

# ANNUAL REPORT

**NOVABANKA**



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ON BUSINESS PERFORMANCE OF THE BANK FOR 2016

May, 2017

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## 1. MACROECONOMIC ENVIRONMENT

According to the International Monetary Fund projections (World Economic Outlook) from April 2017, real growth rate of the world economy in 2016 will amount 3,1% and it will be lower compare to 2015 (3,4%). Projection of slower growth rate of world economy is result of slow down of growth of Emerging Markets and Developing Economies as well as Advanced Economies.

*Table Real GDP growth rate (%)*

<i>GDP growth rate</i>	2013	2014	2015	2016	2017p	2018p
<b>World</b>	3,4	3,5	3,4	3,1	3,5	3,6
<b>Advanced Economies</b>	1,3	2,0	2,1	1,7	2,0	2,0
<b>Eurozone</b>	-0,3	1,2	2,0	1,7	1,7	1,6
<b>Other advanced economies (except G7 and Eurozone)</b>	2,4	2,9	2,0	2,2	2,3	2,4
<b>Emerging Market and Developing Economies</b>	5,1	4,7	4,2	4,1	4,5	4,8

*Source: International Monetary Fund, World Economic Outlook Database*

This year, for the Montenegrin economy is expected lower GDP growth rate, primarily due to slow implementation of major infrastructure projects. Available statistical indicators in most sectors during the first nine months of 2016, mostly have a growing trend.

During 2016, the banking sector is characterized by positive trends in key business indicators. Liquidity and solvency ratios were significantly above the prescribed level. Non-performing loans (without interest and prepayments) decreased.

At the end of 2016, loan receivables from customers amounted to EUR 2,046 million and increased by 7.3% compared to the end of 2015. Customer deposits at the end of 2016 amounted to EUR 2,883 million which is 9.4% more than at the end of 2015.

Industrial production in the first nine months of 2016 compared to the same period in 2015 decreased by 4.2%. The decline in production was recorded in all three sectors: mining and quarrying (-26.1%), manufacturing (-3.2%) and electricity, gas and steam supply (-2.6%).

Number of tourist arrivals in the first nine months of 2016 was 1.7 million, which is 5.2% more than in the same period last year. Number of foreign tourists amounted to 1.6 million. Overnight stays is recorded on 10.8 million, which is 1.2% more than in the same period in 2015.

In the period January-September 2016, according to preliminary data, net foreign direct investments amounted to 281,9 million euros, representing a decrease of 46,3% compared to the same period in 2015. Total FDI inflow amounted to 551,9 million euros, which is 8,3% less compared to the previous year. FDI inflows in the form of equity investments amounted to 227,4 million euros, of which 139,5 million related to investments in companies and banks, while the inflow from investment property amounted to 87,9 million euros. The inflow from intercompany debt amounted to 135 million euros (decrease of 27,2%), while withdrawals from investments by residents abroad amounted to 189,5 million euros. Total FDI outflow in this period amounted to 270 million euros. Most of this outflow refers to the dividend paid from accumulated profits, which according to the methodology of the IMF is recorded as withdrawal of capital, and a decrease of foreign investments.

Consumer prices in September 2016 compared to the same month of previous year decreased by 0.1%, while compared to the previous year recorded an increase of 0.3%.

The average number of employees in September 2016 amounted to 180.409 persons, which is 2.1% less compared to the previous month, but 1.9% more than in September 2015. The number of unemployed persons in Montenegro in September 2016 amounted to 42.483 representing an increase of 3,4% compared to the previous month and an

increase of 25,8% compared to September 2015. Unemployment rate, in September was 18,31%, and it increased by 3,75 percentage points compared to September last year.

In the first nine months, average (gross) salary in Montenegro amounted to EUR 748 and was higher by 3,3% compared to the same period last year. The average wage without taxes and contributions amounted to EUR 498, which is 4% more than in the same period last year. Compared to neighboring countries, Montenegro in September 2016, was on the third place considering the highest average salary, right behind Slovenia and Croatian, and before Bosnia and Herzegovina, Serbia and Macedonia.

## 2 IDENTITY CARD OF THE BANK

Nova Banka A.D. was formed by Azmont Investmenta DOO, the company that operates in Monetenegro since 2012, with the aim of building a luxury tourist complex "Portonovi" in Kumbor, Municipality Herceg Novi.

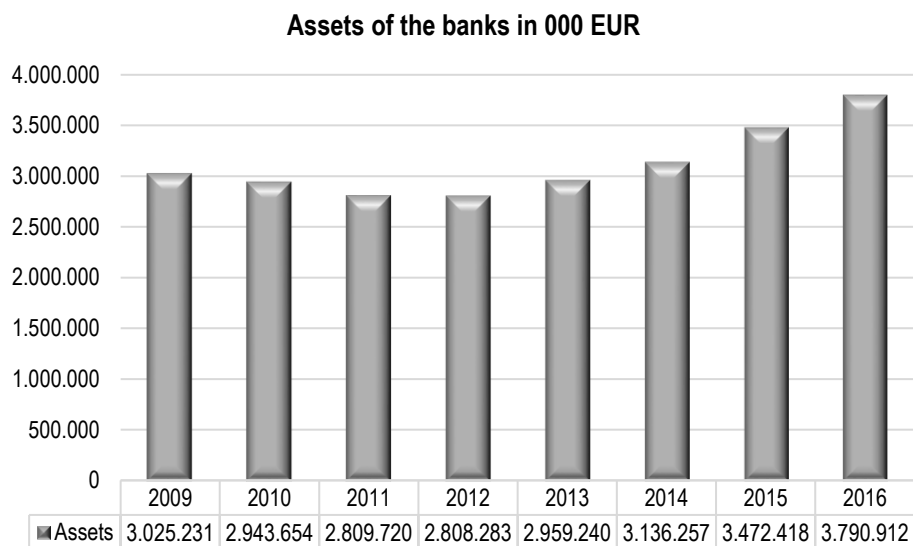
Activity of the Bank includes loan, deposit and guarantee activities, as well as foreign-exchange transactions, depot operations, treasury services, issuance, processing and recording of payment instruments.

The Bank is headquartered in Podgorica, Marka Miljanova street, no. 46.

Table 2 – Market share of the bank on December 31, 2016

31.12.2016				
Bank	Asstes	Loans	Deposits	Eqity
<b>Banking sector (in 000 Eur)</b>	3.790.912	2.045.882	2.882.750	487.428
<b>Nova banka AD (in 000 Eur)</b>	11.686	2.254	668	10.753
<b>% of share</b>	0,31%	0,11%	0,02%	2,21%

Graph 1 – Asstes of the banking sector for the period 2009-2016



In order to better positioning in the banking market, the Bank has maintained the quality of human resources, range of products and services and the selection and development of information systems.

Nova Banka AD Podgorica, the bank with the level of capital that provides the basis for a stable and safe operations, with the absorption capacity of potential risks from operations. The level of own funds at 31 December 2016 was EUR 10.304 thousand.

As at 31 December 2016, the Bank is consisted of headquarter in Podgorica and one branch office on the same location.

## 21. Organization and employees

### a) Bord of directors

Table 3.- Bord of directors of the bank

Position	Name	Date of birth	Residence
1. President	Ahmet Erentok	21.9.1962	Turkey
2. member	Rashad Aliyev	25.1.1982	Azerbaijan
3. member	Rashad Rasullu	11.4.1980	Azerbaijan
4. member	Gorhmaz Aghayev	1.5.1980	Azerbaijan
5. member	Ana Ivanović	12.8.1981	Montenegro

### b) Executive management of the Bank

Table 4.- Executive directors of the Bank

Name	Position	On the position starting from
Miodrag Radonjić	Chief Executive Officer	01.05.2016.
Kamran Mammadov	Chief Risk Officer	20.05.2016.

### c) Members of Asset and Liability Committee (ALCO)

Table 5.- Members of ALCO

Name	Position
Miodrag Radonjić	President
Kamran Mammadov	Member
Ana Rašović	Member
Enesa Bekteši	Member
Maja Barada	Member
Nikola Marinović	Member

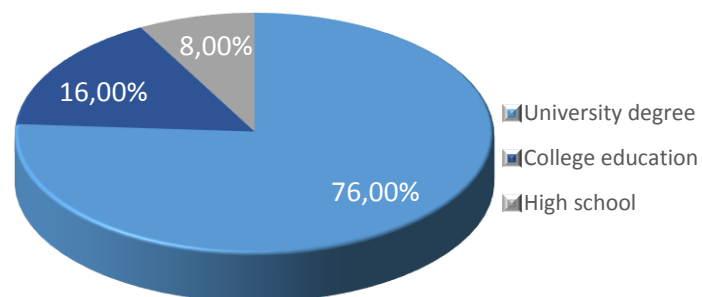
## 22. Personnel structure

On 31 December 2016 the Bank had 25 employees, with the following structure:

- University degree 19 employees or 76%,
- College education 4 employees or 16%,
- High school 2 employees or 8%.

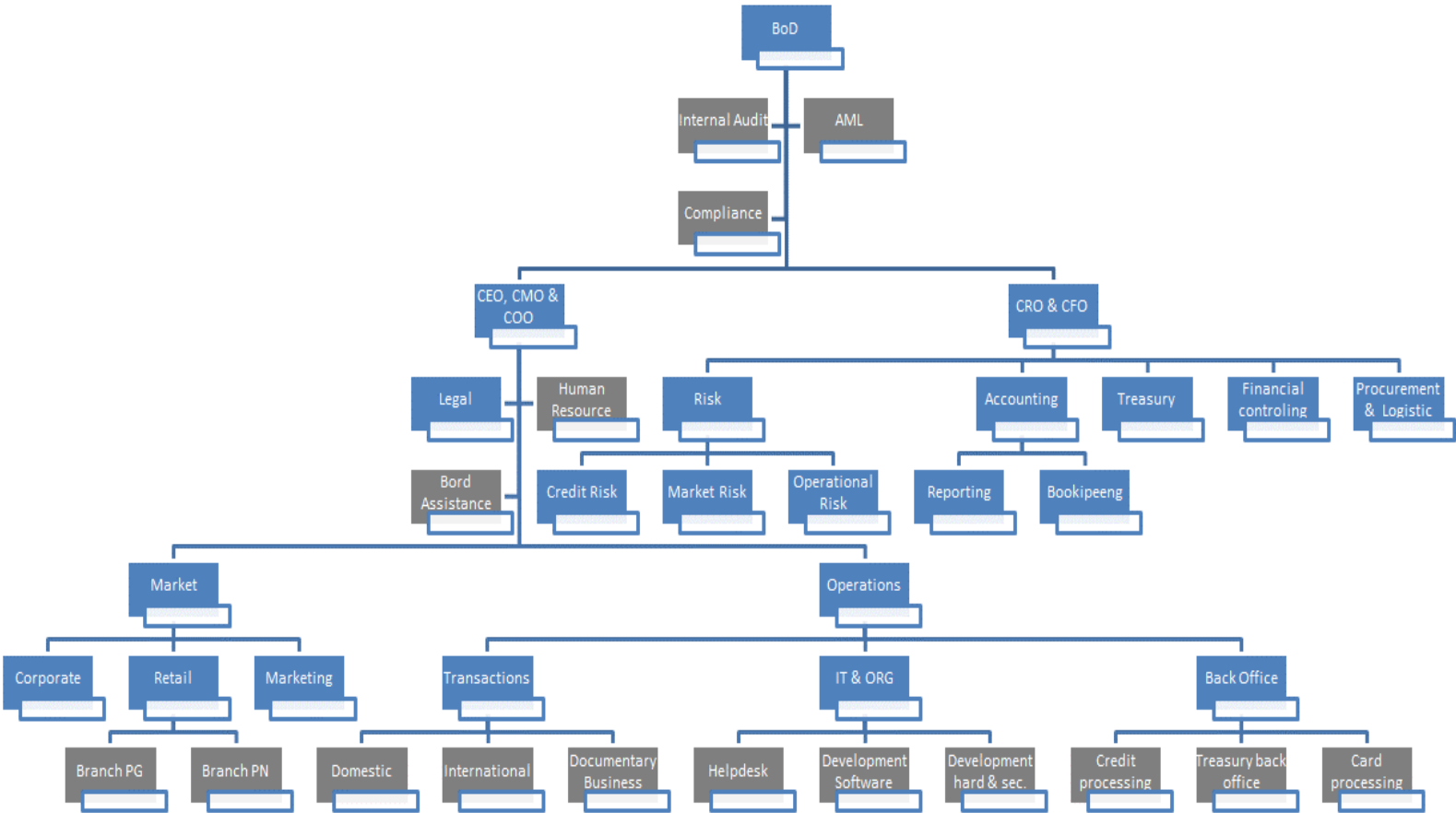
Graph 2. – Personnel structure

Qualification structure of the employees in 2016



23. Organizational structure of the Bank

Graph 3 – Organizational chart



3. PERFORMANCE OF THE BANK IN 2016

Table 6.- Performance indicators in 2016

(in 000 EUR)

DESCRIPTION	2016 (13.04.2016-31.12.2016)	2015
BALANCE SHEET ASSETS	<b>11.686</b>	<b>0</b>
GROSS LOANS	2.254	0
<b>Retail loans</b>	1.289	0
<b>Corporate loans</b>	965	0
DEPOSITS	<b>668</b>	<b>0</b>
<b>Retail deposits</b>	428	0
<b>Corporate deposits</b>	240	0
Total equity	<b>10.753</b>	0
LOSS FROM OPERATIONS	-1.227	0
PROFITABILITY RATIOS IN %		
ROA - financial result / balance sheet assets %	<b>-18,00</b>	<b>0</b>
ROE – financial result / total equity %	<b>-19,56</b>	<b>0</b>
NET INTEREST INCOME	27	0
NET FEE AND COMMISSION INCOME	-100	0
NUMBER OF EMPLOYEES	25	0
<b>Assets per employee in 000 EUR</b>	467	0
OPERATING EXPENSES	1.137	0
<b>INDICATORS</b>		
CAPITAL ADEQUACY %	<b>325,94</b>	<b>0</b>
LIQUIDITY RATIOS %	<b>17,7</b>	<b>0</b>
CASH IN 000 EUR	<b>5.950</b>	<b>0</b>
<b>Interest income / Interest bearing assets %</b>	3,42	0
<b>Interest income / Total assets %</b>	0,47	0
<b>Interest expenses / Interest bearing liabilities%</b>	1,04	0
<b>Operating expenses / Total expenses %</b>	91,53	0
<b>Liquid assets / Deposits %</b>	890,15	0
<b>Liquid assets / Total assets %</b>	50,91	0
<b>Liquid assets / Short-term liabilities %</b>	1.582,89	0



**4. REGULATORY REQUIREMENTS IN 2016**

*Table 7.- Regulatory requirements on 31 december 2016*

No	DESCRIPTION	LIMIT	31.12.2016
1	Capital Adequacy Ratio	min. 10 %	325,94%
3	Exposure to the related parties to the Bank	max. 25%	1,64%
4	Sum of big exposures	max. 800%	1,64%
5	Total equity in 000 EUR	min 5 mil	10.753
6	Own funds in 000 EUR	min 5 mil	10.304
7	Total risk assets and other risks in 000 EUR		
7.1.	Risk weighted assets		2.468
7.2.	Capital need for market risk		69
7.3.	Capital need for operating risk		0
7.4.	Capital need for country risk		0
7.5.	Capital need for other risks		0
7.6.	Open FX position		4

Audit company Ernst&Young d.o.o Montenegro, audited financial statements and regulatory requirements for 2016 and stated that there was no breaching of the same.

5. BALANCE SHEET FOR 2016

5.1. Assets of the bank on 31 December 2016

Table 8. – Assets of the Bank on 31 December 2016 in 000 EUR

ASSETS	31 December 2016	31 December 2015
<b>ASSETS</b>		
Cash and cash on the accounts with Central bank	5.488	0
Loans and receivables form banks	462	0
Loans and receivables form clients	2.254	0
Investments securities held to maturity	2.411	0
Property, plant and equipment	560	0
Intangible assets	449	0
Other financial receivables	8	0
Other operational receivables	54	0
<b>TOTAL ASSETS</b>	<b>11.686</b>	<b>0</b>

Total assets of the Bank in 2016 amounted EUR 11.686 thousands.

Loans to the clients amounted EUR 2.254 thousands i loan portfolio represents 19% of total Bank's assets.

As at 31 December 2016 the portfolio of the securities held to maturity amounts EUR 2.411 thousand.

This consists of the following:

- T-bills in the amount of EUR 400 thousand purchased on July 15, 2016, with a rate of return 1.2% per annum, with a maturity of 182 days, issued by the Ministry of Finance of Montenegro
- Government bonds of EUR 2.000 thousand purchased on 15 November 2016, with yearly interest rate of 4%, and maturity on 15 November 2020,
- Accrued interest on government bonds in amount of EUR 11 thousand.

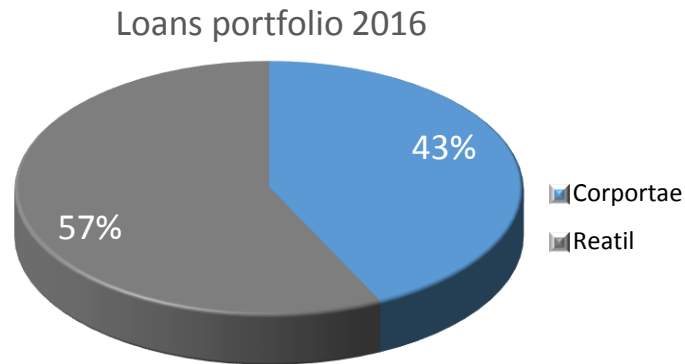
Accepted loans to the clients, significant part of the assets of the Bank is cash representing 51%.

5.2. Loans to the clients on 31 december 2016

Table 9.- Gross loans to the clients on 31 december 2016 in 000 EUR

NO	DESCRIPTION	31.12.2016	31.12.2015
<b>1</b>	<b>LOANS TO THE CLIENTS</b>	<b>2.254</b>	<b>0</b>
1	Corporate	965	0
2	Retail	1.289	0

Graph 4.- Loans to the clients - 2016



Total loans to the clients, on 31 december 2016, amounted EUR 2.254 thousands.

Retail loans amounted EUR 1.289 thousands, and corporate loans were EUR 965 thousands.

Table 10.- Portfolio overview on 31 december 2016 in 000 EUR

Type of loan	2016	% share
Balance sheet item		
<b>Loans and receivables form banks</b>	462	17%
<b>Short term loans to clients</b>	110	4%
<b>Long term loans to clients</b>	1.567	58%
<b>Overdue loans</b>	580	21%
<b>Interest receivables and prepayments</b>	-3	0%
<b>Total balance sheet exposure to credit risk</b>	2.716	100%
Off-balance sheet items		
<b>Performance guarantees</b>	1	20%
<b>Undrawn loans</b>	4	80%
<b>Total off-balance sheet exposure to credit risk</b>	5	100%
Total exposure to credit risk	2.721	

Bank started with its loan activity in August 2016. The highest share in loan portfolio is a share of long-term loans (58%), first of all housing loans.

Table 11 - Overview of total portfolio by holders 31 december 2016 in 000 EUR

Type of loan	2016	% share
<b>Banks, nonresidents</b>	462	17%
<b>Privately owned companies</b>	728	27%
<b>Entrepreneurs</b>	165	6%
<b>NGOs and other non-profit organisations, residents</b>	70	3%
<b>Individuals, residents</b>	1.291	48%
Total portfolio	2.716	100%

In 2016 the highest amount of approved loans relates to retail loans.

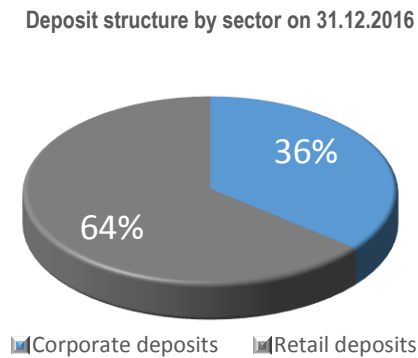
5.3. Equity and liabilities of the bank on 31 december 2016

Table 12 . - Equity and liabilities on 31 december 2016 in 000 EUR

EQUITY AND LIABILITIES	31. december 2016.	31. december 2015.
<b>LIABILITIES</b>		
Deposits of the clients	668	0
Other liabilities	265	0
TOTAL LIABILITIES	933	0
<b>EQUITY</b>		
Share capital	11.980	0
Profit / (loss) of the current year	-1.227	0
TOTAL EQUITY	10.753	0
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>11.686</b>	<b>0</b>
		0
<b>OFF-BALANCE SHEET RECORDS</b>	<b>2.204</b>	<b>0</b>

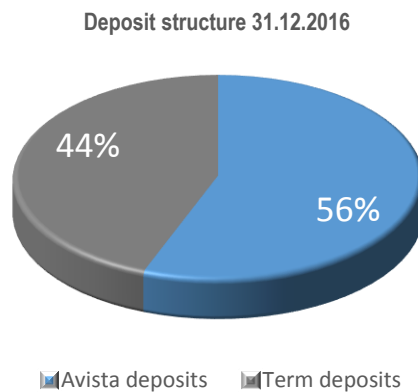
In the eqity and liabilities structure total deposits of the clients, with accrued interest on 31 December 2016, represents 6% and amounts EUR 668 thousands.

Graph 5.- Deposit structure by sector 31 december 2016



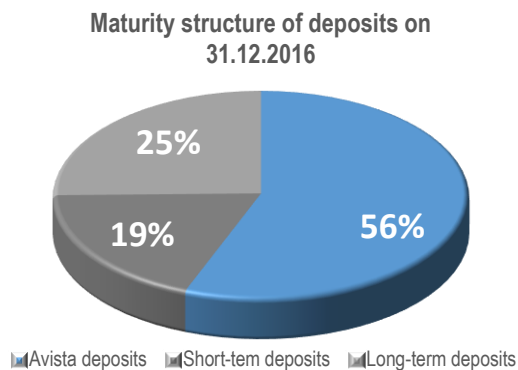
Deposit structure by sector at the end of 2016, shows that retail deposits represents 64% of total deposits, or EUR 428 thousands. Corporate deposits are 36% of total deposits of the Bank, or EUR 240 thousands.

Graph 6.- Deposit structure on 31 december 2016 by type



Avista deposits at the end of 2016 amounts EUR 374 thousands or 56% of total deposits, while term deposits are EUR 295 thousands or 44% total Bank's deposits.

Graph 7.- Maturity structure of deposits on 31 december 2016



Maturity structure of deposits at the end of 2016, shows that long-term deposits represents 25% of total deposits and they amounts EUR 169 thousands. Short-term and avista deposits are 75% of total deposit portfolio of the Bank and amounts EUR 499 thousands.

#### 5.4. Changes on equity for the period 13 April to 31 December 2016

As of 31 December 2016, the Bank's share capital was comprised of 299.511.761 ordinary shares, with nominal value per share of EUR 0,04.

The ownership structure of the Bank as at 31 December 2016 is as follows:

Name of the person/company	31. decembar 2016		
	No of shares	In EUR	% ownership
Azmont Investments d.o.o. Herceg Novi	299.511.761	11.980.470,44	100,00%
	<b>299.511.761</b>	<b>11.980.470,44</b>	<b>100,00%</b>

In accordance with the regulations of the Central Bank of Montenegro, the Bank is required to maintain a minimum capital adequacy ratio of 10%. The Bank is required to comply its operations within the prescribed parameters, ie to comply the volume and structure of risky assets with the Law on Banks ("Official Gazette of Montenegro" no. 17/08, 44/10, 40/11) and the regulations of the Central Bank of Montenegro.

The Bank's solvency ratio as at 31 December 2016 amounted to 325,94%.

Na 31. decembar 2016. godine nivo sopstvenih sredstva Banke je iznad propisanog minimuma od EUR 5.000 thousands i iznosi EUR 10.304 thousands.

As of 31 December 2016, the own funds of the Bank are above prescribed minimum of EUR 5.000 thousand and amount EUR 10.304 thousand.

On 31 December 2016 the Bank's capital is above the regulatory minimum.

Table 14.- Changes on equity

Position	Share Capital	Retained earnings	TOTAL
<b>Balance on 13 april 2016</b>	0	0	0
<b>Issue of share capital</b>	11.980	0	11.980
<b>Loss of current period</b>	0	-1.227	-1.227
Balance on 31 december 2016	<b>11.980</b>	<b>-1.227</b>	<b>10.753</b>

#### 5.5. Bank's off-balance sheet records

Commitments of the Bank as at 31 December 2016 consists of the contingent liabilities of the Bank and the rest off-balance sheet relating to the records of received collateral for loan receivables and contingent liabilities of the bank.

Table 15 – Off-balance records of the Bank

In thousands EUR	31.dec 2016.	31.dec 2015.
Contingent liabilities of the Bank	5	0
<b>Irrevocable commitments to grant loans</b>	4	0
<b>Guarantees</b>	1	0
- <b>issued performance guarantees</b>	1	0
Other off-balance items	<b>2.199</b>	0
<b>Collaterals on receivables</b>	2.199	0
Total	2.204	0

Off-balance sheet exposure of the Bank on December 31, 2016 is very low and amounts to EUR 5 thousands, of which 4 EUR thousands (80%) of the unused, approved loans and guarantees of EUR 1 thousand (20%).

In accordance with the Decision of Central Bank of Montenegro on Minimum Standards for Credit Risk Management in Banks ("Official Gazette of Montenegro", no. 22/12, 55/12 and 57/2013) the receivables from bank balance sheets are transferred to the internal records if the bank estimates in the process of collecting the receivables that the value of receivables measured at amortized cost will not be compensated and that the conditions are met for derecognition of financial assets, which includes the following cases:

- 1) for unsecured receivables:
  - when the debtor subject to bankruptcy proceedings lasting longer than one year, or
  - if the debtor is late with payments for more than two years
- 2) for secured receivables, when the debtor is late with payments for more than four years, or if the bank during this period did not receive any payment from the realization of collateral.

In accordance with current regulations, as at 31 December 2016, no receivables were written off from the Bank's balance sheet records.

6. INCOME STATEMENT FOR 2016

Table 16.- Income statement

In thousands EUR:	2016.	2015.
<b>Interest income</b>	28	0
<b>Interest expenses</b>	-2	0
NET INTEREST INCOME	27	0
<b>Impairment losses</b>	0	0
<b>Fee and commission income</b>	4	0
<b>Fee and commission expenses</b>	-104	0
NET FEE AND COMMISSION INCOME	-100	0
<b>Net FX result</b>	0	0
<b>Personal expenses</b>	-571	0
<b>Other administrative expenses</b>	-464	0
<b>Depreciation</b>	-102	0
<b>Other costs</b>	0	0
<b>Other income</b>	0	0
OPERATING PROFIT	-1.210	0
<b>Income tax</b>	-17	0
NET PROFIT	-1.227	0

6.1. Interest income and expenses

Table 17.- Interest income and expenses in 000 EUR

Interest income and expenses	2016	2015
Interest income		
<b>Loans:</b>		
- private companies	3	0
- entrepreneurs	1	0
- individuals	12	0
	16	0
<b>Interest on HTM securities</b>	12	0
Total interest income	28	0
Interest expenses		
<b>Deposits:</b>		
- individuals	1	0
	1	0
Total interest expenses	1	0
<b>Net interest income</b>	27	0

From the interest income details we can see that the highest share in income by holder is related to interests income from retail segment which is understandable having in mind bank's portfolio structure.

**6.2. Fee and commissions income and expenses**

*Table 18.- Fee and commissions income and expenses in 000 EUR*

	2016	2015
Fee and commissions income and expenses		
<b>Fee and commission income</b>		
<b>Loan approval fees</b>	1	0
<b>Payment transaction and e-banking fees</b>	3	0
Total fee and commission income	<b>4</b>	<b>0</b>
<b>Fee and commissions expenses</b>		
<b>Central bank fees</b>	16	0
<b>International payment fees</b>	35	0
<b>Deposit protection Fund fees</b>	50	0
<b>E-banking fees</b>	3	0
Total fee and commission expenses	<b>104</b>	<b>0</b>
<b>Net fee and commission income</b>	<b>-100</b>	<b>0</b>

Actual fee and commission income for the period 13 April to 31 December 2016 is on the low level first of all because first operational year is followed by small client base, no cards and most of the period in the year there was no international payment transactions.

Actual fee and commission expenses are too high in 2016 first of all because this amount includes start up fees for the opening of the Bank (Deposit Protection Fund, SWIFT, etc). Beside this, it includes fees for payment transactions which are fixed monthly charges not based on number or amount of transactions.



6.3. Operating expenses

Table 19.- Operating expenses in 000 EUR

<b>Operating expenses</b>	<b>2016</b>
<i>Personnel expenses</i>	
Net salaries	311
Taxes, contributions and surtax on salaries	220
Other payments to employees	1
Temporary contracts	9
Provision for unused annual leave	24
Travel expenses and per diem	4
Training expenses	2
<b>Total personnel expenses</b>	<b>571</b>
<i>Other administrative expenses</i>	
Rent	68
Audit expenses (CBM and external audit)	98
Security	22
Advertizing and marketing	47
Legal cost	29
Licenses and SW maintenance	106
Consulting fees	22
Electricity and fuel	8
Office material	10
Communication network	10
Subscriptions	4
Phone charges	6
Membership fees for Bank Association	8
Insurance	5
Representation costs	4
Cleaning	8
Other costs	9
<b>Total administrative expenses</b>	<b>464</b>
<b>Depreciation</b>	<b>102</b>
<b>TOTAL OPETAING EXPENSES</b>	<b>1.137</b>

Operating expenses in 2016 amounted EUR 1.137 thousands out of which EUR 571 thousands or 50% is related to staff costs.

## 7. RISK MANAGEMENT

The Bank is exposed to various risks in its operations, of which the most significant are the following:

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

The risk management procedures are designed to identify and analyse risks, to define limits and controls required for risk management and to monitor the Bank's exposure to each individual risk. The risk management procedures are subject to regular review in order to allow adequate response to the changes in the market, products and services.

The Risk Management Department is responsible for monitoring the Bank's exposures to certain risks. In addition, monitoring of the Bank's exposures to certain risks is the responsibility of Credit Risk Management Committee and Asset and Liability Management Committee.

### Credit risk

Credit risk is of possible negative effects on financial result and capital of the Bank due to unsettled liabilities of the Bank's debtors. The primary exposure to credit risk arises through loans and investments. Bank approves loans in accordance to its business policies, aligning the maturities of loans approved and interest rate policy with the purpose of the loan and credit ability of the debtor.

Bank is providing for credit losses based on impairment test, and those losses are losses incurred on the date of statement of financial position. Significant changes in the economy, or in certain industries which are involved in Bank's loan portfolio, could result in losses that are different from losses provided for in the statement of financial position. Management therefore carefully manages exposure to credit risk.

Exposure to credit risk is risk of financial loss resulting from the inability of the debtor to fulfill its obligations towards the Bank. Bank is managing credit risk by setting up the limits for big exposures, individual exposures and related parties. Those risks are monitored continuously and are reviewed regularly.

In accordance to the limits prescribed by the Central Bank of Montenegro, U skladu sa limitima propisanim od strane Centralne banke Crne Gore, sector concentration is constantly monitored.

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

### Commitments and Contingent Liabilities

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

Loan portfolio at the end of 2016 amounts EUR 2.254 thousands while off-balance sheet exposure was EUR 5 thousands, and all exposures were classified in A category. At the end of the year there was no impairments on balance sheet or off-balance sheet exposures of the Bank.

### Market risk

The Bank is exposed to market risks. Market risks arise from open positions due to changes in interest rates and foreign currency exchange rates.

### Currency Risk

Currency risk management is defined with Risk Management Strategy and Interest rate management Policy from banking book and market risks. Those documents define the way in which the bank identifies, measures, controls, mitigates and monitors the currency risk. Measuring the currency risk is performed applying GAP analysis for

currency risk, while the control system established by limiting long, short and net positions individually by currencies and aggregately. On a daily basis Treasury Department reports to the risk management the amount and character of currency update. Risk Management Department reports on a monthly basis to Asset and Liability Committee on all important aspects of the management of foreign exchange risk.

The Bank's financial position and cash flows are exposed to the effects of the changes in foreign currency exchange rates. Currency risk exposure is continuously monitored and reconciled with the limits prescribed by the Central Bank of Montenegro.

Exposure of the Bank to the currency risk on 31 December 2016 was low due to the fact that the balance of the cash in foreign currency was on the low level (converted in EUR 5 thousands).

### Interest Rate Risk

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

The following table presents the level of interest bearing and non-interest bearing assets and liabilities of the Bank on 31 December 2016:

Table 20 - Interest bearing and non-interest bearing assets and liabilities of the Bank

U thousands EUR	Interest bearing	Non-interest bearing	Total
<b>ASSETS</b>			
Cash balances and deposits with central banks	15	5.935	5.950
Loans and receivables from clients	2.254	0	2.254
Investment securities	2.400	11	2.411
<b>Total assets</b>	<b>4.669</b>	<b>5.946</b>	<b>10.615</b>
<b>LIABILITIES</b>			
Deposits from clients	668	0	668
<b>Total liabilities</b>	<b>668</b>	<b>0</b>	<b>668</b>
Exposure to interest rate risk:	<b>4.001</b>	<b>5.946</b>	<b>9.947</b>

Exposure to interest rate risks on 31 December 2016 is shown in the table below:

Tabela 21 – Rizik od promjene kamatnih stopa

Interest sensitive assets in 000 EUR	Up to one month	From 1 to 3 months	From 3 to 6 months	From 6 to 12 months	Over 1 year	Total
Interest bearing securities	400	-	-	-	2.000	2.400
Loans and receivables from clients	171	289	217	102	1.475	2.254
<b>Total</b>	<b>571</b>	<b>289</b>	<b>217</b>	<b>102</b>	<b>3.475</b>	<b>4.654</b>
% total interest bearing assets	12,27%	6,21%	4,66%	2,19%	74,67%	100,00%
<b>Interest sensitive liabilities</b>						
Interest-bearing deposit	375	67	48	167	11	668
<b>Total</b>	<b>375</b>	<b>67</b>	<b>48</b>	<b>167</b>	<b>11</b>	<b>668</b>
% interest bearing liabilities	56,14%	10,03%	7,19%	25,00%	1,65%	100,00%
<b>Interest rate GAP:</b>						
- 31 December 2016	196	222	169	-65	3.464	3.986
<b>Cumulative GAP:</b>						
- 31 December 2016	196	418	587	522	3.986	

### Liquidity risk

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

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

The maturities of assets and liabilities and the ability of the Bank to obtain sources of funding upon maturity of liabilities at an acceptable cost are an important factor in assessing the liquidity of the Bank and its exposure to changes in interest rates and foreign exchange rates.

Liquidity requirements to support calls on guarantees and contingent liabilities are on the low level at the end of 2016 (EUR 4 thousandse).

As of 31 December 2016, the Bank has managed the liquidity risk in accordance with the adopted Strategy for risk management. To measure liquidity risk, the Bank uses the GAP analysis. Beside liquidity risk monitoring on a daily basis it is monitored for a 10-days and monthly period through a set of reports prepared for Central Bank of Montenegro as well for Asset and Liability Committee.

According to the Central Bank of Montenegro methodology liquidity ratio is calculated comparing receivables, liquid assets (cash, bank accounts domestic and foreign banks and mandatory reserve) with due liabilities (loans received, liabilities for fees and interest, liabilities for term deposits and 30% of avista deposits, 10% of approved unused loans – credit lines, and other due liabilities).

Calculation of daily liquidity ratio on 31 December 2016 is shown in the following table:

Table 22 – Liquidity ratio on 31 December 2016

No.	DESCRIPTION	AMOUNT
<b>I</b>	<b>Liquid assets/receivables(claims)</b>	<b>5.934</b>
1.	Cash	263
2.	Assets on the account in Central Bank of Montenegro	5.180
3.	Other cash claims	0
4.	Assets on the accounts in domestic banks (Avista deposits)	0
5.	Assets in the agents of payment system	0
6.	Assets on the accounts in international bankas (A vista deposits)	462
7.	Required reserve in the Central Bank of Montenegro (according to the current decision)	30
<b>II</b>	<b>Matured liabilities for loans and borrowings</b>	<b>335</b>
1.	Due liabilities aDospjele obaveze based on loans received (borrowings)	0
2.	Due liabilities based on interest rates and fees	0
3.	Due liabilities based on term deposits	0
4.	30% Avista deposits	112
5.	10% Approved but unused, irrevocable credit obligations (credit lines)	0
6.	Other due liabilities	223
	<b>SUFICIT / DEFICIT ( I - II )</b>	<b>5.599</b>
	<b>Liquidity ratio ( I / II )</b>	<b>17,70</b>

The Bank is exposed to daily calls on its available cash resources which influence the available cash held on the current accounts or as deposits. The Bank does not maintain cash to meet all of these needs since historical experience demonstrates that a minimum level of reinvestment of maturing funds can be predicted with a high degree of certainty.

Other liquidity ratios of the Bank on the quarterly bases are presented below:

Table 23 – Liquidity ratios

Description	31.12.2016	30.9.2016	30.6.2016
Liquid assets	5.950	10.269	11.155
Total assets	11.686	11.758	12.135
Short-term liabilities	374	152	95
Liquid assets / Total assets	50,92%	87,33%	91,92%
Liquid assets / Short-term liabilities	1590,91%	6755,92%	11742,11%
Daily liquidity ratio	17,70	54,22	38,08
Loan to Deposit ratio	337,43	17,06	0,00

The remaining contractual maturity matching of financial assets and liabilities as of 31 December 2016 is as follows:

Table 24 – Maturity gap

	Up to a month	From 1 to 3 months	From 3 to 6 months	From 6 to 12 months	From 1 to 5 years	Over 5 years	Total
<b>Financial assets</b>							
Cash balances and deposits with central banks	5.488	-	-	-	-	-	5.488
Loans and receivables to banks	462	-	-	-	-	-	462
Loans and receivables to customers	171	289	217	102	590	885	2.254
Investment securities - HTM	400	-	-	11	2.000	-	2.411
<b>Total</b>	<b>6.521</b>	<b>289</b>	<b>217</b>	<b>113</b>	<b>2.590</b>	<b>885</b>	<b>10.615</b>
<b>Financial liabilities</b>							
Deposits due to clients	375	67	48	167	11	-	668
Other financial liabilities	145	78	-	-	17	-	240
<b>Total</b>	<b>520</b>	<b>145</b>	<b>48</b>	<b>167</b>	<b>28</b>	<b>-</b>	<b>908</b>
<b>Maturity GAP</b>							
- 31 December 2016	6.001	144	169	(54)	2.562	885	9.707
<b>Cumulative GAP:</b>							
- 31 December 2016	6.001	6.145	6.314	6.260	8.822	9.707	
<b>% of total funds:</b>							
- 31 December 2016	661,7%	677,6%	696,3%	690,3%	972,8%	1.070,3%	

### Operating risk

Operational risk management at the Bank is not internally regulated. The Bank is currently working on the preparation of the procedure for the operational risk management, which precisely defines method of identification, assessment and monitoring, management, and giving proposals of measures for the elimination of exposure and consequences arising from operational risk exposure

The Bank will in 2017 work on establishing a system for the management of operational risk. The measurement or assessment of operational risk will be done through quantitative and / or qualitative assessment of identified operational risk. In addition, the Bank will carry out the identification of operational risks, classifying them according to priority by measuring the potential financial impact and frequency of events that can result in losses.

In order to efficiently manage operational risk, the Bank will create an internal model, through which organizational units are obliged to submit reports on adverse events occurred and identify operational risks for the reporting period.

In the process of identifying sources of operational risk, the Bank shall take care to identify risks arising from:

- inadequate information and other systems in the Bank;
- business interruption and fault in the system (for example, faults related to the information technology, telecommunications, interruptions in the work etc);
- inability of adequate integration or sustainability of information and other systems, in case of status changes of the Bank;
- unproper treatment of employees in the Bank, as well as attempts of fraud, money laundering, unauthorized access to client accounts, misuse of confidential information, giving false or misleading information about the status of the Bank, delays in carrying out tasks, errors in data entry, failure to comply with good business practices, etc .;
- involvement of people outside the Bank to perform the jobs for the Bank;
- acts or omissions which may cause court and other proceedings against the Bank (legal risk);
- Foreign illegal acts such as theft, unauthorized transfer of funds, unauthorized entry into a database, illegally obtaining documents of the Bank, etc .;
- events that can not be predicted, such as natural and other disasters, terrorism etc.

Operational risk events records includes the systematic collection and analysis of operational risk in the Bank's operations that led to the losses.

According to the plan of improving operational risk management system, the Bank will in future:

- work on improving the model for identifying operational risks and collecting data on adverse events that occurred as a result of operational risk;
- to train employees in order to increase operational risk management at the Bank

## 8. CAPITAL ADEQUACY

### Own Funds

The Bank is required to publicly disclose information and data relating to the amount of own funds, including:

- 1) a summary comprising the main characteristics of all items which are included in the calculation of its own funds and its elements;
- 2) the amount of capital, with special public disclosure of all items included in the share capital and deductibles;
- 3) the total amount of additional capital;
- 4) deductions from Tier one and Tier II capital, and
- 5) the total own funds, reduced by the deductions

Table 25 – Own Funds for 2016

		in 000 EUR
		<b>31.12.2016</b>
<b>I</b>	<b>Own Funds</b>	<b>11.980</b>
	<i>Issued share capital</i>	<i>11.980</i>
<b>II</b>	<b>Odbitne stavke pri izračunu osnovnog kapitala</b>	<b>1.676</b>
	<i>Losses from the previous years</i>	<i>0</i>
	<i>Loss from the current year</i>	<i>1.227</i>
	<i>Intangible assets</i>	<i>449</i>
	<i>Positive difference between the amount of regulatory provisions for potential losses and impairments for balance and off-balance sheet items</i>	<i>0</i>
<b>III(I-II)</b>	<b>Tier I capital</b>	<b>10.304</b>

On 31 December 2016, deductible items reducing the Bank's own funds are related to:

- Actual loss in 2016 of EUR 1,227 thousands,
- The book value of intangible assets of the Bank at December 31, 2016 in the amount of EUR 449 thousands.

On 31 December 2016 the Bank had no loans in arrears over 30 days. The quality of the loan portfolio on this day was satisfactory and there was no impairments calculated. Therefore, there was no insufficient provisions calculated in accordance with applicable regulations on individual credit risk exposure (representing deduction from capital).

Risk weighted assets calculated in accordance to the Decision on Capital Adequacy for the banks, on December 31, 2016 amounted EUR 2.467 thousands.

Capital adequacy Ratio is calculated by deviding own funds by risk weighted assets.

In accordance to Decision on Capital Adequacy for the banks, which is applicable on 31 Decembre 2016, Bank is obliged keep Capital Adequacy Ratio on a level of at least 10%.

Capital Adequacy Ratio of the Bank on 31 Decembre 2016 was **325,94%** and it is above prescribed limit of 10%.