ZIRAAT BANK MONTENEGRO AD, PODGORICA

Financial Statements
Year Ended December 31, 2017
and Independent Auditors' Report

This Report is translation of the Auditors' Report issued in the Montenegrin language. In the case of any discrepancy between the Montenegrin and English versions, the Montenegrin shall prevail.

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholder of Ziraat Bank Montenegro AD, Podgorica

We have audited the accompanying financial statements (pages 3 to 58) of Ziraat Bank Montenegro AD, Podgorica (hereinafter: the „Bank"), which comprise the balance sheet as of December 31, 2017, income statement, statement of changes in equity and cash flow statement for the year then ended, as well as a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We have conducted our audit in accordance with Law on Auditing, Law on Accounting and standards on auditing applicable in Montenegro. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal controls relevant to the preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal controls. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as of December 31, 2017, and of its financial performance and its cash flows for the year then ended in accordance with accounting regulations of Montenegro and regulations of the Central Bank of Montenegro governing financial reporting of banks.

Other Matters

An audit of the financial statements of the Bank as of and for the year ended December 31, 2016 was performed by another auditor who issued unqualified opinion in his report dated May 25, 2017.

INDEPENDENT AUDITORS' REPORT (Continued)

To the Board of Directors and Shareholder of Ziraat Bank Montenegro AD, Podgorica (Continued)

Report on Other Legal and Regulatory Requirements

The Management of the Bank is responsible for preparation of annual management report on business operations in accordance with the requirements of the Law on Accounting of Montenegro, which is not an integral part of the accompanying financial statements. In accordance with the Law on Auditing of Montenegro, it is our responsibility to express an opinion on the compliance of the accompanying annual management report on business operations for 2017 with financial statements for the related business year. In our opinion, the financial information disclosed in the annual management report on business operations for 2017 are reconciled with the audited financial statements for the year ended December 31, 2017, and the annual management report on business operations for 2017 contains all the elements defined by the provisions of the Law of Accounting.

Deloitte d.o.o. Podgorica	Katarina Bulatović, Certified auditor
April 3, 2018	(License No. 067 issued on March 31, 2015)

INCOME STATEMENT
Year Ended December 31, 2017
(In thousands of EUR)

	Notes	2017	2016
Interest income	3.1, 5a)	1,791	916
Interest expenses	3.1, 5b)	(675)	(215)
Net interest income		**1,116**	**701**
Allowance for impairment	3.5, 6a)	(3)	(18)
Provisions	3.5, 6b)	(5)	(5)
Fee and commission income	3.1, 7a)	148	89
Fee and commission expense	3.1, 7b)	(102)	(46)
Net fee and commission income		**46**	**43**
Net losses on investment securities		-	26
Net foreign exchange gains		20	2
Staff costs	8	(963)	(956)
General and administration expenses	9	(672)	(601)
Depreciation and amortization	16, 17	(380)	(339)
Other expenses	10	(33)	(28)
LOSS FROM OPERATIONS		(874)	(1,175)
Income tax	3.3, 11a)	9	(2)
NET LOSS		**(865)**	**(1,177)**

Notes on the following pages (7 to 58)
form an integral part of these financial statements.

Signed on behalf of Ziraat Bank Montenegro AD by:

In Podgorica, April 3, 2018

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Mustafa Şenman — Chief Executive Officer

Goran Bakić — Executive Director

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Jelena Božović
Head of Accounting, Reporting and
Budgeting Department

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BALANCE SHEET
As of December 31, 2017
(In thousands of EUR)

	Note	2017	2016
ASSETS			
Cash and deposits held with central banks	3.4, 12	2,955	3,140
Loans and receivables due from banks	3.4, 13	2,368	1,149
Loans and receivables due from customers	3.5, 14	44,194	32,600
Financial assets available for sale	3.5, 15	2,250	2,235
Properties and equipment	3.6, 16	300	398
Intangible assets	3.7, 17	600	702
Other financial receivables	18 a)	11	16
Other accounts receivable	18 b)	15	14
TOTAL ASSETS		**52,693**	**40,254**
LIABILITIES			
Deposits due to customers	19	25,303	10,683
Borrowings due to banks	3.8, 20	20,089	21,533
Provisions	21	10	5
Current tax payable	3.3	-	2
Deferred tax payables	3.3, 11 c)	27	34
Other liabilities	22	201	86
Total Liabilities		**45,630**	**32,343**
EQUITY			
Share capital	3.10	10,000	10,000
Accumulated loss		(2,222)	(1,045)
Current year loss		(865)	(1,177)
Other reserves		150	133
Total equity	23	**7,063**	**7,911**
TOTAL LIBILITIES AND EQUITY		**52,693**	**40,254**
OFF-BALANCE SHEET ITEMS	24	**22,511**	**24,497**

Notes on the following pages (7 to 58)
form an integral part of these financial statements.

STATEMENT OF CHANGES IN EQUTY
Year Ended December 31, 2017
(In thousands of EUR)

	Share capital	Other reserves	Accumulated losses	Total
Balance as of January 1, 2016	10,000	45	(1,045)	9,000
Net increase in the fair value of financial assets available for sale	-	88	-	88
Loss for the year	-	-	(1,177)	(1,177)
Balance as of December 31, 2016	**10,000**	**133**	**(2,222)**	**7,911**
Balance as of January 1, 2017	10,000	133	(2,222)	7,911
Net increase in the fair value of financial assets available for sale	-	17	-	17
Loss for the year	-	-	(865)	(865)
Balance as of December 31, 2017	**10,000**	**150**	**(3,087)**	**7,063**

Notes on the following pages (7 to 58)
form an integral part of these financial statements.

CASH FLOW STATEMENT
Year Ended December 31, 2017
(In thousands of EUR)

	Note	2017	2016
Cash flows from operating activities			
Interest income received		1,595	672
Interest charges paid		(639)	(129)
Fees and commissions received		125	61
Fees and commissions paid		(102)	(46)
Cash payments to employees and suppliers		(1,624)	(1,568)
Net increase in loans and other assets		(11,514)	(30,004)
Net increase in deposits		14,641	9,928
Other income cash receipts		115	-
Net cash generated by/(used in) by operating activities		**2,597**	**(21,086)**
Cash flows from investing activities			
Cash used for purchase of equipment		(32)	(11)
Cash used for purchase of intangible assets		(149)	(245)
Net increase T-Bills and financial assets available for sale		98	1,690
Net cash (used in)/generated in investing activities		**(83)**	**1,434**
Cash flows from financing activities			
Net (decrease)/increase in borrowed funds		(1,500)	18,100
Net cash (used in)/generated in financing activities		**(1,500)**	**18,100**
Effects of exchange rate changes		20	2
Net increase/(decrease) in cash and cash equivalents		**1,034**	**(1,550)**
Cash and cash equivalents at the beginning of period		4,289	5,839
Cash and cash equivalents at end of the period	26	**5,323**	**4,289**

Notes on the following pages (7 to 58)
form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2017

1. ESTABLISHMENT AND OPERATIONS OF THE BANK

Ziraat Bank Montenegro AD (hereinafter: the "Bank") was established in 2015, and as at May 20, 2015 it was registered as the shareholding company with the Central Registry of Business Entities in Podgorica – registration number 4-0009452.

The Bank was registered with the Commission for Securities in the Register of Securities issuer under registration number 02/10e-5/2-15 as at May 8, 2015 (Decision number 02/10e-5/2-15).

The Bank performs its financial operations via the transaction account number 907-0000000057501-83 with the Central Bank of Montenegro - Payment Transactions.

In accordance with the Law on Banks, the Founding Contract, the Statute and the Decision of the Central Bank of Montenegro, the Bank performs the following activities:

1) Issuing guarantees and undertaking other off-balance sheet obligations;
2) Purchasing, selling and collecting receivables (factoring, forfaiting and other);
3) Issuing, processing and recording payment instruments;
4) Performing domestic and foreign payment transactions;
5) Performing finance lease operations;
6) Performing securities operations;
7) Trading in its own name and for its own account or for the account of its customer:
   - In foreign payment instruments, including money exchange
   - Financial derivative transactions;
8) Providing depot services;
9) Performing analysis and providing information and advices on the creditworthiness of companies, entrepreneurs and other issues relating to business operations;
10) Renting of safes.

The Bank is headquartered in Podgorica at St. Slobode No. 84 and performs its activities through its branch office in Bulevar Ivana Crnojevića No. 101.

As of December 31, 2017, the Bank had 32 employees (December 31, 2016: 30 employees).

The Bank is managed by the shareholder, in accordance with the law and Statute of the Bank. The governing bodies of the Bank are the Shareholders Assembly consisting of the shareholder of the Bank and the Board of Directors that is appointed by the Shareholders Assembly. The Board of Directors of the Bank has 5 members.

As of December 31, 2017, the members of the Board of Directors of the Bank were the following:

Name and Surname	Function
Savaş KÖLEMEN	Chairman
Burcu TURKER	Member
Bilge LEVENT	Member
Ertan AYDIN	Member
Ertan ALTIKULAÇ	Member

The Management of the Bank consists of the Chief Executive Officer and the Executive Director (Management members). The Chief Executive Officer represents the Bank and is in charge of coordinating and monitoring of the execution of operations of the Bank and the work of employees of the Bank on a daily basis.

As of December 31, 2017, the Executive Directors of the Bank were the following:

Name and Surname	Key Area
Mustafa ŞENMAN	Chief Executive Officer
Goran BAKIĆ	Executive Director

1. ESTABLISHMENT AND OPERATIONS OF THE BANK (Continued)

As of December 31, 2017, the members of the Audit Committee of the Bank were the following:

Name and Surname	Function
Ertan YILMAZ	Chairman
Aykut ARSLAN	Member
Hamdullah GURSOY	Member

As of December 31, 2017, the Compliance Manger was Milena Lakić.

As of December 31, 2017, the Internal Auditor of the Bank was Vladimir Zloković.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS

2.1. Basis of Preparation and Presentation of the Financial Statements

The financial statements have been prepared in accordance with accounting regulations applicable to financial reporting of banks in Montenegro.

The Bank is obliged to prepare the financial statements in accordance with Law on Accounting ("Official Gazette of Montenegro", No. 52/16) and regulations of the Central Bank of Montenegro governing the financial reporting of banks.

Accompanying financial statements have been prepared in accordance with the Decision on the contents, terms for preparation and submission of banks financial statements ("Official Gazette of Montenegro", No. 15/12 and 18/13).

In preparation of these financial statements the Bank has applied the policies that are in accordance with the regulations of the Central Bank of Montenegro, which, in the recording of receivables for which the conditions were met for exclusion from the balance sheet of the Bank and the format of presentation of financial statements, differ from the requirements of the International Accounting Standards ("IAS") and International Financial Reporting Standards ("IFRS") applicable as of December 31, 2017.

In accordance with the Law on Accounting of Montenegro, the legal entities shall prepare the financial statements upon the IAS and IFRS published by the International Accounting Standards Board, and determined and published by the state authority of Montenegro competent for the finance affairs, i.e. a legal entity appointed for such affairs performance, who got the right on translation and publishing from the relevant body of the International Federation of Accountants ("IFAC"). Therefore, only IFRS and IAS officially adopted and published by the respective competent authority of Montenegro may be applicable. In 2009 were last officially translated IAS and IFRS (except for IFRS 7), and newly adopted IFRS 10, 11, 12 and 13, which are applicable from 2013.

Bearing in mind the effects that differences of accounting regulations of Montenegro from IFRS and IAS may have on the presentation of the Bank's financial statements, the accompanying financial statements in that section are different and depart from IFRS and IAS and cannot be treated as financial statements prepared in accordance with IFRS and IAS.

The financial statements have been prepared under the historical cost basis, except otherwise stated in accounting policies. In the preparation of the accompanying financial statements, the Bank has adhered to the accounting policies described in Note 3 to the financial statements.

Official currency in Montenegro and functional and reporting currency of the Bank is the euro (EUR).

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

2.2. Use of estimates

Presentation of financial statements requires of management of the Bank to make best estimates and reasonable assumptions that affect the presented amounts of assets and liabilities, and disclosures of contingent receivables and liabilities as at the date of financial statement preparation, and of income and expenses during the reporting period (Note 3.15). Such estimates and assumptions are based on available information on the date of financial statements preparation and mainly related to: estimate the amount of provisions for loans and interest, provisions for deposits with other banks, the provision for permanent placements and off-balance sheet items. Actual amounts of assets and liabilities may differ from estimated amounts in this way.

2.3. Going concern

The financial statements were prepared on the going concern basis, which means that the Bank will continue operating during the unlimited time period for the foreseeable future.

2.4. Comparison Data

If necessary, the Bank reclassifies comparative data in order to achieve consistency in the financial statement data for the current year.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1. Interest and fee income and expense

Interest income and expense are recognized in the income statement for all interest bearing debt instruments, using the effective interest method, on an accrual basis, in accordance with the terms of the contractual relationship defined by the contract between the Bank and the client.

Effective interest method is the method of calculation of costs of repayment of financial assets or liabilities and deferral of interest income or interest expense during relevant period. The effective interest rate is the rate that discounts future cash inflows or outflows, during expected life period of financial instrument or when it is applicable, shorter period, to the carrying value of financial asset or liability. When calculating the effective interest rate, the Bank estimates cash flows taking into consideration all contractual terms of financial instrument except for the future credit losses. The calculation includes all paid and received fees between contractual parties, which are integral part of the effective interest rate, transaction costs and all other premiums and discounts.

Income and expenses from fees were generated by providing or using banking services, and in the income statement are recognized at the time of delivery, or use of services. These revenues and expenses are also recognized at the sectoral affiliation of clients whose assets the bank uses.

Fees for approved and received loans are considered as an integral part of an ongoing involvement with the resultant financial instrument and are recognized as an adjustment to the effective yield over the life of the loan, using the effective interest rate.

Income and expenses from fees include fees for guarantees issued by the Bank for the benefit of clients, fees for payment transactions in the country and abroad, fees for brokerage and other services provided by the Bank. Expenses from fees are also expenses from fees based on the deposit insurance.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

3.2. Foreign Exchange Translation

a) Functional and Presentation Currency

Items included in the financial statements are measured using the currency of the primary economic environment in which the Bank operates (the functional currency).

The financial statements are presented in EUR, which is the functional and presentation currency.

b) Transactions and Balances

Transactions made in foreign currencies are translated into euros using the exchange rates prevailing at the date of the business transaction.

Monetary assets and liabilities denominated in foreign currency at the balance sheet date are translated into euros at the exchange rate prevailing at that day. Non-monetary items that measured at historical cost in a foreign currency are translated into euros at the current exchange rate at the transaction date.

Foreign exchange gains and losses arising from the translation of business transactions in foreign currency and from the translation of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

3.3. Income Tax

Income tax expense is based on taxable profit for the business year and comprises current and deferred tax.

Current Income Tax

Income taxes are calculated and paid in accordance with the Corporate Income Tax Law ("Official Gazette of the Republic of Montenegro", No. 65/01, 12/02, 80/04, "Official Gazette of Montenegro", No. 40/08, 86/09, 14/12, 61/13 and 55/16), applying the prescribed rate on the taxable profit reported for tax purposes. The amount of taxable profit is determined by harmonizing profit reported in the income statement, for the income and expenses amounts, as defined by tax regulations.

The corporate income tax is calculated using the proportional rate of 9% on the total reported income for tax purposes.

Law on Income Tax stipulates that losses from the tax balance sheet in the current year can not be carried back. However, losses per tax balance for the year can reduce taxable income of the future period (except if the loss arises from capital losses or gains), but for a period not exceeding five years.

Deferred Taxes

Deferred taxes are calculated on temporary differences arising between the tax bases of assets and liabilities and their carrying value reported in the financial statements of the Bank.

Deferred tax liabilities are recognized for all taxable temporary differences between the tax bases of assets and liabilities on the balance sheet date and their carrying amounts for financial reporting purposes, which will result in taxable amounts in future periods.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.3. Income Tax (Continued)

Deferred Taxes (Continued)

Deferred tax assets are recognized for all deductible temporary differences, unused tax assets and unused tax losses, to the extent that it is probable that future taxable profits will be sufficient to enable realization (utilization) of deductible temporary differences, unused tax assets and unused tax losses. The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the use of all or part of the deferred tax assets. The Bank calculates deferred taxes based on:

- Differences between the carrying value of fixed assets and intangible assets, which are recorded in the financial statements and their tax values. The difference is a result of the application of different methods of calculation and the rate of depreciation for financial reporting purposes and for tax purposes;
- Changes in the fair value of securities available for sale.

Deferred taxes related to the subsequent measurement of fair value of securities available for sale are charged directly against or in favor of equity and are transferred to the income statement at the same time with the profit / loss from the subsequent measurement of fair value.

Deferred taxes are calculated by applying the 9% rate.

Indirect taxes, contributions and other duties

Indirect taxes, contributions, and other duties which do not depend on Bank's operations include property and other taxes, contributions on salaries paid by the employer, as well as fees and contributions paid in accordance with various state and local tax regulations.

3.4. Cash and cash equivalents

As presented in the Statement of Cash Flows, cash and cash equivalents comprise cash and coins in the cash in hand and ATMs, balances with the Central Bank of Montenegro, balances at the accounts held with commercial banks and other highly liquid financial assets with maturity up to three months.

3.5. Financial instruments

The Bank classifies financial assets in the following categories: financial assets available-for-sale, loans and receivables. The Management of the Bank classifies financial placements at the moment of initial recognition.

Financial assets are initially recognized at fair value plus transaction costs (except for financial assets or financial liabilities that are measured at fair value through profit and loss), which are directly attributable to the acquisition or issue of a financial asset or financial liability.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial Instruments (Continued)

Financial assets and financial liabilities are recognized in the balance sheet of the Bank, from the moment when the Bank was bound to the instrument by means of contractual provisions.

Financial assets are derecognized when the Bank loses control of the contractual rights governing such instruments, which occurs when the rights of use are realized, expired, waived or assigned. A financial liability is derecognized when the obligation under the contract is discharged, canceled or expired.

Financial assets available for sale

Securities that are intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, foreign exchange rates or equity prices are classified as "securities available for sale".

Subsequent measurement of securities that are available for sale is conducted on the basis of changes in fair value due to price fluctuations in the regulated market as well as on the basis of impairment caused by the existence of objective evidence of impairment of financial assets.

Fluctuations in fair value of securities available for sale are recorded directly in equity, until derecognition or impairment loss, when the cumulative income or expense, previously recognized in equity should be recognized in the income statement. However, interest calculated using the effective interest method is recognized in the income statement. Dividends are recognized in the income statement when the entity's right to receive payment is established.

The fair value of securities listed in active markets is based on current bid prices. If the market for a financial asset (the market of securities which are not listed on the stock exchange) is not active, the Bank establishes fair value using valuation techniques. These include the use of recent arm's length transactions between independent parties, reference to other instruments that are substantially the same, discounted cash flow analysis and other valuation techniques.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near future. They arise when the Bank directly provides funds or provides services to a debtor with no intention of trading the receivable. Loans and receivables consist of placements to clients and banks.

Loans and receivables are initially measured at fair value plus direct transaction costs, and subsequently at amortized cost using the effective interest rate method. Amortized cost is calculated taking into account any issue costs and any discount or premium on settlement. Loans and receivables are recognized in net amount less for an individual and group impairment.

At each reporting date, the Bank assesses whether there is objective evidence of impairment of a financial asset or group of financial assets. Impairment losses are recognized only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of an asset and when the same impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Individual and group adjustment of value is formed by reducing the carrying value of loans and receivables for which the impairment was identified in order to reduce their carrying value to the recoverable amount.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial Instruments (Continued)

Provisions and allowance for impairment

The Central Bank of Montenegro has adopted the Decision on minimum standards for credit risk management in banks ("Official Gazette of Montenegro", No. 22/12, 55/12, 57/13, 44/17 and 82/17), which is applicable from January 1, 2013, which includes the application of International Financial Reporting Standards in the valuation and presentation of items of balance sheet assets and off-balance sheet items. Pursuant to the above Decision, the Bank has established a methodology for assessing the impairment of the balance sheet assets and the probable loss on off-balance sheet items. The Bank consistently applies the methodology, reviews it at least once a year and, if necessary, adjusts it to the results of the review, and also adjusts the assumptions on which the methodology is based.

The assessment of impairment is based on the losses incurred. Impairment is recognized solely when incurred. According to International Accounting Standard 39 – "Financial Instruments: Recognition and Measurement", financial asset or group of financial assets is impaired and loss has occurred if and only if there is an objective evidence of impairment, which is a result of one or more events of loss that occurred after the initial recognition of the asset (a "loss event") and that loss event had a measurable impact on the estimated future cash flows and financial assets.

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant.

If the Bank decides that there is no objective evidence of impairment for individually assessed property, regardless of whether it is significant or not, it is included in a group of financial assets with similar characteristics and then a group evaluation of impairment is carried out.

Objective evidence that suggest that there was an impairment of advance include the following events:

- Significant financial difficulties of the debtor;
- Violation of the agreed terms of the contract by the debtor, such as fulfilling the obligations arising from interest and / or principal;
- Delinquency over 90 days for any materially significant obligation of this debtor towards the Bank. Overdrafts maturities over 90 days are considered the overrun which indicates an increased level of credit risk;
- The existence of a substantial likelihood that the borrower will enter bankruptcy proceedings or liquidation or restructuring due to financial difficulties;
- Restructuring of advances (individual loans) due to deterioration in the financial condition of the debtor or the extension of the repayment of principal and / or reduction of interest rates and / or fees;
- Blocking of the account of the debtor;
- The economic, national, local, technological and legal conditions that may adversely affect the settlement of obligations of the debtor (a significant increase in the price of raw materials, a decrease in property prices for mortgages in the area, other changes in market conditions in which the borrower operates, changes in regulations that may adversely affect the borrower's business, technological obsolescence of products that the borrower produces, etc.).

One of the key factors in determining the appropriate level of impairment is determining the level of significance. In the analysis of the portfolio by materiality, the Bank used approach based on the client level. Under this approach, total exposure to the client is observed, which is compared with the level of materiality of the accounting adjustments.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial Instruments (Continued)

Provisions and allowance for impairment (Continued)

Exposure to a single entity or group of related entities above 50,000 euros, for loans approved to legal as well as for loans approved to natural persons is considered individually significant. The existence of delay in settlement of obligations to the bank by materially significant amounts over 90 days, above the designated threshold of materiality of EUR 200 for corporate and EUR 20 for retail customers is also considered individually significant.

Assets that are individually evaluated for impairment and for which an impairment loss is recognized or continues to be recognized are not included in a collective assessment of impairment.

If there is objective evidence that the loss was incurred due to the impairment, impairment loss is measured as the difference between the carrying value of the loan and its recoverable amount, being the present value of estimated future cash flows, discounted at the original effective interest rate of that financial asset.

The Bank currently does not have the information on the transition of clients within certain categories because it has relatively recently started operating and does not have enough data sets needed to determine these values. Therefore, the amount of the one-year PD is estimated at 5% and the LGD at 45%, which is the standard prescribed by the Basel II standards. In the future period the Bank will develop procedures for monitoring claims transition from one classification group to another and after a certain period of time it will form a database that will enable the development of the transition matrix.

Within the meaning of Decision on minimum standards for credit risk management in banks (“Official Gazette of Montenegro”, No. 22/12, 55/12, 57/13, 44/17 and 82/17), if the conditions for excluding receivables from the balance of the bank are fulfilled, the bank is obliged to write off such a receivable and to keep it, in the amount of the amount owed, in the internal records until the completion of the collection procedure. The conditions for exclusion of a receivable from the Bank’s balance sheet shall be deemed to be met if the bank estimates in the collection process that the value of receivable measured at amortized cost shall not be compensated and that all conditions have been met for terminating the recognition of the financial asset, including the following cases:

1) for unsecured receivable when bankruptcy proceedings has been initiated against the debtor which shall last more than one year, or if the borrower is late with the payment for more than two years;
2) for secured receivable, when the debtor defaults more than four years or if the bank has not received any of payments from realization of collateral during such period.

In addition to valuation of items of assets and off-balance sheet items in accordance with International Accounting Standards, the Bank is obliged to classify items of assets in one of the following classification groups depending on the likelihood of a loss:

1) Group A - "quality assets" Classification group “A” classifies a loan and other receivables where there is firmly documented evidence that they will be collected in accordance with the agreed terms and conditions in full amount;
2) Group B - "assets with special note" - with subgroups B1 and B2, classifies the loan for which it is unlikely that the loss would incur, and such a loan requires special attention due to the fact that potential risk, unless adequately monitored, could lower the probability of collection;
3) Group C "substandard assets" - with subgroups C1, C2, classifies loans for which there is a high probability of incurring loss, due to clearly identified weaknesses, jeopardizing collection of those assets;
4) Group D - "doubtful assets" - classifies assets ,i.e. total exposure, for which the collection, taking into consideration the debtor’s creditworthiness, value and marketability of collaterals, is highly unlikely;
5) Group E - "loss" - classifies the loans, i.e. total exposure, which will not be collected at all or will be collected in the insignificant amount.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial Instruments (Continued)

Provisions and allowance for impairment (Continued)

The amount of provision for potential losses is not envisaged for placements of the Bank classified in the group A, 2% and 7% for asset classified in group B, from 20% to 40% for asset classified in group C, 70% for asset classified in group D and 100% for asset classified in group E.

The Bank is obliged to develop a comprehensive strategy for dealing with non-performing loans for a period of three years and determine the annual goals related to reduction of the level of non-performing loans (operating goals).

According to the Decision on minimum standards for credit risk management in banks ("Official Gazette of Montenegro", No. 22/12, 55/12, 57/13, 44/17 and 82/17), the Bank is obliged to determine the difference between the amount of provisions for potential losses, calculated in accordance with the Decision and the sum of the amounts of allowance for impairment for items of balance sheet assets and provisions for off-balance sheet items, calculated in accordance with the provisions of the Decision which prescribes the method of valuing items of assets using the International Accounting Standards. The positive difference between the amount of calculated provisions for potential losses and the collection of the amount of the correction for items of balance sheet assets and provisions for off-balance sheet items is a deductible item from the bank's own funds.

3.6. Property and Equipment

As of December 31, 2017, property and equipment are stated at cost less accumulated depreciation and impairment. Cost represents the prices billed by suppliers, plus the associated costs for the purchase and the cost of bringing the asset into use.

Depreciation is calculated using the straight-line method to the purchase price, using the following annual rates in order to entirely write off the business premises and other fixed assets over their useful lives, and there was no change in depreciation rates in 2017 compared to 2016.

The estimated useful life of property and equipment is the following:

	Year
Construction facilities	40
Computers and computer equipment	4
Furniture	10
Equipment	5
Vehicles	4

Gains and losses based on disposal of assets are determined by the difference between cash inflow and carrying amount and are recognized in the income statement.

3.7. Intangible assets

Licenses

Acquired licenses are recorded at historical cost. Licenses have a finite useful life and are stated at cost, less accumulated amortization. Depreciation is calculated using the proportion method, in order to distribute the cost of licenses over their estimated useful lives up to 4 years.

Computer software

Computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use. These costs are amortized over their estimated useful lives of 4 years.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.8. Loan Liabilities

Loan liabilities are initially recognized at fair value, without the incurred expenses. Loan liabilities are subsequently stated at amortized cost, any difference between the inflow of funds, reduced for transaction costs and the redemption values is recognized in the income statement in the period of the loan use, by applying the effective interest rate method.

Loan liabilities are classified as current liabilities, unless the Bank has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

3.9. Liabilities to employees

Short-term benefits to employees include salaries and all related contributions, as well as social security contributions. Short-term employee benefits are recognized as expense in the period in which those incurred.

The Bank and its employees are legally obliged to make payments to the Pension Fund of Montenegro. The Bank has no obligation to pay further contributions which are an obligation of the Fund. Taxes and contributions relating to defined plans of the benefits upon salaries, are recognized as expenses in period to which they relate.

3.10. Share capital

Paid-up share capital of the Bank is the amount of cash paid by the shareholder for all ordinary shares. Bank's share capital consists of common shares and is recorded as a separate item in the balance sheet.

Dividends on shares are recorded as a liability in the period in which a decision was made about their payment. Dividends for the year after the balance sheet date are disclosed as an event after the balance sheet date.

3.11. Off-setting of financial instruments

Financial assets and liabilities are set-off and the difference between their amount reported in the balance sheet when there is a legally enforceable right to set-off the recognized amounts and there is an intention to settle on a net basis, or to simultaneously sell the asset and settle the liability.

3.12. Provisions

Provisions are liabilities with an uncertain maturity or amount and are recognized when the following conditions are met:

- The Bank has an applicable legal or constructive obligation as a result of past events;
- There is a likelihood that the settlement of the obligation will require an outflow of funds, which generate economic benefits;
- When the amount of the obligation can be reliably estimated.

Provisions are measured at the present value of the expected expenditure required to settle the liabilities, using a discount rate that reflects current market assessments of the time value of money. Provisions are reviewed on each balance sheet date and are adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the given liability, provisions should be reversed through the income statement.

In accordance with the Decision on minimum standards for operational risk management in banks (“Official Gazette of Montenegro”, No. 24/09), the Bank performs provisions for operational risk and potential losses from litigations.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.13. Commitments and contingent liabilities on off-balance sheet items

As part of the ordinary operations, the Bank assumes the contractual and contingent liabilities on off-balance sheet items such as guarantees, commitments for loans and letters of credit and transactions with financial instruments. These financial instruments are recorded in the balance sheet if and when they become payable.

Provision for possible losses on commitments and contingent liabilities are formed on the basis of estimates of possible losses, in accordance with the criteria established in the Decision on minimum standards for credit risk management in banks ("Official Gazette of Montenegro", No. 22/12, 55/12 , 57/13, 44/17 and 82/17).

3.14. Transactions with the Bank's related parties

The Bank's related parties are parties that represent:

- members of the bank bodies, shareholders, bank employees, as well as their immediate family members (spouse and children),
- legal entity with which entity that holds qualified interest in a Bank, also has a qualified interest,
- legal entity in which one of the entities from paragraphs 1 and 2, of this section holds a significant influence or entity from paragraph 1 of this section is a director or member of the board of directors or another relevant body of that legal entity,
- an entity holding at least 50% of shares or voting rights of legal entity that has a qualified interest in the bank.

When observing each possible transaction with the related party the attention is paid to the substance of the relationship, and not only to the legal form.

3.15. Critical accounting estimates and judgments

The Bank makes estimates and assumptions on effects that the amounts of assets and liabilities included in the financial statements will have in the next financial year. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable in the given circumstances.

Impairment losses due to decrease in value of balance and off-balance sheet placements

The Bank reviews its loan portfolios at least once a quarter, in order to assess the impairment of credit receivables. The Bank estimates whether there are reliable evidence to show that there will be a reduction in future cash flows from the loan portfolio, which can be identified with an individual loan, and which may affect the income statement.

The methodology and assumptions used for estimating impairment provision in accordance with the policies are disclosed in Note 3.5).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.15. Critical accounting estimates and judgments (Continued)

Fair value of financial instruments

Fair value is the amount for which an asset can be exchanged, or a liability settled, in an arm's length transaction between notified and willing parties.

The fair value of financial instruments traded on active markets are determined based on published market prices at the balance sheet date, or the price that represents the best demand for financial resources, or the best deal for financial liabilities.

Depreciation and Amortization

The rate of depreciation is prescribed by the Bank with its accounting policy. The useful life of an asset is estimated and the rates are derived from the estimated useful life by the formula: Annual depreciation rate=100/useful life in years.

The review of useful lives is done at the end of each financial year, and if the resulted expectations significantly differ from the original ones, an adjustment of the calculation of costs for the current and future period is performed. The review shall determine whether the previously established useful life of the fixed asset is correct and whether it is necessary to correct it. Therefore, an adjustment of the depreciation rate is made, which affects the overstated or understated costs. If the carrying amount of a fix asset is greater than its estimated recoverable amount, the asset shall be written off to the recoverable amount. Impairment losses are recognized in the period in which they are determined and reported in operating expenses. After recognition of the impairment loss of a fixed asset, the depreciation charge is adjusted in future periods, so that the reassessment of the carrying amount of the assets less any possible residual value is systemically allocated during the remaining useful life of the asset.

Litigations

The Bank's management assesses the amount of provisions for outflows arising from legal disputes based on estimates of probability weather future cash outflows will happen based on contractual or legal obligation from past periods.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.16. Fair Value

International Financial Reporting Standard 13 "Financial instruments: Fair Value Measurement" assumes disclosure of fair value of financial assets and liabilities in the Notes to the financial statements.

For those requirements, fair value is defined as an amount an asset can be exchanged for, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Bank's obligation is to disclose all information relating to fair value of the asset, receivables and liabilities for which available market information exist and for which materially significant difference between carrying amount and fair value is identified.

In Montenegro, there is not sufficient market experience, stability and liquidity for purchase and sale of financial assets and liabilities, and other financial instruments, and official market information are not available in every moment. Therefore, fair value cannot be reliably determined in the lack of active market, as required by IAS and IFRS. According to Management, amounts disclosed in financial statements reflect real value, which is most accurate in the circumstances and most useful for reporting purposes. For the amount of the identified estimated risks that the carrying amount will not be realized, the amount is impaired based on the decision of the management of the Bank.

4. RISK MANAGEMENT

4.1. Introduction

In its business operations, the Bank is exposed to various risks, the most important of which are:

- Credit risk;
- Market risk;
- Operational risk;
- Interest rate risk;
- Liquidity risk.

The risk management acts of strategy, policy, procedures are designed with a view to identify and analyze risks, to define the adequate limits and controls required for risk management, as well as to keep track of the Bank's exposure to each individual risk. The risk management acts are subject to regular control ensuring the adequate response to the changes in the market, products and services.

4.2. Risk Management Framework

The Board of Directors is responsible for establishing a system of managing all the risks that the Bank is exposed to in its operations, and determining policies and procedures for managing all risks.

The Board of Directors was established by the Audit Committee, the Assets and Liabilities Management Committee (ALCO), the Credit Committee.

The responsibility of the Board of Directors is to establish, through the adoption of the strategy, policies, procedures and other documents from the domain of risk management, an adequate ratio of yield and risks that will enable the effective realization of the objectives of the Bank's shareholder. The Board of Directors monitors the efficiency and adequacy of the risk management system in the context of legal obligations, but also the interests of shareholder.

4. RISK MANAGEMENT (Continued)

4.2. Risk Management Framework (Continued)

The Audit Committee prepares proposals, opinions and standpoints from the scope of work for the decision of the Board of Directors on these issues. The Audit Committee analyzes and monitors the functioning of the risk management system that the Bank is exposed to in its operations and makes suggestions for the improvement of strategies, policies and procedures for risk management. At least once a year, the Audit Committee submits to the Board of Directors information and data on the functioning of the risk management system through its annual work report, points to weaknesses and makes suggestions for improvement and upgrading of this system.

The Assets and Liabilities Management Committee (ALCO) reviews the monthly risk reports of the Risk Management Department, which examines the current risk profile of the Bank and sets it in the context of the relationship between assets and liabilities necessary for achieving the strategic objectives of the Bank. The ALCO has competencies and responsibilities for managing the market risk, liquidity risk and other risks that the Bank is exposed to in its operations, managing the Bank's capital, managing the price policy and prescribing the value of internal indicators, as well as the limits of allowed deviations from the indicators on the basis of which the balance sheet structure of the Bank is monitored.

4.3. Credit Risk

The Credit Committee is in charge of defining the Bank's exposure policy and for evaluating, but also for rejecting all credit exposures that are not in line with that policy. The Credit Committee makes a decision on the approval of the placements to the level when the individual placement represents 10% of the Bank's own funds (large exposures). The decision to approve large exposures can be made exclusively by the Board of Directors of the Bank.

Risk Management Department is responsible for monitoring the Bank's exposure to individual risks, which is reported monthly to the Assets and Liabilities Management Committee and the Board of Directors.

Exposure to credit risk is a risk of financial loss, which may occur as a consequence of a counterparty being unable to fulfil its obligations towards the Bank. The Bank manages the credit risk it undertakes by placing limits in relation to large loans, single borrowers and related persons. Such risks are monitored on a continuous basis and subject to at least annual reviews. Credit risk is managed both at the level of individual loan placement as well as at the level of the entire portfolio. The exposure to any borrower including banks and brokers is further restricted by sub-limits covering statement of financial position and off-balance sheet exposures. Actual exposures against limits are monitored regularly.

In order to provide the necessary preconditions for the proper management of credit risk exposure analysis is carried out on two grounds - at the level of individual loans when determining credit worthiness and the upper limit of indebtedness of the client or group of connected clients and at the level of the entire portfolio in the following basis:

- structure of the portfolio in each category (corporate loans, loans to government, retail loans, off-balance sheet exposures);
- structure of the portfolio by credit rating groups (movements between individual credit categories, the transitional matrix, the percentage of cover reserves, coverage ratio);
- portfolio structure by regularity of settlement of liabilities;
- portfolio structure by industries;
- concentration in clients with so called large exposures (client or group of connected clients in which the exposure is greater than 10% of own capital);
- concentration of loans by certain geographic regions etc.

4. RISK MANAGEMENT (Continued)
4.3. Credit Risk (Continued)

Credit risk provisions are allocated in accordance with the valid regulations of the Central Bank of Montenegro. The amount of provisions for potential losses on items of assets is calculated using the carrying amount of receivables multiplied by the established percentage of reserves, while the Bank may reduce the previous book value of an item of assets for which the reserve is calculated by the amount of first class collateral defined by the Decision on minimum standards for credit risk management in banks ("Official Gazette of Montenegro", No. 22/12, 55/12, 57/13, 44/17 and 82/17).

In its operations, the Bank seeks to operate with good creditworthiness clients in order to minimize the credit risk exposure as much as possible, which poses a risk that debtors will not be able to settle the debts to the Bank in full and in due time. When making a decision on loan, it takes into account the changes in the economy, i.e. the state of individual branches that form part of the Bank's loan portfolio, which can lead to losses that differ from the losses on the basis of which the provision was made on the balance sheet date. In order to efficiently manage credit risk, the bank creates stressful credit risk scenarios, while considering the impact of the credit portfolio's weakening on the liquidity, profitability and capital adequacy of the bank.

The Bank's previous practice in making decisions about granting placements paid attention to respect the maximum permissible exposure to a single entity or group of related entities. All placements approved so far are in accordance with the defined internal limits as well as with limits defined by current legislation.

In addition to loans, the Bank approved to the clients the guarantees and the letters of credit, which represent off-balance exposures.

Rating of the creditworthiness was the basis for the approval of each placement, the defined maximum amount of debt (limit). The Bank was assessing the creditworthiness of the client using primarily tools such as quantitative (financial) and qualitative analysis and evaluation of the quality of collateral, without neglecting the principle of evaluation of risks taken by the classification of placements and potential liabilities of the Bank. Before approving loans and other placements, the Bank assesses the borrower's creditworthiness taking into account the criteria determined by the internal act, as well as the legal validity and estimated value of the collateral.

Credit risk mitigation involves maintaining the risk at an acceptable level of the Bank, i.e. maintaining an acceptable loan portfolio. Credit risk mitigation is carried out through the negotiation of adequate collaterals for receivables. The collateral value is calculated as its net value, by which is meant the market value less any costs relating to the realization of collateral. Types of collateral are as follows:

- Deposits;
- Pledges placed against industrial machines, securities, inventories and vehicles;
- Mortgages against property;
- Bills of exchange (corporate and personal);
- Authorizations for payments from the account;
- Administrative injunctions;
- Guarantors (for retail loans);
- Insurance policies;
- Bank guarantees.

4. RISK MANAGEMENT (Continued)
4.1. Credit Risk (Continued)

After the assessment of the financial condition and creditworthiness of the borrower, as well as after a review of the value and legal security of credit security and other relevant factors, Loans Management Department determines the classification of the debtor as a measure of the expected credit risk, verifies internal rating, and gives his opinion on the justification of taking the identified risk.

Credit Related Commitments and Contingent Liabilities

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and letters of credit, which represent irrevocable written assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. In the case of credit risk in respect of commitments under approved unused loans, the Bank is exposed to a potential loss in the amount of the approved unused loan. However, the probable amount of loss under credit risk is lower than total unused loan, because most of the commitments under approved loans are conditioned by the fulfillment of certain standards by the clients. The Bank monitors the maturity of loan liabilities since a longer period of validity simultaneously carries a higher credit risk.

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

In thousands of EUR

	December 31, 2017	December 31, 2016
Balance sheet items		
Loans and receivables due from banks	2,368	1,149
Loans and receivables due from customers	44,194	32,600
Financial assets available for sale	2,250	2,235
Other financial receivables	11	16
	48,823	**36,000**
Off-balance sheet items		
Payable guarantees	1,241	50
Performance bonds	45	984
Uncovered letters of credit	-	800
Undrawn loan facilities	2,034	1,854
	3,320	**3,688**
Total credit risk exposure	**52,143**	**39,688**

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

Before approving loans and other placements, the Bank assesses the debtor's creditworthiness taking into account the criteria established by the internal regulation, and the legal validity and the estimated value of collateral.

The collateral value is calculated as its net value, by which is meant the market value less any costs relating to the realization of collateral.

4. RISK MANAGEMENT (Continued)
4.3 Credit Risk (Continued)

Loans and advances are presented in the following tables:

In thousands of EUR
December 31, 2017

Description	Not past due not collectively impaired	Past due but not collectively impaired	Individually assessed	Total, (Gross)	Individual Allowance for Impairment	Collective Allowance for Impairment	Total Allowance for Impairment	Total, net
Loans and receivables due from customers								
Loans to Government	25,268	-	-	25,268	-	-	-	25,268
Units of local self-government – long-term	945	-	-	945	-	-	-	945
Retail loans	**631**	**-**	**-**	**631**	**-**	**-**	**-**	631
Cash loans	247	-	-	247	-	-	-	247
Housing loans	380	-	-	380	-	-	-	380
Overdrafts on bank accounts	4	-	-	4	-	-	-	4
Corporate loans	**17,134**	**37**	**-**	**17,171**	**-**	**22**	**22**	**17,149**
For permanent working capital	8,266	9	-	8,275	-	5	5	8,270
Overdraft	375	-	-	375	-	3	3	372
Revolving	3,724	-	-	3,724	-	14	14	3,710
Investment loan	1,933	20	-	1,953	-	-	-	1,953
Special purpose loans	2,836	8	-	2,844	-	-	-	2,844
Loans and receivables due from customers (gross)	**43,978**	**37**	**-**	**44,015**	**-**	**22**	**22**	**43,993**
Interest receivables	-	-	-	11	-	-	-	11
Accruals and prepayments	-	-	-	190	-	-	-	190
Total loans and receivables due from customers	**43,978**	**37**		**44,216**	**-**	**22**	**22**	**44,194**
Loans and receivables due from banks	-	-	-	**2,368**	-	-	-	**2,368**
	43,978	**37**	**-**	**46,584**	**-**	**22**	**22**	**46,562**

In thousands of EUR
December 31, 2016

Description	Not past due not collectively impaired	Past due but not collectively impaired	Individually assessed	Total, (Gross)	Individual Allowance for Impairment	Collective Allowance for Impairment	Total Allowance for Impairment	Total, net
Loans and receivables due from customers								
Loans to Government	11,890	-	-	11,890	-	-	-	11,890
Units of local self-government – long-term	1,140	-	-	1,140	-	7	7	1,133
Retail loans	**333**	**-**	**-**	**333**	**-**	**-**	**-**	**333**
Cash loans	163	-	-	163	-	-	-	163
Housing loans	170	-	-	170	-	-	-	170
Overdrafts on bank accounts	-	-	-	-	-	-	-	-
Corporate loans	**19,111**	**27**	**-**	**19,138**	**-**	**13**	**13**	**19,125**
For permanent working capital	7,152	-	-	7,152	-	-	-	7,152
Overdraft	17	-	-	17	-	-	-	17
Revolving	7,461	-	-	7,461	-	13	13	7,448
Investment loan	2,038	19	-	2,057	-	-	-	2,057
Special purpose loans	2,443	8	-	2,451	-	-	-	2,451
Loans and receivables due from customers (gross)	**32,474**	**27**		**32,501**		**20**	**20**	**32,481**
Interest receivables	-	-	-	31	-	-	-	31
Accruals and prepayments	-	-	-	88	-	-	-	88
Total loans and receivables due from customers	**32,474**	**27**	-	**32,620**	-	**20**	**20**	**32,600**
Loans and receivables due from banks	-	-	-	**1,149**	-	**-**	**-**	**1,149**
	32,474	**27**	**-**	**33,769**	-	**20**	**20**	**33,749**

4. RISK MANAGEMENT (Continued)
4.3 Credit Risk (Continued)

a) Past due, collectively not impaired loans and placements

December 31, 2017	Up to 30 days	Total
For permanent working capital	9	9
Investment loans	20	20
Special purpose loan	8	8
Total	**37**	**37**

December 31, 2016	Up to 30 days	From 31 to 60 days	Total
Investment loans	19	-	19
Special purpose loan	-	8	8
Total	**19**	**8**	**27**

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

In thousands of EUR

	December 31, 2017	December 31, 2016
Mortgages	1,913	1,332
Pledge/other	702	358
Pledge deposit	7	-
Bank guarantee	13,948	15,920
Contract on Cession	255	60
Total	**16,825**	**17,670**

The Bank defined both collateral factors and the timing of realization in accordance with the estimated quality of each type of collateral. The collaterals with a short timing of realization comprise, as a principle, bills of exchange, cash deposits, guarantees of legal entities and individuals, collection through a cession, corporate guarantee, guarantee whose principal is the state or other bank, life insurance policy vinculated for the benefit of the Bank.

c) Restructured Loans and Placements

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

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

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

At the end of 2017, the Bank had no restructured loans.

4. RISK MANAGEMENT (Continued)
4.3 Credit Risk (Continued)

d) Geographic Concentration

Geographic concentration of the Bank's exposure to the credit risk is shown in the table below:

In thousands of EUR

	Montenegro	European Union	Turkey	Other	Total
Loans and receivables due from banks	5	749	1,614	-	2,368
Loans and receivables due from clients	31,967	-	10,489	1,738	44,194
Financial assets available for sale	1,156	-	1,094	-	2,250
December 31, 2017	**33,128**	**749**	**13,197**	**1,738**	**48,812**
December 31, 2016	**20,616**	**1,070**	**12,553**	**1,745**	**35,984**

With the aim of identifying, measuring, assessing and monitoring country risk, the Bank uses Country risk management policy as well as the Decision on the methodology for country risk measurement in banks issued by the Central Bank of Montenegro.

The Bank measures the exposure to country risk for all countries in which the head office or residence of the Bank's debtors is located. The Bank's exposure to country risk is measured based on individual placement, defined in a document, which implies the control of the debtor's country rating, taking into account the political, economic and social conditions in the country of the debtor.

When allocating a rating to a particular country, the rating of an agency is based on a greater number of indicators, out of which the key ones are as follows: per capita income, gross domestic product growth, inflation, external debt, level of economic development and earlier regularity of debt settlement.

Based on the recommendation of the Central Bank, the Bank uses the long-term rating of the borrower's country, determined by the internationally recognized rating agencies (Standard & Poors, Moody's, Fitch) for all specific exposures in asset classification and country risk allocation.

The Bank ranks all debtors' counties in the following risk categories:

- risk-free countries;
- low-risk countries;
- medium-risk countries;
- high-risk countries.

Ranking of debtors' countries serves the Bank for determining the required capital for country risk and for limiting the bank's exposure to certain debtors' countries, groups of countries or regions.

The required capital for the country risk is calculated using weights ranging from 0% to 150%. As of December 31, 2017, the Bank allocated the amount of capital to cover the exposure to country risk, since it granted loans to certain legal entities and individuals from the Republic of Turkey, and it had securities in its portfolio issued by the Ministry of Finance of this country.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2017

4. RISK MANAGEMENT (Continued)
4.3 Credit Risk (Continued)

e) Industry Concentration

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

	Loans and receivables due from customers	Loans and receivables due from banks	Financial assets available for sale	Total
Manufacturing	2,040	-	-	2,040
Construction	1,341	-	-	1,341
Wholesale and retail trade and repair of motor vehicles and motorcycles	947	-	-	947
Information and communication	500	-	-	500
Financial and insurance activities	-	5	2,250	2,255
Professional, scientific and technical activities	146	-	-	146
Public administration, defense and mandatory social insurance	26,212	-	-	26,212
Other services	4	-	-	4
Individuals – residents	598	-	-	598
Non-residents	12,227	2,363	-	14,590
TOTAL	**44,015**	**2,368**	**2,250**	**48,633**
Interest receivables and impairment of interest receivables	11	-	-	11
Accruals of interest and fees and impairment	168	-	-	168
December 31, 2017	**44,194**	**2,368**	**2,250**	**48,812**
December 31, 2016	**32,600**	**1,149**	**2,235**	**35,984**

Off-balance sheet items

The maturity of off-balance sheet items under which the Bank is exposed to credit risk is as follows:

December 31, 2017
In thousands of EUR

	Undrawn loan facilities	Guarantees	Total
Up to 1 year	2,024	906	2,930
From 1 to 5 years	10	380	390
	2,034	**1,286**	**3,320**

December 31, 2016
In thousands of EUR

	Undrawn loan facilities	Guarantees	Uncovered letters of credit	Total
Up to 1 year	1,854	984	800	3,638
From 1 to 5 years	-	50	-	50
	1,854	**1,034**	**800**	**3,688**

4. RISK MANAGEMENT (Continued)

4.4 Market risk

The Bank is exposed to market risks. Market risk is a potential loss caused by unfavorable changes in the market: interest rates, foreign exchange positions, prices, indexes and/or other factors that affect the value of financial instruments. Most often, the main sources of market risk are foreign currency positions and interest rate risk. The limits for exposure to market risks are internally prescribed and adjusted to the limits prescribed by the Central Bank of Montenegro.

4.4.1 Foreign currency risk

The risk of changes in foreign exchange rates is the risk of change of assets and liabilities value due to changes in foreign currency rates. Bank measures foreign exchange risk and limits it daily, on an aggregate basis and individually by currencies.

The net open foreign exchange position of the Bank at the end of the day, for individual currency which is on the reference exchange rate of the European Central Bank on a daily basis, may not exceed 15% of the share capital of the Bank. The sum of the net open foreign currency position at the end of the day for all the currencies at the reference exchange rate of the European Central Bank on a daily basis, may not exceed 20% of the share capital of the Bank.

The net open positions at the end of the day for other currencies cannot exceed:

- 5% of share capital, individually by currency;
- 10% of the share capital, in total for all other currencies of the Bank.

The Bank takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The exposure to currency risk is regularly monitored by harmonizing them with the limits prescribed by the Central Bank of Montenegro.

The Bank is exposed to effects of changes in the exchange rates of the most important currencies, which affect its financial position and cash flows. The management establishes limits on the level of exposure by currencies that are regularly monitored.

The exposure to foreign currency risk as of December 31, 2017 is presented in the following table:

In thousands of EUR

	USD	Other Currencies	Total Foreign Currencies	Local currency (EUR)	Total
ASSETS					
Cash and deposits held with central banks	12	-	12	2,943	2,955
Loans and receivables due from banks	38	1	39	2,329	2,368
Loans and receivables due from customers	-	-	-	44,194	44,194
Financial assets available for sale	-	-	-	2,250	2,250
Other financial receivables	-	-	-	11	11
Total assets	**50**	**1**	**51**	**51,727**	**51,778**
LIABILITIES					
Deposits due to customers	109	-	109	25,194	25,303
Borrowings due to banks	-	-	-	20,089	20,089
Total liabilities	**109**	**-**	**109**	**45,283**	**45,392**
Net exposure to foreign currency:					
- December 31, 2017	**(59)**	**1**	**(58)**	**6,444**	**6,386**
- December 31, 2016	**(23)**	**-**	**(23)**	**6,947**	**6,924**

4. RISK MANAGEMENT (Continued)
4.4 Market risk (Continued)
4.4.1 Foreign currency risk (Continued)

The Bank is exposed to foreign exchange risk to a small extent, given the fact that, as of December 31, 2017, it had foreign currency funds in USD in the amount of 50 thousand and liabilities in the same currency in the amount of 109 thousand, resulting in a net short position of 59 thousands. On the basis of the aforementioned, the Bank was not obliged to allocate capital based on the coverage of foreign exchange risk exposure, since the net foreign exchange position is less than 2% of its own funds (as at December 31, 2017 it amounted to 1% of own funds). All other positions of financial assets and liabilities as of December 31, 2017 were stated in EUR (December 31, 2016: USD 58 thousand).

4.4.2 Operational risk

Operational risk represents the risk of losses due to the lack or inadequacy of internal processes, people and systems, or due to external events. Also, operational risk can be the result of engagement of persons outside the Bank, unlawful actions, weaknesses and omissions in the performance of business, and the like.

In order to adequately manage operational risk, the Bank has developed a Policy for identifying, measuring and controlling this type of risk. The policy sets out the basic principles for managing operational risk in order to achieve the optimum acceptable level of risk.

A phenomenon that is a source of operational risk can be classified into one of the 7 categories of events as follow:

- internal frauds;
- external frauds;
- failures in relation to employees and in the workplace safety system;
- problems in customer relationships, product placements and business practice of the Bank;
- damages on the physical assets of the bank;
- interruptions in operations and errors in the bank's systems;
- execution of transactions, deliveries and management of processes in the bank.

The operational risk associated with credit risk refers to an event arising from credit risk, and includes some of the elements of operational risk (eg. error in the execution of a process, internal/external fraud, commercial dispute).

The qualification of operational risk associated with credit risk requires the two of the following conditions met:

- Loan overdue and delayed by the loan holder - Credit Risk;
- Operational risk case, internal defect (execution error, internal/external fraud) or an external event (external fraud, commercial dispute) that partially or completely contributes to credit loss.

Exposure to operational risk is regularly monitored by aligning with the limits prescribed by the Central Bank of Montenegro.

The objective of operational risk management is to ensure that the level of exposure to operational risk is in line with the Bank's Risk Management and Policy Strategy, i.e. minimizing losses under operational risk.

As of December 31, 2017, the Bank allocated provisions for potential operational risk losses in the amount of EUR 6 thousand (Note 21).

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2017

4. RISK MANAGEMENT (Continued)
4.4 Market Risk (Continued)
4.4.3 The risk of changes in interest rates

The risk of changes in interest rates on cash flows is the risk that the future cash flows of a financial instrument will be subject to fluctuations due to variable interest rates in the market.

Interest rate risk is the risk that the value of a financial instrument will be subject to fluctuations due to variable interest rates in the market. The Bank is exposed to the effects of changes in current interest rates in the market, based on the risk of changes in interest rates on cash flows.

The management of interest rate risk is considered to be the risk management of non-compliance of updating interest rates periods (Repricing Risk), sources of funds and placements As a consequence of such changes, there may be an increase in interest margins, however, those may reduce profits or lead to loss in case of unexpected movements. Interest rates are based on market rates so that the Bank regularly re-measure the prices.

Sensitivity of assets, liabilities and off-balance sheet items to a change in the interest rate affects two categories - the amount of net interest income and the market value of certain financial instruments (interest-sensitive sources and placements), which consequently affects the market value of the Bank's capital.

The causes of interest rate risk are:

- Unsatisfactory interest spread ("spread")
- Mismatch of interest-sensitive assets and liabilities of banks ("gap")
- Changes in customer preferences.

The following table shows the interest bearing and non-interest bearing assets and liabilities of the Bank as of December 31, 2017:

In thousands of EUR

	Interest bearing	Non-interest bearing	Total
ASSETS			
Cash and deposits held with central banks	581	2,374	2,955
Loans and receivables due from banks	749	1,619	2,368
Loans and receivables due from customers	44,194	-	44,194
Financial assets available for sale	2,250	-	2,250
Other financial receivables	11	-	11
Total assets	**47,785**	**3,993**	**51,778**
LIABILITIES			
Deposit due to customers	25,247	56	25,303
Borrowing due to banks	20,089	-	20,089
Other financial liabilities	201	-	201
Total liabilities	**45,537**	**56**	**45,593**
Exposure to interest rates changes:			
- December 31, 2017	**1,499**	**4,685**	**6,173**
- December 31, 2016	**2,855**	**3,984**	**6,838**

4. RISK MANAGEMENT (Continued)

4.5 Liquidity Risk

Liquidity management is one of the key tasks of the Bank. Liquidity risk is defined as a risk of the Bank's inability to provide sufficient funding for settling liabilities as they become due or a risk that the Bank will have to obtain such funding from other sources at a reasonable price and in due time.

4.5.1. Liquidity Risk Management

Liquidity risk presents the risk that the bank will not be able to provide sufficient volume (financial) resources to cover all the liabilities (balance sheet and off-balance sheet) as they mature.

Liquidity risk is identified on the basis of daily, ten-day, monthly, quarterly projections of liquidity, i.e. based on the gaps incurred due to mismatch of assets and resources.

Adequate liquidity risk management is a basic requirement for the safe and efficient operation of the bank. The quality of liquidity risk management depends on the balance sheet structure of the Bank, i.e. matching between inflows and outflows. The required liquidity is achieved by rational management of assets and liabilities in order to maintain an appropriate ratio between liquid assets and volatile liabilities.

Aiming to create a secondary liquidity reserves the Bank was investing in debt securities in the amount of EUR 2,250 thousand. As of December 31, 2017, most of the portfolio of debt securities relates to securities issued by the Ministry of Finance of Montenegro in the amount of EUR 1,148 thousand, which are classified as available for sale. Also, the Bank in its portfolio has EUR 1,102 thousand of securities issued by the Ministry of Finance of the Republic of Turkey, which are also classified as securities available for sale.

Based on the monitoring and measurement of the basic liquidity indicators (daily and decade liquidity coefficients), determined coefficients show that, during 2017, the Bank did not have liquidity problems and the liquidity coefficients were above the limit of values prescribed by the Central Bank. As of December 31, 2017, the daily liquidity ratio amounted to 5.44 (December 31, 2016: 3.97), while the minimum value of this coefficient defined by the Central Bank's decision was 0.9.

The Bank's liquidity is strongly supported by the parent bank, which provides loans or overnight deposits in case of need for liquid assets. In addition, the Bank has defined and adopted the Liquidity Management Plan in cases of jeopardized liquidity or unforeseen circumstances, which clearly define the duties, tasks and bearers of the tasks to be performed in the event of a jeopardized liquidity of the Bank.

The table below provides an analysis of maturity of assets and liabilities based on the contractual terms of payment. The contractual maturities of assets and liabilities are determined based on the remaining period at the balance sheet date in relation to the contractual maturity date.

Considering the fact that the Bank started its operations in the second half of 2015, the methodology for determining the stable level of demand deposits is still not prepared. This requires a series of data for a minimum of several years, so at this point the Bank classifies all demand deposits in the column from 1 to 7 days. Time deposits are classified by maturity scales in relation to the agreed maturity dates.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2017

4. RISK MANAGEMENT (Continued)
4.5 Liquidity Risk (Continued)
4.5.1 Liquidity Risk Management (Continued)

In thousands of EUR

	From 1 to 7 days	8-15 days	16-30 days	31-90 days	91-180 days	180-365 days	1-5 years	More than 5 years	Total
December 31, 2017									
ASSETS									
Cash and deposits held with central banks	**2,955**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**2,955**
Cash and cash equivalents	1,793	-	-	-	-	-	-	-	1,793
Allocated mandatory reserve funds	1,162								1,162
Funds held with banks	**2,368**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**2,368**
Loans and receivables due from customers	**165**	**18**	**48**	**3,334**	**16,350**	**3,929**	**19,189**	**1,161**	**44,194**
Financial assets available for sale	**2,250**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**2,250**
Other receivables	**8**	**1**	**-**	**-**	**-**	**2**	**-**	**-**	**11**
Total assets	**7,746**	**19**	**48**	**3,334**	**16,350**	**3,931**	**19,189**	**1,161**	**51,778**
LIABILITIES									
Total deposits, funds on esc. account and liabilities for interests and accruals	**2,053**	**-**	**400**	**161**	**561**	**20,022**	**2,106**	**-**	**25,303**
Demand deposits	2,019	-	-	-	-	-	-	-	2,019
Time deposits		-	400	161	561	20,022	2,106	-	23,250
Liabilities for interests and accruals	34	-	-	-	-	-	-	-	34
Total borrowings	**5,000**	**1,000**	**4,001**	**2,036**	**5,026**	**3,025**	**-**	**-**	**20,088**
Borrowings from other credit and financial institutions	5,000	1,000	4,000	2,000	5,000	3,000	-	-	20,000
Liabilities for interests and accruals	-	-	1	36	26	25	-	-	88
Other due liabilities	200	1	-	-	-	27	-	-	228
Total liabilities	**7,253**	**1,001**	**4,401**	**2,197**	**5,587**	**23,074**	**2,106**	**-**	**45,619**
Maturity gap as of 12/31/2017									
Maturity gap	493	(982)	(4,353)	1,137	10,763	(19,143)	17,083	1,161	6,159
Cumulative gap	493	(489)	(4,842)	(3,705)	7,058	(12,085)	4,998	6,159	(2,413)
% of total funds sources	1.1%	(1.1%)	(10.6%)	(8.1%)	15.5%	(26.5%)	11.0%	13.5%	-
Maturity gap as of 12/31/2016									
Maturity gap	4,322	(4,574)	(10,980)	985	8,856	(3,989)	10,890	1,195	6,705
Cumulative gap	4,322	(252)	(11,232)	(10,247)	(1,391)	(5,380)	5,510	6,705	(11,965)
% of total funds sources	13.4%	(0.8%)	(34.7%)	(31.7%)	(4.3%)	(16.6%)	17.0%	20.7%	-

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2017

4. RISK MANAGEMENT (Continued)
4.5 Liquidity Risk (Continued)
4.5.1 Liquidity Risk Management (Continued)

The liquidity of the Bank as its ability to fulfill its due liabilities within the deadline, depends on one side of the balance sheet structure, and on the other hand, the compliance of inflows and outflows of funds. The structure of financial assets and liabilities as of December 31, 2017 indicates the existence of a maturity mismatch between the remaining maturity of assets and liabilities from 8 to 90 days and from 6 months to one year. During 2017, the Bank did not have problems with maintaining its liquidity. The daily liquidity ratio as of December 31, 2017 was 5.44% (December 31, 2016: 3.97%), while the decade liquidity ratio as of December 31, 2017 was 3.39% (December 31, 2016: 4.21%). As a member of the Ziraat Group, the Bank has access to the intergroup money market, and in a very short period of time it can provide liquid cash in a form of a loan from the parent bank or another member bank of the Ziraat Group. This fact significantly influences the liquid position of the Bank and the reduction of liquidity risk exposure.

4.6 Fair Value of Financial Assets and Liabilities

In thousands of EUR

	Carrying value		Fair value	
	2017	**2016**	**2017**	**2016**
Financial assets				
Loans and receivables due from banks	2,368	1,149	2,368	1,149
Loans and receivables due from customers	44,194	32,600	44,194	32,600
Financial assets available for sale	2,250	2,235	2,250	2,235
Other financial receivables	11	16	11	16
Financial liabilities				
Deposits due to clients	25,303	10,683	25,303	10,683
Borrowings due to banks	20,089	21,533	20,089	21,533
Other liabilities	201	86	201	86

Fair value of financial instruments is the price that would be received to sell an asset or paid to settle a liability, between notified willing participants during the independent transaction. However, no readily available market prices exist for a certain portion of the Bank's financial instruments. In this circumstances where the quoted market prices are not readily available, the fair value is estimated using discounted cash flow models or other pricing models as appropriate. Changes in underlying assumptions, including discount rates and estimated future cash flows, significantly affects the estimates. Therefore, the calculated fair market estimates cannot be realized in a current sale of the financial instrument.

In estimating the fair value of the Bank's financial instruments not measured at fair value, the following assumptions were used:

a) ***Loans and receivables due from banks***

Loans and receivables due from banks include inter-bank placements and line items in the course of collection. The fair value of floating rate placements and overnight deposits approximates their carrying amount at the statement of financial position date.

b) ***Loans and receivables due from customers***

In order to determine the fair value of loans to clients with fixed interest rates measured at amortized cost, a comparison of interest rates was made according to which loans were granted to clients with available information on the prevailing market interest rates in the banking sector of Montenegro, i.e. the average weighted interest rates by activities.

4. RISK MANAGEMENT (Continued)
4.6 Fair Value of Financial Assets and Liabilities (Continued)

b) Loans and receivables due from customers (Continued)

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

c) Financial assets available for sale

The fair value of financial assets available for sale is based on market prices.

d) *Deposits and borrowings*

The estimated fair value of demand deposits and deposits with remaining contractual maturities less than one year approximates their carrying amount.

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

4.6.1 Fair Value of Financial Instruments Measured at Fair value

Fair value hierarchy for financial instruments measured at fair value

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

- Level 1 – Quoted prices (unadjusted) on active markets for identical assets or liabilities. This level includes listed equity investments.
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for an asset or a liability, either directly (that is, as prices/values) or indirectly (that is, as derived from prices/values).
- Level 3 – inputs for assets or a liability that are not based on observable market data. This Level includes equity investments with Bank's market assumption (no observable data available). The Bank does not have financial instruments measured at fair value included within Level 3.

This hierarchy requires the use of observable market data when available, upon estimation of fair value. The Bank considers available market prices where possible. As of December 31, 2017 the market price of securities valued at fair value in the Bank's portfolio were available.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2017

4. RISK MANAGEMENT (Continued)
4.6 Fair Value of Financial Assets and Liabilities (Continued)
4.6.1 Fair Value of Financial Instruments Measured at Fair value (Continued)

December 31, 2017	Level 1	Level 2	Level 3	Total
Financial assets available for sale	2,250	-	-	2,250
Total assets	**2,250**	**-**	**-**	**2,250**

December 31, 2016	Level 1	Level 2	Level 3	Total
Financial assets available for sale	2,235	-	-	2,235
Total assets	**2,235**	**-**	**-**	**2,235**

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

The fair value for financial assets available for sale and securities measured at fair value through profit or loss is based on market prices. Where this information is not available, fair value has been estimated using quoted market prices for securities with similar characteristics. As of December 31, 2017, for securities measured at fair value in Bank's portfolio, market prices were available.

Fair value hierarchy for financial instruments not measured at fair value

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

December 31, 2017	Level 1	Level 2	Level 3	Total	Carrying value
Cash and deposits held with central banks	-	2,955	-	2,955	2,955
Loans and receivables due from banks	-	2,368	-	2,368	2,368
Loans and receivables due from customers	-	44,194	-	44,194	44,194
Other financial receivables	-	11	-	11	11
Total assets	-	49,528	-	49,528	49,528
			-		
Deposits due to customers	-	25,303	-	25,303	25,303
Borrowings due to banks	-	20,089	-	20,089	20,089
Total liabilities	-	45,382	-	45,382	45,382

December 31, 2016	Level 1	Level 2	Level 3	Total	Carrying value
Cash and deposits held with central banks	-	3,140	-	3,140	3,140
Loans and receivables due from banks	-	1,149	-	1,149	1,149
Loans and receivables due from customers	-	32,600	-	32,600	32,600
Other financial receivables	-	16	-	16	16
Total assets	-	36,905	-	36,905	36,905
Deposits due to customers	-	10,683	-	10,683	10,683
Borrowings due to banks	-	21,533	-	21,533	21,533
Total liabilities	-	32,216	-	32,216	32,216

4. RISK MANAGEMENT (Continued)
4.6 Fair Value of Financial Assets and Liabilities (Continued)
4.6.2 Fair Value of financial instruments not carried at fair value

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

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

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

4.7 Capital Management

The Bank's capital management objectives are:

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

The Bank's capital is divided into two tiers:

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

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

In accordance with the requirements of the Central Bank of Montenegro, the Bank is under obligation to maintain a minimum capital adequacy ratio of 10%. The Bank is required to maintain certain minimum or maximum ratios with respect to its activities and composition of risk assets in compliance with the Law on Banks of the Republic of Montenegro and with the Central Bank of Montenegro regulations.

On December 31, 2017, capital adequacy ratio calculated by the Bank for financial statements was 27.82%.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2017

4. RISK MANAGEMENT (Continued)
4.8 Risk Exposure Analysis
4.8.1 Risk Exposure Analysis (foreign currency risk)

Exposure to foreign exchange risk management, in addition to the Bank's analysis of the Bank's foreign currency debt and liabilities, includes an analysis of exposure to exchange rate fluctuations. The following table shows the exchange rate changes scenario in the range of + 10% to -10% in relation to EUR.

In thousands of EUR

	Total	Amount in foreign currency	Change in exchange rate 10%	(10%)
Assets				
Cash and deposits held with central banks	2,955	12	1	(1)
Loans and receivables due from banks	2,368	39	4	(4)
Total assets	5,323	51	5	(5)
LIABILITIES				
Deposits due to customers	25,303	109	11	(11)
Other liabilities	201	-	-	-
Total liabilities	25,504	109	11	(11)
Net exposure to foreign currency risk:				
- December 31, 2017			6	(6)
- December 31, 2016			1	(1)

As of December 31, 2017, assuming all other parameters were unchanged, the change in the EUR exchange rate against other currencies by + 10% and -10% would increase or decrease the Bank's profit by EUR 6 thousand (December 31, 2016: profit would increase or decrease by EUR 1 thousand). The cause to the Bank's low exposure to the exchange rate change is the fact that the greatest portion of the Bank's receivables and liabilities is expressed in EUR.

4.8.2 Risk Exposure Analysis (Interest Rate Risk)

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

In thousands of EUR

		Net effect of movements in interest rates +0.4 b.p. EUR/FX KS	-0.4 b.p. EUR/FX KS
ASSETS			
Cash and balances held with central banks	2,955		
Loans and receivables due from banks	2,368	9	(9)
Loans and receivables due from customers	44,194	177	(177)
Financial assets available for sale	2,250	9	(9)
Other financial receivables	11	-	-
	51,778	195	(195)
LIABILITIES			
Deposits due to customers	25,303	101	(101)
Borrowings due to banks	20,089	80	(80)
	45,392	181	(181)
Net exposure to interest rate risk			
- December 31, 2017		14	(14)
- December 31, 2016		31	(31)

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2017

4. RISK MANAGEMENT (Continued)
4.8 Risk Exposure Analysis (Continued)
4.8.2 Risk Exposure Analysis (Interest Rate Risk) (Continued)

Under the assumption that all other parameters remain the same, the increase, or decrease in variable interest rates applied to assets and liabilities denominated in EUR and in foreign currency, by 0.4 percentage points, the Bank's profit would increase, or decrease, respectively by EUR 14 thousand (December 31, 2016: the respective decrease would amount to EUR 31 thousand).

The reason why the Bank's exposure to interest rate is small is based on the fact that the major portion of the Bank's assets and liabilities are contracted with a fixed interest rate.

5. INTEREST INCOME/EXPENSES

a) Interest income

	In thousands of EUR Year ended December 31, 2017	2016
From deposits with:		
- Foreign banks	-	6
	-	**6**
From loans and receivables due from customers to:		
- Government of Montenegro	840	149
- Corporate customers	782	634
- Retail customers	29	7
- Other	44	25
	1,695	**815**
Financial assets available for sale	96	95
	1,791	**916**

b) Interest expenses

	In thousands of EUR Year ended December 31, 2017	2016
Interest expense from deposits due to:		
- Financial institutions	55	-
- Corporate customers	51	53
- Retail customers	6	1
- Other	53	4
	165	**58**
Borrowed funds, from banks	510	157
	510	**157**
	675	**215**

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2017

6. ALLOWANCE FOR IMPAIRMENT AND PROVISION EXPENSES

a) Allowance for impairment expenses

	In thousands of EUR Year ended December 31, 2017	 2016
Loan losses	3	18
	3	**18**

b) Provision expenses

	In thousands of EUR Year ended December 31, 2017	 2016
Provision for off-balance sheet items	(1)	5
Provision for other liabilities	6	-
	5	**5**

c) Movement in impairment losses and provisions

	Loans (Note 14)	Off-balance (Note 21)	Other provisions (Note 21)	Total
As of January 1, 2017	20	5	-	25
Allowance for impairment and provisions during the year-NET	3	(1)	6	7
Other	(1)	-	-	-
As of December 31, 2017	**22**	**4**	**6**	**32**

	Loans (Note 14)	Off-balance (Note 21)	Other reserves (Note 21)	Total
As of January 1, 2016	2	-	-	2
Allowance for impairment and provisions during the year-NET	18	5	-	23
As of December 31, 2016	**20**	**5**	**-**	**25**

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2017

7. FEES INCOME AND EXPENSES

a) Fee and Commission Income

	In thousands of EUR Year ended December 31, 2017	2016
Fees from operations with loans	35	18
Fees from off-balance items	30	5
Clearing and settlement	75	62
Fees for cards and ATM operations	2	-
Other fees and commissions	6	4
	148	**89**

b) Fee and Commission Expenses

	In thousands of EUR Year ended December 31, 2017	2016
Fees to Central Bank of Montenegro	25	20
Clearing and settlement charges	2	2
Deposit insurance premium fees	56	24
Fees for cards and ATM operations	5	-
Other fees and commissions	14	-
	102	**46**

8. STAFF COSTS

	In thousands of EUR Year ended December 31, 2017	2016
Net salaries	490	480
Taxes and contributions related to salaries	348	353
Fees to members of Board of Directors	93	91
Taxes and contributions related to fees to members of Board of Directors	12	12
Business trips expenses	17	19
Employees trainings	3	1
	963	**956**

9. GENERAL AND ADMINISTRATIVE EXPENSES

	In thousands of EUR Year ended December 31, 2017	2016
Rental expenses	132	132
Security	37	37
Property maintenance	174	172
Insurance	5	5
Cleaning services	14	14
Audit expenses	121	103
Sponsorship and donations	4	2
Advertising	22	9
Electricity and fuel	18	21
Entertainment	24	24
Telecommunication and postal costs	54	51
Office material	4	4
Professional services	41	4
Utility services	3	2
Other expenses	19	21
	672	**601**

10. OTHER EXPENSES

	In thousands of EUR Year ended December 31, 2017	2016
Tax and other duties of local self-government units	33	28
	33	**28**

11. INCOME TAX

a) Income tax components

	In thousands of EUR Year ended December 31, 2017	2016
Deferred tax income	9	1
Current tax expense	-	(3)
	9	**(2)**

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2017

11. INCOME TAX (Continued)

b) Reconciliation of income tax from Income Statement and results before taxation and prescribed tax rate

	In thousands of EUR Year ended December 31, 2017	2016
Loss before taxation	(874)	(1,175)
Income tax at the prescribed rate of (9%)	(78)	(106)
Income tax at the prescribed rate of (9%) on capital losses	-	2
Tax effects of expenses not recognized for tax purposes	2	1
Difference between the present value of fixed assets and intangible assets recognized in the financial statements and their value for tax purposes	9	3
Tax effects of current year tax losses carried forward	76	98
Income tax stated in income statement	9	(2)

c) Deferred tax liabilities

Deferred tax assets and liabilities in the balance sheet refer to the following:

In thousands of EUR

	Year ended December 31, 2017			Year ended December 31, 2016		
	Assets	Liability	Net amount	Assets	Liability	Net amount
Amortization of fixed assets	9	(21)	(12)	1	(22)	(21)
Change in fair value of the Financial assets available for sale	8	(23)	(15)	11	(24)	(13)
Deferred tax assets/ (liabilities)	17	(44)	(27)	12	(46)	(34)

d) Unused operating tax losses that can be carried forward:

Year of Inception	Year of Expiry	In thousands of EUR
2015	2020	1,268
2016	2021	1,165
2017	2022	751
		3,184

In accordance with the Law on Corporate Income Tax ("Official Gazette of Montenegro", No. 55/16), losses arising from business relations, except those from which capital gains and losses arise, may be carried forward to the profit account for future accounting periods, but not longer than five years. As of December 31, 2017, the Bank did not recognize deferred tax assets arising from the capital losses incurred in previous years, due to the uncertainty that existed at the time of the loss that future taxable profits against which the deferred tax assets can be utilized will be available.

e) Unused capital tax losses that can be carried forward:

As of December 31, 2017, the Bank did not have capital tax carried forward, and therefore there were no grounds for capital losses carrying forward to the account of capital gains in the next five years.

12. CASH AND DEPOSITS HELD WITH CENTRAL BANKS

	In thousands of EUR	
	December 31, 2017	December 31, 2016
Cash in hand in EUR	452	505
Cash in hand in foreign currencies	12	9
Cash in ATMs	19	-
Gyro account balance	1,311	1,406
Obligatory reserve held with the Central Bank of Montenegro	1,161	1,220
	2,955	**3,140**

The Bank's obligatory reserve as of December 31, 2017 represents the minimum deposits set aside in accordance with the Central Bank of Montenegro Regulation with respect to "Decision on Bank Reserve Requirements to be held with the Central Bank of Montenegro" ("Official Gazette of Montenegro", No. 35/11, 22/12, 61/12, 57/13, 52/14, 07/15, 33/16 and 15/17). In accordance with the said Decision, the reserve is calculated based on demand deposits and time deposits.

The required reserves are calculated by applying the rate of:

- 7.5 % - to a part of principal made of demand deposits and deposits with agreed maturity of up to one year, i.e. up to 365 days;
- 6.5% - to a part of principal made of deposits with agreed maturity of over one year, i.e. over 365 days; and
- 7.5 % - to deposits with agreed maturity of over 365 days, with an option of early withdrawal (within less than one year, or within less than 365 days).

A Bank may use up to 50% of its allocated reserve to maintain its daily liquidity. The Bank shall not be charged any fee for the use of its reserve. The Bank shall pay monthly fee for the amount of reserve not returned the same day, at the rate established under a separate Central Bank of Montenegro regulation.

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

13. LOANS AND RECEIVABLES DUE FROM BANKS

	In thousands of EUR	
	December 31, 2017	December 31, 2016
Accounts held with foreign banks	2,363	1,149
Settlement account - Master Card	5	-
	2,368	**1,149**

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2017

14. LOANS AND RECEIVABLES DUE FROM CUSTOMERS

In thousands of EUR

	December 31, 2017	December 31, 2016
Loans:		
Corporate customers	17,171	19,138
Government of Montenegro	25,268	11,890
Retail customers	631	333
Local self-government units	945	1,140
Out of which:		
Short-term loans:	**16,589**	**19,494**
Corporate customers	6,599	9,456
Government of Montenegro	9,970	10,000
Retail customers	20	38
Long-term loans:	**27,426**	**13,007**
Privately owned companies	10,571	9,682
Government of Montenegro	15,298	1,890
Retail customers	612	295
Local self-government units	945	1,140
Total	**44,015**	**32,501**
Interest receivables:		
Loans	11	31
Accruals	**190**	**88**
Loan interest	249	130
Loan fees	(59)	(42)
TOTAL GROSS LOANS AND RECEIVABLES	**44,216**	**32,620**
Less: Allowance for impairment on loans	(22)	(20)
TOTAL LOANS AND RECEIVABLES	**44,194**	**32,600**

Concentration of total (gross) loans by industry is as given in the following table:

In thousands of EUR

	December 31, 2017	December 31, 2016
Manufacturing	2,040	3,436
Construction of residential and non-residential units	1,341	1,642
Wholesale and retail trade	947	1,111
Information and communication	500	-
Engineering activities and technical advisory	146	-
Public administration	26,212	13,030
Other services	4	-
Individuals – residents	598	273
Non-residents	12,227	13,009
	44,015	**32,501**

Loans to legal entities were approved at the following interest rates:
- Short-term loans with fixed interest rate: 3.50% - 6.20%
- Long-term loans with a fixed interest rate: 3.90% - 7.25%

14. LOANS AND RECEIVABLES DUE FROM CUSTOMERS (Continued)

The active interest rates applied to approved loans to legal entities during 2017 were as follows:

Type of loan	**Interest rate**
For permanent working capital	3.50% - 6.20%
Overdraft	3.50% - 6.20%
Revolving	3.50% - 5.50%
Investment loan	3.90% - 7.25%
Special purpose loan	3.90% - 7.25%

The active interest rates applied to approved loans to individuals during 2017 were as follows:

Type of loan	**Interest rate**
Cash loans	6.50% - 7.75%
Housing loans	3.99% - 5.00%
Overdrafts at bank accounts	9.00%

15. FINANCIAL ASSETS AVAILABLE FOR SALE

	In thousands of EUR	
	December 31, 2017	**December 31, 2016**
Governments and treasury bonds	2,250	2,235
	2,250	**2,235**

As of December 31, 2017, the Bank has in its portfolio the bonds of the Republic of Turkey ISIN XS1057340009 in the amount of EUR 1,102 thousand (December 31, 2016 in the amount of EUR 1,107 thousand), traded as at October 5, 2015 with the maturity date of April 11, 2023.

Treasury bonds of Montenegro ISIN XS1377508996 in the amount of EUR 1,148 thousand (December 31, 2016 in the amounted of EUR 1,128 thousand), were traded as at March 29, 2016, with maturity date as at March 10, 2021.

16. PROPERTY AND EQUIPMENT

	In thousands of EUR Equipment	Total
Cost		
Balance as of January 1, 2016	562	562
Additions during the year	10	10
Balance as of December 31, 2016	572	572
Additions during the year	32	32
Balance as of December 31, 2017	604	604
Accumulated depreciation		
Balance as of January 1, 2016	48	48
Charge for the year	126	126
Balance as of December 31, 2016	174	174
Charge for the year	130	130
Balance as of December 31, 2017	304	304
Net book value as of:		
- December 31, 2017	**300**	**300**
- December 31, 2016	**398**	**398**

As of December 31, 2017 the Bank has no assets under pledge as a collateral for repayment of loans or settlement of other liabilities.

17. INTANGIBLE ASSETS

Changes in intangible assets during 2017 are shown in the following table:

	In thousands of EUR Software and Licenses
Cost	
Balance as of January 1, 2016	739
Additions	245
Balance as of December 31, 2016	984
Additions	148
Balance as of December 31, 2017	1,132
Accumulated amortization	
Balance as of January 1, 2016	69
Charge for the year	213
Balance as of December 31, 2016	282
Charge for the year	250
Balance as of December 31, 2017	532
Net book value as of:	
- December 31, 2017	**600**
- December 31, 2016	**702**

18. OTHER RECEIVABLES

a) Other financial receivables

	December 31, 2017	In thousands of EUR December 31, 2016
Other receivables for fees and commissions	1	8
Fees for maternity leave, which are claimed by the state	4	3
Given advances	6	5
	11	**16**

b) Other accounts receivable

	December 31, 2017	In thousands of EUR December 31, 2016
Prepaid expenses	15	14
	15	**14**

19. DEPOSITS DUE TO CUSTOMERS

	December 31, 2017	In thousands of EUR December 31, 2016
Demand deposits		
Corporate customers	855	1,593
Entrepreneurs	2	9
State funds	12	-
NGOs and other non-profit organizations	59	11
Individuals	1,084	581
Other	6	-
	2,018	**2,194**
Short-term deposits		
State owned and privately owned funds	3,000	2,000
Corporate customers	415	1,300
NGOs and other non-profit organizations	1,000	-
Individuals	553	80
	4,968	**3,380**
Long-term deposits		
State owned and privately owned funds		
Corporate customers	18,165	5,000
Individuals	117	55
	18,282	**5,055**
Interest payables	3	-
Accruals	32	54
	25,303	**10,683**

19. DEPOSITS DUE TO CUSTOMERS (Continued)

The passive interest rates applied to received deposits of companies during 2017 were as follows:

Type of deposit	Interest rate
Short-term deposits	0.20%-0.80%
Long-term deposits	1.15%-2.30%

The passive interest rates applied to received deposits of individuals during 2017 were as follows:

Type of deposit	Interest rate
Demand deposits	0.01%
Time deposits in EUR:	
- three months	0.30% - 0.60%
- six months	1.30% - 1.50%
- 12 months	1.20% - 2.30%
- 24 months	2.25% - 2.40%
- 36 months	2.40% - 2.60%

20. BORROWINGS DUE TO BANKS

		In thousands of EUR	
	Currency	December 31, 2017	December 31, 2016
Borrowings:			
Ziraat Bank International AG	EUR	-	4,000
T.C. ZIRAAT BANKASI ATHENS CENTRAL BRANCH	EUR	4,000	-
T.C. ZIRAAT BANKASI LONDON	EUR	4,000	15,500
T.C. ZIRAAT BANKASI - SOFIA BRANCH	EUR	5,000	2,000
UT Bank JSC	EUR	4,000	-
ZIRAAT BANK BAHRAIN BRANCH	EUR	3,000	-
		20,000	**21,500**
Interest and fees payables:			
Ziraat Bank International AG	EUR	-	2
T.C. ZIRAAT BANKASI - SOFIA BRANCH	EUR	2	1
UT Bank JSC	EUR	45	-
ZIRAAT BANK BAHRAIN BRANCH	EUR	17	-
T.C. ZIRAAT BANKASI LONDON	EUR	25	30
		89	**33**
		20,089	**21,533**

20. BORROWINGS DUE TO BANKS (Continued)

The maturity overview of liabilities based on loans is given in the following table:

	Currency	Currency date	Maturity date	In thousands of EUR December 31, 2017
T.C. ZIRAAT BANKASI ATHENS CENTRAL BRANCH	EUR	27.12.2017	03.01.2018	4,000
T.C. ZIRAAT BANKASI LONDON	EUR	27.12.2017	03.01.2018	1,000
T.C. ZIRAAT BANKASI - SOFIA BRANCH	EUR	15.12.2017	15.01.2018	1,000
T.C. ZIRAAT BANKASI - SOFIA BRANCH	EUR	20.12.2017	19.01.2018	4,000
UT Bank JSC	EUR	08.02.2017	08.02.2018	2,000
UT Bank JSC	EUR	11.10.2017	11.04.2018	2,000
ZIRAAT BANK BAHRAIN BRANCH	EUR	11.10.2017	11.04.2018	3,000
T.C. ZIRAAT BANKASI LONDON	EUR	17.07.2017	17.07.2018	3,000
				20,000

21. PROVISIONS

	In thousands of EUR December 31, 2017	December 31, 2016
Provision for potential losses on off-balance items	4	5
Provision for potential losses on operational risk	6	-
	10	**5**

22. OTHER LIABILITIES

	In thousands of EUR December 31, 2017	December 31, 2016
Other taxes and contributions payable	1	6
Trade payables	11	51
Temporary account	115	-
Accrued liabilities	74	29
	201	**86**

Accrued liabilities mostly referred to costs of: hardware maintenance, external audit, consulting services, software maintenance, marketing and other expenses.

Temporary account related to deposited foundation roles of bank clients temporarily standing in this account until clients formally complete the registration process with the CRBE and officially open accounts with the Bank.

23. CAPITAL

As of December 31, 2017, the Bank's share capital comprised 10,000 ordinary shares (December 31, 2016: 10,000 ordinary shares), with nominal value of 1 thousand EUR each. All issued shares have been fully paid.

As of December 31, 2017, the 100% shareholder of the Bank was TURKIYE CUMHURIYETI "ZIRAAT BANKASI ANONIM SIRKETI".

In accordance with the regulations of the Central Bank of Montenegro, as of December 31, 2017, the Bank was obliged to maintain a minimum capital solvency ratio of 10%. As of, December 31, 2017, the Bank's solvency ratio was 27.82%.

23. CAPITAL (Continued)

23.1. Own funds

The Bank continuously manages its capital, which is a broader concept than the capital position in the balance sheet, in order to:

- ensure compliance with the requirements for capital, which are defined by the Central Bank of Montenegro,
- provide adequate level of capital to continue operations on the "going concern" and,
- Maintain capital at a level that will allow for future business development.

Capital adequacy and the use of the Bank's capital is monitored monthly by the Bank Management. The Central Bank of Montenegro has defined the following capital limits:

- the minimum amount of capital of EUR 5 million and
- Capital adequacy ratio of 10%.

Total capital or own funds of the Bank consist of core capital, supplementary capital and deduction items:

Core capital consists of: paid-in share capital at nominal value, excluding cumulative preferential shares; collected share premiums; reserves that are formed at the expense of profit after tax (statutory and other reserves); retained earnings from previous years; profit for the year for which the Shareholders Assembly decided to be included in the core capital; capital gains made from the purchase and sale of own shares.

Deduction items from core capital are: loss from previous years; loss of the current year; capital losses arising from the acquisition and sale of own shares; intangible assets such as goodwill, licenses, patents, trademarks and concessions; nominal value of acquired own shares, excluding cumulative preferential shares; less accrued provisions for potential losses, determined in the process of control.

Supplementary capital comprises: a nominal value of preferential cumulative shares; general reserves, up to 1.25% of total risk weighted assets; subordinated debt hybrid instruments, for which the conditions of the Decision on banks' capital adequacy for inclusion in Tier I have been met. Deductions from Tier I capital are: acquired own preferential cumulative shares and claims and contingent liabilities secured by hybrid instruments or by subordinated debt of the Bank to the extent in which these instruments are included in Tier I.

Needs for capital are determined separately for different types of risks - credit, operational, market and other risks in accordance with applicable regulations in this area. Most of the needs for capital refer to the capital required to cover credit risk. In this sense, credit risk-weighted assets are calculated using the weights range from 0% to 100% depending on the type of exposure and the amount of credit risk that each individual exposure carries.

The required capital for the country risk is calculated using weights ranging from 0% to 150%. As of December 31, 2017, the Bank allocated the amount of capital to cover the exposure to country risk, since it granted loans to certain legal entities and individuals from the Republic of Turkey, and it had securities in its portfolio issued by the Ministry of Finance of this country.

The required capital for covering the exposure to operational risk is calculated using the simple method, in accordance with the Decision on the capital adequacy of banks. The basis for calculating the required capital for operational risk is an average of net interest bearing and net non-interest bearing income for the three previous consecutive business years. The required capital for operational risk is calculated by multiplying the base for calculating the required capital for operational risk with a coefficient of 0.15 and increasing of the result by 25%.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2017

23. CAPITAL (Continued)

23.1. Own funds (Continued)

In accordance with the regulations of the Central Bank of Montenegro, the Bank is obliged to maintain a minimum level of capital adequacy, expressed as a solvency ratio of a minimum of 10%. As of December 31, 2017, the solvency ratio of the Bank was 27.82% and it exceeded the limit of 10% determined by the Law on Banks.

The own funds of the Banks as of December 31, 2017 comprise the following:

		In thousands of EUR
	December 31, 2017	December 31, 2016
Basic elements of own funds		
Paid-up share capital at nominal value, excluding cumulative preferential shares	10,000	10,000
Reserves that are formed at the expense of profit after tax (statutory and other reserves)	150	133
	10,150	**10,133**
Deduction items in the calculation of core capital		
Losses from current years	2,222	1,045
Loss from current year	865	1,177
Intangible assets	600	702
The positive difference between the amount of accrued provisions for potential losses and the sum of value adjustments for balance sheet assets and provisions for off-balance sheet items	42	32
	3,729	2,956
Core capital	**6,421**	**7,177**
OWN FUNDS	**6,421**	**7,177**

23.2. Bank's solvency ratio

Pursuant to the provisions of the Decision on the capital adequacy of banks ("Official Gazette of Montenegro", No. 38/11 and 55/12) the Bank calculated capital required for the risks it is exposed to in the course of is operations, as well as its capital adequacy ratio. Solvency ratio must not be lower than 10%. The solvency ratio represents the percentage ratio of the Bank's own funds and the sum of the following:

- total amount of risk weighted assets for credit risk;
- total amount of risk weighted assets for market risks;
- total amount of risk weighted assets for operational risk;
- total amount of risk weighted assets for other risks.

As of December 31, 2017, according to the Bank's calculations, the solvency ratio equaled as follows:

		In thousands of EUR
	December 31, 2017	December 31, 2016
Core capital	6,421	7,177
Weighted balance assets	19,113	19,613
Weighted off-balance sheet items	1,024	1,170
Total weighted balance assets	**20,137**	**20,783**
Capital required for operational risk	70	67
Capital required for country risk	2,242	2,129
Solvency ratio of the Bank	**27.82%**	**30.43%**

24. OFF- BALANCE SHEET ITEMS

	In thousands of EUR	
	December 31, 2017	December 31, 2016
Guarantees:		
Payable guarantees to corporate customers	1,241	50
Performance bonds to corporate customers	45	984
	1,286	**1,034**
Collaterals:		
- cash deposit	17	-
- mortgages	2,867	3,275
- pledge/other	2,126	1,824
- pledge deposit	40	-
- bank guarantee	14,141	16,160
	19,191	**21,259**
Other off-balance items:		
- irrevocable liabilities from loans approval	2,034	1,854
- irrevocable documentary letters of credit issued for foreign payments	-	800
Total	**22,511**	**24,947**

25. RELATED PARTY TRANSACTIONS

Numerous transactions with related parties arise in the regular course of business. Related parties are: parent bank, other legal entities that are members of ZIRAAT Group, as well as the key management of the Bank. Transactions include placements, deposits, foreign currency transactions and personal income of members of the Management Board and individuals with concluded individual contracts with the Bank. The overview of receivables and liabilities to related parties as of December 31, 2017 is given in the following table:

	In thousands of EUR	
	December 31, 2017	December 31, 2016
Loans and receivables due from banks:		
TURKIYE CUMHURIYETI ZIRAAT BANKASI A.S.	1,614	79
ZIRAAT BANK INTERNATIONAL AG	2	-
	1,616	79
Loans:		
- to employees	301	128
TOTAL RECEIVABLES	**1,917**	**207**
Borrowings due to banks:		
ZIRAAT BANK INTERNATIONAL AG	-	4,002
T.C.ZIRAAT BANKASI ATHENS CENTRAL BRANCH	4,000	-
T.C.ZIRAAT BANKASI LONDON	4,025	15,530
T.C. ZIRAAT BANKASI - SOFIA BRANCH	5,002	2,001
UT-BANK JSC	4,045	-
ZIRAAT BANK BAHRAIN BRANCH	3,017	-
	20,089	**21,533**
Deposits		
- due to employees	83	79
TOTAL LIABILITIES	**20,172**	**21,612**
NET LIABILITIES	**(18,255)**	**(21,405)**
Off-balance sheet items		
Received guarantees:		
- Ziraat TC	14,141	16,160
- Overdrafts on bank accounts of employees	4	3
Total off-balance records	**14,145**	**16,163**

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2017

25. RELATED PARTY TRANSACTIONS (Continued)

Short and long-term loans to Bank's employees were granted for periods from one to twenty years. Short-term loans (cash loans) were granted at annual nominal interest rates ranging from 6.5% to 6.90%.

Long-term loans to Bank employees include loans for purchase of residential units at interest rates ranging from 3.99% to 5%

Exposure to parties related to the Bank as of December 31, 2017 amounted to EUR 7,266 thousand and did not exceed the limit of 200% of the Bank's own funds.

Income and expenses from transactions with related parties during 2017 and 2016 were as follows:

	In thousands of EUR	
	December 31, 2017	**December 31, 2016**
Interest income (from employees):	12	3
Total income	**12**	**3**
Interest expenses:		
ZIRAAT BANK BAHRAIN BRANCH	17	-
ZIRAAT BANK INTERNATIONAL AG	215	27
T.C.ZIRAAT BANKASI LONDON	120	101
T.C. ZIRAAT BANKASI - SOFIA BRANCH	23	11
UT-BANK JS	45	-
TURKIYE CUMHURIYETI ZIRAAT BANKASI A.S	90	-
ZIRAAT BANK BH	-	8
T.C. ZIRAAT BANKASI-NEW YORK BRANCH	-	10
Total expenses	**510**	**157**
Net expenses	**(498)**	**(154)**

In 2017, the calculated personal income for related individuals, by type of income, amounted as follows:

	Management of the Bank	**Key Management**	**Members of the Board**	**Total**
Salaries	155	273	-	428
Fees for membership in the boards	-	-	100	100
Total	**155**	**273**	**100**	**528**

In 2016, the calculated personal income for related individuals, by type of income, amounted as follows:

	Management of the Bank	**Key Management**	**Members of the Board**	**Total**
Salaries	178	292	-	470
Fees for membership in the boards	-	-	77	77
Total	**178**	**292**	**77**	**547**

26. CASH AND CASH EQUIVALENTS (for the needs of Statement of Cash Flows preparation)

	In thousands of EUR December 31, 2017	December 31, 2016
Cash in hand and ATMs (Note 12)	483	514
Bank account (Note 12)	1,311	1,406
Mandatory reserve with the Central Bank of Montenegro (Note 12)	1,161	1,220
Correspondent accounts with foreign banks (Note 13)	2,363	1,149
Settlement account - Master Card (Note 13)	5	-
	5,323	**4,289**

27. LITIGATIONS

As of December 31, 2017, there were neither litigations against the Bank nor the Bank was in the process of litigation against third parties.

28. COMPLIANCE WITH INDICATORS OF THE CENTRAL BANK OF MONTENEGRO

The Bank is required to conduct its operations in accordance with the provisions of the the Law on Banks and by-laws adopted on the basis of this Law.

Compliance with the performance indicators prescribed by the Central Bank of Montenegro as of December 31, 2017 is presented as follows:

	Prescribed limit of CBM	Achieved performance indicators as of December 31, 2017	2016
The Bank's solvency ratio	min 10%	27.82%	30.43%
The Bank's exposure to a single entity or group of related entities	max 25%	24.92%	25.00%
Sum of large exposures	max 800%	186.67%	224.09%
Total exposure to persons related to the Bank	max 200%	113.16%	100.67%
Total exposure to Bank’s employees	max 1%	1.09%	0.91%
Liquidity ratio of the Bank	min 1%	3.39%	4.21%

Deviation from the total exposure to the Bank's employees as of December 31, 2017 in the amount of 1.09% was caused by a decrease in own funds that were at a higher level at the time of granting the loan. At the issuance date of these financial statements, the Bank resolved to address the issue of total exposure to the Bank's employees, and the indicator was within the limits of CBM limits (Note 33). Further, the Bank intends to make recapitalization in the amount of EUR 8,000 thousand in the second quarter of 2018.

29. TAX RISKS

Montenegrin tax legislation is subject of varying interpretations, and legislative changes occur frequently. The interpretation of tax legislation by tax authorities as applied to the transactions and activities of the Bank may not coincide with the views of the Bank’s management. Consequently, transactions may be challenged by the relevant tax authorities and the Bank could be imposed additional taxes, penalties and interest. The period of obsolescence of the tax liability is five years. This practically means that the tax authorities are entitled to determine unpaid obligations in the period of five years from origination of the liability.

30. FOREIGN EXCHANGE RATES

The official exchange rates used in the translation of foreign currency balance sheet items in EUR as of December 31, 2017 and 2016 were as follows:

	December 31, 2017	December 31, 2016
USD	1,1993	0,9487
TRY	4,54640	3,70720

31. GENERAL INFORMATION OF THE BANK

In accordance with the Decision on the contents, deadlines and manner of compiling and submitting bank's financial statements ("Official Gazette of Montenegro", No. 15/12 and 18/13), general information of the Bank are presented as follows:

Name of Bank:ZIRAAT BANK MONTENEGRO AD
Address: Ul. Slobode br. 84, 81 000, Podgorica
Corporate ID: 03048136
Phone/Fax: 020/442-200
Number of entry in the register: 4-0009452
Date of Establishment: May 20, 2015
Description of the structure of ownership: one shareholder with 100% ownership
Description of activity: Other monetary intermediation
Activity Code: 6419
Web page address: http://www.ziraatbank.me/
E-mail address: info@ziraatbank.me
The Bank has its headquarters in Podgorica, St. Slobode No. 84
Number of employees as of December 31, 2017 was 32
Account number: 575-1-22
Information about the chairman and members of the Board of Directors

Title	Name and surname
Chairman	Savaş KÖLEMEN
member	Burcu TURKER
member	Bilge LEVENT
member	Ertan AYDIN
Member	Ertan ALTIKULAÇ
Chief Executive Officer	Mustafa ŞENMAN
Executive Director	Goran BAKIĆ

Share issuance and issuance label:

Issuance label	Nominal value of the shares	Number of shares
MEZIBMRA1PG6	EUR 1,000	10,000

International identification number of ordinary shares (ISIN): MEZIBMRA1PG6.

During 2017, there were no trading in the Bank’s shares.

32. IFRS 9 – FINANCIAL INSTRUMENTS

a) IFRS 9 – First Application

In accordance with IFRS 9, which entered into force as at January 1, 2018, the Bank has altered the accounting policies for the recognition, classification and measurement of financial assets and liabilities, as well as the impairment of financial assets.

The Bank did not apply the provisions of IFRS 9 to earlier financial reporting periods. The effects of adjusting the carrying value of financial assets and liabilities as of the date of the first application of the standard will be recognized through retained earning as an adjustment of the opening balance for 2018.

b) Classification and Measurement of Financial Assets and Liabilities

In accordance with IFRS 9, the classification and measurement of financial assets depends on two basic criteria:
- the business model on the basis of which the Bank manages a financial asset
- characteristic of the contractual cash flows of financial asset (so-called SPPI criterion).

The business model reflects the manner in which the Bank manages its financial assets for the purpose of collecting cash flows. The Bank conducted a detailed analysis of its business models, taking into account past experience in sale of financial assets, as well as future expectations thereof. During the analysis, other objective and relevant information were considered, such as: the risks that affect the success of business model and the manner those risks are managed, the manner of business model's performance assessment, the manner financial assets within that model are valued and reported by the Bank's management and other. The analysis is based on reasonably expected scenarios, without taking into account the worst projections or stress scenarios. Accordingly, the Bank defined the following business models:

- Held to collect cash flows,
- Held to collect cash flows and sell and
- other business models (eg. Held to sell).

If a change occurs in the business model of financial asset management, the reclassification of the financial asset shall be carried out. The reclassification shall be carried out prospectively i.e. from the first day of the next reporting period. The Bank does not expect frequent changes in business models. The Bank re-assesses the business model at least once a year.

If the business model is a "held-to-collect" or "held-to-collect and sell", an assessment is made of whether cash flows represent only principal and interest payments (so-called "SPPI test"). In accordance with the basic loan arrangement, the interest includes compensation for the time value of money, the accepted level of credit risk of the borrower and other basic credit risks including an appropriate margin. If the contractual terms include exposure to risks that are not in line with the underlying loan arrangement, the financial asset is classified and measured at fair value through the profit and loss independently of the business model.

c) Classification and Measurement of Financial Assets and Liabilities

Based on the conducted analysis of business models and characteristics of contracted cash flows, the Bank, starting from January 1, 2018, classifies all financial assets into the following categories of assets:

- Financial assets at amortized cost,
- Financial assets at fair value through the comprehensive other result and
- Financial assets at fair value through profit and loss.

The Bank bears no changes in the classification and measurement of financial liabilities in accordance with IFRS 9 in relation to IAS 39.

32. IFRS 9 – FINANCIAL INSTRUMENTS (Continued)

d) Impairment of financial instruments in accordance with IFRS 9

Expected credit losses are recalculated on each reporting date in order to reflect the change in credit risk from the initial recognition of a financial instrument. This approach results in the early recognition of credit losses by necessitating the conversion of the 12-month expected credit losses for all credit exposures. The conversion of expected credit losses throughout the life-cycle is necessary for all credit exposures that have a significant deterioration in the credit risk in relation to the moment of recognition of the asset.

When calculating the expected credit losses, the Bank uses future information and macro-economic variables, i.e. the Bank does not only consider historical information tailored to reflect the effects of current conditions and information provided by objective evidence that the financial assets are reduced by losses incurred, but also considers comprehensible and supportive information that include projections of future economic conditions in calculating the expected credit losses, both on an individual and group basis. The level of loss provisions will increase as the projected economic conditions deteriorate, i.e. they will fall as projected economic conditions become more favorable.

The basic principles and rules of the Bank in accounting for provisions under IFRS 9 are:

The Bank calculates the 12-month expected credit loss or the expected credit loss for the entire life of the financial instrument, depending on the significance of the change in the credit risk of a financial instrument since its initial recognition. For these purposes, the Bank applies the following three stages of impairment:

- Stage 1 applies to all financial assets and instruments from initial recognition, as long as there is no significant deterioration in credit quality, or these instruments are in the category of low credit risk;
- Stage 2 applies to financial instruments that have significant deterioration in credit quality from the moment of initial recognition, with no objective evidence of impairment loss;
- Stage 3 applies to financial assets with an objective evidence of impairment on a reporting date.

Stage 1 and 2 include only performing financial assets. Level 3 includes only non-performing financial assets.

For financial instruments at Stage 1, the 12-month expected credit losses are calculated.

For financial instruments at Stage 2, the expected credit losses for the whole lifetime of the instrument are calculated.

For financial instruments at Stage 3, the expected credit losses for the entire lifetime of the instrument are calculated and interest income is calculated on net exposure. In accordance with its accounting policies, the Bank recognizes interest income on instruments at Stage 3 at the moment of collection.

32. IFRS 9 – FINANCIAL INSTRUMENTS (Continued)

d) Impairment of financial instruments in accordance with IFRS 9(Continued)

The transfer of financial assets from Stage 1 to Stage 2 is realized when the Credit Risk of financial assets has significantly increased since the moment of initial recognition. Transfer logic is based on quantitative and qualitative criteria and must be applied to all financial instruments. A probability of default (PD) is the main element on which the quantitative logic transfer criterion shall be based. Three additional qualitative criteria that come after applying the quantitative criterion are:

- Classification into the status of restructured performing exposures - results in an automatic classification at Stage 2 for the next 9-month period (starting from the date of classification into such a status).
- After that period, if there are no other significant signs of credit risk deterioration, the transaction may be returned to Stage 1.
- 30 days of default - when the transaction reaches 30 days of default, it should be recognized at Stage 2.
- classification into the status of restructured performing exposures - all performing exposures assigned under the responsibility of the department in charge of restructured exposures shall be automatically classified at Stage 2.

e) Determining significant increases in credit risk (classification into Stage 2)

When assessing significant increases in credit risk, IFRS 9 standard asks for an entity to consider all reasonable and supportable information that is available without undue cost or efforts.

The assessment whether there has been a significant deterioration in credit quality since initial recognition is performed through the evaluation of the following criteria:

- Days past due of an account greater than 30 days but less than 90,
- CBM rating of an account deteriorated since origination,
- Expert judgement by an analyst of the Bank.

If any of the above criteria is satisfied account is classified into Stage 2.

In the impairment procedure, the Bank specifically treats the purchase of already impaired assets of the so-called non-performing or NPL portfolio, or the granting of new placements to clients who are already impaired in the portfolio i.e. in NPL status. Such assets are in accordance with the Standard defined as so-called POCI (purchased and originated impaired credit assets) and those shall be particularly valued through a cumulative change in expected credit losses over the whole lifetime of an instrument after initial recognition. A positive change in the expected credit losses over the instrument's lifetime shall be recognized as a gain on the impairment of an instrument if the expected credit loss is less than the amount of expected credit losses that are included in the estimated cash flows for initial recognition. Bearing in mind the business model, the Bank currently does not have identified assets in its portfolio that would be considered POCI, i.e. there is neither purchased NPL portfolio nor additional financing of existing NPL clients in its portfolio.

32. IFRS 9 – FINANCIAL INSTRUMENTS (Continued)

f) Determining the effects of transition to IFRS 9

Reconciliation of the carrying amount of financial instruments due to transition to IFRS 9 that will be recognized through retained earnings as a correction of opening balance of 2018.

In accordance with Article 4 of the Decision on Capital Adequacy, the Bank decided to determine the amount of the total effects that represents a deductible item to its own funds in the period from 2018 until the end of 2022 by reducing the total amount of negative effects by:

1) 5% when calculating of own funds in 2018;
2) 15% when calculating own funds in 2019;
3) 30% when calculating own funds in 2020;
4) 50% when calculating own funds in 2021;
5) 75% when calculating own funds in 2022.

As of December 31, 2017, the calculation of allowances for impairment in accordance with IFRS 9 amounted to EUR 442 thousand, while the calculated impairment in accordance with IAS 39 was EUR 26 thousand. Effects of the application of IFRS 9 represent the difference between the resulting impairment under IFRS 9 and the impairment allowance under IAS 39, amounting to EUR 416 thousand.

In accordance with Article 4 of the Decision on Capital Adequacy, the Bank decided to recognize 5% when calculating own funds of the bank in 2018.

33. EVENTS AFTER THE REPORTING PERIOD

As at March 30, 2018, the Bank reduced the limit on the total exposure to employees of the Bank, which was 1.09% as of December 31, 2017. The overdraft amount exceeded the above prescribed limits by 0.09%. This overdraft has been eliminated by placing a cash deposit as an additional collateral per a Bank’s employee loan.

Thus, as of March 30, 2018, the total exposure to employees in the Bank was within the prescribed limits of 1%.

The Bank's management believes that there are no significant subsequent events that would affect the financial statements of the Bank for 2017 or require special disclosure or adjustments.

Ziraat Bank
Montenegro

ANNUAL MANAGEMENT REPORT FOR 2017

Podgorica, April 2018

This Report is translation of the Auditors' Report issued in the Montenegrin language. In the case of any discrepancy between the Montenegrin and English versions, the Montenegrin shall prevail.

Contents

1. Brief description of business activities and organizational structure

1.1. General information

Ziraat Bank Montenegro AD, Podgorica (hereinafter: the “Bank”) was granted the authorization to conduct banking activities in Montenegro, issued by the Central Bank of Montenegro, in accordance with the provisions of the Law on Banks, as at April 6, 2015.

The Bank is officially registered in the Central Registry of Business Entities in a legal form of the company - a shareholding company, all in accordance with the provisions of the Companies Law, as at May 20, 2015.

The provisions of the Law on Banks, *lex specialis*, are applied to the Bank's operations, jointly with the relevant by-laws, as well as the Companies Law, *lex generalis*, where the Bank is legally recognized as a shareholding company.

The material assumptions for start of operations of the Bank were fulfilled on July 1, 2015, when the employees of the Bank started using the business premises of the Bank's administrative building. On the same date, all necessary equipment of the Bank was installed and put into operation.

The Bank has opened its first branch office of a universal type that provides services to clients, both individuals and legal entities. The branch was formally registered in the Central Registry of Business Entities as at July 20, 2015. The address of the branch is Bulevar Ivana Crnojevića No. 101, 81000 Podgorica.

In the process of developing internal rules and procedures, the Bank has prepared a catalogue of products intended for corporate and retail clients.

The Bank started with loan activities in September 2015.

1.2. Vision

The Bank's vision is to offer products and services in accordance with universal standards, create a difference, add value and cover Montenegro as a whole, be a prestigious and reliable financial institution with high market value, offer quality that will make it more than a bank in every section of the banking and clients’ business operations.

1.3. Mission

The mission of the Bank is to be a financial institution that offers optimal solutions from the most adequate sources, which are the result of a better understanding of the needs and expectations of its clients, in order to perform a complete offer of products and services for clients in the fastest and most efficient way through its affiliates and alternative distribution channels at the level of the world standards of sustainable profitability and productivity by emphasizing the ethical principles, treating customer satisfaction as a primary objective, as a respectable member of the Ziraat financial group and the Montenegrin banking sector, contributing to the strengthening of bilateral, economic and trade relations between the two countries and to be a pioneer of mutual investments.

1.4. Business strategy

The Bank's business strategy is to be part of a broad international network, to extend the services of the Ziraat financial group throughout Europe, convey the multi-year know-how of the parent bank in the economy and the banking sector in Montenegro, contribute to economic and financial cooperation between Montenegro and the Republic of Turkey through building stable and long-term business relations with local institutions and businessmen, to support trade and investment opportunities between the two countries and contribute to development of the banking sector in Montenegro, as well as of the synergies in the Ziraat financial group.

1.5. Bank's Values

- Create added value for our clients;
- Be fair and reliable;
- Respect cultural and social values;
- Work as a team with joint values;
- Be open and participative, as well as to
- Have an ambition for success.

1.6. Information on the registration, the areas of business operations to which the business license obtained from the Central bank of Montenegro relates

The Bank was established in 2015, and as at May 20, 2015, it was registered as a shareholding company with the Central Registry of Business Entities in Podgorica - registration number 4-0009452.

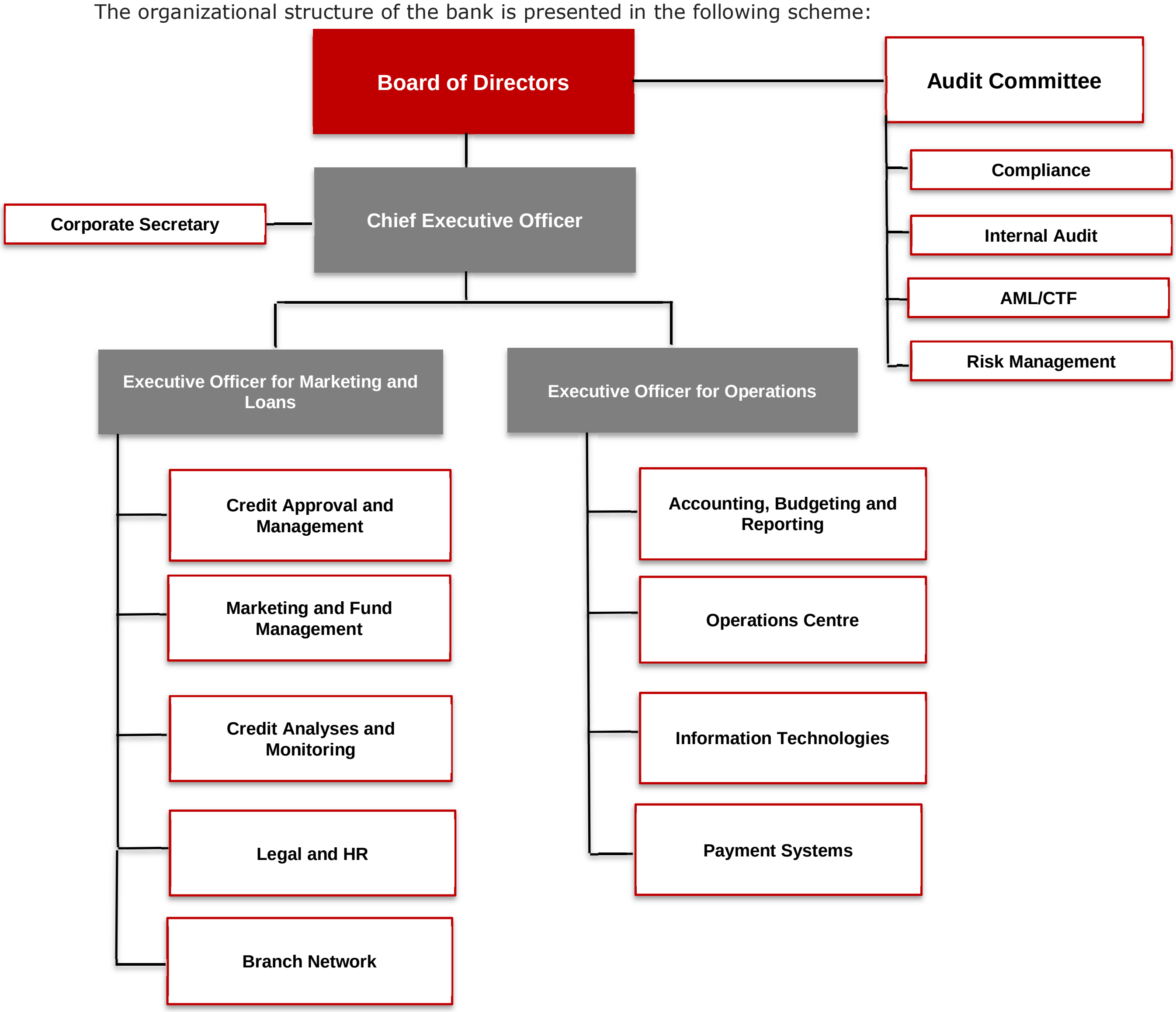
The Bank is registered with the Securities Commission in the Register of Securities Issues under the number 02/10e-5/2-15 as at May 8, 2015 (Decision No. 02/10e-5/2-15).

The Bank performs its financial operations through the transaction account number 907-0000000057501-83 held with the Central Bank of Montenegro - Payment Transactions.

1.7. Organizational structure

As of December 31, 2017, the Bank had 32 employees, out of which 31 employees worked on the basis of a labour contract with an indefinite period of time agreed, while 1 employee had a labour contract with an definite period of time agreed on.

The organizational structure of the bank is presented in the following scheme:



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1.8. Activity

In accordance with the Law on Banks, the Founding Contract, the Statute and the Decision of the Central Bank of Montenegro, the Bank was register to perform the following activities:

1) Issuing guarantees and undertaking other off-balance sheet obligations;
2) Purchasing, selling and collecting receivables (factoring, forfaiting and other);
3) Issuing, processing and recording payment instruments;
4) Performing domestic and foreign payment transactions;
5) Performing finance lease operations;
6) Performing securities operations;
7) Trading in its own name and for its own account or for the account of its customer:
   - In foreign payment instruments, including money exchange
   - Financial derivative transactions;
8) Providing depot services;
9) Performing analysis and providing information and advices on the creditworthiness of companies, entrepreneurs and other issues relating to business operations and
10) Renting of safes.

The Bank is headquartered in Podgorica at street Slobode No. 84 and performs its activities through its branch office in Bulevar Ivana Crnojevića No. 101.

1.9. Ownership and capital structure

The foundation, inscribed (share) capital of the Bank amounts to EUR 10,000,000 (ten million EUR).

The share capital of the Bank comprises of 10,000 shares. The nominal value of one share is EUR 1,000. All shares of the Bank are ordinary voting shares issued in a dematerialized form.

All shares are owned by "TURKIYE CUMHURIYETI ZIRAAT BANKASI ANONIM SIRKETI".

1.10. Workforce Capacities

As of December 31, 2017, the Bank had 32 employees, out of which 31 employees worked on the basis of a labour contract with an indefinite period of time agreed, while 1 employee had a labour contract with an definite period of time agreed on.

Out of 32 employees, 27 employees have University degree of education, while 5 employees have secondary education degree.

Out of the total number of employees in the Bank, 18 employees i.e. 56% are men while 14 employees i.e. 44% are women.

The Branch Office in Podgorica has 5 employees, while 27 employees are employed in the headquarters.

2. Analysis of financial position and results from operations

BALANCE SHEET

In thousands of EUR

ASSETS	2016	2017
Cash and deposits held with central banks	3,140	2,955
Loans and receivables due from banks	1,149	2,368
Loans and receivables due from customers	32,600	44,194
Financial assets available for sale	2,235	2,250
Properties and equipment	398	300
Intangible assets	702	600
Other financial receivables	16	11
Other accounts receivable	14	15
TOTAL ASSETS	**40,254**	**52,693**
LIABILITIES	**2016**	**2017**
Deposits due to customers	10,683	25,303
Borrowings due to banks	21,533	20,089
Provisions	5	10
Current tax payables	2	-
Deferred tax payables	34	27
Other liabilities	86	201
Total Liabilities	**32,343**	**45,630**
EQUITY		
Share capital	10,000	10,000
Accumulated loss	(1,045)	(2,222)
Current year loss	(1,177)	(865)
Other reserves	133	150
Total equity	**7,911**	**7,063**
TOTAL LIBILITIES AND EQUITY	**40,254**	**52,693**

2. Analysis of financial position and results from operations (Continued)

INCOME STATEMENT

In thousands of EUR

ITEM	2016	2017
Interest income	916	1,791
Interest expenses	(215)	(675)
Net interest income	**701**	**1,116**
Allowance for impairment	(18)	(3)
Provision expenses	(5)	(5)
Fee and commission income	89	148
Fee and commission expense	(46)	(102)
Net fee and commission income	**43**	**46**
Net losses on investment securities	26	-
Net foreign exchange gains	2	20
Staff costs	(956)	(963)
General and administration expenses	(601)	(672)
Depreciation and amortization	(339)	(380)
Other expenses	(28)	(33)
LOSS FROM OPERATIONS	**(1,175)**	**(874)**
Income tax	(2)	9
NET LOSS	**(1,177)**	**(865)**

2. Analysis of financial position and results from operations (Continued)

2.1. Racio Indicators

Racio analysis is the basic instrument for estimating the financial position and potential of the Bank. Linking the logically associated wholes of the financial statements (Balance Sheet and Income Statement) results in the established relations aiming at assessing the position and activities of the Bank.

Return indicators

In thousands of EUR

ROE (Return on Equity)	2016	2017
Net loss	-1,177	-865
Share capital	10,000	10,000
Net loss after taxation / Share capital	**-11.77%**	**-8.65%**

ROA (Return on assets)	2016	2017
Net loss	-1,177	-865
Total assets	40,254	52,693
Net loss after taxation / Total assets	**-2.92%**	**-1.64%**

Interest margin	2016	2017
Interest income	916	1,791
Interest expenses	216	675
Total assets	40,254	52,693
(Interest income – Interest expenses) / Total assets	**1.74%**	**2.12%**

Financial position indicators

In thousands of EUR

S1	2016	2017
Share capital	10,000	10,000
Total assets	40,254	52,693
Share capital / Total assets	**24.84%**	**18.98%**

S2	2016	2017
Total liabilities	32,343	45,630
Total assets	40,254	52,693
Total liabilities / Total assets	**80.35%**	**86.60%**

S3	2016	2017
Profit from operations (interest + fee)	1,005	1,939
Loss from operations (interest + fee)	261	777
Profit from operations / Loss from operations	**385.06%**	**249.55%**

2. Analysis of financial position and results from operations (Continued)

2.1. Racio Indicators (Continued)

The most important financial indicators of the Bank's operations for the last 2 years are presented in the following table.

In thousands of EUR

Description	31/12/2016	31/12/2017	Banking sector as of 31/12/2017
Liquid assets (LA)	3,679	4,743	1,058,900
Total loans	32,600	44,194	2,700,500
Total assets (TA)	40,254	52,693	4,180,341
Total equity and liabilities (TEL)	40,254	52,693	4,180,341
Total deposits	10,683	25,303	3,267,200
Short-term deposits	2,193	2,109	61,200
Total borrowings	21,533	20,089	280,083
Total deposits + borrowings	32,216	45,392	3,547,283
Total liabilities	32,342	45,630	
Fixed assets	1,100	900	
Other assets	851	828	
Total equity	7,911	7,063	514,200
Liquidity indicators			
Liquid assets/deposits	34.44%	18.74%	32.41%
Liquid assets/total liabilities	11.38%	10.39%	
Loans/deposits	305.16%	174.66%	82.65%
Loans/deposits + borrowings	101.19%	97.36%	76.13%
Structure of assets and Equity and liabilities:			
Liquid assets/total assets	9.14%	9.00%	25.33%
Loans/total assets	80.99%	83.87%	64.60%
Fixed assets/total assets	2.73%	1.71%	
Other assets/total assets	2.11%	1.57%	
Equity/total assets	19.65%	13.40%	48.56%
Structure of Equity and liabilities:			
Deposits/total equity and liabilities	33.03%	55.45%	78.16%
Borrowings/total equity and liabilities	66.58%	44.03%	6.70%
Deposits + borrowings/total equity and liabilities	80.03%	86.14%	84.86%

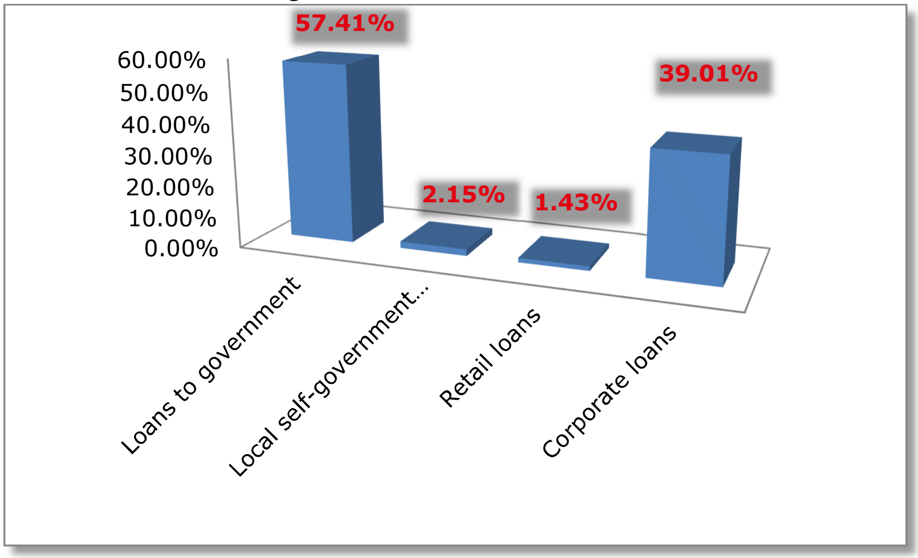
At the end of 2017, the loans/deposits ratio amounted to 174.66%, which represents a decrease by 130.50% when compared to 2016. The reason for such a decrease is the increase in deposits compared to 2016 by 136.85%.

The liquid assets/total assets ratio as of December 31, 2017 was 9%. This ratio registered a decrease by 0.14% when compared to 2016. Share capital/total assets ratio as of December 31, 2017 registered a decrease by 6.25% when compared to December 31, 2016. Such a decrease resulted in a decrease in share capital and an increase in total assets as of December 31, 2017. The Bank is well capitalized and the Bank's solvency ratio is 27.82%, i.e. significantly higher than 10% that is the minimum prescribed by the Law on Banks.

2. Analysis of financial position and results from operations (Continued)

2.1. Racio Indicators (Continued)

Chart 1 – Structure of given loans to structure of clients



Corporate loans are approved at the following interest rates:

– Short-term loans with fixed interest rate: 3.50% - 6.20%
– Long-term loans with fixed interest rate: 3.90% - 7.25%

The active interest rates applied to approved corporate loans during 2017 are as follows:

Type of loan	Interest rate
For permanent working capital	3.50% - 6.20%
Overdraft	3.50% - 6.20%
Revolving	3.50% - 5.50%
Investment loan	3.90% - 7.25%
Special purpose loan	3.90% - 7.25%

The active interest rates applied to approved retail loans during 2017 are as follows:

Type of loan	Interest rate
Cash loans	6.50% - 7.75%
Residential loans	3.99% - 5.00%
Overdrafts at bank accounts	9.00%

As of December 31, 2017, the Bank had no loans classified as non-performing ones (NPL).

2.2. Data on corporate governance bodies

Rules of appointment and dismissal of members of the Management

Appointment of the members of the Board of Directors

The Board of Directors members are appointed and dismissed by the Shareholders Assembly in accordance with the provisions of the Companies Law and the Law on Banks.

It is particularly important to point out that a requirement for appointing members of the Board of Directors is a necessary prior approval from the Central Bank of Montenegro. Such an approval by the Central Bank is a condition for the registration of members of the Board of Directors in the CRBE.

Before a member of the Board of Directors is appointed, the Central Bank checks the fulfillment of negative/eliminatory criteria. In that sense, a member of the Board of Directors can not be a person:

1. who is controlling or is a member of the board of directors or the executive director of another bank or financial institution, of a legal entity controlled by another bank or financial institution or financial holding;
2. who is related to a legal entity:
    a. in which another bank has a qualified stake,
    b. which is a subordinate member of the banking group to which such a bank belongs;
    c. which worked for the Central Bank in the past 12 months in the affairs in which it had access to information about the operations of banks that are considered classified, the knowledge of which could lead to a competitive advantage over other banks;
3. who has been, in the last 12 months, a director or member of the Management Board of the Deposit Protection Fund;
4. whose property has undergone bankruptcy, i.e. enforcement carried out on a significant scale;
5. who has been engaged on managerial activities in a bank or other legal entity at the time when the bankruptcy proceeding or liquidation proceedings were initialized against that legal entity, unless the Central Bank assesses that there is no liability of that person for bankruptcy or liquidation thereof;
6. who has been a member of the board of directors or a manager of a bank at a time when a temporary administration was introduced in that bank;
7. to whom, pursuant to a decision of the competent court, was pronounced a protective measure of prohibition of performing a title, activity or duty;
8. who has been convicted of an offense that makes him unworthy of exercising the function of a member of the Board of Directors;
9. to whom the bank has a total exposure of more than 2% of the amount of own funds, or it is the owner, member of the board of directors or executive director of a company to which the bank has great exposure.

The Central Bank shall revoke the authorization if it is issued on the basis of untrue data or if there are the obstacles to a selection in the sense of the aforementioned restrictions prescribed by the Law on Banks.

The approval of the Central Bank of Montenegro shall cease to be valid:

1. if the person the approval for appointment of whom has been issued has not been appointed or does not begin to perform his duties within six months from the issuance date of approval;
2. on the day of termination of the member of the Board of Directors function.

The approval of the Central Bank shall not cease to apply in case of reappointment of a member of the Board of Directors for the duration of the mandate.

Appointment of members of the Audit Committee

Regarding the members of the Audit Committee, they are appointed and dismissed by the Board of Directors of the Bank. For the appointment of members of the Audit Committee, the Law on Banks does not prescribe necessary prior approval by the Central Bank of Montenegro, as is the case with the appointment of the members of the Board of Directors.

Appointment of Executive Directors

In accordance with Article 33 of the Law on Banks, the Executive Directors of the Bank are appointed by the Board of Directors. Candidates for Executive Directors must first obtain approval from the Central Bank of Montenegro, which is a necessary condition for their appointment.

In terms of the provisions of the Law on Banks, the Bank must have at least two executive directors, one of which is the chief executive officer.

Only the person with a university education, recognized personal reputation and adequate professional qualifications, professional ability and experience in managerial affairs in the bank or in the financial sector may be appointed for a position of the executive director of the Bank, if for his appointment there are no obstacles referred to in Article 31 of the Law onBanks.

Executive directors may be foreign nationals, with at least one executive director having to know the language that is in official use in Montenegro.

Executive directors are full-time employees at the bank.

When deciding on the issuance of an approval for the executive director, the Central Bank may request from the candidate for the executive director position a presentation on the conduct of the Bank's affairs.

The approval of the Central Bank for appointment of the Executive Director is a condition for registration in the CBM.

The Central Bank shall dismiss the approval if it is issued on the basis of untrue data or if the executive director ceases to fulfill the conditions on the basis of which the approval was issued.

Approval ceases to be valid:

1. if the person for the appointment of whom the approval has been issued is not appointed or does not begin to perform duties within 30 days from the issuance date of the approval;
2. on the day of termination of the executive director title;
3. on the expiration date of the labour contract with the bank.

Appointment of members of other bodies

In addition to the Audit Committee, the Board of Directors has appointed, in accordance with the Law on Banks and the other bodies such as: the ALCO, the Upper Credit Committee and the Credit Committee.

The members of these bodies are appointed and dismissed by the Board of Directors at regular sessions. The appointment or dismissal of the members of the ALCO, the Upper Credit Committee and the Credit Committee does not require the prior approval of the Central Bank of Montenegro in terms of the provisions of the Law on Banks.

Scope of work and competences of the Board of Directors

In accordance with the provisions of the Law on Banks, the Statute of the Bank and the Corporate Governance Code, the Board of Directors is responsible for the following scope of works:

1. Establishes and maintains a risk management system that the bank is exposed to in its business operations;
2. Determines the goals and strategies of the bank and ensures their implementation;
3. Establishes policies and procedures for managing all the risks that the bank is exposed to in its operations;
4. Determines the annual plan of the bank, including the financial plan;
5. Approves the annual report on business operations of the bank with the report of external auditor and reports on the bank's operations during the year;
6. Approves transactions that significantly affect the structure of the balance sheet and the riskiness of the bank's operations, in accordance with the policies and procedures for risk management;
7. Periodically reviews and evaluates the exceptions made in relation to the established policies and procedures;
8. Adopts the annual internal audit plan and the internal audit reports;
9. Establishes the basis for the internal control system functioning, adequate to the size of the bank, the complexity of the operations and the level of risk assumed;
10. Reviews the reports of the Central Bank prepared upon the performed control;
11. Appoints executive directors and other persons responsible for conducting business within certain areas of the bank's business and determines their earnings;
12. Appoints an external auditor of a bank;

Scope of work and competences of the Board of Directors (Continued)

13. Appoints members of the Audit Committee;
14. Reviews the annual report on the work of the audit committee;
15. Determines the proposals for decisions made by the General Shareholders Assembly and takes care of the implementation of decisions of the General Shareholders Assembly;
16. Adopts general acts of the bank, except for the acts adopted by the Shareholders Assembly;
17. Adopts ethical standards of conduct of employees in the bank;
18. Approves the introduction of new products and services into the bank's operations;
19. Calls for the General Shareholders Assembly;
20. Performs other activities determined by the law and the Statute of the Bank.

In terms of the provisions of the Law on banks, the responsibility of the Board of Directors is specifically defined for:

1. Establishing the system of managing all the risks that the bank is exposed to in its operations;
2. Provision of bank operations in accordance with the law, regulations of the Central Bank and acts of the bank, as well as for the implementation of the imposed measures of the Central Bank;
3. Business safety and financial stability of the bank;
4. Accuracy of all reports on the operations of banks that are published or submitted to the General Shareholders Assembly, the Central Bank and the competent authorities.

Scope of work and responsibilities of the Audit Committee

The Audit Committee consists of at least three members, most of which are not related to the bank, but have experience in financial affairs.

The executive directors of the bank can not be appointed for a member of the audit committee.

The Audit Committee is responsible to:
1) analyze and monitor the functioning of the risk management system that the bank is exposed to in its business operations and provide suggestions for the improvement of strategies, policies and procedures for risk management;
2) analyze and monitor the functioning of the internal control system;
3) consider the program and reports of internal audit and give an opinion on the findings of the internal audit;
4) monitor the implementation of internal audit recommendations;
5) analyze the financial statements of the bank prior to their submission to the Board of Directors;
6) evaluate the quality of reports and information prior to their submission to the Board of Directors, and in particular:
- application of accounting policies and procedures,
- decisions requiring a high degree of assessment,
- effect of unusual transactions on the financial statements,
- quality of data integration policies,
- changes arising as a result of performed audits,
- assumptions about the sustainability of operations,
- compliance with International Financial Reporting Standards and Regulations;

7) give opinion on the appointment of the external auditor of the bank and proposes the amount of the fee for conducting the audit.

The Audit Committee prepares proposals, opinions and standpoints from the scope of work for the decision of the Board of Directors on these issues.

The Audit Committee submits annual reports on its work to the Board of Directors.

Scope of work and competences of Credit Committees

The Board of Directors, pursuant to its legal competencies, has appointed the Upper Credit Committee and the Credit Committee responsible for making decisions on the approval of loans to legal entities and individuals, all in accordance with the Decision on approval limits adopted by the Board of Directors at a regular meeting held on September 11, 2015, under serial number 65.

Members of the Upper Credit Committee and the Credit Committee shall be appointed and dismissed by the Board of Directors.

The data on the Chairman and members of the Board of Directors, the Audit Committee, the Credit Committee and the Upper Credit Committee of the Bank are as follows:

Board of Directors	**Name and Surname**
Chairman	Savaş KÖLEMEN
member	Burcu TURKER
member	Bilge LEVENT
member	Ertan AYDIN
member	Ertan ALTIKULAÇ

Audit Committee	**Name and Surname**
Chairman	Ertan YILMAZ
member	Aykut ARSLAN
member	Hamdullah GURSOY

Management	**Name and Surname**
Chief Executive Officer	Mustafa ŞENMAN
Executive Director	Goran BAKIĆ

Credit Committee	**Name and Surname**
Chairman	Mustafa ŞENMAN
member	Vanja KIKOVIĆ

Upper Credit Committee	**Name and Surname**
Chairman	Burcu TURKER
member	Mustafa ŞENMAN
member	Vanja KIKOVIĆ

3. Measures of Environmental Protection

All activities of the Bank can be considered as environment friendly. The Bank complies with all the rules, procedures and best practices of the local community in the mentioned context.

Waste Management

In its business operations, the Bank uses mostly paper as a consumable. Annual consumption is estimated at 540 packs of paper of A4/80g/m2 format, which is about 270,000 sheets. The greatest part is archived or delivered to clients, while the estimated annual amount of paper waste is up to 7% or 18,900 sheets of paper. Given that the stated amount is significantly below 20t of waste, the Bank is not obliged to prepare a Waste Management Plan.

By introducing the Document Management System (DMS) in later years of business operations, paper consumption will be significantly additionally reduced.

Water Management

The bank is considered a modest consumer of water that amounts to less than 1,200 cubic meters per annum.

Energy Management

In its business operations, the Bank mostly uses electricity that is considered as an ecological energy source. There is also a constant effort to optimize electricity to meet basic needs.

In accordance with the criteria defined by Law, the Bank is not recognized as a pollutant and, on that basis, does not pay any fines or penalties. Also, in the foreseeable future, it does not plan any project that could have a negative impact on the environment.

In accordance with the Law on Environmental Impact Assessment, if we consider that a particular project or business activity that we plan can or will have an impact on the environment, we will seek the approval of the competent authority on the impact assessment study or a decision that an environment impact assessment is not required.

4. Planned Future Development

The planned budget projections for 2018, 2019 and 2020 are shown in the following tables.

In thousands of EUR

ASSETS	2018	2019	2020
Liquid assets	**6,479**	**8,991**	**10,611**
Securities (Net)	**2,365**	**2,476**	**2,587**
LOANS	**69,789**	**93,891**	**108,261**
Corporate	64,951	83,101	89,374
Retail	4,838	10,790	18,887
NPL	**-**	**116**	**364**
FIXED ASSETS AND INTANGIBLE ASSETS	**723**	**524**	**467**
OTHER ASSETS	**551**	**742**	**855**
ALLOWANCE FOR IMPAIRMENT	**(173)**	**(648)**	**(784)**
Loans	(165)	(640)	(776)
Other	(8)	(8)	(8)
TOTAL ASSETS	**79,734**	**106,092**	**122,361**
EQUITY AND LIABILITIES			
TOTAL DEPOSITS	**50,248**	**67,685**	**83,641**
A-vista	6,979	9,401	13,035
Term deposits	43,269	58,284	70,606
BORROWINGS	**14,600**	**23,300**	**22,000**
RESERVES	**3**	**23**	**27**
OTHER EQUITY AND LIABILITIES	**209**	**260**	**283**
EQUITY	**14,674**	**14,824**	**16,410**
Share capital	18,000	18,000	18,000
Provisions	112	216	320
Loss	(3,438)	(3,392)	(1,910)
TOTAL EQUITY AND LIABILITIES	**79,734**	**106,092**	**122,361**

In thousands of EUR

INCOME STATEMENTS	2018	2019	2020
INTEREST INCOME	**2,737**	**3,882**	**4,787**
LOAN INTEEREST INCOME	2,642	3,787	4,692
SECURITIES INTEREST INCOME	95	95	95
INTEREST EXPENSES	**(574)**	**(717)**	**(944)**
DEPOSITS INTEREST EXPENSES	(419)	(554)	(768)
BORROWINGS INTEREST EXPENSES	(155)	(163)	(176)
NET INTEREST INCOME	**2,163**	**3,165**	**3,843**
FEE INCOME	**374**	**727**	**1,402**
FEE EXPENSES	**(219)**	**(378)**	**(701)**
NET FEE INCOME	**155**	**349**	**701**
FOREIGN EXCHANGE GAINS/LOSSES	**17**	**28**	**35**
OTHER OPERATING EXPENSES	**(2,668)**	**(2,987)**	**(3,192)**
STAFF COSTS	(1,161)	(1,301)	(1,477)
TAXES AND FEES	(24)	(28)	(32)
AMORTIZATION/DEPRECIATION	(450)	(500)	(335)
OTHER ADMINISTRATIVE EXPENSES	(1,033)	(1,158)	(1,348)
PROVISIONS EXPENSES	**(33)**	**(497)**	**(164)**
PROFIT BEFORE TAXATION	**(366)**	**58**	**1,223**
INCOME TAX	**-**	**5**	**109**
NET PROFIT / LOSS	**(366)**	**53**	**1,114**

In 2018, the Bank planned the annual growth of the loan portfolio by 58%, in 2019 by 35%, while the planned growth for 2020 is 15%.

4. Planned Future Development (Continued)

The structure of portfolio growth by sectors is given in the following tables:

In thousands of EUR

Corporate loans	2018	2019	2020
Annual growth (%)	50%	28%	7%
Balance as of the year end	64,951	83,101	89,374
Cumulative interest income	2,472	3,316	3,887

Retail loans	2018	2019	2020
Annual growth (%)	666%	123%	75%
Balance as of the year end	4,838	10,790	18,887
Cumulative interest income	170	471	805

The planned growth of deposits and loans in 2018, 2019 and 2020 is shown in the following tables:

A-vista deposits	2018	2019	2020
Balance at the end of the period	6,979	9,401	13,035

Term deposits	2018	2019	2020
Balance at the end of the period	43,269	58,284	70,606
Cumulative interest expense	419	554	768

Borrowings	2018	2019	2020
Balance at the end of the period	14,600	23,300	22,000
Cumulative interest expense	155	163	176

The Bank planned investments in fixed assets and intangible assets, which mostly relate to investments in opening of new branches.

CAPEX total	2018	2019	2020
Investment in card operations	28	40	15
Investment in IT	138	-	-
Total investments in new branches	143	277	277
CAPEX total	**309**	**317**	**292**

In 2018, the Bank plans to open one branch. In 2019, it plans to open two branches, while in 2020, the Bank plans to open 2 more branches.

In 2018, the Bank plans to increase its capital by the amount of EUR 8 million.

5. Data on Research and Development Activities

5.1. Research and Development

Introduction and efficient use of new technologies

At the stage of its establishment in 2015, the Bank introduced carefully designed state-of-the-art technologies that are applied in banking operations. First of all, that refers to hardware, software, and communication technologies.

Modernization of equipment

Although it is a continuous process, at the time of preparation of this report, the Bank has adequate modern equipment that does not require further significant investment placements.

Automation of business performance

Automation of business performance is a development process that is continuously taking place in the bank considering the dynamic development of ICT, market demands, and the effect of competition.

Scientific-research, development and technological studies

The Bank did not have any activities in the given context so far.

5.2. Investing in Staff Improvement

The Bank takes into account the professional improvement of employees. In the organizational structure of the Bank, there is one Authorized Accountant and one Certified Accountant holding the External Auditor License issued by the Ministry of Finance of Montenegro. The internal auditor is holding the certificate of the Authorized Internal Auditor Specialist for banking and corporate sector.

The employees with these certificates regularly acquire continuous education organized by the Institute of Certified Accountants and the Institute of Internal Auditors.

Continuous education is carried out by monitoring professional literature, seminars, counseling and symposia.

As of December 31, 2017, the Bank allocated EUR 3,000 for the education of its employees in the country.

In the prior year, in cooperation with the Parent Bank, trainings and education for employees were organized in order to improve the business processes in the Bank.

The Bank participates in the Government's program of vocational training of higher education students each year.

6. Information on redemption of own shares, i.e. ownership

As of December 31, 2017, the 100% shareholder of the Bank was TURKIYE CUMHURIYETI ZIRAAT BANKASI ANONIM SIRKETIU. The share capital of the Bank comprises 10,000 ordinary shares with nominal value of EUR 1,000 each. All issued shares have been fully paid.

As of December 31, 2017, the Bank did not redempt its shares/ownership in 2017.

7. Business units

After the start of its operations in 2015, the Bank opened its first branch of universal type that provides services to clients, individuals and legal entities. The branch was formally registered in the Central Registry of Business Entities, as at July 20, 2015. The address of the branch is Bulevar Ivana Crnojevića No. 101, 81 000 Podgorica.

Currently there are 5 employees in the branch, including Branch Manager.

8. Data on financial instruments of importance for the assessment of financial position and operations performance

As of December 31, 2017, the Bank incurred a loss in the amount of EUR 865 thousand. As of December 31, 2017, the total own funds amounted to EUR 6,421 thousand, which represented a decrease by 11.77% in relation to own funds as of December 31, 2016 when those amounted to EUR 7,177 thousand.

Compared to December 31, 2016, as a result of increased loan activity, total loans increased by 35.57%. As of December 31, 2017, total loans amounted to EUR 44,194 thousand, while as of December 31, 2016, total loans amounted to EUR 32,600 thousand.

As of December 31, 2017, total assets amounted to EUR 52,693 thousand, which is an increase of 30.90% compared to 2016, when it amounted to EUR 40,254 thousand. This is a consequence of the increased credit activity in 2017.

As of December 31, 2017, the total liabilities of the Bank amounted to EUR 45,630 thousand, which is an increase of 41.08% compared to December 31, 2016 when those amounted to EUR 32,342 thousand.

As of December 31, 2017, the total amount of clients' deposits amounted to EUR 25,303 thousand, which is an increase by 136.86% if compared to December 31, 2016, when those amounted to EUR 10,683 thousand.

The total deposits of clients make 48.02% of the total assets of the Bank.

As of December 31, 2017, the borrowings due to banks amounted to EUR 20,089, which represented a decrease by 6.70% if compared to December 31, 2016, when it amounted to EUR 21,533 thousand.

All funds are borrowed from Ziraat Group members and represented 38.12% of the Bank's total assets.

As a member of the Ziraat Group, the Bank has access to the interbank (intergroup) money market, in which in a very short period of time it can provide liquid cash in the form of a loan from a parent bank or another member bank of the Ziraat Group.

On the basis of the above positions, we can conclude that the Bank has provided the necessary diversification of the sources of financing.

9. Objectives and methods for financial risk management

9.1. Strategies and policies for managing all types of risks

The risk management system implies an appropriate Risk Management Strategy, as a general act that represents the starting point for the implementation of policies and procedures for managing individual types of risks. The risk management system is established in a way that corresponds to the size of the Bank, the complexity of products and services in the business as well as the level of risk assumed.

The risk management strategy is adopted, according to the legal provisions, for a time period not shorter than three years. The Bank periodically, and at least once a year, reassesses the adequacy of the risk management strategy.

The Bank, in accordance with the law, regulations of the Central Bank and good practices for risk management in banks, continuously manages all the risks to which it is exposed in its operations. In this regard, the Bank has prepared a Risk Management Strategy.

In accordance with the regulations, the Bank seeks to establish a risk management system, which provides:

- identification of risks arising from existing ones, as well as risks that may arise from new business products or activities;
- measuring risk by establishing mechanisms and procedures for accurate and timely risk assessment;
- monitoring and analyzing risks; and
- controlling risk by limiting and minimizing risks.

9.1. Strategies and policies for managing all types of risks (Continued)

In accordance with the Risk Management Strategy, the Bank has adopted several internal acts: policies, procedures, decisions, instructions, etc. (see chapter 9.4).

The Board of Directors of the Bank, which through the Executive Directors of the Bank seeks to manage all types of risks with emphasis on credit, operational and market risks, is responsible for reporting and monitoring of risks.

9.2. Structure and organization of risk management functions

In accordance with the Law, **the Board of Directors** is responsible for establishing a system of managing all the risks that the Bank is exposed to in its operations and defining policies and procedures for managing all risks. For that purpose, the Board of Directors has established permanent working bodies for monitoring of risk management in certain areas of the Bank's operations. The responsibility of the Board of Directors is to establish, through the adoption of the strategy, policies, procedures and other documents from the domain of risk management, an adequate ratio of yield and risks that will enable the effective realization of the objectives of the Bank's shareholder. The Board of Directors monitors the efficiency and adequacy of the risk management system in the context of legal obligations, but also the interests of shareholder.

The Audit Committee prepares proposals, opinions and standpoints from the scope of work for the decision of the Board of Directors on these issues. The basic duties and responsibilities of the Audit Committee are to analyze the financial statements of the Bank, to review the programs and reports of internal audit and to give opinions on the findings of the internal audit, to monitor and analyze the compliance of the Bank's operations with the law and regulations, to give an opinion on the selection of the external auditor of the Bank and to propose the amount of fee for auditing, etc. The Audit Committee analyzes and monitors the functioning of the risk management system that the Bank is exposed to in its operations and proposes improvements to strategies, policies and procedures for risk management.

At least once a year, the Audit Committee submits to the Board of Directors information and data on the functioning of the risk management system through its annual work report, points to weaknesses and makes suggestions for improvement and upgrading of this system.

The Assets and Liabilities Management Committee (ALCO) reviews the monthly risk reports of the Risk Management Department, upon which examines the current risk profile of the Bank and sets it in the context of the relationship between assets and liabilities necessary for achieving the strategic objectives of the Bank. The ALCO has competencies and responsibilities for managing the market risk, liquidity risk and other risks that the Bank is exposed to in its operations, managing the Bank's capital, managing the price policy and prescribing the value of internal indicators, as well as the limits of allowed deviations from the indicators on the basis of which the balance sheet structure of the Bank is monitored.

The Credit Committee is in charge of defining the Bank's exposure policy and for evaluating, but also for rejecting all credit exposures that are not in line with that policy. The Credit Committee makes a decision on the approval of the placements to the level when the individual placement represents 10% of the Bank's own funds (large exposures). The decision to approve large exposures can be made exclusively by the Board of Directors of the Bank.

In its organizational structure, the Bank has an independent organizational unit that is fully committed to identifying, measuring and monitoring of all risks the Bank is exposed to - the Risk Management Department. This approach provides for the separation of the management function, i.e. the monitoring of the risk of a business function in the bank, which is necessary due to the achievement of the necessary objectivity in making decisions.

The Risk Management Department is responsible for regular monitoring and analyzing of the quality of the entire loan portfolio and, accordingly, proposes the formation of an appropriate amount of value adjustments and provisions for potential loan losses.

In terms of market and liquidity risk and securities portfolio risk monitoring, the Risk Management Department, in accordance with the adopted policies and in cooperation with the business part, sets the limits for certain types of risk, adopted by the Board of Directors. The Risk Management Department monitors exposure to a particular type of risk and determines whether this exposure is within the defined limits and reports it to the ALCO Committee and the Board of Directors.

The organizational part of the risk management is also responsible for the reporting system, both to external users (Central Bank of Montenegro, external auditor, creditors) and to internal users (ALCO, Executive Management, Audit Committee, Board of Directors).

9.3. The scope and nature of the risk reporting system and the risk measurement system

The Risk Management Department analyzes and assesses the underlying risk categories:
- Credit risk;
- Market risk;
- Liquidity risk;
- Country risk;
- Operational risk and
- other risks (reputation, compliance risk etc.).

In the case of credit risk, the Risk Management Department and the Credit Management Department:

- carry out a control analysis of loan proposals, determine the quality of the arrangement, classify individual placement/client and determine the level of provisions;
- continuously analyze the structure and quality of the entire loan portfolio, which includes risk concentration analysis, assessment of future trends in the structure and quality of the loan portfolio, stress testing of credit risk, etc.;
- within the scope of their responsibilities that involve the provision of a stable portfolio of risky placements, determine, propose and/or revise the limits, that is, the maximum level of exposure in relation to individual clients, activities and geographical areas, etc.;
- monitor the exposure concentration, keep a record of exposure to individuals, groups of related parties and persons associated with the Bank, certain industrial and economic sectors, geographical regions, as well as other groups of loans and other exposures that have similar risk characteristics and control whether the Bank operates in accordance with established exposure limits;
- take special care of placements classified into substandard, non-performing assets and/or loss and report monthly to ALCO and the Board of Directors;
- submit to the ALCO and the Board of Directors at the monthly level a comprehensive risk report to which the Bank is exposed in order to provide recommendations for risk management of the Bank, in which the Bank's credit risk is elaborated;
- prepare individual reports within the competence of the Sector prescribed by CBM decisions that are submitted to CBM at the monthly and quarterly level and
- perform other activities related to monitoring, managing and reporting on credit risk.

The Risk Management Department monitors market risks by controlling the interest rate risk, exchange rate risk, liquidity risk, and other, as well as the liquidity and risk of the country, by conducting the following:

- identification of existing market risks and market risks that may arise from the affirmation of new products or activities;
- measuring market risks through establishing mechanisms for assessing market risks;
- monitoring market risks through analysis of the situation, changes and trends;
- setting limits;
- control of market risks, risk management adequate to the risk profile of the Bank, through defining the limits and monitoring the compliance of the Bank's operations with set limits;
- measuring exposure to interest rate risk once a month using the gap analysis and standardized interest rate shock;
- In order to minimize the exposure to the risk of placements, the Bank performs the categorization of domestic and foreign banks or financial institutions based on the rating of foreign banks established by the recognized international rating agencies Standard & Poors, Fitch and Moody's and the financial position of domestic banks on the basis of data from the last financial statements of domestic banks on balance sheet result and equity;
- manage the liquidity risk by monitoring the maturity of funds and sources of funds and, in this regard, prepare appropriate Gap analysis, monitor the concentration of deposits by individual clients and by maturity, monitor the variability of deposits and report on compliance with established limits of manual compliance of funds and sources of funding, etc.;
- measuring the country risk exposure for all countries in which the head office is located, i.e. the place of residence of the debtor of the Bank. The Bank ranks all debtor countries into one of the following risk categories: risk-free countries; low-risk countries; medium-risk countries and of high-risk countries, at least twice during the calendar year, if necessary and more often.

9.4. Risk Policy, Risk Mitigation and Strategies and Processes for Continuous Monitoring of the Effectiveness of Risk Protection and Risk Mitigation

The Bank defined the following policies, procedures and other internal Risk Mitigation acts of the Bank:

1. Risk Management Strategy;
2. Capital Management strategy;
3. Annual Equity Plan for 2017;
4. Strategic Equity Plan and Amendments to the Strategic Equity Plan;
5. Liquidity Risk Management Strategy and Policy;
6. Liquidity Management Plan in cases of liquidity jeopardized;
7. Operational Risk Management Policy;
8. Market Risk Management Policy;
9. Country Risk Management Policy;
10. Credit Policy for Corporate Sector;
11. Credit Policy for Retail Sector;
12. Internal methodology for assessing impairment of balance sheet assets and probable loss on off-balance sheet items;
13. Methodology for determining the required capital for residual risk;
14. Procedure for stress testing of credit risk exposure;
15. Procedure for asset management and financial statements;
16. Procedure for stress testing of liquidity risk;
17. Methodology for determining the required capital for concentration risk and
18. Procedure for detailed categorization of high-risk exposures.

9.5. Internal control system

The system of reporting on conducted internal controls is based on individual reports of responsible persons in the Bank, which are in charge of organizing and managing individual organizational units, on special reports of authorized persons: internal auditor, compliance manager and authorized person for prevention of money laundering and financing of terrorism, as well as on the recommendations of the Audit Committee.

In this way the Board of Directors is fully informed about the quality of the internal control system in the Bank and about the measures that need to be taken in order to improve the system.

Management control is also carried out by the management through:

- Implementation of strategies, policies, procedures and acts;
- Delegation of duties in accordance with the Rulebook on organization and job classification;
- Monitoring the deadlines for carrying out delegated tasks and the realization of business plans;
- Monitoring procedures and records related to decision making on business transactions, at all levels of the organizational structure;
- Monitoring the process of recording business transactions and preparation of financial statements.

By establishing the described internal control system, the Bank controls the level of operational risk as well as the risk in relation to the financial reporting process.

9.6. Information System

The Bank is based on a technologically rounded Information System based on the primary location in Podgorica and a backup location in Bijelo Polje fully capable of supporting the business, growth and development of the Bank in business and IT.

The Disaster Recovery Site in Podgorica was implemented on the hardware platform of reliable and well-known brands that fully meet industry and technology standards.

Key services are hosted on a virtual platform composed of physical hosts and the associated storage system. Backup of the data is stored on a separate hardware platform consisting of a physical server and a tape system, and the creation of backup data is done several times a day.

9.6. Information System (Continued)

Network Infrastructure is composed of a core and access segment based on switches, while communication with DR location and partners takes place and is secured with the latest-generation firewalls. Communication services for communication with the regulator and partners use the MPLS network of providers with which the Bank is connected with two different physical links, terminated on redundant devices. In the same way, the Bank is also connected to a global Internet network.

The backup location is implemented so that it completely maps the primary location, with a somewhat lesser capacity in terms of hardware, while in functional terms it is completely equal to the production location. The procedures of the IT sector clearly define the technical process of switching from primary to backup location.

For the Core Banking System, the software product PUB2000 of Asseco SEE was selected, which supports corporate and retail business, card operations, regulatory reporting, electronic banking services, etc. Regular updating of software versions ensures functionality and reliability. Apart from Core Banking System, the Bank also implemented additional software packages to complete the business processes required for the undisturbed growth and development of the Bank.

The Bank independently hosts and maintains services such as e-mail, active directory, monitoring and IT security systems. All instances of the Information System are protected by security mechanisms: IPS/IDS, end-point-protection, anti-spam and anti-malware.

The complete hardware platform is implemented and is based on redundant devices, and their updating is carried out in a way that follows all technological aspects and ensures the stable operation of the Information System.

9.7. The Process of Internal Capital Adequacy Assessment

The Bank has reliable, effective and comprehensive strategies and processes for the continuous assessment and maintenance of the amount, type and distribution of internal capital, which implies capital that the Bank considers adequate in relation to the types and levels of risk it it exposed to or could be exposed to in its business operations. Strategies and processes are subject to regular internal review, which ensures their comprehensiveness and proportionality to the nature, scope and complexity of the Bank's business activities.

The Bank conducts an internal capital adequacy assessment once a year and submit it to the Central Bank of Montenegro no later than April 30 for the previous year, in accordance with Article 250 of the Decision on Capital Adequacy.

The Bank is still ranked as a small bank with a small percentage of participation in the market. Therefore, the ICAAP Report is prepared in accordance with the principle of proportionality, taking into account the size of the Bank, the level of the loan portfolio, and the nature, scope and complexity of the operations that the Bank performs and is based on the use of simple methods based on the ICAAP principle.

9.8. Implementation of New International Standards

In accordance with IFRS 9, which entered into force as at January 1, 2018, the Bank has altered the accounting policies for the recognition, classification and measurement of financial assets and liabilities, as well as the impairment of financial assets.

The Bank did not apply the provisions of IFRS 9 to earlier financial reporting periods.

The effects of adjusting the carrying value of financial assets and liabilities as of the date of the first application of the standard will be recognized through retained earning as an adjustment of the opening balance for 2018.

10. Information on Exposure to Price Risks, Credit Risks, Liquidity Risks

The Bank recognizes the following material risks to which it is exposed or may be exposed in its business operations:

Credit Risk represents the probability of loss occurrence in Bank's operations due to debtor's defaults toward Bank.

Concentration Risk is a part of credit risk, which refers to the large (related) individual exposures and significant exposures to groups of other contracting parties, whose probability of default is determined by common basic factors (sector, economy, geographical area, etc.). Concentration risk - for other risks defines exposure or set of exposures related by common risk factors, which may lead to losses that could jeopardize Bank's operations.

Residual Risk is a sub-category of credit risk and it represents the risk implying that recognized risk measurement and mitigation techniques, used by Bank, proved to be less effective than expected.

Market Risk is the probability of loss occurrence on financial instruments in the on-balance sheet and off-balance sheet of Bank, caused by changes in interest rates, exchange rates, prices, indexes and/or other market factors that affect the value of financial instruments, as well as the risks related to the financial instruments turnover on the market.

Position Risk is the loss risk resulting from the changes in the prices of financial instruments, in case of financial instrument derived from the change of financial instrument price, i.e. variable. Position risk is divided into:

a. general positions risk;
b. specific position risk.

- **a. General position risk** is the risk of loss resulting from the changes in the prices of financial instrument due to changes in the level of interest rates or changes in the capital market independently of any specific feature of this financial instrument.
- **b. Specific position risk** is the risk of loss resulting from the changes in prices of financial instruments due to the facts relating to the issuer, i.e. in the case of derived financial instrument related to the issuer of the underlying financial instrument.

FX risk is the probability of loss occurrence in on-balance sheet and off-balance sheet positions due to changes in exchange rates and/or discrepancies in the level of assets, liabilities and off-balance sheet items in the same currency.

Operational risk is the probability of loss occurrence in Bank's operations due to inadequate internal systems, processes and controls, weaknesses and misdemeanors, illegal actions performing and external events that may expose Bank to loss.

The interest rates risk not resulting from Bank's trading activities (interest rates risk in the banking book) is the risk of loss occurrence in Bank's operations due to changes in interest rates for on-balance sheet and off-balance sheet items that are not trade intended.

Liquidity risk is the probability that Bank will not be able to provide enough funds to_meet the obligations at the time of their maturity, or the probability that Bank will have to obtain funds experiencing significant costs in order to meet its obligations.

Country risk is the probability of loss occurrence for Bank due to inability to collect receivables from persons outside of Montenegro for reasons related to political, social and economic environment of the country in which the debtor's head office, i.e. residence are located and it includes political and economic risk and transfer risk.

Strategic risk is an existing or potential risk in terms of the income and capital arising from the changes in the business environment and from unfavorable business decisions, inadequate implementation of decisions and the lack of adequate response to changes in the business environment.

11. Objectives and Policies in Managing Financial Risks and Uncertainties in Business Opertions

In its business operations, the Bank is exposed to various risks, the most important of which are:

- Credit risk;
- Market risk;
- Operational risk;
- Interest rate risk and
- Liquidity risk.

11.1. Credit Risk

Exposure to credit risk is a risk of financial loss, which may occur as a consequence of a counterparty being unable to fulfil its obligations towards the Bank. The Bank manages the credit risk it undertakes by placing limits in relation to large loans, single borrowers and related persons. Such risks are monitored on a continuous basis and are subject to at least annual reviews. Credit risk is managed both at the level of individual loan placement as well as at the level of the entire portfolio. The exposure to any borrower including other banks and financial institutions is further restricted by sub-limits covering statement of financial position and off-balance sheet exposures. Actual exposures against limits are monitored regularly.

In order to provide the necessary preconditions for the proper management of credit risk exposure analysis is carried out on two grounds - at the level of individual loans when determining credit worthiness and the upper limit of indebtedness of the client or group of connected clients and at the level of the entire portfolio in the following basis:

- structure of the portfolio in each category (corporate loans, loans to government, retail loans, off-balance sheet exposures);
- structure of the portfolio by credit rating groups (movements between individual credit categories, the transitional matrix, the percentage of cover reserves, coverage ratio);
- portfolio structure by regularity of settlement of liabilities;
- portfolio structure by industries;
- concentration in clients with so called large exposures (client or group of connected clients in which the exposure is greater than 10% of risk capital);
- concentration of loans by certain geographic regions etc.

Credit risk provisions are allocated in accordance with the valid regulations of the Central Bank of Montenegro. The amount of provisions for potential losses on items of assets is calculated using the carrying amount of receivables multiplied by the determined percentage of provisions, while the bank may reduce the previous carrying value of an item of assets for which the provision is calculated by:

- the amount of collateral in a form of a cash deposit;
- the amount of the receivable covered by the irrevocable guarantee;
- countries or central banks of OECD countries;
- parent bank or banks belonging to a banking group to which the Bank belongs;
- banks with a rating higher than BBB+ / A+, determined by the external agency Standard&Poor's, or the equivalent rating of other internationally recognized rating agencies;
- legal entities whose business is controlled by the Central Bank of Montenegro.

In its operations, the Bank seeks to operate with good creditworthiness clients in order to minimize the credit risk exposure as much as possible, which poses a risk that debtors will not be able to settle the debts to the Bank in full and in due time. When making a decision on loan, it takes into account the changes in the economy, i.e. the state of individual branches that form part of the Bank's loan portfolio, which can lead to losses that differ from the losses on the basis of which the provision was made on the balance sheet date. In order to efficiently manage credit risk, the bank creates stressful credit risk scenarios, while considering the impact of the credit portfolio's weakening on the liquidity, profitability and capital adequacy of the Bank.

The Bank's previous practice in making decisions about granting placements paid attention to respect the maximum permissible exposure to a single entity or group of related entities. All placements approved so far are in accordance with the defined internal limits as well as with limits defined by current legislation.

11.1. Credit Risk (Continued)

Compliance with the performance indicators prescribed by the Central Bank of Montenegro as of December 31, 2017 is presented as follows:

Performance indicators	Prescribed limit by CBM	Achieved performance indicators as of December 31,	
		2017	2016
The Bank's solvency ratio	min 10%	27.82%	30.43%
The Bank's exposure to a single entity or group of related entities	max 25%	24.92%	25.00%
Sum of large exposures	max 800 %	186.67%	224.09%
Total exposure to persons related to the Bank	max 200%	113.16%	100.67%
Total exposure to Bank's employees	max 1%	1.09%	0.91%
Liquidity ratio of the Bank	min 1%	3.39%	4.21%

In addition to loans, the Bank approved to the clients the guarantees and the letters of credit, which represent off-balance exposures.

Rating of the creditworthiness was the basis for the approval of each placement, the defined maximum amount of debt (limit). The Bank was assessing the creditworthiness of the client using primarily tools such as quantitative (financial) and qualitative analysis and evaluation of the quality of collateral, without neglecting the principle of evaluation of risks assumed through the classification of placements and potential liabilities of the Bank. Before approving loans and other placements, the Bank assesses the borrower's creditworthiness taking into account the criteria determined by the internal act, as well as the legal validity and estimated value of the collateral.

Credit risk mitigation involves maintaining the risk at an acceptable level of the Bank, i.e. maintaining an acceptable loan portfolio. Credit risk mitigation is carried out through the negotiation of adequate collaterals for receivables. The collateral value is calculated as its net value, by which is meant the market value less any costs relating to the realization of collateral. Types of collateral are as follows:

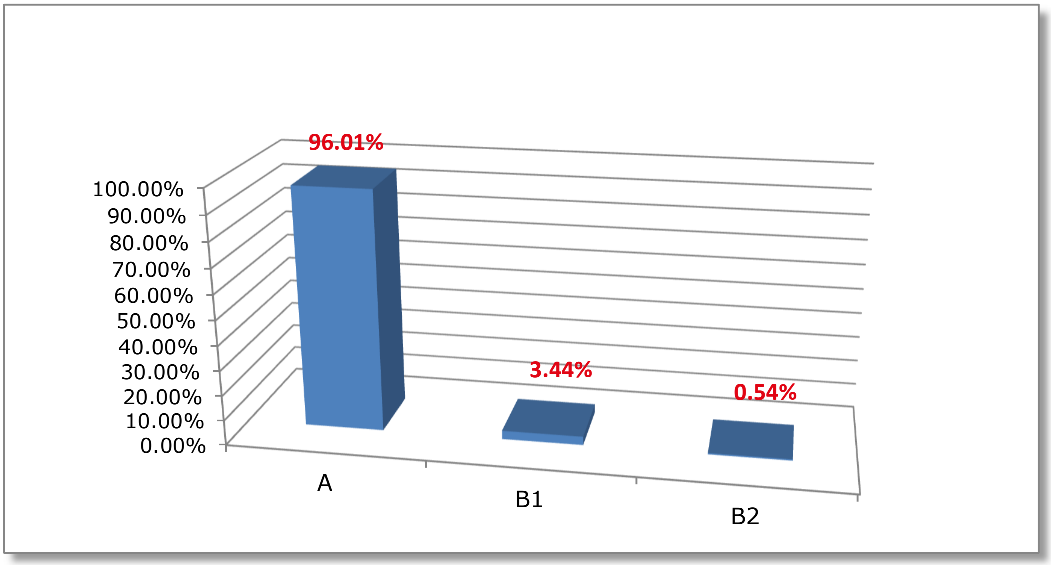
- Deposits;
- Pledges placed against industrial machines, securities, inventories and vehicles;
- Mortgages against property;
- Bills of exchange (corporate and personal);
- Authorizations for payments from the account;
- Administrative injunctions;
- Guarantors (for retail loans);
- Insurance policies and
- Bank guarantees.

After the assessment of the financial condition and creditworthiness of the borrower, as well as after a review of the value and legal security of credit security and other relevant factors, Loans Management Department determines the classification of the debtor as a measure of the expected credit risk, verifies internal rating, and gives his opinion on the justification of taking the identified risk.

11.1. Credit Risk (Continued)

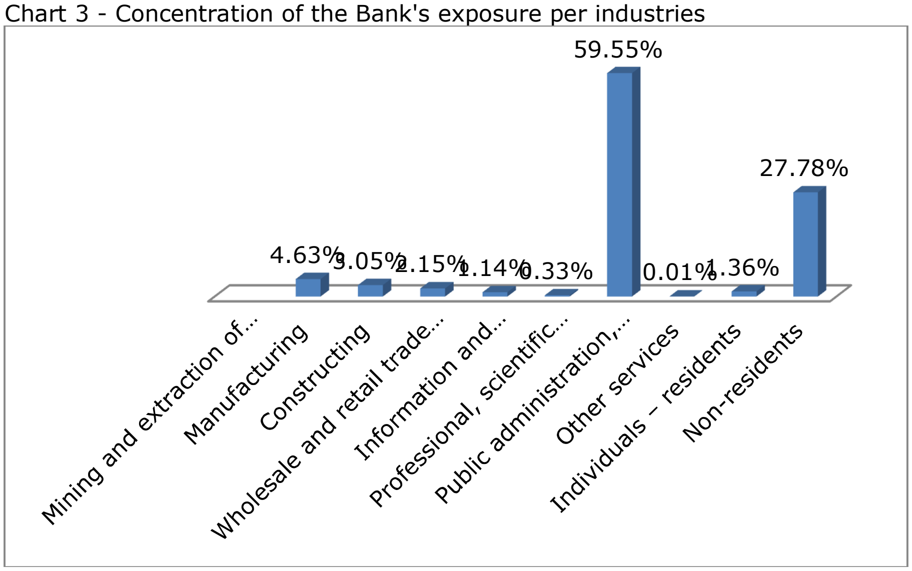
The credit portfolio structure is shown in the following chart:

Chart 2 - Credit Portfolio Structure



The industry concentration to the Bank's exposure to credit risk is shown in the following chart:

Chart 3 - Concentration of the Bank's exposure per industries



11.2. Market Risk

The Bank is exposed to market risks. Market risk is the risk of the possibility of adverse effects on the financial result and the Bank's capital based on losses in the balance sheet and off-balance sheet items due to market price fluctuations. Market risk primarily refers to changes in interest rates, exchange rates and shares prices, so the most significant risks arising from market risk are as follows:

- Foreign currency risk;
- Position risk (price and interest rate risk);
- Market risks associated with credit risk (counterparty risk and settlement risk).

The Market Risk Management Policy defines the method of identification, measurement, monitoring and management of interest rate risk, currency risk, price risk and other risks associated with trading activities. The Market Risk Management Policy will be adapted to the scope of the Bank's operations.

11.2. Market Risk (Continued)

11.2.1. Foreign Currency Risk

The risk of changes in foreign exchange rates is the risk of change of assets and liabilities value due to changes in foreign currency rates.

Bank measures foreign exchange risk and limits it daily, on an aggregate basis and individually by currencies.

The net open foreign exchange position of the Bank at the end of the day, for individual currency which is on the reference exchange rate of the European Central Bank on a daily basis, may not exceed 15% of the share capital of the Bank.

The sum of the net open foreign currency position at the end of the day for all the currencies at the reference exchange rate of the European Central Bank on a daily basis, may not exceed 20% of the share capital of the Bank.

The net open positions at the end of the day for other currencies cannot exceed:

- 5% of share capital, individually by currency;
- 10% of the share capital, in total for all other currencies of the Bank.

The Bank takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The exposure to currency risk is regularly monitored by harmonizing them with the limits prescribed by the Central Bank of Montenegro.

The Bank is exposed to foreign exchange risk to a small extent, given the fact that, as of December 31, 2017, it had foreign currency funds in USD in the amount of 50 thousand and liabilities in the same currency in the amount of EUR 109 thousand, resulting in a net short position of EUR 59 thousands.

11.3. Operational risk

Operational risk represents the risk of losses due to the lack or inadequacy of internal processes, people and systems, or due to external events. Also, operational risk can be the result of engagement of persons outside the Bank, unlawful actions, weaknesses and omissions in the performance of business, and the like.

In order to adequately manage operational risk, the Bank has developed a Policy for identifying, measuring and controlling this type of risk. The policy sets out the basic principles for managing operational risk in order to achieve the optimum acceptable level of risk.

The occurrence that is a source of operational risk can be classified into one of the 7 categories of events as follow:

- internal frauds;
- external frauds;
- failures in relation to employees and in the workplace safety system;
- problems in customer relationships, product placements and business practice of the Bank;
- damages on the physical assets of the bank;
- interruptions in operations and errors in the bank's systems and
- execution of transactions, deliveries and management of processes in the bank.

The operational risk associated with credit risk refers to an event arising from credit risk, and includes some of the elements of operational risk (eg. error in the execution of a process, internal/external fraud, commercial dispute).

11.3. Operational Risk (Continued)

The qualification of operational risk associated with credit risk requires the two of the following conditions met:

- Loan overdue and delayed by the loan holder - Credit Risk;
- Operational risk case, internal defect (execution error, internal/external fraud) or an external event (external fraud, commercial dispute) that partially or completely contributes to credit loss.

Exposure to operational risk is regularly monitored by aligning with the limits prescribed by the Central Bank of Montenegro.

The objective of operational risk management is to ensure that the level of exposure to operational risk is in line with the Bank's Risk Management and Policy Strategy, i.e. minimizing losses under operational risk.

As of December 31, 2017, the Bank allocated provisions for potential operational risk losses in the amount of EUR 6 thousand.

11.4. Liquidity Risk

Liquidity risk presents the risk that the bank will not be able to provide sufficient volume (financial) resources to cover all the liabilities (balance sheet and off-balance sheet) as they mature.

Liquidity risk is identified on the basis of daily, ten-day, monthly and quarterly projections of liquidity, i.e. based on the gaps incurred due to mismatch of assets and resources.

Adequate liquidity risk management is a basic requirement for the safe and efficient operation of the bank. The quality of liquidity risk management depends on the balance sheet structure of the Bank, i.e. matching between inflows and outflows. The required liquidity is achieved by rational management of assets and liabilities in order to maintain an appropriate ratio between liquid assets and volatile liabilities.

Aiming to create a secondary liquidity reserves the Bank was investing in debt securities in the amount of EUR 2,250 thousand. As of December 31, 2017, most of the portfolio of debt securities relates to securities issued by the Ministry of Finance of Montenegro in the amount of EUR 1,148 thousand, which are classified as available for sale. Also, the Bank in its portfolio has EUR 1,102 thousand of securities issued by the Ministry of Finance of the Republic of Turkey, which are also classified as securities available for sale.

Based on the monitoring and measurement of the basic liquidity indicators (daily and decade liquidity coefficients), determined coefficients show that, during 2017, the Bank did not have liquidity problems and the liquidity coefficients were above the limit of values prescribed by the Central Bank. As of December 31, 2017, the daily liquidity ratio amounted to 5.44 (December 31, 2016: 3,39), while the minimum value of this coefficient defined by the Central Bank's decision was 0,9.

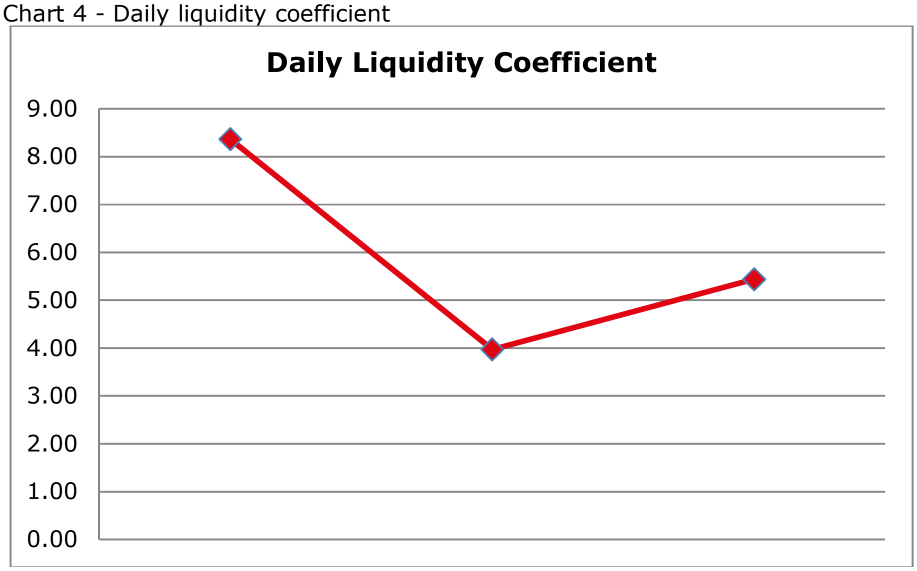
The Bank is obliged to maintain the liquidity level so that the liquidity ratio amounts at least:

1) 0,9 - when calculated for one business day;
2) 1,0 - when calculated as the average of the liquidity ratios for all business days in a single decade.

11.4. Liquidity Risk (Continued)

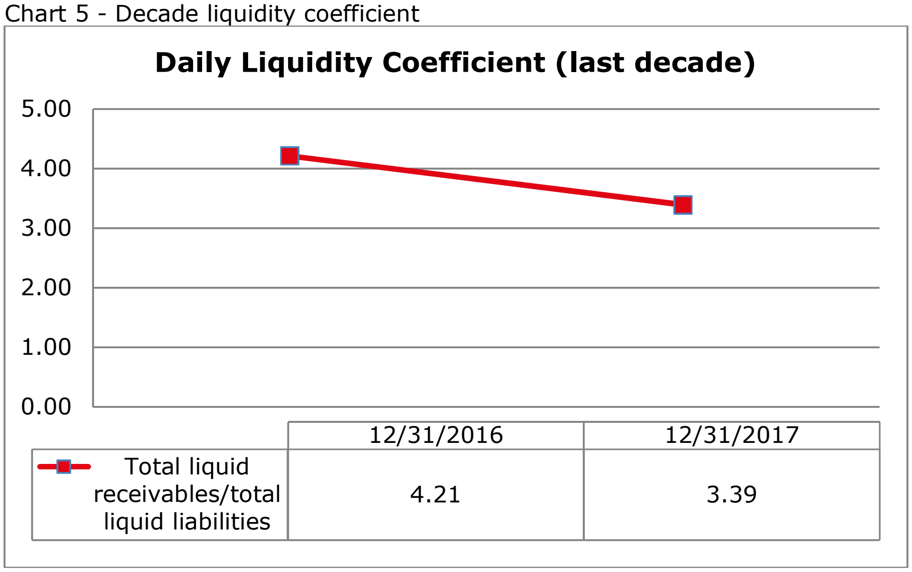
Daily liquidity coefficient for 2016 and 2017 is shown in the following chart:

Chart 4 - Daily liquidity coefficient



The decade liquidity coefficient (last decade) is shown in the following chart:

Chart 5 - Decade liquidity coefficient



The Bank's liquidity is strongly supported by the parent bank, which provides loans or overnight deposits in case of need for liquid assets. In addition, the Bank has defined and adopted the Liquidity Management Plan in cases of jeopardized liquidity or unforeseen circumstances, which clearly define the duties, tasks and bearers of the tasks to be performed in the event of a jeopardized liquidity of the Bank.

12. Statement on Application of Corporate Governance Code

In accordance with the Law on Banks ("Official Gazette of Montenegro", No. 17/08, 44/10 and 40/11), the Bank acquired a status of a legal entity on the date of its registration as a a shareholding company. As the shareholding company, the Bank regulate the mutual relations of all concerned partied in accordance with its Founding Contract and the Statute.

The Bank's bodies are the Shareholders Assembly, the Board of Directors, the Audit Committee and the Executive Directors. The roles of the bodies of the company are defined by the Statute and the Corporate Governance Code.

The Corporate Governance Code has become an indispensable element of business reports in the annual management report based on the provision of Article 14 of the Law on Accounting ("Official Gazette of Montenegro", No. 52/16).

In its content, this Code represents a set of rules and principles for improving corporate governance practices.

In its management activities, the Bank applies the best international corporate governance practices.

In the first place, the Corporate Governance Code defines the relations between the Shareholders Assembly, the Board of Directors, the Audit Committee and the Executive Directors.

Corporate governance is established in the following manners:

- To ensure that the legal framework of Montenegro and good business practices are complied with all segments of corporate governance;
- to set principles in this framework that are flexible and allow the Board of Directors to manage and govern the Bank in the best possible way and achieve the set goals;
- To ensure that all the mutual relations of stakeholders in the functioning of the Bank are clearly segregated, that there are no overlaps or gaps in responsibilities and competencies, and that a balance of responsibilities and obligations, i.e. rights and competencies is established among all stakeholders;
- The relationship between all interested parties is set up so that in each of those the common interest or interest of the Bank in relation to their individual interests prevail;
- To fully, efficiently and effectively perform all the functions of management and government of the Bank, i.e., to manage the Bank in a manner that leads to achievement of the set goals and tasks.

The application of corporate governance rules comprises all these acts implemented, as well as other internal acts of the Bank, and there are no deviations in the application thereof.

In Podgorica, April 3, 2018

Signed on behalf of Ziraat Bank Montenegro AD by:

________________________	___________________________
Mustafa Şenman Chief Executive Officer	Goran Bakić Executive Director

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Jelena Božović
Head of Accounting, Reporting and
Budgeting Department