/16). In accordance with the said bank reserve requirements calculated on demand deposits and time deposits.

14. CASH AND BALANCES WITH THE CENTRAL BANK (Continued)

Required reserves are calculated by applying the rate of:

- 7,5 % - on the part of the base consisting of demand deposits and deposits with agreed maturity up to one year, or up to 365:
- 6,5% - on the part of the base comprised of deposits with agreed maturity over one year, or over 365 days.
- 7,5 % - on deposits with agreed maturity over 365 days, with an option clause of the termination deposits within less than one year, or within less than 365 days.

A bank may use up to 50% of its reserve requirement deposits to maintain its daily liquidity. The bank shall not be charged any fee for the use of its reserve requirement provided that it meets the prescribed level of the reserve requirement at the end of the same day. The Bank shall pay monthly fee for the amount of reserve not returned the same day, at the rate established under a separate Central Bank regulation.

On 50% of funds set aside in accordance with the Decision, the Central Bank pays a monthly fee to the banks until the 8th of the month for the previous month, calculated at the rate of EONIA decreased by 10 basis points annually, whereby this rate may not be lower than zero.

If the Bank plans to withdraw the reserve requirement from the Central Bank foreign account in the amount of more than euro 500 thousand, the Bank shall announce it and notify the Central Bank thereof in writing at least three working days before the day of the withdrawal of the reserve requirement funds.

15. LOANS AND ADVANCES TO BANKS AT AMORTIZED COST

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Accounts in foreign banks	16.572	38.234
Placements with foreign banks - up to 3 months	21.360	18.247
Interest on term deposits	37.932	56.481
Interest on term deposits	2	
Nostro-covered letters of credit and guarantees	1.268	1.209
Less: Allowance for impairment	(1)	(1)
	39.201	57.689

At December 31, 2019, nostro-covered letters of credit and guarantees with foreign banks stated in the amount of EUR 1.268 thousand primarily relate to cash placed in Visa international service Association in the amount of EUR 1.042 thousand as security for Visa credit cards, EUR 226 thousand with Deutsche Bank Frankfurt to securitize American express credit cards.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

16. LOANS AND ADVANCES TO CUSTOMERS AT AMORTIZED COST

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Up to one year in EUR	119.935	116.969
Over one year in EUR	380.471	312.759
	500.406	429.728
Less: Allowance for impairment	(22.625)	(34.633)
	477.781	395.095

Short-term loans to non-financial sector (enterprises) during 2019 were primarily granted for working assets with maturity from one to twelve months, while long-term loans were granted for periods from one to ten years, and mainly refer to enterprises from trade activities. Short-term loans to enterprises are mainly granted with annual interest rate from 2,0 to 12 percent, while annual interest rate for long-term loans was ranging from 2,3 to 10 percent.

Short-term loans for retail customers during 2019 were granted with annual interest rate ranging from 6,5 (cash loans) to 20,00 percent (overdraft and credit card loans). Long term loans to retail customers include loans for purchase of residential units, adaptation of residential units and business premises, financing of consumers goods and other purposes were granted on period from one to twenty-five years with variable interest rate ranging from 2,99 to 6,99 percent. Loans under the Government's project "1000+" were granted with annual interest rate of 2,99%. Geographic distribution of granted loans in Bank’s loans portfolio mainly refer to clients from Montenegrin territory.

Movement in allowance for losses on loans and advances at amortized cost is as follows:

	In thousands of EUR	
	Year Ended December 31,	
	2019	2018
Balance at January 1	34.633	63.156
Effect of the first application of IFRS 9		811
Provision charged for the year (Note 11)	(1.825)	1.776
Utilization of provisions due to the sale of loans to third parties	(7.555)	(3.649)
Partial write offs	(97)	(20.087)
Write offs	(2.531)	(7.393)
Reclassification from other assets	-	19
Balance at December 31	22.625	34.633

17. SECURITIES AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Equity securities - at fair value - listed:		
- Montenegroberza	104	105
- SWIFT	49	46
- Centralna depozitarna agencija	143	143
- VISA	-	3.900
- Electric Power Utility of Montenegro	206	200
- Lutrija Crne Gore	18	18
- Mastercard	-	2.580
	520	6.992

In October 2019, the Bank sold 15,670 shares of Mastercard, Class B and 8,466 shares of VISA International, Class C. Effects from sales the Bank recognized in other comprehensive income in amount of EUR 4.880 thousand.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

18. SECURITIES AT AMORTIZED COST

	In thousands of EUR December 31, 2018	December 31, 2018
Governments bonds	78.395	77.990
Interest receivables	1.606	2.029
	80.001	80.019
Less: Allowance for impairment	(435)	(741)
	79.566	79.278

As of December 31, 2019 securities at amortized cost in the amount of EUR 79.566 thousand (December 31, 2018: EUR 79.278 thousand) relate to Governments bonds issued by State of Montenegro .
As of December 31, 2019 securities at amortized cost in the gross carrying amount of EUR 80.001 thousand (December 31, 2019: EUR 80.019 thousand) relate to the following:

	Gross carrying amount with contractual maturity date to 1 year	Gross carrying amount with contractual maturity date over 1 year	Nominal Interest rate	Value date
Eurobonds - Ministry of Finance of the Government of Montenegro	33.885	-	3,875%	18.03.2020.
Eurobonds - Ministry of Finance of the Government of Montenegro	17.210	-	5,375%	16.11.2020.
Long term Bonds - Ministry of Finance of the Government of Montenegro	-	27.300	4%	24.03.2024.
	51.095	27.300		

19. SHARES AND EQUITY INVESTMENTS

As December 31, 2019 equity investmets in associated companies, subsidiaries and joint ventures amounted to EUR 41.810 thousand (December 31, 2018 EUR 335 thousand).

The Bank bought 100% shares in OTP Debt Collection, doo Podgorica for a price of EUR 335 thousand. The Bank obtained approval of the Central Bank of Montenegro No. 0102-07700-2/2018 on 24.10.2018 for this transfer. The Bank as the owner of OTP Debt Collection, doo Podgorica was officially registered in the Central Registry of Commercial Entities on December 17, 2018.

During 2019, the Bank acquired a 100% interest in Podgoricka Bank, a.d. Podgorica for the amount of EUR 41,475 thousand. The Bank became the majority owner of shares in Podgoricka Bank, a.d. Podgorica in July 16, 2019. On that occasion, 90.5578% of the shares were taken. Owners of minority shares (7,963 shares) accepted the Bank's offer to take over the remaining shares to Podgorica Bank, a.d. Podgorica, on December 20, 2019, when the Bank acquired 8.23% of the shares. Following the conclusion of the public takeover bid, the Bank exercised the right of forced purchase of minority shareholder shares (1,171 shares) at the price of the public takeover bid, and on December 23, 2019, the Bank became the owner of 100% of the share capital in Podgoricka Bank, a.d. Podgorica.

The Bank considers that in the period from the date of payment to the day of the report, the market conditions are not substantially changed and there are no internal and external indications that would affect the value of the investment.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

20. FORFEITING

	In thousands of EUR	
	December 31, 2019	**December 31, 2018**
Forfeiting receivables	2.640	2.697
Less: Allowance for impairment	(1.399)	(1.476)
	1.241	1.221

As of December 31, 2019, the Bank's receivables arising from forfeiting operations totalled EUR 1.241 thousand (December 31, 2018: EUR 1.221 thousand). In the course of 2011, the Bank repurchased the receivables that had previously (during 2009, 2010 and 2011) been sold to OTP Bank Plc, Budapest. The repurchase was performed in five tranches.

Movement in allowance for forfeiting is as follows:

	In thousands of EUR	
	Year Ended December 31,	
	2019	**2018**
Balance at January 1	1.476	1.717
Effect of the first application of IFRS 9	-	(99)
(Release)/Provision charged for the year (Note 11)	(77)	(23)
Write offs	(1)	(119)
Balance at December 31	1.398	1.476

21. INTANGIBLE ASSETS

			In thousands of EUR
	License	**Software**	**Total**
Cost			
Balance at January 1, 2018	3.590	8.947	12.537
Additions	932	187	1.119
Balance at January 1, 2019	4.522	9.134	13.656
Additions	776	363	1.139
Acumulated impairment		(1)	(1)
Balance at December 31, 2018	5.298	9.496	14.794
Accumulated depreciation			
Balance at January 1, 2018	1.430	7.695	9.126
Charge for the year (Note 10)	693	275	968
Balance at January 1, 2019	2.123	7.970	10.093
Charge for the year (Note 10)	812	273	1.085
Balance at December 31, 2019	2.935	8.243	11.178
Carrying amount:			
- as of December 31, 2019	**2.363**	**1.253**	**3.616**
- as of December 31, 2018	**2.399**	**1.164**	**3.563**

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

22. PROPERTY, PLANT AND EQUIPMENT

In thousands of EUR

	Buildings	Equipment and Other Assets	Right of use assets	Total
Cost				
Balance at January 1, 2018	9.805	21.767	-	31.572
Additions	446	1.124	-	1.570
Disposals	(83)	(154)	-	(237)
Balance at January 1, 2019 (Note 2.6.(i) RoU)	10.168	22.737	3.723	36.628
Additions	148	2.026	290	2.464
Disposals	(15)	(86)	(17)	(118)
Acumulated impairment	(1.673)	(77)	-	(1.750)
Balance at December 31, 2019	8.628	24.600	3.996	37.224
Accumulated depreciation				
Balance at January 1, 2018	2.117	16.094	-	18.211
Charge for the year (Note 10)	198	1.381	-	1.579
Disposals	(26)	(138)	-	(164)
Balance at January 1, 2019	2.289	17.337	-	19.626
Charge for the year (Note 10)	248	1.906	803	2.957
Disposals	(15)	(77)	(9)	(101)
Balance at December 31, 2019	2.522	19.166	794	22.482
Carrying amount:				
- as of December 31, 2019	6.106	5.434	3.202	14.742
- as of December 31, 2018	7.879	5.400	-	13.279

As of December 31, 2019 the Bank had no mortgages instituted over its property and equipment to securitize loan repayment.

Types of right of use assets are:

In thousands of EUR

	December 31, 2019	December 31, 2018
Buildings	3.996	-
Accumulated depreciation	(794)	-
	3.202	-

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

23. OTHER ASSETS

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Other receivables for fees and commissions	1.673	1.428
Temporary accounts	1.138	745
Receivables from checks	3	3
Other financial receivables	38	32
Receivables from commission business	246	250
Prepayments	128	168
Receivables from buyer	49	33
Deferred expenses	328	110
Other operating receivables	176	139
Current tax	11	26
Receivables in respect of the legal suits assets and other assets in delay	7.685	14.578
	11.475	17.512
Less: Allowance for impairment	(9.040)	(15.699)
	2.435	1.813

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

23. OTHER ASSETS (Continued)

Receivables arising from legal suits assets and uncollectable receivables, which were fully provided for as of December 31, 2019 in the amount of EUR 9.040 thousand include the following:

- Provisions for receivables based on legal suits filed against the Bank's former employees in the amount of EUR 6.229 thousand (December 31, 2018: EUR 6.223 thousand);
- Provisions for uncollectable receivables based on payment transfer fees, commissions, bills of exchange, cheques, electronic banking, payment and credit cards, etc. in the amount of EUR 2.485 thousand (December 31, 2018: EUR 2.221 thousand);
- Other uncollectable receivables in the amount of EUR 326 thousand (December 31, 2018: EUR 326 thousand).

Movement in allowance for other assets is as follows:

	In thousands of EUR Year Ended December 31, 2019	**2018**
Balance at January 1	15.699	15.411
Provision charged for the year (Note 11)	431	628
Write-off	(7.090)	(322)
Reclassification to loans and advances to customers	-	(18)
Balance at December 31	9.040	15.699

24. DEPOSITS FROM BANKS

As December 31, 2019 Deposits from domestics banks are in the amount of EUR 10.982 thousand (December 31, 2018: EUR 7.022 thousand) and in total amount represent sight deposits.

25. DUE TO CUSTOMERS

	In thousands of EUR December 31, 2019	December 31, 2018
Demand deposits in Euro:		
- Enterprises	192.913	154.334
- Governmental institutions	44.430	64.132
- Retail customers	265.471	232.597
- Other entities	4.895	8.796
Demand deposits in foreign currencies:		
- Enterprises	6.918	6.212
- Governmental institutions	56	99
- Retail customers	18.711	18.756
- Other entities	-	-
Short-term deposits in Euro:		
- Enterprises	5.987	3.140
- Governmental institutions	60	142
- Retail customers	42.191	42.083
- Other entities	-	1
Short-term deposits in foreign currencies:		
- Retail customers	1.581	2.645
Long-term deposits in Euro:		
- Enterprises	6.859	2.622
- Governmental institutions	216	215
- Retail customers	16.673	19.743
- Other entities	1	-
Long-term foreign currency deposits:		
- Retail customers	-	-
	606.963	555.517

Demand deposits of natural persons in EUR were deposited at an interest rate of 0,10% on an annual basis. Demand deposits of natural persons in foreign currency were deposited at a uniform interest rate of 0,01% per annum.

On term deposits of companies in EUR with maturity in 2019, the interest at interest rates ranging from 0,01% to 0,5% per annum was calculated, depending on the term and deposit amount.

Currently, the maximum interest rate at which term deposits of companies may be deposited without purpose is 0,13% for a period of 12 months or more, according to the current terms and conditions.

Term deposits of natural persons in EUR were deposited at an interest rate ranging from 0,01% to 0,5% per annum, depending on the term and deposit amount.

Interest rate for demand deposits of companies in 2019 ranged from 0% - 0,5% per annum.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

26. OTHER BORROWED FUNDS

As December 31, 2019, other non-current borrowed funds are in total amount of EUR 13.913 (December 31, 2018 EUR 2.733 thousand), and consist of following borrowings:

				In thousands of EUR
	Current Year Ended December 31,		**Non-current Year Ended December 31,**	
	2019	**2018**	**2019**	**2018**
Long-term domestic borrowings:				
- Directorate for Development of Small and Medium Sized Enterprises	-	-	485	568
- Government of Montenegro – 1000+ housing	8	9	3.419	2.156
	8	9	3.905	2.724
Short-term foreign borrowings:				
- OTP Bank	-		10.000	-
	-		10.000	-
	8	9	13.905	2.724

As of December 31, 2019, the total amount of EUR 485 thousand (December 31, 2018: EUR 568 thousand) represents long-term borrowings in domestic currency received from the Directorate for Development of Small and Medium Sized Enterprises. These borrowings were granted for periods ranging from three to eight years, at annual interest rates ranging up to 7 %.

As of December 31, 2019, the total amount of EUR 2.066 thousand (December 31, 2018: EUR 2.156 thousand) represents long term borrowings in domestic currency received from the Ministry of Finance and the Ministry of Sustainable Development and Tourism of Montenegro on the basis of the Project "1000+" for approving housing loans for social vulnerable groups.

- Liabilities in the amount of EUR 1,065 thousand (31 December 2018: EUR 1,153 thousand) relate to the Business Cooperation Agreement concluded in October 2010, for a period of 20 years, with a grace period of up to 5 years and a fixed interest rate of 0,98%;
- Liabilities in the amount of EUR 1,002 thousand (31 December 2018: EUR 1,002 thousand) relate to the Cooperation Agreement for the implementation of the "1000+" apartments project concluded in October 2016, for a period of 20 years, with a grace period of up to 5 years and a fixed interest rate of 0,75%;
- Liabilities in the amount of EUR 1,353 thousand relate to the Cooperation Agreement for the implementation of the "1000+" apartments - Phase III project, which was concluded in June 2019, for a period of 20 years, with a grace period of up to 3 years and an interest rate of 0%. For this purpose, the Bank issued promissory notes, as collateral.

During 2019, the Bank used short-term borrowings from parent company at annual interest rate ranging from (0.36)% - 0.615%.

27. OTHER LIABILITIES

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Liabilities to employees	1.131	1.046
Liabilities to employees - severance payment	5.483	-
Accrued liabilities	1.573	864
Deferred guarantees fee	900	895
Trade payables	56	53
Temporally accounts	268	1.082
Other taxes and contributions	1.806	1.269
Leasing liabilities (Note 32)	3.265	-
Other liabilities	630	289
	15.112	5.498

Integration plan for Bank and Podgorička banka includes closing of a number of branches and decreasing number of employees. Decreasing number of employees will done in accordance with the Labour Law, Collective Agreement and individual employment contracts. For this purpose the Bank recognised provisions for severance payment in amount EUR 5,483 thousand. These direct costs are necessarily caused by restructuring and are not related to the Bank's regular activities.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

28. PROVISIONS

	December 31, 2019	December 31, 2018
	In thousands of EUR	
Provisions for potential litigation losses	1.935	1.929
Provisions for losses per off-balance sheet items	659	877
Provision for termination of contract (Note 11)	21	-
Other provisions	420	421
	3.035	3.227

December 31, 2019	Provisions for potential litigation losses	Provisions for losses per off-balance sheet items	Other provisions and Provision for termination of contract	Total
Balance at January 1	1.929	877	421	3.227
Charged during the year (Note 11)	305	(218)	14	101
Utilization of provisions payments made during the year	(300)	-	-	(300)
Other muvements	-	-	7	7
Balance at December 31	1.935	659	441	3.035

December 31, 2018	Provisions for potential litigation losses	Provisions for losses per off-balance sheet items	Other provisions	Total
Balance at January 1	1.438	649	421	2.508
Effects of first application of IFRS 9	-	(118)	-	(118)
Accumulated impairment on January 01, 2018	1.438	531	421	2.390
Charged during the year (Note 11)	77	347	(35)	389
Utilization of provisions payments made during the year	(92)	-	-	(92)
Other muvements	506	(1)	35	540
Balance at December 31	1.929	877	421	3.227

29. EMPLOYEE BENEFITS

In accordance with the Collective Bargaining Agreements, the Bank has an obligation to disburse an employment retirement benefit to a retiree, in an amount equal to six average net salaries effective in the Bank in the month prior to the employee's retirement.

The independent actuary carried out the most recent actuarial valuations of the defined benefit obligation at December 31, 2019. Technical bases applied for calculating the estimated present value of retirement benefits and jubilee awards include implementation of the following:

a) Discount rate – 2.55%
b) Estimated annual salary growth rate 0%

Movements in the present value of the defined benefit obligation in the current period were as follows:

In thousands of EUR

	December 31, 2019			**December 31, 2018**		
	Retiremen t Benefits	**Other Long-Term Employee Benefits**	**Unused vacation**	**Retirement Benefits**	**Other LongTerm Employee Benefits**	**Unused vacation**
Balance at January 1	534	42	605	543	42	605
Charged during the year (Note 12)	(8)	100	-	-	-	-
Actuarial losses on defined benefit pension plans	138					
Payments made during the year	(1)	(1)	-	(9)	-	-
Balance at December 31	663	141	605	534	42	605

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

30. SHARE CAPITAL

As of December 31, 2019, the Bank’s share capital is comprised of 355.717 common shares (December 31, 2018: 267.705 common shares), with an individual par value of EUR 511,2919 All issued shares are fully paid.

In June 2019, pursuant to the GSM Decision no. 128/2019 the shareholder carried out a capital increase of EUR 45.000 thousand, consisting of 88.012 shares of nominal value of 511,2919 each

As of December 31, 2019, the sole shareholder of the Bank's shares is OTP Bank Plc., Budapest with 100 percent of equity interest.

In accordance with the regulations of the Central Bank of Montenegro, as of December 31, 2019, the Bank is obligated to maintain the minimum capital adequacy ratio of 10%. As of December 31, 2019, according to the Bank’s calculations, capital adequacy ratio was 23,67%.

31. OFF-BALANCE-SHEET ITEMS

	In thousands of EUR	
	December 31, 2019	**December 31, 2018**
a) Guarantees, Other Contingent Liabilities and Commitments		
Payment guarantees	14.987	8.378
Performance bonds	17.379	8.316
Uncovered letters of credit	542	549
Undrawn credit facilities	40.148	41.603
	73.056	58.846
b) Other off-balance-sheet items		
Partial written off loans	13.575	15.754
Partial written off interest	7.134	4.532
Other off-balance sheet items	-	-
	20.709	20.286
	93.765	79.132

32. LEASE LIABILITY

Following the adoption of IFRS 16, the Bank recognised lease liabilities related to leases for office buildings which were previously classified as "operating leases" in accordance with IAS 17 Leases. These liabilities is measured at the present value of lease payments receivable as at the date of commencement of the application of IFRS 16, as of January 01, 2019.

	In thousands of EUR
Future lease payments under operating lease arrangement as of December 31, 2018,VAT excluded	4.115
Present value of the future lease payments as of the first-time adoption date January 01, 2019	3.723
Lease liability recognized as at January 1, 2019	3.723
Of which:	
- lease liability maturing over a year	3.040
- lease liability within a year	683
Lease liability recognized as at January 1, 2019	3.723
Interest on lease liabilities	123
Adjustments during the year due to new leases and terminations of contracts	282
Payments during the year	(863)
Lease liability recognized as at December 31, 2019 (Note 27)	3.265
Of which:	
- lease liability maturing over a year	2.505
- lease liability within a year	760

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

33. CASH AND CASH EQUIVALENTS

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three month maturity from the date of acquisition including: cash on hand, non-restricted balances with the Central Bank of Montenegro and other banks.

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Cash and balances with the Central Bank (Note 14)	113.797	95.304
Loans and advances to banks (Note 15)	37.932	56.481
	151.729	151.785

34. RELATED PARTY TRANSACTIONS

All transactions with related parties arise in the normal course of business and their value is not materially different from the terms and conditions that would prevail in arms-length transactions. The amounts of loans and advances given to related parties are secured in accordance with Procedures of the Bank and Central Bank of Montenegro legislation. As of December 31, 2019, and December 31, 2018, the Bank did not recognize impairment provisions for the loans and advances given to related parties.

The following table summarizes receivables from and payables to related parties as of the statement of financial position date:

	In thousands of EUR	
	December 31, 2019	December 31, 2018
Loans and advances to banks at amortized cost		
- OTP Bank Plc. Budapest	26.867	39.008
-OTP Bank Hrvatska	*28*	*28*
- OTP-Vojvođanska Banka	*3*	-
Loans and advances to customers at amortized cost:		
-OTP BANK Plc.Budapest	-	-
Loans at amortized cost		
- Bank's employees	9.066	8.176
Shares and equity investments		
- OTP Debt Collection doo, Podgorica	335	335
- OTP PG Bank	41.475	-
Other assets:		
- OTP Bank Plc. Budapest:	2	-
- OTP Albania	23	-
Total receivables	77.799	47.547
Due to customers:		
- Bank's employees	4.811	3.807
- OTP Factoring Montenegro	2.530	4.055
- Debt Management Project Montenegro d.o.o. Podgorica	1.089	1.126
	8.430	8.988
Short term foreign borrowings:		
- OTP Bank Plc. Budapest	10.000	-
	10.000	-
Total liabilities	18.430	8.988
Receivables, net	59.369	38.559
Off-balance-sheet items		
Received guaranties :		
- OTP Bank Plc., Budapest	1.733	1.693
Total off-balance	1.733	1.693

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2019

34. RELATED PARTY TRANSACTIONS (Continued)

Short and long-term loans to Bank employees were granted on period from one to twenty-five years. Loans were granted with annual interest rate ranging from 2,1 to 8 percent. Long-term loans to Bank employees include loans for purchase of residential units were granted with annual interest rate 3,99 percent and mortgage loans were granted with annual interest rate ranging from 3,99 to 4,99 percent.

Income and expenses from transactions with related parties during 2019 and 2018 were as follows:

	In thousands of EUR Year Ended December 31, 2019	2018
Interest income:		
- OTP Bank Plc. Budapest	361	376
- Bank's employees	443	437
	804	813
Fee income:		
- OTP Bank Plc. Budapest	4	7
- OTP Debt Collection doo, Podgorica	2	3
- Debt Management Project Montenegro d.o.o. Podgorica	5	6
- Podgorička banka, a.d.,Podgorica	32	-
Total income	43	16
Other non-interest income		
- OTP Debt Collection doo, Podgorica	-	6
Total income	-	6
Total income	*847*	*835*
Interest expense:		
- Bank's employees	-	-
- OTP Bank Plc., Budapest	(179)	(115)
	(179)	(115)
Fee expense:		
- OTP Bank Plc. Budapest	(15)	(14)
- Debt Management Project Montenegro d.o.o. Podgorica	-	-
	(15)	(14)
Other costs and expenses:		
- OTP Debt Collection doo, Podgorica	-	(8)
- OTP Bank Plc., Budapest	(8)	
	(8)	(8)
Total expenses	(202)	(137)
Income, net	645	698

During 2018, remunerations paid to persons with special authorizations and responsibilities in the Bank amounted to EUR 1,216 thousand (2018: EUR 1,028 thousand).

35. LITIGATION

As of December 31, 2019, the Bank was involved with a number of lawsuits filed against it by legal entities and private individuals. In the assessment of the Bank's Legal Affairs Department, the total value claimed in these legal proceedings, not including costs of court expenses, amounts to EUR 5.921 thousand (2018: EUR 5.776 thousand). This amount does not include potential penalties that may be assigned after the completion of the legal proceedings, given that the Bank's management was unable to determine potential effects of penalties that might arise from the proceedings in progress until the date of issuance of these financial statements.

35. LITIGATION (Continued)

As of December 31, 2019, the Bank recorded provisions against potential losses on litigation in the amount of EUR 1.935 thousand (2018: EUR 1.929 thousand). The outcome of the proceedings in progress cannot be anticipated with certainty; however, the Bank's management and legal advisor do not expect additional negative outcomes that could have materially significant effects on the Bank's financial statements.

As of December 31, 2019, the Bank was involved in lawsuits for 1.045 contracts that as a plaintiff the Bank filed against legal entities and private individuals, claiming the total value of EUR 19.955 thousand.

36. TAXATION RISKS

The tax legislation of Montenegro is subject to varying interpretations and changes occur frequently. The interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Bank may not coincide with that of the management. As a result, tax authorities may challenge transactions and the Bank may be assessed additional taxes, penalties and interest. The periods remain open to review by the tax and customs authorities with respect to tax liabilities for five years. This practically means that tax authorities could determine payment of outstanding liabilities in the period of five years from the origination of the liability.

37. EVENTS AFTER THE REPORTING PERIOD

The rapid development of the Covid-19 virus and its social and economic impact in Montenegro and globally may result in assumptions and estimates that will require modifications. At this stage, the Management is not able to reliably estimate the impact as the new events are emerging on a daily basis.

In addition to the afore stated, at the session of its Council held on March 17, 2020, the Central Bank of Montenegro adopted the Decision on temporary measures on mitigation of newly-emerged coronavirus negative impact on financial system ("Official Gazzete of Montenegro", No. 019/20 dated March 19, 2020) (the "Decision") thereby providing for the clients (corporate, retail, entrepreneurs and other) a standstill (moratorium) for the period of 90 days in repayment of the loans approved by the banks. The Management of the Bank is unable to estimate possible effects of the above Decision on the Bank's financial statements.

The long-term forecasts show that the consequences may affect the loan volume, cash flows and profitability. Notwithstanding the above, as at the date of issuance of these financial statements, the Bank continues to settle its liabilities in due time, and, therefore, continues to apply the going concern principle as the accounting basis of financial statements preparation.

38. EXCHANGE RATES

The official exchange rates for major currencies used in the translation of statement of financial position items denominated in foreign currencies, into euros as at December 31, 2019 and 2018 are as follows:

	December 31, 2019	December 31, 2018
USD	0,8937	0,8731
CHF	0,9199	0,8907
GBP	1,1736	1,108

Podgorica, March 24, 2020

Signed on behalf of Crnogorska komercijalna banka AD, Podgorica by:

Pal Jozsef Kovacs	Maja Krstič	Srđan Janković
Chief Executive Officer	Executive director for Finance and Bank operation	Director of Accounting & Controlling Directorate

CRNOGORSKA KOMERCIJALNA BANKA A.D. Member of OTP group PODGORICA