ANNUAL REPORT

2020

HIPOTEKARNA BANKA

Vama posvećena

CONTENT

1 FROM THE EXTERNAL AUDITOR’S REPORT

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

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Hipotekarna banka AD Podgorica

Opinion

We have audited the accompanying financial statements of Hipotekarna Banka AD, Podgorica (hereinafter: "the Bank"), which comprise the balance sheet as at 31 December 2020, income statement, statement of other comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes, comprising a summary of significant accounting policies and other disclosures (hereinafter 'financial statements'.)

In our opinion, the accompanying financial statements present truly and objectively, in all material respects, the Bank's financial position as of December 31, 2020, as well as its operating results and cash flows for the year ended that day, in accordance with the accounting regulations applicable in Montenegro and the regulations of the Central Bank of Montenegro governing the financial reporting of banks.

Basis for opinion

We conducted our audit in accordance with Law on Audit of Montenegro, Law on Accounting of Montenegro and International Standards on Auditing (ISA) applicable in Montenegro. Our responsibilities under these standards are described in more detail in the report section entitled *Auditor's Responsibility for the Audit of Financial Statements.* We are independent of the Bank in accordance with the Code of Ethics for Professional Accountants of the Committee on International Ethics for Accountants (IESBA Code) and the ethical requirements relevant to our audit of financial statements in Montenegro, and have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

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

Key Audit Matters

Key audit questions are those matters that, in our professional judgment, were of paramount importance for auditing the financial statements of the current period. We have addressed these issues in the context of our audit of the financial statements as a whole and in forming our opinion on them, and we do not give a separate opinion on these issues.

Key Audit Matters	Appropriate audit procedure
Impairment of given loans and receivables from clients and provisions for off-balance sheet items	
As at December 31 2020 the gross value of given loans and receivables from clients amounted EUR 229.963 thousand (31. December 2019.:EUR 243,316 thousand), while the total amount of impairment of given loans and receivables from clients amounted EUR 14,568 thousand as od December 31 2020. thousand (31. December 2019: EUR 14,404 thousand).	Based on our risk assessment and industry knowledge we examined the cost of impairment of given loans, receivables from clients and provisions for off-balance sheet items and evaluated the applied methodology as well as used assumptions and in accordance with the key audit matter.

INDEPENDENT AUDITOR'S REPORT (continued)

Key Audit Matters (continued)

Key Audit Matters	Appropriate audit procedure
Impairment of given loans and receivables from clients and provisions for off-balance sheet items	
The measurement of the cost of impairment of given loans and receivables from clients and provision for off-balance sheet items is considered key audit matter considering that the determination of the amount of provision for impairment requires the significant assessment by the management to determine the moment when the impairment is recognized as well as the impairment amount. The most significant consideration relate to: • Assumption that are used in the model of expected credit loss for the assessment od credit risk related to exposure and expected credit losses for future cash flow of the client. • Timely identification of the exposure with significant increase of exposure to the credit risk and credit impairment. • Valuation of collateral and assumptions of the future cash flow on individually estimated credit exposures. • the potential impact on these assumptions, the increase in credit risk and impairment, the valuation of collateral and future cash flows as a result of the socio-economic consequences of the COVID 19 crisis including the moratorium and other events. The management disclosed the additional information about the impairment cost of the given loans and receivables from clients for off-balance sheet items in Notes 3.8, 5.2, 7, 17.2 and 23 of the financial statements.	Our audit procedures included: • The assessment of key controls over assumptions which are used in expected credit loss model for the assessment of the credit risk related to exposure and future expected cash flows of the client. • detailed testing of the calculation of risk parameters, based on the official methodology of the Bank, which is the subject of assessment of compliance with accounting requirements. This testing also includes the assessment of model assumptions with special reference to assumptions concerning the impact of the crisis caused by the COVID 19 virus on expected credit losses; • Assessment of key controls over the timely identification of exposure with significant increase of the credit risk and exposure identification of the impairment. • Collection and detailed testing which support the appropriate determination of the impairment cost of the loans and receivables including valuation of collateral and assumptions of future cash flow for individually assessed exposure of the loan impairment. • Assessment of key development of high-risk portfolio from the previous period with regard to industry standards and historical data. • Assessing the adequacy of various identified decisions of the Management regarding to assumptions related to the calculation of expected credit losses for individually assessed loans, as well as decisions on the approach to assessment of expected credit losses for collectively assessed loans, as well as evaluating applied methodologies using our industry knowledge; • assessment of the adequacy of management analysis and correction as a result of the impact of the COVID 19 crisis on all aspects of the assessment of expected credit losses. Impact analysis includes management assessment of different scenario analysis and sensitivity analysis and • Assessment of the accuracy and completeness of disclosure in financial statements.

INDEPENDENT AUDITOR'S REPORT (continued)

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

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the Accounting Law of Montenegro and other regulations of Central Bank of Montenegro governing the financial reporting of the banks, as well as for those internal controls that management considers it necessary to prepare financial statements that are free from material misstatement, whether due to fraud or error.

When preparing financial statements, management is responsible for assessing the Bank's ability to continue operating in accordance with the going concern principle, disclosing, if necessary, issues relating to going concern principle and applying the principle of going concern as an accounting basis, unless management intends to liquidate The bank either discontinues its business or has no other realistic option other than the above. The persons responsible for management are responsible for managing the financial reporting process that is established by the Bank.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an Auditor's Report that contains our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the Law on Audit, Law on Accounting of Montenegro and ISAs applicable in Montenegro will always detect a material misstatement when it exists. Misstatements can arise due to fraud or error and are considered material if, individually or as a group, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with the Law on Audit of Montenegro, Law on Accounting in Montenegro and ISAs applicable in Montenegro, we apply professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or avoiding of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the applied accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

INDEPENDENT AUDITOR'S REPORT (continued)

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

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cause significant doubt on the Banks's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the 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 Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the basic transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit. We also provide those charged for managing with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be expected to affect on our independence, and where applicable, related protection measures.

From the matters communicated with those charged with managing, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation excludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be included in our report because it is reasonable to expect the adverse consequences to be greater than benefits of such communication.

INDEPENDENT AUDITOR'S REPORT (continued)

Report on other legal and law requirements

Management of the Bank is responsible for the preparation and presentation of the Annual Management Report.

Our opinion on financial statements does not include the Annual Management Report and except to that extent that is explicitly stated in our report we do not express any form of conclusion with the expression of an assurance about them.

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

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

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

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

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

The auditing partner on the basis of which this independent auditor's report was prepared is Pero Đuričković.

Crowe MNE d.o.o. Podgorica

May 20, 2021

DRUŠTVO ZA REVIZIJU "CROWE MNE" PODGORICA

Pero

Pero Đuričković, Certified Auditor

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INCOME STATEMENT
For the period from January 1 to December 31, 2020

(in thousand EUR)

	Notes	2020	2019
Interest income and similar income	3.1, 6	18,239	19,741
Interest expenses and similar expenses	3.1, 6	(3,200)	(3,091)
NET INTEREST INCOME		**15,039**	**16,650**
Fee income	3.2, 9	12,821	16,989
Fee expenses	3.2, 9	(7,893)	(10,775)
NET FEE INCOME		**4,928**	**6,214**
Net profit/loss from derecognition of financial instruments not measured at fair value through income statement.		212	150
Net profit/loss based on financial instruments held for trade		153	-
Net foreign exchange gains		461	788
Net profit/(loss) based on derecognition of other assets		152	311
Other income	13	645	246
Staff costs	10	(5,551)	(5,486)
Depreciation/amortization cost	12	(2,542)	(1,077)
General and administrative costs	11	(6,069)	(7,802)
Net income/(expenses) based on impairment of financial instruments not valued at fair value through income statement	3.14, 7	(3,518)	(3,723)
Provision cost	3.14, 8	(6)	(96)
Other expenses	14	(70)	(786)
OPERATING PROFIT		**3,834**	**5,389**
Income tax	3.6, 15	(346)	(526)
NETO PROFIT		**3,488**	**4,863**
Earnings per share	32	111,42	155,34

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

These financial statements are approved on behalf of Board of Directors of Hipotekarna banka A.D., Podgorica, as at February 1, 2021. In Podgorica..

Signed and approved on behalf of Hipotekarne banke A.D., Podgorica:

Esad Zaimović Chief executive officer	Ana Golubović Executive Director for Corporate
Jelena Vuletić Executive Director for Risks	Nikola Špadijer Executive director for retail

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STATEMENT OF OTHER COMPREHENSIVE INCOME
For the period from January 1 to December 31, 2020

(In thousand EUR)

	Notes	2020	2019
Net profit		**3,488**	**4,863**
Other comprehensive income			
The effects of changes in the value of securities measured at fair value through other comprehensive income		(2.051)	1,625
Income tax based on the item of other comprehensive income		186	(166)
Total other result for current year		**(1,865)**	**1,459**
TOTAL OTHER RESULT		**1,623**	**6,322**

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Chief executive officer

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BALANCE SHEET
As of December 31, 2020

(In thousand EUR)

	Notes	December 31, 2020	December 31, 2019
ASSETS			
Cash and deposit accounts held with Central Banks	3.7, 16	**163,390**	**137,133**
Financial assets at amortized cost		**240,348**	**251,741**
Loans and receivables from banks	3.8.3, 17.1	22,060	20,864
Loans and receivables from clients	3.8.3, 17.2	215,395	228,912
Securities	17.3	1,107	-
Other financial receivables		1,786	1,965
Financial assets at fair value through other comprehensive income		**128,150**	**134,758**
Securities	18.1	128,150	134,758
Investments in associates and joint ventures at equity method		-	**5**
Property, Plants and Equipment	3.10, 19	**6,214**	**2,352**
Intangible assets	3.10, 20	**2,019**	**2,037**
Deferred tax assets	15c	**27**	**24**
Other assets	21	**2,433**	**2,428**
TOTAL ASSETS		**542,581**	**530,478**
LIABILITIES			
Financial liabilities at amortized cost		**451,662**	**443,122**
Deposits due to banks and Central banks	22.1	1,214	1,148
Deposits due to clients	22.2	428,346	419,592
Borrowings from clients which are not banks	22.3	22,048	22,335
Other financial liabilities		54	47
Reserves	23	**1,453**	**1,535**
Current tax liabilities		**342**	**514**
Deferred tax liabilities	15c	**23**	**209**
Other liabilities	24	**13,301**	**11,148**
Subordinated debt	26	**22,256**	**22,050**
TOTAL LIABILITIES		**489,037**	**478,578**
EQUITY			
Share equity	25	16,006	16,006
Share issue premium		7,444	7,444
Retained earnings		25,425	20,541
Current year Profit/(Loss)		3,488	4,863
Other reserves		1,181	3,046
TOTAL EQUITY		**53,544**	**51,900**
TOTAL EQUITY AND LIABILITIES		**542,581**	**530,478**
OFF – BALANCE SHEET	28	**753,678**	**766,334**

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STATEMENT OF CHANGES IN EQUITY
For the period from January 1 to December 31, 2020

In thousand EUR	Share capital	Share issue premium	Profit of the year	Other reserves	Total
Balance as of January 1, 2019	**16,006**	**7,444**	**20,545**	**1,587**	**45,582**
Effect on the fair value of financial assets through other comprehensive income	-	-	-	1,459	**1,459**
Other effects of securities on equity	-	-	(4)	-	**(4)**
Profit of the current year	-	-	4,863	-	**4,863**
Balance as at 31 December 2019	**16,006**	**7,444**	**25,404**	**3,046**	**51,900**
					-
Balance as of January 1, 2020	**16,006**	**7,444**	**25,404**	**3,046**	**51,900**
Effect on the fair value of financial assets through other comprehensive income	-	-	-	(1,865)	(1,865)
Other impact of securities to the Equity	-	-	21	-	**21**
Profit of the current year	-	-	3,488	-	**3,488**
Balance as at 31 December	**16,006**	**7,444**	**28,913**	**1,181**	**53,544**

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STATEMENT OF CASH FLOWS
In the period from 1 January to 31 December 2020
(In thousand EUR)

DESCRIPTION	Notes	2020	2019
Cash flows from operating activities			
Inflows from interest and similar income		18,363	19,829
Outflows from interest and similar expense		(3,240)	(2,993)
Inflows from fees and commissions		12,821	16,988
Outflows from fees and commissions		(7,893)	(10,775)
Outflows based on earnings of the employees and costs for suppliers		(21,909)	(22,664)
Increase/decrease of the loans and other assets		13,568	(52)
Inflow/outflow based on deposits and other liabilities		8,550	18,995
Paid tax		(1,037)	(1,052)
Other income		(20,950)	(46,039)
Net cash inflow / outflow from operating activities		**(1,727)**	**(27,763)**
Cash flows from investing activities			
Purchase of property and equipment		(573)	(1,176)
Purchase of intangible assets		(475)	(768)
Treasury bills		30,104	35,616
Income from sale of tangible and fixed assets		87	26
Net cash inflow / outflow from investing activities		**29,143**	**33,698**
Cash flows from financing activities			
Increase in borrowings		(283)	(2,887)
Net cash (outflow)/inflow from financing activities		**(283)**	**(2,887)**
Effects of foreign exchange in cash and cash equivalents		461	788
Net (decrease)/increase in cash and cash equivalents		**27,594**	**3,836**
Cash and cash equivalents, beginning of year		**153,005**	**149,169**
Cash and cash equivalents, end of year	29	**180,599**	**153,005**

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2 BUSINESS ACTIVITIES AND ORGANISATIONAL STRUCTURE OF THE BANK

BUSINESS ACTIVITIES AND ORGANISATIONAL STRUCTURE OF THE HIPOTEKARNA BANKA

ABOUT THE BANK

Hipotekarna Banka AD Podgorica (hereinafter: the Bank) provides the widest range of banking and financial products and services to legal and natural persons in Montenegro in accordance with the licenses issued by the competent institutions.

The Banking Law, the Law on Business Organisations and enabling regulations of the Central Bank of Montenegro (hereinafter: the CBCG) prescribe the conditions for founding and operating of banks in Montenegro.

The provision of services performed by the Bank in the securities market is regulated by the Law on Capital Markets and enabling regulations of the Capital Market Authority. The Bank also performs payment operations that are governed by the Payment System Law including the enabling regulations of the CBCG.

The Bank also performs the insurance agency activities that are regulated by the Law on Insurance and relevant enabling regulations of the Insurance Supervision Agency.

The Bank is subject to the supervision and oversight of the CBCG, the Capital Market Authority and the Insurance Supervision Agency.

As at 31 December 2020, the Bank had 218 employees, of which 10 held a master's degree (4.5%), 97 held a university degree (44.5%), 59 held a bachelor's degree (27.1%), and 52 held a secondary school degree (23.9%).

CORPORATE GOVERNANCE AND CORPORATE GOVERNANCE RULES

The General Meeting of Shareholders of the Bank is composed of its shareholders.

Pursuant to Article 15b of the Law on takeover of joint stock companies:

1) The structure of the Bank's capital is as follows:

» Share capital of the Bank amounts to EUR 16,005,933.45 and it consists of 31,305 pieces of common shares issued in the name of the holder;

» Nominal value of one share is EUR 511.29;

» Shares are dematerialised, indefinitely transferrable and issued in the name of the holder. The excerpt from the registry with the Central Securities Depository and Clearing Company of Montenegro (former Central Depository Agency AD Podgorica) is the only evidence of the ownership of shares;

» A shareholder of the Bank, as the owner of common shares, has the following rights:

1. right to attend the General Shareholders Meeting,

2. right to manage proportionately to the share in capital of this class of shares,

3. right to dispose of shares, in accordance with the applicable regulations,

4. pre-emptive right to acquire new shares,

5. right to acquire shares free of charge in case of the increase in share capital from the Bank's funds, proportionately to its investment,

6. right to dividend pay-out, after the distribution of preferred shares to owners, when the General Meeting of Shareholders of the Bank decides to pay the dividend,

7. right to obtain, at personal request, a copy of the balance sheet and profit and loss statement, as well as external auditor's report,

8. right to have insight, thirty days prior to the session of the General Meeting of Shareholders and at the General Shareholders Meeting, in the financial reports including also external auditor's report,

9. right to proportionate part of assets in case of Bank's winding up and other rights in accordance with the applicable regulations.

2) There are no restrictions for transferring shares i.e. securities

3) Significant direct and indirect equity investments:

Generali Financial Holdings FCP-Sif	*16.8695 %*
Cerere S.P.A. - Italy	*13.9275 %*
Lorenzo Gorgoni - Italy	*12.9788 %*
Antonia Gorgoni – Italy	*10.0016 %*
Miljan Todorović - Italy	*7.3982 %*
Podravska Banka DD - Croatia	*2.9931%*
Ibis Srl - Italy	*4.8682 %*
Dario Montinari - Italy	*4.6159 %*
Sigilfredo Montinari - Italy	*4.6159 %*
Piero Montinari - Italy	*4.6127 %*
Andrea Montinari - Italy	*4.6127 %*

4) There are no securities giving special control rights;

5) Applicable laws and other regulations apply to the acquisition of shares by employees;

6) There are no restrictions of voting rights, such as restriction of the voting right of the owner of a certain percentage of securities or number of shares by deadlines for exercising right to vote, and the like;

7) There is no agreement between shareholders with which the issuer is familiar and that may result in the restriction of transfer of securities and/or voting rights;

8) The manner of appointing and relieving from office of members of the Board of Directors is defined by applicable laws and other regulations;

9) The powers of the members of the Board of Directors are defined by the applicable laws and other regulations;

10) There are no significant agreements in which the issuer is a contracting party and which produce legal action, are amended or terminated after the takeover of the issuer in the process of the public initial offering for takeover and their legal effects, unless these agreements are such that their disclosure would have significant harmful effects on the issuer, provided that the issuer is not explicitly obliged to publish such a data in accordance with the law;

11) Executive directors and individual directors of the organisational parts of the Bank have covenants which regulate the payment of fee for the termination of term of office in the amount ranging from 6 (six) to 18 (eighteen) net monthly salaries.

Board of Directors of the Bank manages the Bank. Members of the Board of Directors are elected and appointed by the General Shareholders Meeting. The structure of the Board of Directors and its bodies is as follows:

1.1. Board of Directors of the Bank:

• Sigilfredo Montinari, Chair

• Božana Kovačević, Deputy Chair

• Renata Vinković, Member

• Goran Varat, Member

• Esad Zaimović, Member

1.2. Audit Committee of the Bank:

• Draško Popović, Chair

• Božana Kovačević, Member

• Goran Knežević, Member

1.3. Credit Risk Management Committee of the Bank:

• Renata Vinković, Chair

• Sigilfredo Montinari, Member

• Esad Zaimović, Member

Board of Directors of the Bank meets as needed and at least once a month.

During 2020, the Board of Directors of the Bank passed decisions on the issues from within its competence, and it had continuously overseen the operations of the Bank by periodical review of the reports on the financial situation and operations. In addition, the Board of Directors regularly discussed the reports of standing and interim bodies of the Bank, control functions and the reports on the functioning of the internal controls system.

The Board of Directors of the Bank also reviewed the reports on the completed examinations of the CBCG, as well as the reports of other supervisory institutions.

The executive directors organise and manage the operations of the Bank and oversee the work of the Bank's employees on daily basis. The Bank has four executive directors.

Executive directors of the Bank:

• Esad Zaimović, Chief Executive Officer

• Nikola Špadijer, Executive Director for retail operations and advanced distribution channels

• Ana Golubović, Executive Director for corporate operations and financial markets

• Jelena Vuletić, Executive Director for risks

CORPORATE GOVERNANCE RULES

The Bank has established corporate governance in accordance with legal regulations, CBCG regulations and best practices.

The goal of the established corporate governance is to provide a transparent organisational structure and division of duties and responsibilities of corporate authorities and their bodies, achieving effective oversight, functioning of internal controls, with emphasis on risk management, and protection of assets and reputation of the Bank.

General Meeting of Bank's Shareholders

The shareholders of the Bank exercise their rights at the General Meeting of Shareholders of the Bank.

The General Meeting of Shareholders of the Bank decides on issues prescribed by the Banking Law, Law on Business Organisations, and the Bank's Articles of Association.

The Board of Directors of the Bank convenes the General Shareholders Meeting, and the shareholders with at least 5% participation in the share capital of the Bank also have the right to convene the General Shareholders Meeting, in accordance the Law on Business Organisations and the Bank's Articles of Association.

The Law on Business Organisations, Articles of Association and internal acts of the Bank govern the convening the General Meeting of Shareholders of the Bank, acting at the General Meeting, quorum, decision-making and other issues important for the work of the General Shareholders Meeting.

Board of Directors and Executive Directors

Obligations and responsibilities of the members of the Board of Directors of the Bank and the Executive Directors of the Bank are determined by the Banking Law, the Law on Business Organisations and Articles of Association of the Bank.

Procedures for appointment and removal, i.e. recall of Board members, directors of the Bank and Executive Directors of the Bank are determined by the Banking Law, the Law on Business Organisations and the Bank's Articles of Association.

Board of Directors

In accordance with legal regulations and the Bank's Articles of Association, the Board of Directors manages the Bank and oversees its operations.

The members of the Board of Directors of the Bank, who are previously authorised by the CBCG, are elected by the General Meeting of Shareholders. The term of office of the members of the Board of Directors of the Bank lasts 4 years and they can be re-elected. Members of the Board of Directors of the Bank must meet the requirements prescribed by the Banking Law, the Law on Business Organisations, relevant Decision of the CBCG and Bank's internal acts. The fulfilment of prescribed conditions and personal reputation of the members of the Board of Directors should provide professional, legal, safe and stable management of the Bank's operations, as they are jointly responsible for establishing a risk management system, compliance of the Bank's operations with regulations, financial stability of the Bank and the accuracy of reporting.

The Board of Directors of the Bank, in addition to the Audit Committee, has established the following bodies: Assets and Liabilities Committee, Credit Risk Management Committee and Investment Committee. A member of the Board of Directors is also included in the composition of these committees / bodies.

Executive Directors of the Bank

In accordance with the legal regulations and the Bank's Articles of Association, the executive directors organise and manage the Bank's operations and oversee the work of the Bank's employees on a daily basis.

In accordance with the provisions of the Bank's Articles of Association, the Bank has at least two and a maximum of five executive directors, one of whom is the chief executive officer.

The executive directors of the Bank, who are previously authorised by the CBCG, are elected by the Board of Directors of the Bank. The executive directors of the Bank must meet the requirements prescribed by the Banking Law, the Law on Business Organisations, relevant Decision of the CBCG, and the internal acts of the Bank. Since the executive directors of the Bank manage the Bank's business on a daily basis, they are also responsible for managing the risks to which the Bank is exposed in its operations. When taking legal action on behalf and for the account of the Bank, the Chief Executive Officer must obtain a signature of another executive director.

The executive directors of the Bank are full-time employees of the Bank.

STATEMENT ON THE APPLICATION OF THE CODE OF CORPORATE GOVERNANCE

As a member of the Association of Montenegrin Banks, the Chamber of Commerce of Montenegro, and the Union of Employers of Montenegro, the Bank adheres to the objectives and guidelines of the code of business conduct of the above stated relevant organisations and the principles they contain.

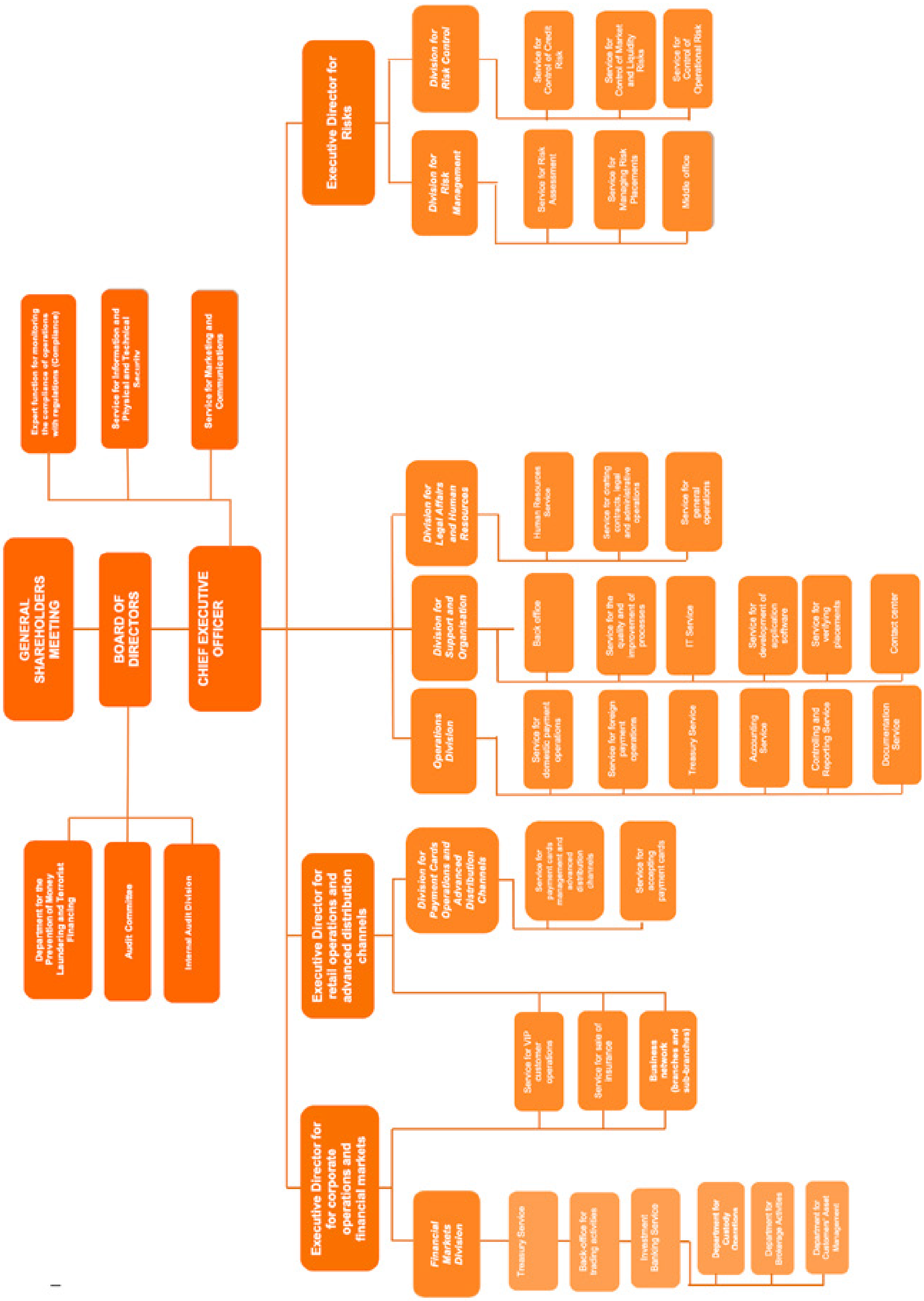
The Bank is a member of the Montenegro Stock Exchange AD Podgorica.

Code of Corporate Governance in Montenegro - the Code, adopted by the Board of Directors of Montenegro Stock Exchange AD Podgorica in 2019 intended for joint stock companies whose financial instruments are listed on the stock exchange, contains a set of rules and principles aimed at improving the corporate governance practice, and its implementation is based on the application of the rule "apply or explain", thus an additional explanation of the method of regulating the issue of preventing and resolving corporate conflicts is provided below.

Namely, the Bank's internal acts regulate the issue of conflict of interest. The Bank has adopted the Code of Ethics, which, in the broadest sense, regulates the modalities of desirable and prohibited actions, as well as the issues of preventing and resolving the conflict of interest of employees. Furthermore, in accordance with regulations governing the capital market, the Bank has, inter alia, regulated the issue of preventing negative effects of the conflict of interest on the provision of investment and ancillary services, and carrying out investment activities, taking into account the interests of the Bank, other persons, and clients. In addition, the Bank's Articles of Association also regulate the prevention and resolution of conflicts of interest of members of the Board of Directors. As the Board of Directors of the Bank manages the Bank, this, by analogy, implies that it also resolves issues of possible (corporate) conflicts that may arise between shareholders and the Bank. In the same vein, the Board of Directors of the Bank is responsible for ensuring that the operations of the Bank are carried out in accordance with the law, other regulations and internal acts of the Bank, and thus for minimizing harmful consequences for the Bank, which may also arise from the relationship between the bank and its shareholders. No shareholder of the Bank has been in conflict with the Bank so far, nor did they file a lawsuit against the Bank.

Having considered the aforesaid, in accordance with the provisions of Article 14 of the Law on Accounting (OGM 52/2016), the executive directors of the Bank declare that they apply the Code of Corporate Governance in Montenegro, as well as codes of business conduct of relevant organizations, of which they are members.

ORGANISATIONAL CHART OF THE BANK



MANAGEMENT OF THE BANK

EXECUTIVE DIRECTORS	Esad Zaimović, Chief Executive Officer Nikola Špadijer, Executive Director for retail operations and advanced sales channels Ana Golubović, Executive Director for corporate operations and financial markets Jelena Vuletić, Executive Director for risks
INTERNAL AUDIT DIVISION	Veselin Ivanović
EXPERT FUNCTION FOR MONITORING THE COMPLIANCE OF OPERATIONS WITH REGULATIONS (COMPLIANCE)	Danka Dragićević
DIVISION FOR PREVENTION OF MONEY LAUNDERING AND TERRORIST FINANCING	Mirjana Jovanović
DEPARTMENTS	Gojko Maksimović, Director of the Financial Markets Department Nataša Lakić, Director of the Department for Operations Nikola Milović, Director of the Department for Support and Organisation Božo Đurašković, Director of the Department for Legal Affairs and Human Resources Goran Smolović, Director of the Department for Risk Control Milana Stevanović, Acting Director of the Department for Risk Management
INDEPENDENT SERVICES	Haris Dizdarević, Director of the Service for Information and Physical and Technical Security

3 DEVELOPMENT, FINANCIAL POSITION AND BUSINESS RESULTS OF THE BANK

DEVELOPMENT, FINANCIAL POSITION AND BUSINESS RESULTS OF THE BANK

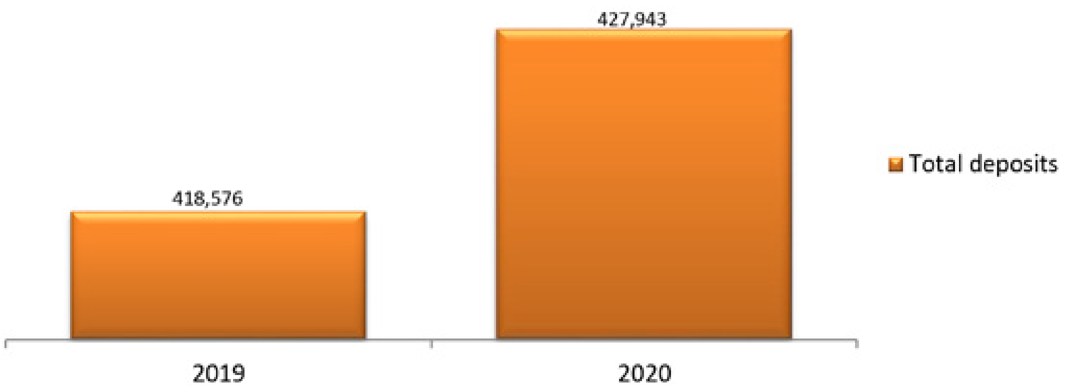
BUSINESS OPERATIONS

DEPOSITS

In 2020, deposits saw a y-o-y growth of 2.24%, which indicates that, in addition to high level of deposits recorded in the previous year, the confidence of citizens and economy in the Bank continued to grow in 2020. In addition to the stable growth of all types of deposits the growth in demand deposits of 5.23% was of particular importance.

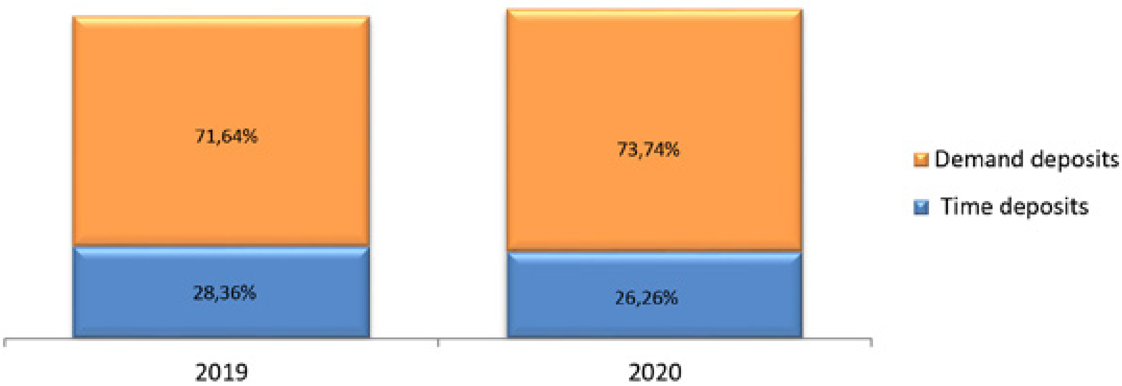
Total deposits:

year	Total deposits (EUR 000)	% of change
2019	418,576	-
2020	427,943	2.24%

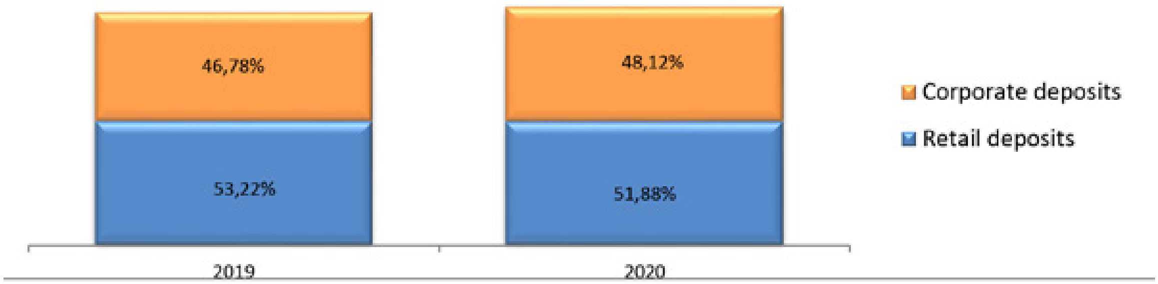


The increase in deposits resulted from the increase in the number of clients as well as the increase in the confidence in the Bank. Thanks to all Bank's features, which are, first and foremost, security, professionalism and high quality of the offer, we are recognised as a trustworthy bank, thus we continued the positive trend of deposit growth.

With regard to the share of time and demand deposits in total deposits, the Bank maintained adequate deposit structure. Time deposits accounted for 26.26% in total deposits, while demand deposits accounted for 73.74%.



The share of corporate deposits accounted for 48.12% of total deposits, while retail deposits stood at 51.88%, as shown in the graph below:

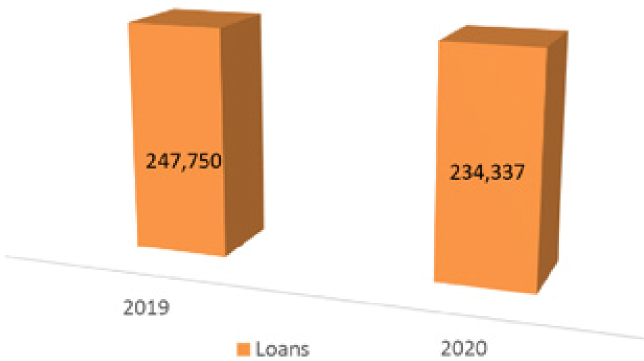


LOANS

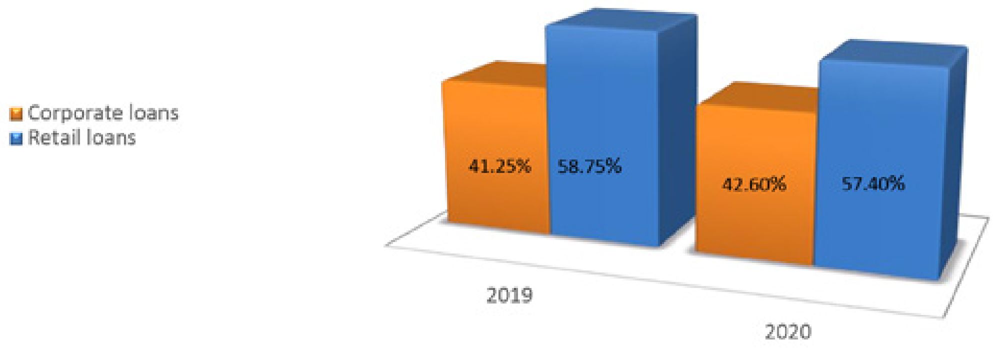
For the Bank, as well as for many financial and other institutions, 2020 brought many challenges due to the COVID-19 pandemic. Despite great uncertainty, declining gross domestic product, lack of tourist season, legal obligation to implement a moratorium on loans to citizens and vulnerable activities, the Bank has managed to preserve the scope and structure, and the quality of its loan portfolio.

Bank acted in a constructive way with regard to all clients who needed a moratorium or restructuring. The loan portfolio was slightly reduced in the last month of 2020, and the deviation in question is in line with the Bank's expectations for the size of the portfolio.

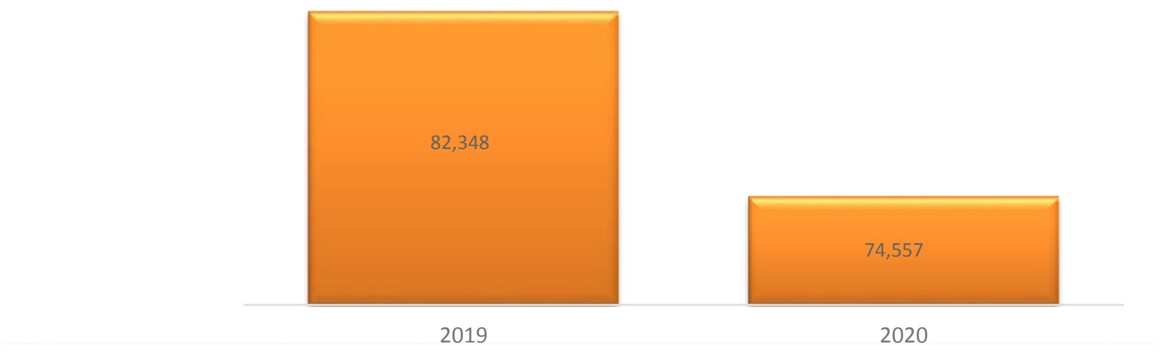
	Loans (EUR 000)	Change in %
2019	247,750	-
2020	234,337	-5.41%



With regard to the structure of total loans, retail loans made up 42.60%, while the share of corporate loans was 57.40% of total loan portfolio.



Overview of guarantees in 2020 (EUR 000):



The Bank has continued its successful cooperation with the Investment and Development Fund (IDF) in the area of lending under favourable conditions.

The Bank's range of services offered to corporate clients included cash loans, revolving loans, loans for payment of liabilities to suppliers, loans for car purchase, loans for refinancing of debts with other banks, loans for financing export receivables, loans for purchase of equipment, loans for refurbishment of office space, loans for tourist season preparation, overdraft loans, factoring, as well as all types of guarantees.

The Bank also offers a wide spectrum of household loans: cash loans, purpose-specific loans, student loans, car purchase loans, reconstruction and refurbishment loans, sailor loans, tourism loans, agriculture loans, overdraft loans, consumer instalment loans, etc. as well as all types of guarantees.

DEVELOPMENT OF NEW PRODUCTS AND SERVICES

In 2020, the Bank maintained the continuity in launching innovative products.

We would especially like to emphasize the improvement of the Premium card program. Namely, the Bank enabled all users to use additional benefits without increasing the price of the product:

- Choice of two among four types of insurance covers,
- Payments in up to 24 instalments with a significant number of partners, free of interest and other charges.

Also, in 2020, we implemented a project with MasterCard -- MDES for Merchants programme - M4M (service for tokenization and digitization of cards in the wallet). This service uses a token with a specific cryptogram associated with the transaction to provide a secure transaction with the cards registered on the websites (wallet). The service helps merchants reduce fraudulent transactions to a minimum, while improving the percentage of approved transactions.

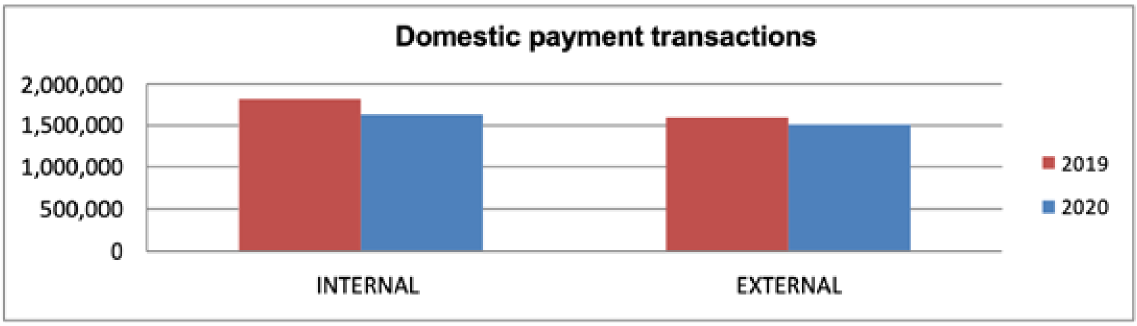
PAYMENT OPERATIONS

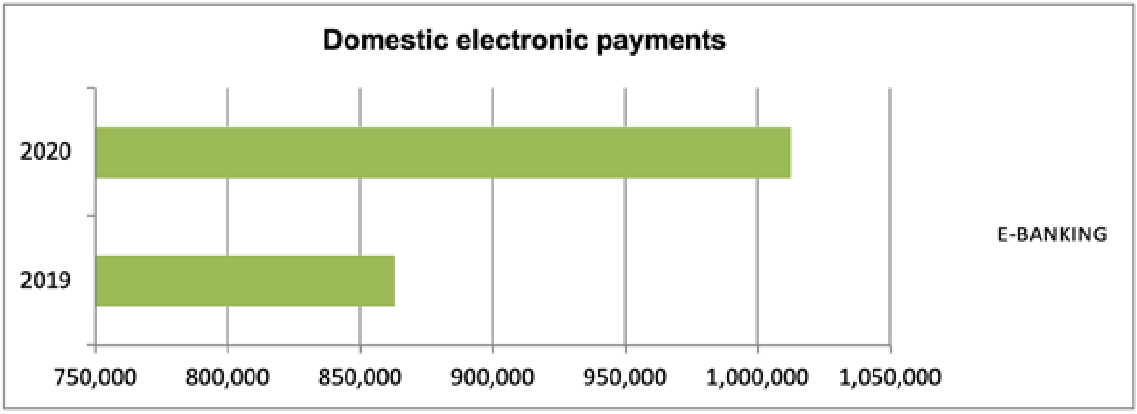
The Covid-19 pandemic had an adverse impact on the entire world economy, and it is evident that its effects were reflected on the segment of payment operations, which recorded a decrease in the total number of operations in 2020. On the other hand, the Covid-19 pandemic had a positive effect on the rise in the financial service users' interest in the use of electronic banking services, which resulted in a higher number of electronic payment transactions in the Bank's total payment transactions.

DOMESTIC PAYMENT OPERATIONS

In relation to 2019, the total number of Bank's payment transactions in domestic payment operations decreased by 8%, while the number of inflows decreased by 5%.

However, in 2020, there was an evident increase in the number of electronic payment transactions (e-banking), specifically by 14% y-o-y.

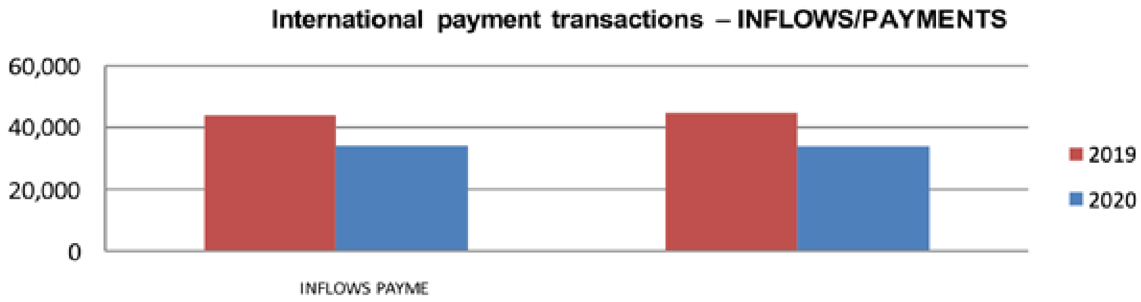




INTERNATIONAL PAYMENT OPERATIONS

The number of international payment transactions decreased by 24%, while the number of inflows decreased by 23%, y-o-y.

However, the structure of international payment transactions shows an increase in the number of e-payments in relation to total payments, whereby e-payments made up 50% of the total number of payments, which represented an increase of 11% compared to the previous year.



ASSET MANAGEMENT

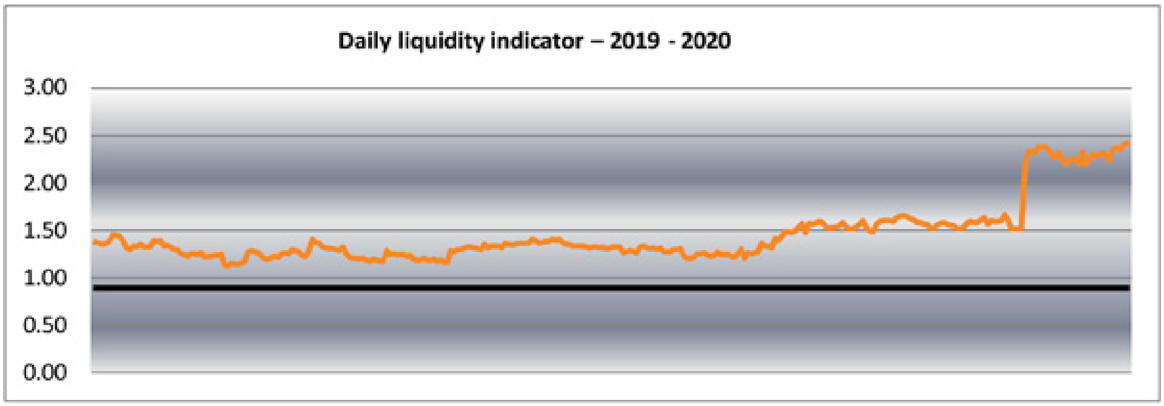
Providing optimal liquidity is a basic requirement for safe and efficient operations of each bank. With a view to maintaining adequate liquid assets to total liabilities ratio, the Bank should provide the liquidity needed by applying rational assets and liabilities management.

In 2020, the Bank also put emphasis on stabilising domestic sources of funding, expanding its depositor base, and reducing short-term sources in favour of long- term sources of funding.

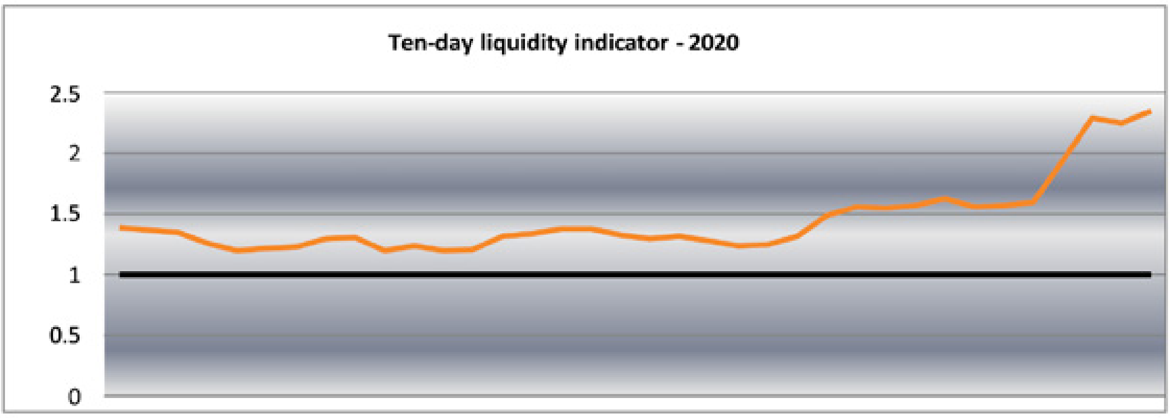
At the end of June 2020, the Bank signed a EUR 5 million loan agreement with the European Bank for Reconstruction and Development (EBRD), which provided assistance to small and medium-sized enterprises affected by the new corona virus pandemic. The loan was signed under the EBRD Solidarity Package.

In order to provide fast sources of funding, the Bank has concluded a Global Master Repurchase Agreement ("GMRA") with Raiffeisen Bank International AG Vienna. The said Agreement enables the Bank to obtain quick sources of liquidity, i.e. to receive funds in a foreign account, in case of urgent need.

The Treasury service operating as part of the Financial Markets Department managed to maintain the level of liquid assets and total liquid position of the Bank at the satisfactory level throughout 2020 thanks to its rational liquidity management. In addition, the Service reconciled funding sources with loans by daily, weekly, ten-day and monthly scheduling of available liquid assets. Adequate allocation of funds was performed through close cooperation with other departments and services in the Bank. This allowed the Bank to meet its obligations towards creditors regularly, as well as to accommodate client requests within the shortest terms possible. The daily liquidity ratio, which is calculated using the methodology set by the CBCG, was above the statutory minimum of 0.90 throughout 2020. (As of 25 November 2020, the RLS reports are compiled in accordance with the altered CBCG methodology which enables the inclusion of 20% demand deposits in liabilities, instead of the previously applicable 30%).



Also, ten-day liquidity indicator was above the statutory minimum of 1.00.



With the aim to manage liquidity within a period, the Bank regularly monitored indicators of the structural liquidity through maturity match of financial assets and liabilities, overview of maturity of large deposits, and by establishing a stable part of demand deposits using the internal model. The Bank maintained liquidity at the satisfactory levels.

Given that 2020 saw a fall in interest rates on deposits of clients and the caution of clients in managing their own funds, it can be noted that, even in such circumstances, the Bank was recognised as one of the most reliable and most liquid banks in the banking system of Montenegro. This statement is supported by the 2019 year-end data that showed total deposits in the amount of EUR 418.58 million, and 2020 year-end data showing total deposits in the amount of EUR 427.94 million, which represented an increase of 2.24%. In addition to lending activity, surpluses of liquid funds were invested in marketable securities.

In 2020, the Bank actively participated in T-Bills auctions and made satisfactory returns. Also, through the activities of the Financial Markets Department, the Bank invested funds in securities both in Montenegro and in the global market.

The total value of the securities portfolio at the end of 2020 amounted to EUR 129.26 million. Compared to the end of 2019, the securities portfolio decreased by about EUR 5 million. In the structure of the securities portfolio, Montenegrin government debt securities accounted for the main share of about EUR 84 million, or about 65%. Of the total portfolio of securities, the amount of EUR 10 million refered to short-term Treasury bills.

Large exchange rate fluctuations were recorded in 2020, particularly in currency pair EUR/USD, which has the highest impact on the exposure of the Bank to foreign exchange risk.

Thus, at the end of 2020, total income from exchange gains/losses amounted to 461 thousand euros, which is a decline compared to 2019.

The entire 2020 was marked by the Covid-19 pandemic, which had huge consequences for the global economic system. The lockdown of many countries due to the pandemic has led to a drastic decline in economic activity. Accordingly, domestic economic activity has suffered significant consequences of the crisis caused by the new corona virus.

INVESTMENT BANKING

Montenegro's Capital Market

In 2020, total turnover recorded at the Montenegro Stock Exchange amounted EUR 62,725,508, which was a y-o-y decline of about 80%. Looking at the data on number of concluded deals, some 38% less deals were concluded in 2020 as compared to 2019.

MNSE 10 index (index that follows the price trend in 10 most liquid companies) fell by 8.33% last year, and it was at 712.83 on the last trading day. MONEX recorded a decline of 9.43% last year, and it stood at 10,328.64 points on the last trading day.

Broker and custody operations

In 2020, total turnover that the Bank recorded at the Montenegro Stock Exchange amounted EUR 5,234,664, which made up 8.35% of total turnover. Observing the realised turnover, the Bank ranked fourth in terms of participation in total turnover realised at the Montenegro Stock Exchange.

The table below provides a structure of the realised turnover of the Bank:

Type of securities	Number of transactions	Realised turnover
Shares	244	3.703.369
Government bods	8	158.533
Corporate bonds	32	1.372.762
TOTAL	**284**	**5.234.664**

In 2020, total turnover realised by trading in subordinated bonds of the Bank, HBO1, HBO2 and HBO3, amounted to EUR 1,372,762.

An overview of trading in Bank's bonds was as follows:

Name of the bond	Number of transactions	Realised turnover
HBO1	28	951.756
HBO2	2	30.720
HBO3	2	400.000
TOTAL	**32**	**1.372.762**

The turnover realised by the Bank at the international market for the account of clients amounted to EUR 90.5 million. The largest portion of the said transactions referred to OTC transactions with bonds.

The table below provides an overview of concluded transactions at the international market in period from 01 January – 31 December 2020. The Bank recorded twice as much turnover as in the previous year.

Total number of executed transactions	467
Total value of executed transactions (EUR):	cca 26.628.008
Total value of executed transactions (USD):	cca 76.178.185

As at 31 December 2020, the Bank's clients held securities with the Bank in the amount of EUR 97 million, which is by 38.6% higher (or by approximately EUR 27 million) than as at end-2019. It is worth emphasizing that of the total amount of clients' portfolio, foreign securities amounted to about EUR 64.5 million. Therefore, the Bank remained one of the leaders in the field of custody operations in Montenegro.

4 FINANCIAL REPORTS AND INDICATORS

FINANCIAL REPORTS AND INDICATORS

PROFIT AND LOSS STATEMENT

from 1 January to 31 December 2020 (in EUR '000)

	POSITION	31-Dec-2020	31-Dec-2019
1.	Interest income and similar income	18,239	19,741
2.	Interest income on impaired loans	-	-
3.	Interest expenses and similar expenses	3,200	3,091
I.	NET INTEREST INCOME (1 + 2 - 3)	15,040	16,650
4.	Fee and commission income	12,821	16,988
5.	Fee and commission expenses	7,893	10,755
II.	NET FEE AND COMMISSION INCOME (4-5)	4,928	6,214
6.	Net gains/losses from derecognition of financial instruments not carried at fair value through profit or loss	212	150
7.	Net gains/losses on held-for-trading financial instruments	153	-
8.	Net gains/losses from financial instruments carried at fair value through profit or loss, not held for trading	-	-
9.	Changes in fair value in hedge accounting	-	-
10.	Net gains/losses from FX revaluation	461	788
11.	Net gains/losses from derecognition of other assets	152	311
12.	Other income	645	246
13.	Employee expenses	5,551	5,486
14.	Depreciation expenses	2,542	1,077
15.	Overhead and administrative expenses	6,069	7,802
16.	Net gains/losses from modification and reclassification of financial instruments	-	-
17.	Net gains/losses from impairment of financial instruments not carried at fair value through profit or loss	3,518	3,723
18.	Provision expenses	6	96
19.	Other expenses	70	786
III.	PROFIT/LOSS BEFORE TAX: I+II+6+7+8+9+10+11+12-13-14-15-16-17-18-19	3,835	5,389
21.	Profit tax	346	526
22.	NET PROFIT/LOSS (III - 21)	3,488	4,863

BALANCE SHEET

as at 31 December 2020 (in EUR '000)

No.	POSITION	31-Dec-2020	31-Dec-2019
1.	**Cash and deposit accounts with central banks**	**163,390**	**137,133**
2.	**Financial assets at amortised cost**	**240,348**	**251,741**
2.a.	Loans and receivables from banks	22,055	20,864
2.b.	Loans and receivables from clients	215,400	228,912
2.c.	Securities	1,107	-
2.d.	Other financial assets	1,786	1,965
3.	**Financial assets at fair value through other comprehensive income**	**128,150**	**134,758**
3.a.	Loans and receivables from banks	-	-
3.b.	Loans and receivables from clients	-	-
3.c.	Securities	128,150	134,758
3.d.	Other financial assets	-	-
4.	**Held-for-trading financial assets**	**-**	**-**
4.a.	Loans and receivables from banks	-	-
4.b.	Loans and receivables from clients	-	-
4.c.	Securities	-	-
4.d.	Other financial assets	-	-
5.	**Financial assets carried at fair value through profit and loss, not held for trading**	**-**	**-**
5.a.	Loans and receivables from banks	-	-
5.b.	Loans and receivables from clients	-	-
5.c.	Securities	-	-
5.d.	Other financial assets	-	-
6.	**Derivative financial assets as hedging instruments**	**-**	**-**
7.	**Changes in the fair value of items being subject to hedging**	**-**	**-**
8.	**Investments in subsidiaries, associates and joint ventures at equity method**	**-**	**5**
9.	**Investment properties**	**-**	**-**
10.	**Property, plant and equipment**	**6,214**	**2,352**
11.	**Intangible assets**	**2,019**	**2,037**
12.	**Current tax assets**	**-**	**-**
13.	**Deferred tax assets**	**27**	**25**
14.	**Non-current assets held for sale and discontinued operations**	**-**	**-**
15.	**Other assets**	**2,433**	**2,429**
16.	**TOTAL ASSETS:**	**542,581**	**530,478**

	LIABILITIES		
17.	**Financial liabilities carried at amortised cost**	**451,661**	**443,122**
17.a.	Deposits of banks and central banks	1,214	1,148
17.b.	Deposits of clients	428,346	419,592
17.c.	Borrowings from banks and central banks	-	-
17.d.	Borrowings from clients other than banks	22,049	22,335
17.e.	Securities	-	-
17.f.	Other financial liabilities	54	47
18.	**Held-for-trading financial liabilities**	**-**	**-**
18.a.	Deposits of banks and central banks	-	-
18.b.	Deposits of clients	-	-
18.c.	Borrowings from banks and central banks	-	-
18.d.	Borrowings from clients other than banks	-	-
18.e.	Securities	-	-
18.f.	Other financial liabilities	-	-
19.	**Financial liabilities not traded and measured at fair value through profit or loss**	**-**	**-**
19.a.	Deposits of banks and central banks	-	-
19.b.	Deposits of clients	-	-
19.c.	Borrowings from banks and central banks	-	-
19.d.	Borrowings from clients other than banks	-	-
19.e.	Securities	-	-
20.	**Derivative financial liabilities as hedging instruments**	**-**	**-**
21.	**Changes in the fair value of items being subject to hedging**	**-**	**-**
22.	**Provisions**	**1,453**	**1,535**
23.	**Liabilities on non-current assets held for sale and discontinued operations**	**-**	**-**
24.	**Current tax liabilities**	**342**	**514**
25.	**Deferred tax liabilities**	**23**	**209**
26.	**Other liabilities**	**13,301**	**11,148**
27.	**Subordinated debt**	**22,256**	**22,050**
28.	**TOTAL LIABILITIES:**	**489,037**	**478,578**
	CAPITAL		
29.	**Share capital**	**16,006**	**16,006**
30.	**Issue premiums**	**7,444**	**7,444**
31.	**Retained earnings**	**25,425**	**20,541**
32.	**Current year profit/loss**	**3,488**	**4,863**
33.	**Other reserves**	**1,181**	**3,046**
34.	**Non-controlling interests in equity**	**-**	**-**
35.	**TOTAL CAPITAL: (29. do 34.)**	**53,544**	**51,900**
36.	**TOTAL CAPITAL AND LIABILITIES: (28. + 35.)**	**542,581**	**530,478**

CAPITAL

As at 31 December 2020, total capital of the Bank amounted to EUR 53.544 million. Capital increased by 3.17% compared to the previous year.

As at 31 December 2020, the nominal value of the share capital amounted to EUR 16,006 million. The share capital consists of 31,305 shares, each with a nominal value of EUR 511.29.

The ownership structure of the Bank consists of foreign legal and natural persons that own 74% of the share capital, while the remaining share capital is owned by domestic legal and natural persons.

PROFIT AND LOSS STATEMENT

In 2020, the Bank recorded profit of EUR 3,488 million. Interest income fell by 7.61% compared to the previous year and they amounted to EUR 18,239 million which was the result of the decrease in lending activity of the Bank due to the COVID-19 pandemic outbreak, as well as the calculation of interest recorded in off-balance in 2019.

Fee income saw a y-o-y decrease of 24.53% and they amounted to EUR 12,821 million. In addition to the previously mentioned decline in lending activity, which affected the decline in fee income, the pandemic outbreak also affected the decline in fee income related to payment transactions and card operations. Net fee income amounted to 29.97% of net income arising from regular operations of the Bank.

Other income grew by 8.51% in the observed period and they amounted to EUR 1,623 million.

Expenses from regular operations, including depreciation, amounted to EUR 14,232 million and they fell by 6.06% compared to the previous year. The decrease in expenses was due to the reduced activities of the Bank that refer to the expansion of business network, new employees as well as other expenses following the operations of the Bank. The aforesaid largely resulted from the pandemic outbreak.

Credit risk assessment and provisioning for risk loans and contingent liabilities of the Bank are based on the implementation of the principles of conservative policy and prevailing laws and regulations.

As at 31 December 2020, total provisions for assets and liabilities positions amounted to EUR 18,536 million.

DISTRIBUTION OF PROFIT

The Board of Directors, upon the proposal of the management of the Bank, proposed to the General Meeting of Shareholders not to distribute profit in 2020 in order to increase total capital of the Bank.

The ownership structure of the Bank consists of foreign legal and natural persons that own 74% of the share capital, while the remaining share capital is owned by domestic legal and natural persons.

INDICATORS

As at 31 December 2020, the position of the Bank in the Montenegrin banking system, according to the last, publicly known, data on financial reports of all banks in Montenegro was as follows:

- Market share: the Bank ranked 3rd;
- Net profit: the Bank ranked 2nd.

Financial indicators as at 31 December 2020:

- ROAA – 0.65%
- ROAE – 6.62%
- SSB – EUR 51.092 million
- Solvency ratio – 17.62%.

ENVIRONMENTAL INVESTMENTS

While carrying out its activities, the Bank takes care of the rational use of natural resources, that is, of providing environmental protection measures.

Particular attention was paid to this segment when using loans from the credit lines of the European institutions, primarily the European Bank for Reconstruction and Development (EBRD).

In the previous year, the Bank started research and analysis on all business segments in the context of the impact on renewable energy sources, the environment, and after the results obtained, it will consider the need to improve the methods and materials we use in our daily work.

PLANNED FUTURE DEVELOPMENT

The available statistical data for the first quarter of 2020 indicated the growth trend in certain economic sectors. With the outbreak of the COVID-19 pandemic, the performance of the Montenegrin economy is predominantly under its influence, so that at the end of March 2020, significant challenges are already emerging, accompanied by a high degree of uncertainty and negative effects on citizens, the real economy and financial system.

In addition to the application of binding measures to mitigate the adverse effects of the COVID-19 pandemic, the Bank supported the needs of its clients throughout the past year with special measures, especially lines to fuel the liquidity of the tourism industry through the model of interest-free lending for summer vacations in Montenegro, not only to its clients but also to all creditworthy citizens of our State. With binding and special measures of the Bank to mitigate the adverse effects of the pandemic on citizens, we managed to improve and introduce additional benefits for users of our most popular payment card, by introducing two types of insurance, optional, and extending instalment payments for the price of obtained goods/services up to 24 months.

In 2020, we provided strong support to the community in various areas, but launching the Platform for collecting, via the Internet, non-refundable funds to fight the COVID-19 pandemic needs to be specifically emphasized. Employees, our clients and citizens strongly supported the Bank's activity, so that donations exceeded the planned amount many times over. The Bank bore all the costs of the execution of internet transactions, so that the collected money was paid in full to the Government of Montenegro.

The pandemic will continue in 2021, and despite the start of immunization of the population, the extent of the consequences for the real economy and financial system is uncertain.

In 2021, we will continue to actively provide banking services, largely through digital channels, with a trend of innovation in business activities and a policy of commitment to customer needs.

After delaying the implementation of systemic laws, in 2021 we will have to comply with complex regulations, aligned with the EU standards, but we are adjusted to face the challenges.

We will persevere with supporting the community in various fields - education, culture, especially health, which will contribute to social and economic recovery and progress.

We expect that the professional work of the employees will contribute also in 2021 to the success and reputation that the Bank has in the market.

RESEARCH, DEVELOPMENT AND INVESTMENT IN EDUCATION OF EMPLOYEES

As in the previous years, however, somewhat to a lesser extent in view of the global COVID-19 pandemic, the Bank continuously monitors and participates in market research, as well as in the analyses published by renowned agencies, thus using the obtained data to position the brand.

As previously mentioned, the key elements of success and our organisational culture are based on the knowledge, skills and dedication of our employees. Therefore, the Bank continually plans the development and improvement of the skills of its employees, both by organising trainings, which is assisted by experienced, competent employees, and by hiring reputable foreign consultants/ consulting firms specialised in human resources management. We particularly consider it important to emphasize expert training seminars for our sales staff, i.e. employees in positions where communication with clients is most commonly accomplished, with the aim of improving their communication skills, styles adapted to different stages of that communication, as well as further developing of skills for understanding clients' needs, which is in their best interest. In addition, the Bank is committed to the concept of continuous development of employees in managerial positions, thus hiring external consulting teams to improve their skills in accordance with modern standards.

BUYBACK OF OWN SHARES

In 2020, the Bank did not buy its shares back.

FINANCIAL INSTRUMENTS IMPORTANT FOR THE ASSESSMENT OF FINANCIAL POSITION AND BUSINESS PERFORMANCE OF THE BANK

With regard to the financial instruments used by the Bank that are important for assessing the financial position and business performance, and for determining assets, liabilities, financial position and profit or loss, three series of subordinated Bonds issued by the Bank in 2014, 2017 and 2019 stand out, which had a positive effect on increasing long - term sources of funding and strengthening the Bank's capital adequacy ratio.

NETWORK OF BANK BUSINESS UNITS

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E-mail: ekspozitura.porto.montenegro@hb.co.me

Sub-branch in Žabljak
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E-mail: ekspozitura.zabljak@hb.co.me

RISK MANAGEMENT

Generally speaking, the risk management process involves: identifying, measuring, monitoring, controlling and reporting on risks. In addition, risk management policies and procedures are being developed within the departments, as well as methodologies and procedures for measuring them. Establishing a comprehensive risk management framework as well as recognising the risk management culture in the general corporate culture of the Bank is a necessary precondition for the long-term success of any banking strategy.

This process is integrated into the Bank's corporate governance framework and is based on a model "Three lines of defence" - "the first line of defence" is the management of the Bank's business lines, which is responsible for managing risks associated with products, activities, processes and systems in business segments and in decision-making on a daily basis; "the second line of defence" is the executive director of the Bank for risk management and the bodies of the Board of Directors for individual risks; and "the third line of defence" are internal audit, independent external auditor, and it may include external independent qualified entities

The Risk Management Department is responsible for managing risks within the Bank, which has two services - Service for Risk Assessment and Service for Managing Risk Loans, both being responsible for risk assessment, identification, and measurement. The Department for Control of Risk is responsible for monitoring, control and reporting on risks.

A special attention within the risk management is paid to policies and procedures related to risk management, as well as the development of the necessary methodologies. Reporting within both departments is performed on a monthly, quarterly and annual basis, and all activities related to the Risk Management Department are reported to the ALCO, the Board of Directors, the Credit Risk Committee and the Non-Financial Risk Committee.

The Bank has identified in its operations the following categories of risks that it wants to actively manage: credit risk, liquidity risk, interest rate risk from the banking book, market risk, operational risk and country risk.

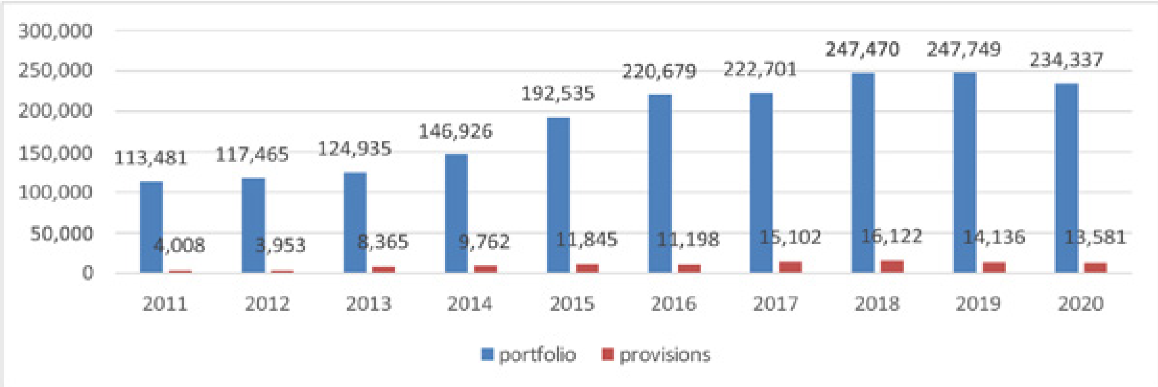
Credit risk

Credit risk is defined as the risk of loss due to the inability or unwillingness of a client to fully and timely meet its obligations to the bank.

Credit risk management is a key component of overall risk management system. Credit risk management is aimed at maximising the ratio between the risk and return of the Bank. In order to accomplish this objective, credit risk is managed at individual level (at the level of sub-account) within the Risk Management Department, and at the portfolio level within the Department for Control of Risk.

In December 2020, the Bank's loan portfolio declined by 5% y-o-y. It is important to note that despite the crisis caused by the adverse effects of the coronavirus epidemic, the Bank maintained the level of the loan portfolio at approximately the same level as in previous years.

Portfolio / provisions 2011-2020 (in EUR thousand)



Bank's performing assets (A and B1) accounted for 54% of total portfolio, while substandard assets (B2) accounted for 37%, and non-performing assets (C, D and E) amounted to 8%.

Asset quality – December 2020 (in EUR million)

The main indicators of credit risk were: the percentage of loan loss provisions, loans past due, and share of non-performing assets in total portfolio (NPL %).

The percentage of loan loss provisions can be observed using the CBCG methodology and internal methodology of the Bank (impairment).

• According to the CBCG methodology, as at 31 December 2020, loan loss provisions made up 5.80% of the portfolio or EUR 13,581,181. When compared to 2019 year-end, these provisions increased by 3.9% or EUR 555,246.

Portfolio / provisions according to the CBCG

	31.12.2019.	31.03.2020.	30.06.2020.	30.09.2020.	31.12.2020.
Portfolio	247.749.409	253.870.221	257.648.351	250.751.083	234.337.109
Provisions	14.136.427	14.977.447	13.428.917	14.114.884	13.581.181
Provisions (%)	5,71%	5,90%	5,21%	5,63%	5,80%

• According to the internal methodology, as at 31 December 2020, loan impairments amounted to EUR 14,590,928 or 6.23% of the portfolio. Y-o-y, the provisions increased by EUR 432,279 or by 3.05%.

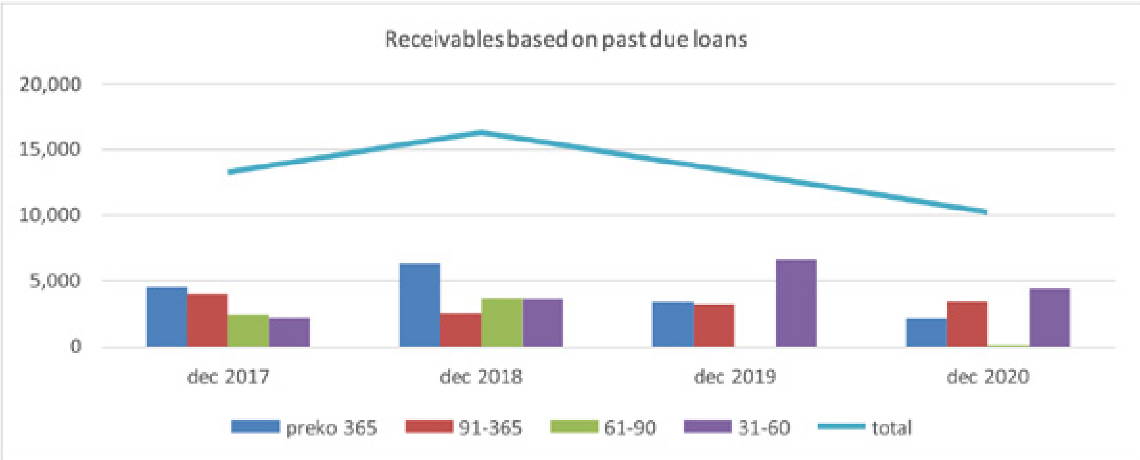
Portfolio / provisions based on internal methodology (model)

	31.12.2019.	31.03.2020.	30.06.2020.	30.09.2020.	31.12.2020.
Portfolio	247.749.409	253.870.221	257.648.351	250.751.083	234.337.109
Provisions	14.158.649	14.764.613	13.750.196	14.009.396	14.590.928
Provisions (%)	5,71%	5,82%	5,34%	5,59%	6,23%

Loans past due:

• As at 31 December 2020, past due loans over 30 days amounted to EUR 10,226,598 or 4.11% of total portfolio of the Bank, while as at 31 December 2019, they stood at EUR 13,273,234 or 5.36% of total portfolio of the Bank.

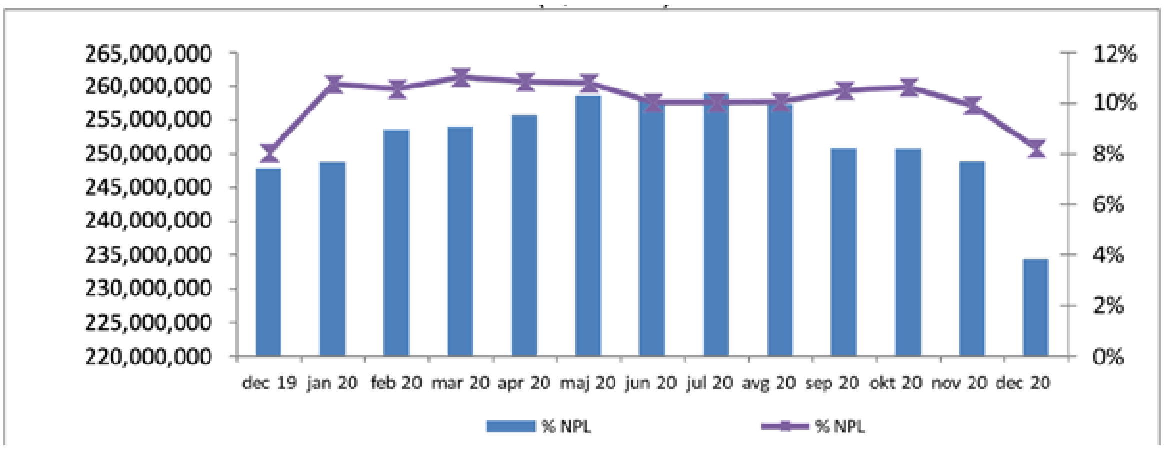
• With regard to the past due loans over 90 days as at 31 December 2020, they amounted to EUR 5,607,861 or 2.25% of total portfolio of the Bank, while as at 31 December 2019, they amounted to EUR 6,607,200 or 2.67% of total portfolio of the Bank.



The share of non-performing assets (NPLs) in total portfolio is monitored on the basis of the client's financial situation, i.e. based on the classification category (C, D and E) and past due days i.e. over 90 days past due.

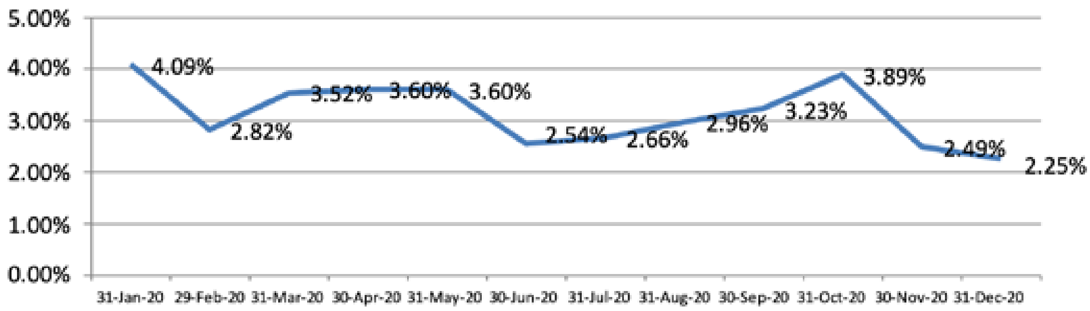
With regard to the classification categories (C, D and E), as at end-December 2020, NPLs amounted to EUR 19,238,690 or 8.21% of the portfolio, which represents an NPL decline of 3.19% compared to December 2019, when they amounted to EUR 19,873,167.

NPL share (C, D and E) in total loans



As at end-December 2020, based on the past due days (>90d), NPLs amounted to EUR 5,607,861 or 2.25% of the portfolio, which represented a decline in NPLs of 15% compared to December 2019 when NPLs amounted to EUR 6,607,200.

NPL based on past due days (over 90 days)



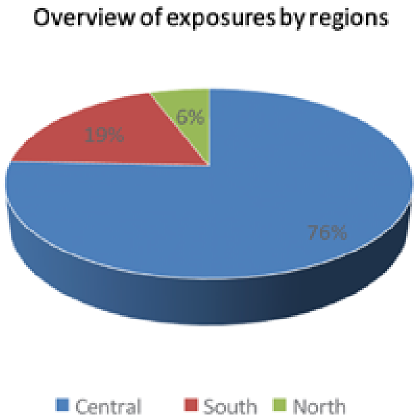
The table below shows the structure of loan portfolio per industries in December 2020. The trade sector accounted for the largest share in loan portfolio and it share accounted for 14.44% of the portfolio, while the share of exposure to natural persons amounted to 39.45%.

Portfolio per economic sectors as at 31 December 2020 (in EUR thousand)

Sector	Amount of loan	% of portfolio	Limit
Agriculture, forestry and fishing	3,346	1.43%	40%
Mining and quarrying	4,154	1.77%	40%
Manufacturing industry	10,291	4.39%	40%
Electricity supply	1,378	0.59%	40%
Water supply	377	0.16%	40%
Construction	28,701	12.25%	40%
Wholesale, retail trade and repair of motor vehicles and motorcycles	33,827	14.44%	40%
Transport and warehousing	8,930	3.81%	40%
Accommodation and food services	23,481	10.02%	40%
Information and communication	1,400	0.60%	40%

Financial and insurance activities	5,706	2.43%	40%
Real estate business	3,956	1.69%	40%
Professional, scientific and technical activities	3,054	1.30%	40%
Administrative and support service activities	2,349	1.00%	40%
Public administration, defence and compulsory social insurance	0	0.00%	40%
Education	134	0.06%	40%
Health and social welfare	453	0.19%	40%
Art, entertainment and recreational activities	337	0.14%	40%
Other service activities	1,012	0.43%	40%
Activities of households as employers	0	0.00%	40%
Activities of extra-territorial organisations and bodies	0	0.00%	40%
Natural persons - residents	92,452	39.45%	45%
Non-residents	8,999	3.84%	40%
	234,337		

The graph below shows the exposure of the Bank to regions in December 2020.



Impact of the COVID-19

In accordance with the presentation of the trend of non-performing loans in the last year as shown in graphs and tables above, it can be concluded that the current economic crisis caused by the effects of the epidemic did not have a significant impact on the deterioration of NPL indicators at the end of 2020.

In accordance with the decisions of the CBCG on interim measures to mitigate the adverse effects of the COVID-19 epidemic on the financial system, the Bank met the needs of clients who needed to defer payment of credit obligations and / or restructure them. Guided by the provisions of the CBCG decisions in the restructuring procedure, clients were granted benefits that facilitate their current financial position, and in the loan classification procedure and calculation of loan loss provisions, loans were treated as new loans, if they met the conditions prescribed by the CBCG.

As at 31 December 2020, there were 50 debtors in the moratorium approved for the tourism sector and the agriculture, forestry and fishing sector with a total exposure of approximately EUR

3.5 million, of which EUR 2.1 million (61%) referred to natural persons, and the remaining referred to entrepreneurs and small and medium enterprises. In addition, the right to a moratorium was exercised by another 32 debtors - other natural persons, with a total exposure of EUR 265,000.

The impact of the epidemic was most pronounced in the tourism and agriculture, forestry and fishing sectors, where loan restructuring was approved in the total amount of EUR 15.1 million, where loan repayment terms were mostly extended, with the possibility of introducing a grace period. In addition, the restructuring was approved to other loan beneficiaries in the total amount of EUR 13.3 million, which gives a total amount of EUR 28.4 million of COVID restructured loans.

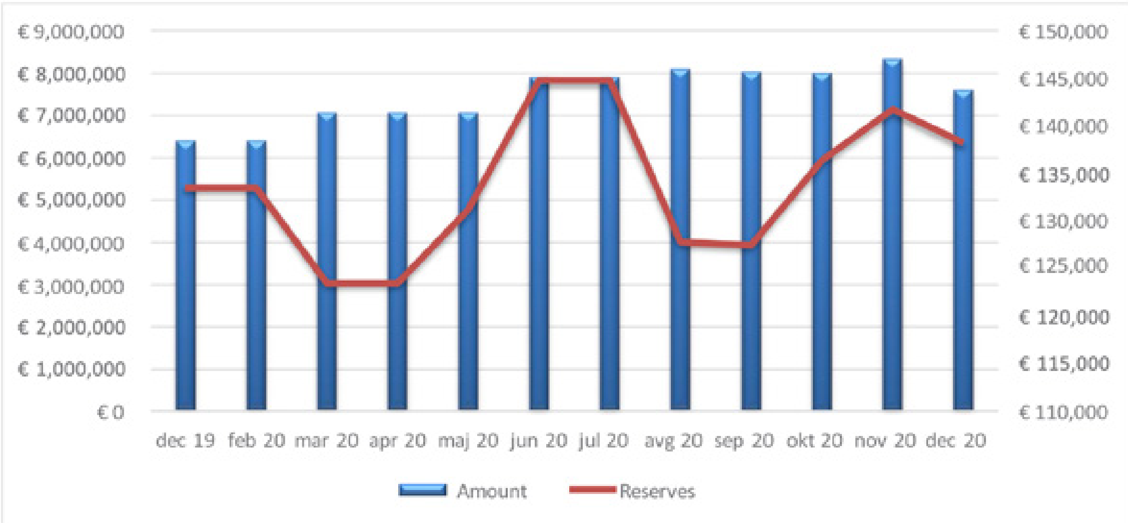
Taking into account the above, it is realistic to expect that the Bank will experience the adverse effects of the impact of the epidemic in this and the following years, when the impact from the real sector is transferred to the financial sectors. At this moment, it is difficult to define more precise forecasts, specifically due to the volatile course of the epidemic so far and, consequently, the volatile impact on the economy.

Securities - within credit risk

As at 31 December 2020, Bank's banking book consisted of equity and debt financial instruments. In December, all positions in the banking book were within the statutory and internally defined limits. As at 31 December 2020, total securities owned by the Bank amounted to EUR 129,257,674. Of that amount, debt securities amounted to EUR 121,656,147, and equity securities were EUR 7,601,527.

Graph: Debt securities and reserves

Graph: Equity securities and reserves



Market risk

The Bank analyses the following risks within market risks: interest rate risk, foreign exchange risk and position risk.

Interest rate risk is the negative impact of changes in interest rates on the bank's financial position.

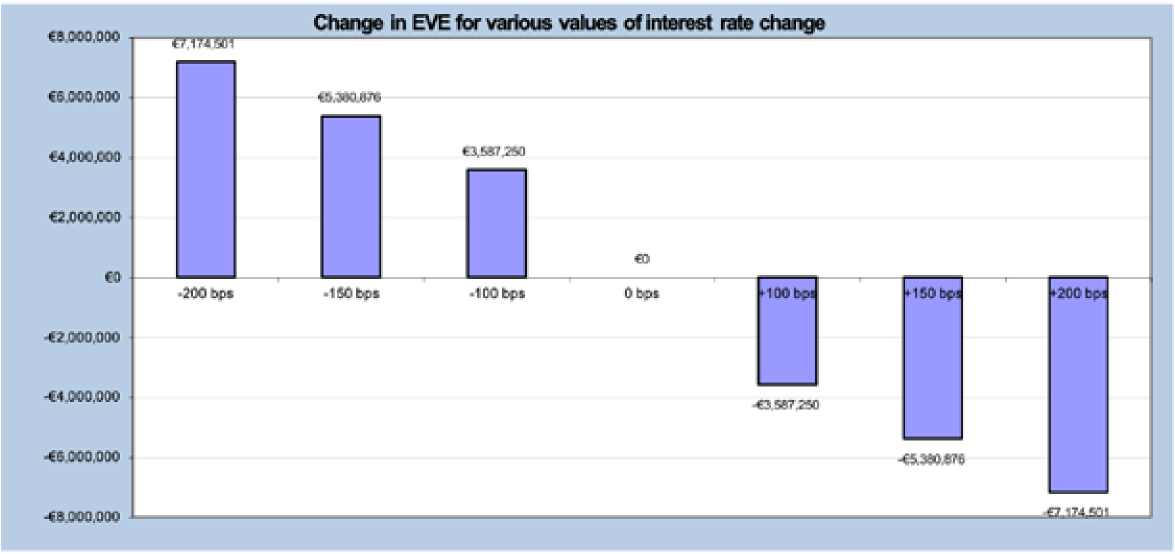
Interest rate risk arises due to:

a) Changes in prices, or mismatches in the maturity of assets and liabilities (risk of price changes);
b) Changes in reference interest rates for assets and liabilities;
c) Changes in the shape of the yield curve (yield curve risk);
d) Exercising the financial option that implicitly exists in the credit arrangements that the Bank has with clients (option risk).

Two complementary perspectives were used for analysing interest rate risk: impact on the economic value of equity of the Bank, as well as net interest income.

Gap duration was applied on the analysis of the impact of interest rate risk arising from the banking book on the economic value of the Bank. The purpose of this method was to present potential change in the value of future lending and deposit cash flows of the Bank sensitive to interest rate risk, which difference represents economic value of equity (EVE) of the Bank. Contrary to interest rate gap that measures the impact of interest rate risk on net interest income, taking into account lending and deposit cash flows up to one year, the duration gap takes into account all cash flows.

In case of the increase of the level of interest rates by 200 basis points, as at 31 December 2020, the EVE of EUR 62.27 million would decrease by EUR 7.17 million or by 11.52%. As at 31 December 2019, the calculated amount of duration gap (or risk weighted position of the banking book) made up 14.07% of own funds of the Bank, which was within the statutory limit of 25%.



Projection of demand deposit withdrawal:

1-30 days	31-90 days	91-180 days	181-365 days	Over 1 year
19%	14%	13%	19%	35%

ASSETS AND LIABILITIES SENSITIVE TO INTEREST RATE (in EUR thousand)

Aggregate as at 31 December 2019

SENSITIVE ASSETS	1-30 days	31-90 days	91-180 days	181-365 days	Over 1 year	TOTAL
Interest-bearing deposits in other institutions	28.634					28.634
Interest-bearing securities	1.508	13.661	162	1.979	101.357	118.667
Loans and other receivables	19.723	19.109	19.133	47.864	128.508	234.337
Other sensitive assets	1.679					1.679
TOTAL	51.545	32.770	19.295	49.843	229.865	383.317
	13%	9%	5%	13%	60%	100%
SENSITIVE LIABILITIES	**1-30 days**	**31-90 days**	**91-180 days**	**181-365 days**	**Over 1 year**	**TOTAL**
Interest-bearing deposits	59.181	47.347	49.477	97.740	131.006	384.751
Interest-bearing borrowings	50	155	887	2.775	18.149	22.017
Subordinated debt and bond				10.000	12.000	22.000
Other sensitive liabilities	704					704
TOTAL	59.935	47.502	50.364	110.515	161.155	429.472
% of total interest-bearing liabilities	14%	11%	12%	26%	38%	100%
DIFFERENCE (GAP)	**1-30 days**	**31-90 days**	**91-180 days**	**181-365 days**	**Over 1 year**	**TOTAL**
GAP AMOUNT	-8.391	-14.732	-31.069	-60.673	68.710	-46.155

A part of the year in which there is GAP exposure	0,96	0,84	0,63	0,26		
Cumulative Gap	-8.391	-23.123	-54.193	-114.865	-46.155	-92.311
Impact on net interest income	-161	-246	-392	-316		
Annual change in interest income (interest rate shock)	**-1,115**					
Cumulative Gap / Total assets	-2%	-5%	-11%	-23%	-9%	-18%
Prescribed limits	54%					

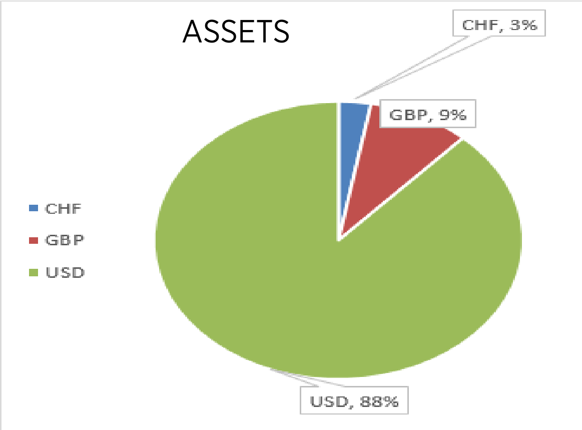
If interest rates rise by 2 percentage points, the expected annual net interest income would decline by EUR 1.115 thousand.

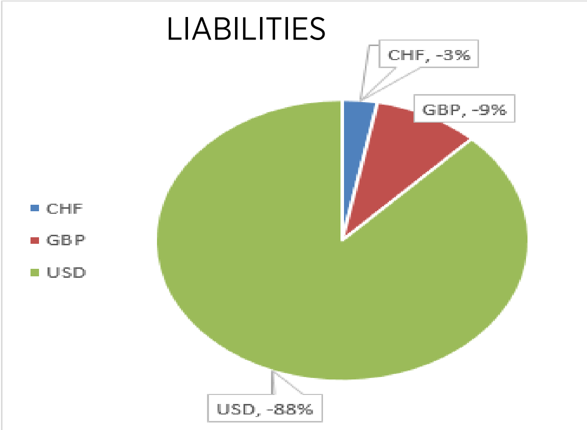
Foreign exchange risk did not have any significant impact on total risk profile of the Bank.

The Bank operated within the established system of limits.

FX position – 31 December 2020 (converted in EUR)

Own funds				EUR 50,984,000	
Currency	**Assets**	**Liabilities**	**Net position**	**Limit (% of core capital)**	**Realised**
AUD	12.693	-9.632	3.061	15%	0%
CAD	36.119	-32.779	3.339	15%	0%
DKK	26.447	0%	26.447	15%	0%
JPY	0	0%	0%	15%	0%
KWD	0	0%	0%	15%	0%
NOK	256	0%	256	15%	0%
SEK	9.073	-4.219	4.854	15%	0%
CHF	524.818	-555.490	-30.673	15%	0%
GBP	1.658.135	-1.668.595	-10.461	15%	0%
USD	16.336.569	-16.054.296	282.273	15%	0,55%
	18.604.109	**-18.325.012**	**279.098**	**20%**	**0,55%**





LIQUIDITY RISK

Liquidity risk is the risk that the Bank will not be able to meet its obligations at any time. Given the Bank's strategic commitments, maintaining a high level of liquidity is imperative in the process of managing this risk. The reputation of a highly liquid Bank is especially important for ensuring business growth through the growth of household and corporate deposits. The high level of liquidity was maintained even in the conditions of the crisis caused by the effects of the coronavirus epidemic, which indicates a stable level of deposits that the Bank has at its disposal, as well as the confidence that clients have in the Bank.

Here, too, we can say that in 2020, the impact of the COVID-19 did not have much impact on the Bank's liquidity and that there was no reduction in the balance sheet total. Despite the challenges, the balance sheet total was maintained. The future period will be challenging from the aspect of preserving the balance sheet total, maturity structure and operations. In this regard, the Bank will not tolerate higher liquidity risk in order to achieve higher returns, because it would jeopardize the strategically defined ratio of return and risk as well as the reputation in the market segment recognized as key to the Bank's development - households and small and medium enterprises.

The Bank measures liquidity risk based on projections of net cash flows and using the liquidity gap report, calculating liquidity ratios, LCR and NSFR, short-term assets and liabilities gap, concentration of time deposits and liquidity stress test.

Net cash flows are calculated as the difference between cash inflows and outflows over a period of time.

In determining cash inflows and outflows, the Bank uses a set of assumptions as defined in the CBCG decision on minimum standards for liquidity risk management in banks.

The liquidity ratio is the ratio between short-term assets and short-term liabilities as defined by the Decision on Minimum Standards for Liquidity Risk Management in Banks.

The liquidity coverage ratio (LCR) refers to ensuring the bank's resilience in conditions of short-term stress. Net stable funding ratio (NSFR) is aimed at ensuring the resilience of banks to liquidity shocks over a longer period of time.

Maturity match of financial assets and financial liabilities as at 31 December 2020

I	Financial assets in the balance sheet	1 - 7 days	8 - 15 days	16 - 30 days	31 - 90 days	91 - 180 days	181 - 365 days	1 - 5 years	Over 5 years	TOTAL
1.	**Cash, deposits with central banks and receivables from banks**	**151.964**	**0**	**0**	**0**	**0**	**0**	**11.426**	**0**	**163.390**
1.a	Cash and cash equivalents	140.538	0	0	0	0	0	0	0	**140.538**
1.b	Reserve requirement	11.426	0	0	0	0	0	11.426	0	**22.853**
2.	**Financial assets at amortised cost**	**20.309**	**316**	**436**	**18.109**	**19.633**	**47.964**	**103.347**	**30.203**	**240.317**
2.a	Receivables from banks (funds with banks)	17.223	0	0	0	0	0	0	0	**17.223**
2.c	Loans to banks	5.396	0	0	0	0	0	11.426	0	**5.396**
2.d	Loans to clients	10.119	316	436	18.109	19.633	47.964	103.347	29.028	**228.952**
2.e	Securities	1.107	0	0	0	0	0	0	0	**1.107**
2.f	Other financial assets	1.886	0	0	0	0	0	0	0	**1.886**
2.g	Interest receivables, accruals and prepayments, and value adjustments	-15.421	0	0	0	0	0	0	1.175	**-14.246**
3.	**Financial assets at fair value through other comprehensive income**	**7.594**	**0**	**420**	**13.820**	**166**	**2.063**	**61.287**	**42.801**	**128.150**
3.e	Securities	7.594	0	408	13.661	162	1.979	59.424	41.934	**125.161**
3.g	Interest receivables, accruals and prepayments, and value adjustments	0	0	11	160	4	84	1.863	867	**2.989**
7.	**Other assets**	**-9.278**	**0**	**773**	**0**	**0**	**25**	**0**	**18.811**	**10.331**
	TOTAL	**170.589**	**316**	**1.629**	**31.930**	**19.798**	**50.051**	**176.061**	**91.815**	**542.188**

II	Financial liabilities in the balance sheet	1 - 7 days	8 - 15 days	16 - 30 days	31 - 90 days	91 - 180 days	181 - 365 days	1 - 5 years	Over 5 years	TOTAL
1.	**Financial liabilities at amortised cost**	**20.009**	**8.158**	**12.976**	**29.549**	**30.761**	**55.175**	**241.704**	**53.352**	**451.684**
1.a	Deposits of banks and central banks	1.214	0	0	0	0	0	0	0	**1.214**

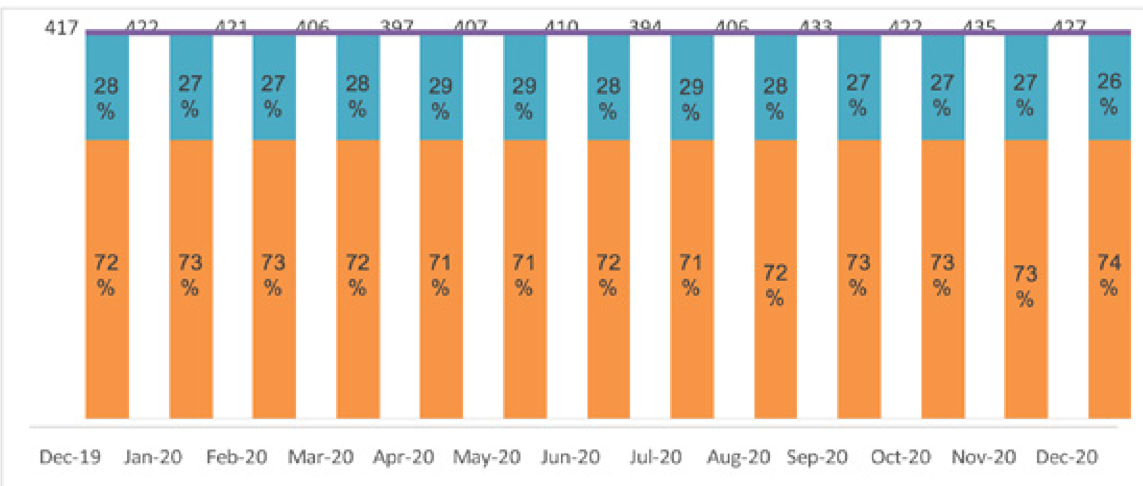
1.b	Deposits of clients	17.020	8.158	12.976	29.394	29.874	52.400	234.285	42.621	**426.728**
1.c	Loans of banks and central banks	0	0	0	145	848	2.676	5.388	0	**9.057**
1.d	Loans of clients, other than banks	50	0	0	11	39	99	2.031	10.731	**12.960**
1.f	Other financial liabilities	1.648	0	0	0	0	0	0	0	**1.648**
1.g	Interests and accruals and prepayments	77	0	0	0	0	0	0	0	**77**
4.	**Subordinated debt**	**-83**	**0**	**0**	**0**	**0**	**10.154**	**4.062**	**8.123**	**22.256**
6.	**Other liabilities**	**14.184**	**0**	**0**	**0**	**0**	**491**	**0**	**0**	**14.676**
	TOTAL	**34.110**	**8.158**	**12.976**	**29.549**	**30.761**	**65.821**	**245.766**	**61.475**	**488.617**

III	**DIFFERENCE:**	**1 - 7 days**	**8 - 15 days**	**16 - 30 days**	**31 - 90 days**	**91 - 180 days**	**181 - 365 days**	**1 - 5 years**	**Over 5 years**	**TOTAL**
1.	**Maturity gap I-II**	**136.478**	**-7.842**	**-11.347**	**2.380**	**-10.963**	**-15.770**	**-69.705**	**30.340**	**0**
2.	**Cumulative gap**	**136.478**	**128.637**	**117.290**	**119.670**	**108.707**	**92.937**	**23.232**	**53.572**	**0**
	% of total sources of funds	27,9%	26,3%	24,0%	24,5%	22,2%	19,0%	4,8%	11,0%	

Liquid Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) were above the 100% limit.

Dec-2020	
LCR	**274%**
NSFR	**161%**

Demand and time deposits, ratio and trend (%)



OPERATIONAL RISK

Operational risk is the probability of loss for the Bank, due to inadequate internal systems, processes and controls, including inadequate information technology, due to the engagement of persons outside the Bank to perform certain tasks for the bank, weaknesses or omissions in performing tasks or internal processes, work of employees, illegal actions and external events, which may expose the Bank to risk.

Operational risk management is regulated by the Bank's internal acts, as well as the CBCG acts. The Bank identifies, on monthly basis, they events arising from exposure to operational risks. The Board of Directors and the Committee for Non-Financial Risks are reported on the identified risks, incurred losses, as well as the measures that need to be taken in order to solve the identified problems. In the part of operational risk management, the improvement of existing processes is constantly applied, mostly related to educating employees about the importance of identifying and reporting events related to operational risks, improvements in identifying and assessing operational risks within the self-assessment process, in the field of new products, processes and systems and outsourcing of business activities.

The objective of the Bank's operational risk management is to establish an efficient and effective operational risk management system, based on a number of risk factors to which the Bank is exposed in performing its activities, including the scope, sophistication, nature and complexity of the Bank's activities. The system ensures the following:

- Identifying existing sources of operational risks and sources of operational risks that may arise from the introduction of new products, systems or activities;
- measuring operational risk, including accurate and timely assessment of that risk;
- monitoring of operational risks by analysing the situation, changes and trends of exposure to that risk;
- controlling operational risks by maintaining that risk at a level acceptable to the Bank, reducing or eliminating it altogether;
- defining powers and responsibilities in the process of establishing an operational risk management system;
- system of reporting and informing the Board of Directors and the Bank's Management on operational risk management.

Operational risk management includes the following methodologies and indicators:

- Quantitative - database with operational risk events;
- Qualitative - self-assessment of operational risks, which gives a view of the Bank's exposure to operational risk;
- Key risk indicators (KRI);
- Analysis of operational risks for the processes of hiring external partners to provide services to the bank – outsourcing;
- Analysis of operational risks during the introduction of new products, systems and processes.

Operational risk is subject to decentralised management, i.e. the organizational units that have operational risk are responsible for managing it in cooperation with the Department for Control of Risk, which is in charge of supporting the identification, measurement, mitigation and monitoring of risks, and to provide a methodology to assist employees to manage risk in a timely and systemic manner.

COUNTRY RISK

Country risk is the probability of incurring a loss for the Bank, due to the inability to collect receivables from natural and legal persons residing / domiciled outside the Republic of Montenegro, and for reasons related to the political, social and economic environment of the country where the debtor is domiciled. It includes:

• Political and economic risk, which means the probability of incurring a loss arising from the inability to collect bank claims due to restrictions set by acts of state and other debtors, as well as the general economic and systemic situation in the country,
• Transfer risk, which means the probability of loss due to inability to collect receivables denominated in a currency other than the legal tender of the debtor's country, arising from restrictions on payment of obligations to creditors from other countries in a particular currency.

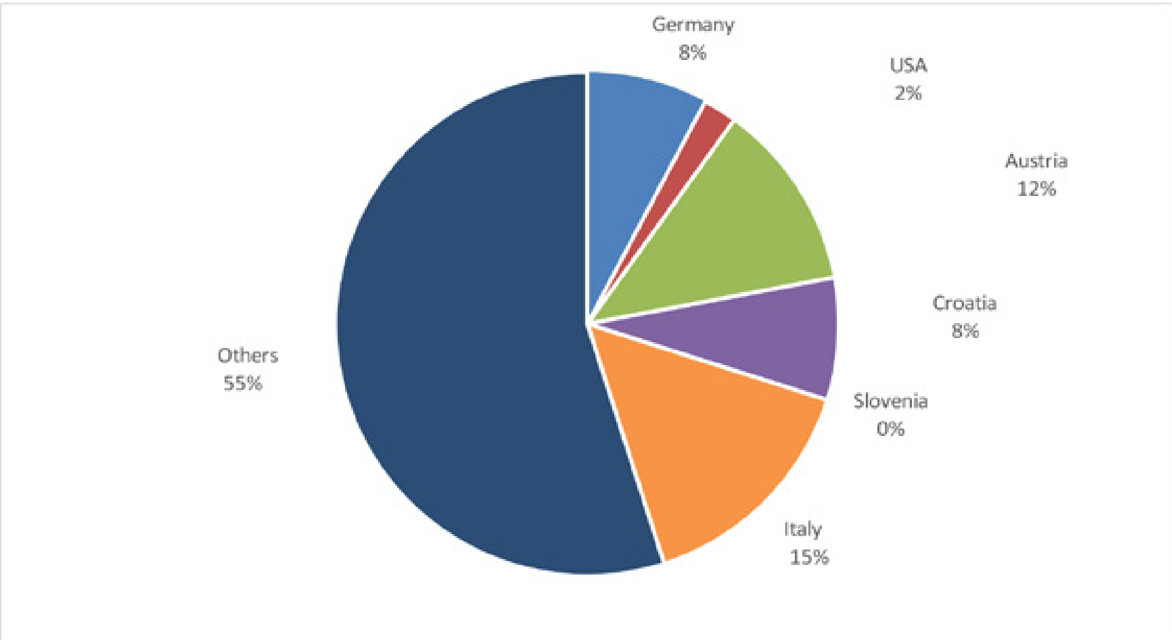
The basic method for managing this type of risk is establishing of exposure limits to non-residents, in accordance with the degree of risk of the non-resident's country.

The Country Risk Management Policy is developed in accordance with the laws and enabling regulations of the CBCG, as well as in accordance with the internal acts of the Bank (Country Risk Management Procedure and Policy). The following is defined in the internal acts:

- Allowed limits of exposure to country risk, individually by countries and on aggregate basis:
- Periodical review of adequacy of country risk management system;
- Powers and responsibilities of persons related to the risk taking and risk management;
- The manner of identifying, measurement, monitoring and control of country risk;
- Obligations regarding periodical reporting on Bank's exposure to country risk;
- classification of asset exposed to country risk and criteria for determining country ratings.

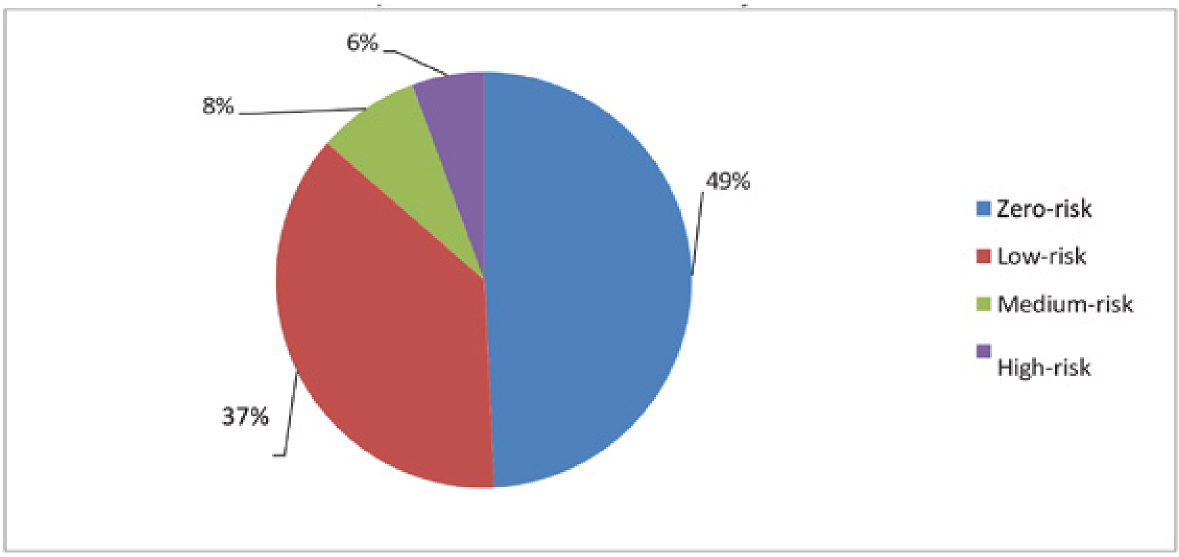
The Bank is exposed to non-residents in total amount of EUR 70.06 million, of which, its largest exposure is to Italy in total amount of EUR 10.6 million.

Exposure structure to non-residents

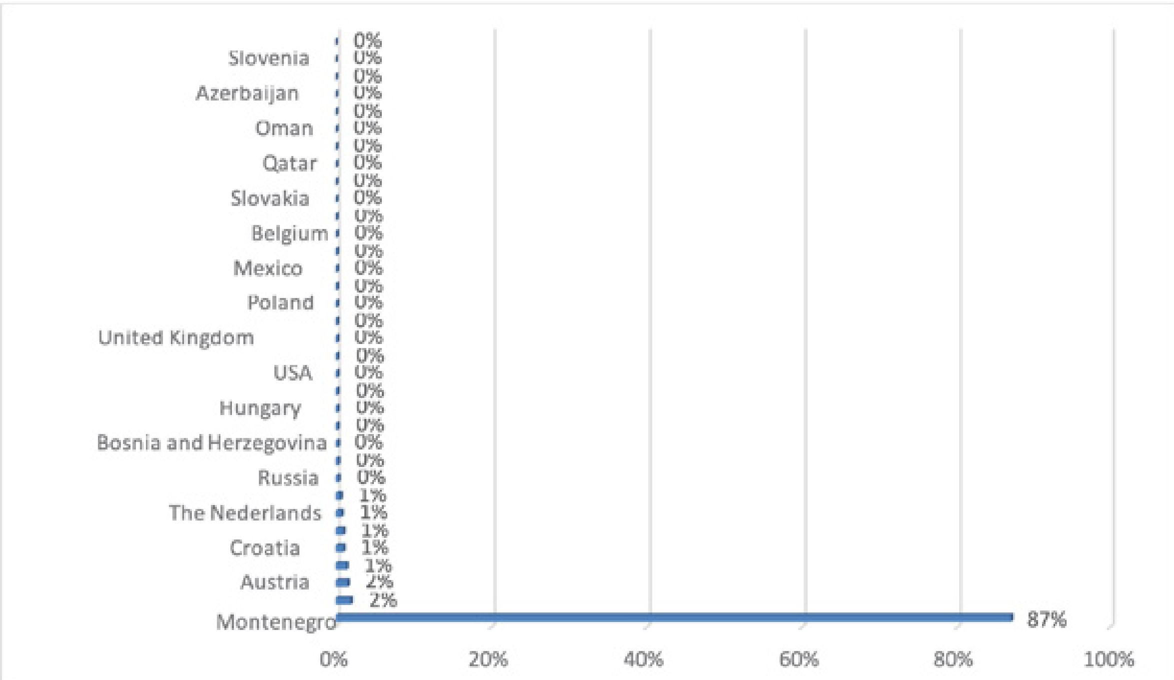


Graph above shows that 49% of exposure of the Bank referred to the exposure to countries classified as zero-risk countries, 34% referred to low-risk countries, 8% referred to medium-risk countries, and 9% referred to high-risk countries. It can be concluded that the Bank has good country risk management.

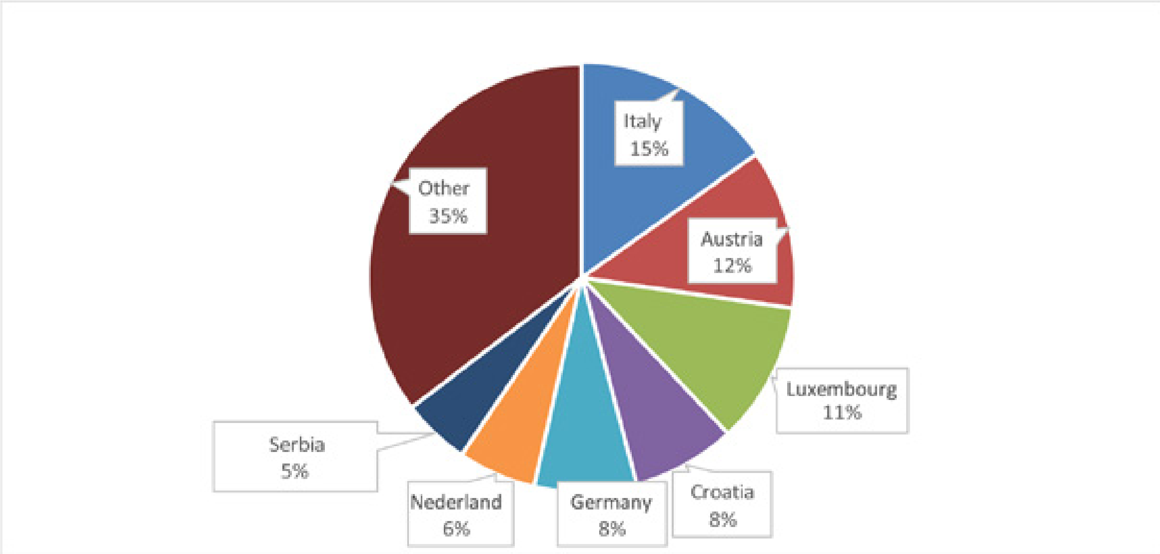
Exposure structure based on country classification



Overview of Bank exposures by countries as at 31 December 2020 (in EUR thousand)



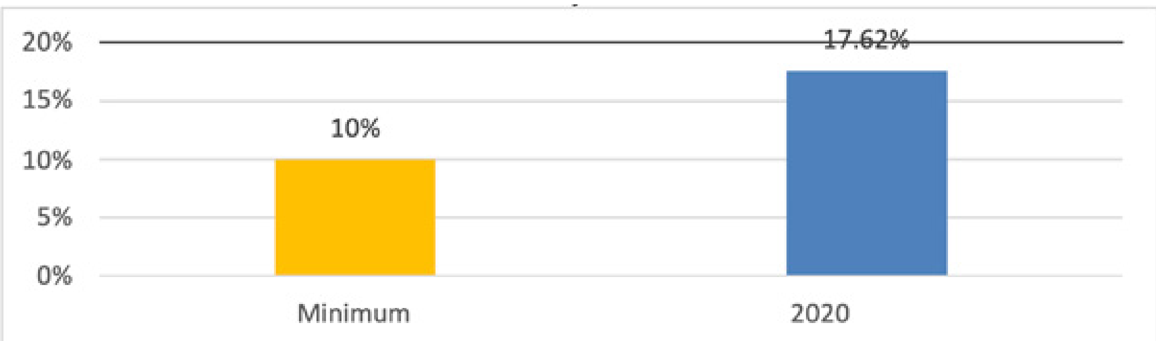
Overview of Bank exposure to non-residents as at 31 December 2020 (in EUR thousand)



SOLVENCY RATIO AND BANK'S OWN FUNDS

As at 31 December 2020, solvency ratio was above the statutory limit (10%), and it amounted to 17.62%. Solvency ratio was the most important indicator of confidence in the Bank, and of the protection of depositors, creditors and business partners of the Bank.

Solvency ratio for 2020

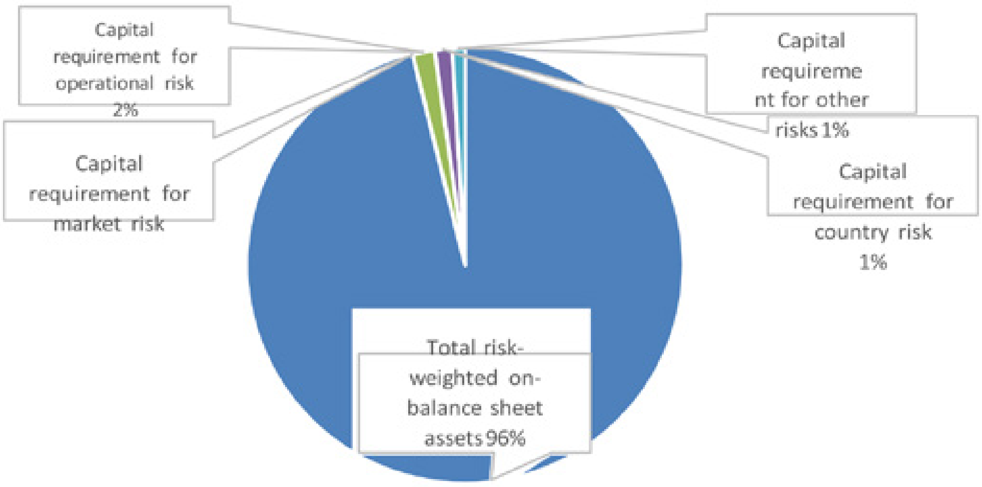


Report on Bank's solvency ratio as at 31 December 2020 (in EUR thousand)

No.	Item	Position	Table	Amount
I	**Bank's own funds**	**43**	**SSB**	**51.092**
1.	Core capital	42	SSB	41.492
2.	Supplementary capital	41	SSB	9.600
II	**Total weighted balance sheet assets**			**242.971**
1.	Weighted balance sheet assets	89	PBA	203.998
2.	Weighted off-balance sheet assets	25	PVB	37.632

3.	Amount mitigating negative impact on own funds of a bank due to the transition to the valuation of asset items by applying IFRS 9, specified in accordance with Article 4 paragraphs 5 and 6 of the Decision of Capital Adequacy of Banks	6	SSB	1.341
III	**Capital requirements for market risks**			**0**
IV	**Capital requirements for operational risks**			**4.131**
V	**Capital requirements for country risks**			**3.322**
VI	**Capital requirements for other risks**			**2.409**
VII	**Bank's solvency ratio**			**17,62%**

Structure of capital requirement for all risks



The structure of Bank's own funds was as follows as at 31 December 2020:

Overview of own funds (in EUR thousand)

I/A	Core elements of own funds	Position	Amount
1.	Paid-in share capital at nominal value, excluding cumulative preferential shares	1	16.006
2.	Collected issue premiums, excluding issue premiums based on cumulative preferential shares	2	7.444
4.	Reserves established against post-tax income (legal, statutory, and other reserves)	4	25.404
6.	Provisions for estimated losses under regulatory requirement, allocated in accordance with the decision governing minimum standards for credit risk management in banks	6	1.341
7.	**Undistributed prior year profit which general meeting decided to include in core capital deducted by corresponding income tax and other foreseeable expenses**	**7**	**50.195**

I/B	**Deductible items in the calculation of core capital**		
3.	Intangible assets (goodwill, licenses, patents, trademarks, concessions)	10	2.019
6.	Positive difference between the amount of calculated loss provisions and the sum of the amount of allowances for impairment on balance sheet and provisioning for off-balance sheet items	13	6.684
8.	**Total (positions 8+9+10+11+12+13+14)**	**15**	**8.703**
I/C	**Core capital (core elements of own funds less deductible items, positions 7-15)**	**16**	**41.492**
II/A	**Supplementary elements of own funds to be included in the supplementary capital**		
4.	Subordinated debt (meeting the requirements set out under Article 6 of the Decision)	20	9.600
7.	**Total (positions 17+18+19+20+21+22)**	**23**	**9.600**
II/C	**Supplementary capital (supplementary elements of own funds less deductible items, positions 23-26)**	**27**	**9.600**
II/D	**Supplementary capital to be included in own funds, Article 8 of the Decision**	**28**	**9.600**
IIIA	**Own funds (core capital + supplementary capital to be included in own funds) prior deductible items**	**29**	**51.092**
IV	**Core capital deducted by 50% of deductions from own funds (position 39)**	**40**	**41.492**
V	**Supplementary capital deducted by 50% of deductions from own funds (position 39)**	**41**	**9.600**
VI	**Core capital deducted as needed, Article 9 paragraph 3 of the Decision**	**42**	**41.492**
VII	**OWN FUNDS (Core capital + Supplementary capital) (V+VI)**	**43**	**51.092**

HEDGING METHODS

Hedging against placement risk is performed using proactive and preliminary analyses based on risk to return ratio (the classification by rating agencies and the CBCG and expected return/interest), comparison of similar investments and alternatives. The Bank makes pre-analysis before making investments (by reviewing published ratings, using external ratings, and the like). Credit risk factors can be changed also during the life of an investment, and the decisions are made on keeping, reducing, selling or rescheduling the placements.

Credit risk is defined as a default or reduction in credit rating. Default is when a client cannot repay its obligations when they become due, for instance inability to pay interest or failure to meet agreed contractual clauses. Since historically the calculations of probability of default can be done, the Bank tends to avoid classes that have had poor classification in the history.

Measurement and assessment of credit risk are performed simultaneously at the level of the account (debtor) as well as at the level of the loan portfolio.

- At the level of the debtor, the potential risk of the client is determined on the basis of a set of risk characteristics. For citizens, these characteristics include socio-demographic and behavioural characteristics, while for corporate clients, creditworthiness and potential credit risk are determined based on a set of financial risk parameters (related to the client's financial condition), as well as business risk and industry risk. The significance of a particular risk characteristic for the purposes of predicting the client's future risk is determined on the basis of an analysis of the historical data that the Bank has on its clients. Summarizing all risk characteristics weighted by the probability of their occurrence, gives a general measure of risk for an individual debtor.

- At the same time, the Bank measures credit risk at the level of the entire portfolio. The Bank continuously assesses its loan portfolio in terms of changes in the quality, composition and level of provisions, and identifies the causes of such changes or possible non-compliance with the target results. Risk analysis at the portfolio level, analysis of portfolio sub-segments, continuous testing of process efficiency and application of risk-based limits are becoming increasingly important for the Bank's lending activity.

Hedging against the risk at the level of individual account and portfolio level is performed by collateralising the loans, and in addition to the cash flow estimation (primary source of repayment), the secondary sources of repayment that can be used include deposits, guarantees, sureties, co-debtors, guarantors, mortgages, cessions.

Several classes of risk are also monitored including:
1. Interest rate fluctuations,
2. Reinvestment risk,
3. Early repayment risk and call risk,
4. Liquidity risk,
5. Exchange rate risks,
6. Inflation risk,
7. Macroeconomic and external risks.

Hedging against them is performed as follows:

Since interest rate risk consists of a series of cash flows, risk in fixed interest rates increases with the increase of interest rate. As the interest rates grows in the market, the existing contracts have fixed interest income, the existing placements are worth less, and they are less attractive (if cash were at the account, it could be invested under higher interest rates and make higher income, opportunity cost). Since the returns are lower than the potential returns, the possibility of sale of these investments decreases i.e. the value of investments reduces.

The Bank monitors changes in interest rates and adjust them proactively by trying to have horizontal or maturity match, and therefore lower maturity gaps. New placements monitor market and periodical adjustments of lending and deposit interest rates so that interest rate spread would remain at the same level and enable the Bank better profitability.

Reinvestment risk is connected with maturity. The shorter the period the lower the risk. The risk is lower if new investments will have more significant changes in interest rates and in conditions under which they will be invested compared to the current ones. The Bank makes mainly short-term investments. The investment to legal persons accounted for the main share in the Bank, smaller portion referred to investments to natural persons, whereas the majority of them referred to consumer loans, cash loans and credit cards, and minimum housing loans. The average weighed period for these loans is about 4 years.

Risk of early repayment is the risk of inability to anticipate cash flows, planning and monitoring. The Bank reduces this risk by negotiating clauses on fee for early repayment of loans, which are aligned with the law on consumer loans. The fee has exclusive purpose of compensation for the expenses based on the payment of interest on deposits and credit lines from which it is funded and from which it monitors maturity match of loans and sources (liabilities, deposits and borrowings).

Liquidity risk reflects in an inability of the Bank to provide funds at the market for financing activities under the same or similar conditions, and to sell loans under the same or similar conditions. The Bank hedges against it by trying to adjust to the maximum possible extent loans with sources and reducing maturity gaps. New loans are monitored through the spread of new price of sources. Transaction expenses of purchase of credit lines, deposits and sale of placements are compensated with fees and they are monitored on the assets side of the balance sheet of the Bank.

Exchange rate hedging is made by currency adjustment of loans with sources and by trying to have net open position at the lowest possible level. In doing so, the exchange rate fluctuations do not reflect on the profit and loss statement; they have neutral position since the positive sign on the asset side is negative sign on the liabilities side and vice versa. Also, the Bank reviews the currency of the client in which it operates and has cash flow, and grants currency loans or make investments to these clients.

Inflation risk also affects the realistic value of money and disrupts the return on equity and the expectations of the owners of the Bank. The Bank calculates the value of cash flows in its projections by monitoring also projections of inflationary expectations in Montenegro and EUR currency. The main operations in the Bank are performed in EUR.

Many external and macroeconomic factors cannot be anticipated and viewed in the present moment. This includes political risk that the debtors will not be able to service regularly their obligations. There is also a regulatory risk, transfers of capital, natural disasters, corporate restructurings, acquisitions, mergers, and the like. The Bank monitors ratings of countries and available information and tends to keep concentration risk to individual countries, products and clients within the limits that cannot jeopardise the survival and operations of the Bank.

The Bank reduces operational risks through higher level of automation, procedures, double controls, and internal audits as overall internal controls system.

Executive Director
for retail operations and advanced
distribution channels,
Nikola Špadijer

____

Chief Executive Officer,
Esad Zaimović,

____

Executive Director for corporate operations
and financial markets,
Ana Golubović,

____

Executive Director for risks,
Jelena Vuletić,

____