ZIRAAT BANK MONTENEGRO AD, PODGORICA

Financial Statements
Year Ended December 31, 2018
and Independent Auditors' Report

CONTENTS **Page**

This Report is translation of the Auditors' Report issued in the language officially used in Montenegro. In the case of any discrepancy between the version in language officially used in Montenegro and English version, the version in the language officially used in Montenegro shall prevail.

Deloitte d.o.o. Podgorica
Bulevar Svetog Petra Cetinjskog bb
81000 Podgorica
Crna Gora
PIB: 02310783
Registarski broj: 5-0103354/21
Tel: +382 (0)20 228 324
Faks: +382 (0)20 228 327

www.deloitte.com/me

This Report is translation of the Auditors' Report issued in the language officially used in Montenegro. In the case of any discrepancy between the version in language officially used in Montenegro and English version, the version in the language officially used in Montenegro shall prevail.

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 65) of Ziraat Bank Montenegro AD, Podgorica (hereinafter: the „Bank"), which comprise the balance sheet as of December 31, 2018, 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.

Auditors' 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 of Montenegro, Law on Accounting of Montenegro 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, 2018, 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.

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 2018 with financial statements for the related business year. In our opinion, the financial information disclosed in the annual management report on business operations for 2018 are reconciled with the audited financial statements for the year ended as of December 31, 2018, and the annual management report on business operations for 2018 contains all the elements defined by the provisions of the Law of Accounting.

Katarina Bulatović, Certified Auditor
(License No. 067 issued on March 31, 2015)

Deloitte d.o.o. Podgorica
May 10, 2019

INCOME STATEMENT
Year Ended December 31, 2018
(In thousands of EUR)

	Notes	2018	2017
ITEM			
Interest income and similar income	3.1, 5.1	2,118	1,791
Interest expenses and similar expenses	3.1, 5.2	(512)	(675)
NET INTEREST INCOME		**1,606**	**1,116**
Fee and commission income	3.5, 7.1	224	148
Fee and commission expense	3.5, 7.2	(228)	(102)
NET FEE AND COMMISSION INCOME		**(4)**	**46**
Net Foreign exchange gains and losses		8	20
Other income	10.1	19	-
Staff costs	8	(991)	(963)
Depreciation expenses	16,17	(421)	(380)
General and administration expenses	9	(692)	(672)
Net income/(expense) of impairment of financial instruments not measured at fair value through profit and loss	3.5, 6.1	(146)	(2)
Provision expenses	3.5, 6.2	-	(6)
Other expenses	10.2	(42)	(33)
PROFIT/LOSS BEFORE TAXATION		**(663)**	**(874)**
Income tax	3.3, 11.1	(15)	(9)
NET PROFIT/(LOSS)		**(648)**	**(865)**

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

In Podgorica, March 27, 2019

Signed on behalf of Ziraat Bank Montenegro AD by:

____
Mustafa Şenman
Chief Executive Officer

____
Goran Bakić
Executive Director

____
Jelena Božović
Head of Accounting, Reporting and
Budgeting Department

BALANCE SHEET
As of December 31, 2018
(In thousands of EUR)

	Note	2018	2017
ASSETS			
Cash and deposits held with central banks	12	6,091	2,955
Financial assets at amortized cost		58,323	46,562
Loans and receivables due from banks	13.1	739	2,363
Loans and receivables due from customers	14	54,251	44,194
Securities	15.1	3,322	-
Other financial assets	13.2	11	5
Financial assets at fair value through other comprehensive income	15.2	1,112	2,250
Properties, plant and equipment	16	404	300
Intangible assets	17	318	600
Other assets	18	24	26
TOTAL ASSETS		**66,272**	**52,693**
LIABILITIES			
Deposit of banks and central banks at amortized value	19	21	-
Deposits due to customers at amortized value	20	23,150	25,303
Loans of banks and central banks at amortized value	21	28,906	20,089
Provisions	22	134	10
Deferred tax liabilities	3.3. 11.3	4	27
Other liabilities	23	137	201
TOTAL LIABILITIES		**52,352**	**45,630**
EQUITY			
Share capital	3.10	18,000	10,000
Retained earnings		(3,502)	(2,222)
Current year loss		(648)	(865)
Other reserves		70	150
TOTAL EQUITY	24	**13,920**	**7,063**
TOTAL EQUITY AND LIBILITIES		**66,272**	**52,693**
OFF-BALANCE SHEET ITEMS	25	**115,529**	**22,511**

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

STATEMENT OF CHANGES IN EQUTY
Year Ended December 31, 2018
(In thousands of EUR)

	Share capital	Other reserves	Accumulated losses	Total
Balance as of January 1, 2017	10,000	133	(2,222)	7,911
Net increase in fair value of securities at amortized value	-	17	-	17
Loss for the year	-	-	(865)	(865)
Balance as of December 31, 2017	**10,000**	**150**	**(3,087)**	**7,063**
Balance as of January 1, 2018	10,000	150	(3,087)	7,063
Effects of IFRS 9 application	-	7	(415)	(408)
Balance as of January 1, 2018, adjusted	10,000	157	(3,502)	(6,655)
Shares issuance	8,000	-	-	8,000
Net decrease in fair value of securities at amortized value	-	(80)	-	(80)
Loss for the year	-	-	(648)	(648)
Balance as of December 31, 2018	**18,000**	**70**	**(4,150)**	**13,920**

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

CASH FLOW STATEMENT
Year Ended December 31, 2018
(In thousands of EUR)

	Note	2018	2017
Cash flows from operating activities			
Interest income received and similar income		2,004	1,595
Interest charges paid and similar expenses		(566)	(639)
Fees and commissions received		209	125
Fees and commissions paid		(228)	(102)
Cash payments to employees and suppliers		(1,634)	(1,624)
Net increase in loans and other assets		(10,515)	(11,514)
(Outflows)/Inflows from deposits		(2,161)	14,641
Other (outflows)/inflows		(1)	115
Net cash generated by/(used in) by operating activities		**(12,892)**	**2,597**
Cash flows from investing activities			
Cash used for purchase of equipment		(241)	(32)
Cash used for purchase of intangible assets		(1)	(149)
Treasury bills and other securities		(2,262)	98
Net cash (used in) in investing activities		**(2,504)**	**(83)**
Cash flows from financing activities			
Net increase / (decrease) in borrowed funds		8,900	(1,500)
Issuance of ordinary shares	24	8,000	-
Net cash (used in)/generated in financing activities		**16,900**	**(1,500)**
Effect of foreign exchange gains and losses on cash and cash equivalents		8	20
Net increase/(decrease) in cash and cash equivalents		**1,513**	**1,034**
Cash and cash equivalents at the beginning of period		5,323	4,289
Cash and cash equivalents at end of the period	27	**6,835**	**5,323**

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

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

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 Issuers 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:
a. In foreign payment instruments, including money exchange
b. 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, branches in Bar at the address Bulevar revolucije B-11 and branches in Budva at the address Ulica Mediteranska bb.

As of December 31, 2018, the Bank had 38 employees (December 31, 2017: 34 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, 2018, 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
Berrin MAHMUTOGLU	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, 2018, the executive directors of the Bank were as follows:

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, 2018, the members of the Audit Committee of the Bank:

Name and Surname	Position
Cetin TURAN	Chairman
Aykut ARSLAN	Member
Sinan SAHIN	Member

As of December 31, 2018, the Compliance Manager was Milena Lakić.

As of December 31, 2018, 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 maintain its accounting records and prepare the financial statements in accordance with Law on Accounting of Montenegro ("Official Gazette of Montenegro", No. 52/16) and regulations of the Central Bank of Montenegro governing the financial reporting of banks.

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, 2018.

In accordance with the Accounting Law of Montenegro, the IAS and IFRS published by the International Accounting Standards Board must be translated by the relevant competent authority of Montenegro, which has the right for translation and publication thereof, approved by the International Federation of Accountants (IFAC). Therefore, only IAS and IFRSs officially translated, approved and published by the Institute of Certified Accountants of Montenegro may be applied. The latest official translations have been published for the part of the IASs that have been in effect since January 1, 2009, or part of IFRS in application since January 1, 2013, which includes only the basic text of the standards and interpretations and does not include the basis for concluding, examples, instructions for use, comments, opinions and other material of the explanation. In addition, the translation does not contain a translation basis for the preparation and presentation of financial statements. Also, changes and improvements to the IAS after January 1, 2009, i.e. IFRS after January 1, 2013, have neither been translated nor published.

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 preparation of the accompanying financial statements, the Bank has adhered to the accounting policies described in Note 2 to the financial statements.

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

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, disclosures of contingent receivables and liabilities as at the date of financial statement preparation, and of income and expenses during the reporting period (Note 3.1).

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

2.2. Use of estimates (Continued)

Such estimates and assumptions are based on available information on the date of financial statements preparation and mainly related to: estimate of the amount of impairment for loans and interest, impairment for deposits with other banks, the impairment for permanent placements and off-balance sheet items.

Actual amounts of assets and liabilities may differ from thus estimated amounts in this way.

2.3. Going concern

Financial statements are prepared in accordance with the goind concern principle, which implies that the Bank will continue to operate during an unlimited period in the foreseeable future.

2.4. Comparative Data

The comparative data in these standalone financial statements represent data from the Bank's financial statements for 2017.

The Bank has adjusted the Balance Sheet as of December 31, 2017 for the purpose of adjusting financial statements from previous years, as well as changes in the accounting policies for securities, in accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" requirements. Adjustment effects are presented in Note 3.5.6 and 3.5.7.

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.

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.

3.2. 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).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued

3.2. Foreign Exchange Translation (continued)

a) *Functional and Presentation Currency (continued)*

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 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.

3.3.1. 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 balance.

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 balance.

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.

3.3.2. 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.

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:

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.3. Income Tax (Continued)
3.3.2. Deferred Taxes (Continued)

- 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 financial instruments 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.

3.3.3. Indirect taxes and contributions

Indirect taxes and contributions which do not depend on Bank's operations include property, value added atx, contributions on salaries paid by the employer, as well as other taxes, 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's financial assets are classified in accordance with the Bank's intention regarding those assets at the time of their acquisition and its investment strategy.

The Bank's financial assets may be classified according to the business models as defined under IFRS as follows:

- Financial assets held within the business model whose objective is to collect the contractual cash flows – financial assets at amortized cost (AC);
- Financial assets held within the business model whose objective is to collect the contractual cash flows or sell the assets – financial assets at fair value through other comprehensive income (FVTOCI); and
- Financial assets held for trading - financial assets at fair value through profit or loss (FVTPL)

Classification and measurement of the financial instruments are based on the following two criteria:

- elected business model for which a financial asset has been initially acquired; and
- characteristics of the contractual cash flows of an asset.

A financial asset is measured at amortized cost of fair value through other comprehensive income only if the object of the entity's business model is to hold the financial asset and the contractual cash flows are solely payments of principal and interest on the principal outstanding ("SPPI criteria"). This is assessed for each individual instrument.

Failure to meet the above said criteria may result in classification of a financial instrument to the category of instruments measured at fair value through profit or loss (FVTPL).

In order to pass the SPPI criterion, the contractual cash flows must be generated solely from:

- collection of principal; and
- collection of the interest on the principal outstanding.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial instruments (Continued)

Unless either of the above specified criteria is met, the financial instrument must be measured at FVTPL.

Cash flows generated from collection of interest on the principal outstanding must reflect:

- the time value of money;
- credit risk;
- other basic risks and costs.

Generally, the expected future cash flows of the financial instruments meet the SPPI test criteria if:

- there are no embedded derivatives;
- the interest rate applied is within the market limits;
- one-off loan origination fees and fees charged for unused credit funds approved are within limits stipulated by the relevant decision;
- early loan repayment fees represent a reasonable compensation and has no "penalty" character;
- the interest rates applied, whether fixed of floating, meet the SPPI test criteria.

IFRS 9 generally permits certain departures from the SPPI principle, as described below:

A contractual cash flow characteristic does not affect the classification of the financial asset if it could have only a *de minimis* effect on the contractual cash flows of the financial asset.

If a contractual cash flow characteristic could have an effect on the contractual cash flows that is more than *de minimis*, but that cash flow characteristic is not genuine, it does not affect the classification of a financial asset.

A cash flow characteristic is not genuine if it affects the instrument's contractual cash flows only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur.

Some options that change the time value of money as a component of the interest may pass the SPPI test depending on the benchmark test results.

3.5.1. Financial assets held with the objective of collecting the contractual cash flows - "held to collect" (held to maturity under IAS 39)

Financial assets held with the objective of collecting the contractual cash flows include:

- Funds held with the Central Bank of Montenegro and other financial assets held with foreign banks;
- Loan receivables (principal, interest, loan fees);
- Receivables arising from activation of bank guarantees issued;
- Receivables per fees and commissions other than those relating to loan receivables;
- Treasury bills of Montenegro;
- Other financial assets.

This category may also include debt securities with fixed or determinable payments and fixed maturities where the Bank has a definite intention and ability to hold them to maturity.

Premiums and discounts, including the initial transaction costs, are included in the carrying value of such a security instrument and are amortized.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial instruments (Continued)

3.5.1. Financial assets held with the objective of collecting the contractual cash flows - "held to collect" (held to maturity under IAS 39)

Loans and receivables include non-derivative financial assets with fixed or determinable future cash flows that are not quoted in an active market.

The Bank's loans and receivables are financial assets originated by the Bank by extending cash funds to its clients.

This category does not include financial assets that initially intended for sale in the near term.

Loans and receivables are initially recognized at fair value increased by transaction costs. They are subsequently stated at amortized cost, using the effective interest method, less impairment allowance.

Impairment allowance charge, i.e., impairment losses on loans and receivables are recognized within expenses in the profit or loss statement (income statement).

The Bank charges default interest on loans and receivables (or portion thereof) outstanding after their due dates.

Interest income on loans is calculated using the effective interest method, with the effecitve interest rate applied to the gross carrying value of the financial assets.

3.5.2. Financial assets held with the objective of collecting the contractual cash flows and sale – "at fair value through other comprehensive income (FVTOCI)"

Financial assets held with the objective of generating income from collection of the contractual cash flows or sales are debt securities – Government bonds.

There are various objectives that may be consistent with this type of business model. For example, the objective of the business model may be to manage everyday liquidity needs, to maintain a particular interest yield profile or to match the duration of the financial assets to the duration of the liabilities that those assets are funding.

Compared to a business model whose objective is to hold financial assets to collect contractual cash flows, this business model will typically involve greater frequency and value of sales. However, there is no threshold for the frequency or value of sales that must occur in this business model because both collecting contractual cash flows and selling financial assets are integral to achieving its objective.

As they are retained for a certain time in order to collect the contractual cash flows and subsequently sold, financial assets classified in this category must pass the SPPI test.

Such assets are initially and subsequently measured at fair value and the changes in their fair value are recognized within other comprehensive income (equity).

Unrealized gains and losses on securities held to collect the contractual cash flows or for sale are recorded under revaluation reserves within equity until the securities are sold, collected or otherwise realized or permanently impaired.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)
3.5. Financial instruments (Continued)

3.5.2. Financial assets held with the objective of collecting the contractual cash flows and sale – "at fair value through other comprehensive income (FVTOCI)"

When "held to collect the contractual cash flows or for sale", securities are amortized or impaired and cumulative impairment allowance is reclassified to the profit or loss (income) statement.

Interest income is recognized using the effective interest method in the income statement. Impairment allowance is made in accordance with the impairment methodology and recorded within the income statement and other comprehensive income (equity).

3.5.3. Financial assets held for trading - "at fair value through profit or loss (FVTPL)"

The category of financial assets measured at FVTPL includes equity instruments and financial assets held for trading.

This means that they are held within the business model characterized by constant purchase and sale of instruments for the purpose of generating cash inflows in the amount of the fair value of the financial assets sold.

In addition to the financial assets acquired for short-term sales, this category is comprised of the loan assets that do not meet the SPPI test criteria.

Such financial assets are initially recorded at fair value that represents their cost. Transactions costs are recorded within expenses in the current period's income statement.

All realized and unrealized gains and losses arising from the sale or change in the market value of these securities are presented within the income statement.

3.5.4. Expected Credit Loss (ECL) Calculation

The Central Bank of Montenegro enacted Decision on the Minimum Standards for Credit Risk Management by Banks (Official Gazette of Montenegro nos. 22/12, 55/12, 57/13, 44/17 and 82/17) effective as from January 1, 2013. Implementation of the said Decision entails application of the International Financial Reporting Standards (IFRS) in measurement and presentation of the bank balance sheet assets and off-balance sheet items.

In accordance with the aforesaid Decision, the Bank has set up a methodology for assessment of the impairment of the balance sheet assets and estimated losses per off-balance sheet items.

The Bank consistently implements this methodology, reviews at least annually and, based on the review results, adjusts the assumptions underlying the methodology as appropriate.

The new IFRS 9 in effect as from January 1, 2018 is based on the expected credit loss (ECL) model, which has replaced the previous model of incurred losses under IAS 39

The following Bank's exposures are subject to impairment under IFRS 9:

1. On-balance sheet exposures:
   - all types of loans, activated guarantees and syndicated loans;
   - factoring and forfeiting receivables;
   - matured interest, fee and commission receivables and other on-balance sheet receivables;
   - deposits held with other banks and other financial institutions;
   - securities within the portfolio measured at amortized cost (AC); and
   - other receivables.
2. Off-balance sheet exposures:
   - guarantees issued;
   - lines of credit approved (overdraft facilities);
   - letters of credit; and
   - other items.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial Instruments (Continued)

3.5.4. Expected Credit Loss (ECL) Calculation (Continued)

The impairment for individually or collectively assessed financial assets must be estimated for all of the above exposures in accordance with IFRS 9. When applying the ECL model, the Bank recognizes the expected loss on each reporting date to reflect changes in the credit risk of the given financial asset and takes into account and information about future events.

Expected loss is defined as the difference between the cash flows that the Bank is entitled to under the contractual terms of the financial instrument and the cash flows that the Bank expects to receive (taking into account the likelihood of non-settlement status and expected payment on that basis).

The Bank's general approach to calculating the expected losses for the entire period of the financial instrument makes the difference between:

- Expected losses of 12 months ("Stage 1") applied to financial assets (from initial recognition) until there is a significant deterioration in credit risk;
- Expected Losses in the Full Life Period of the Financial Asset ("Stage 2" and "Stage 3") applied when there has been a significant increase in credit default, i.e. non-performing.

Stages 2 and 3 differ in the manner of recognition of interest income. In Stage 2 interest income is accounted for gross book value. In Stage 3, interest income is accounted for as net book value.

At each reporting date, an assessment is made as to whether there was a significant increase in the credit risk from initial recognition or performance of non-performing status to assess the amount of default (ECL for 12 months or for the entire life of the asset) and the amount of the basis for recognition of interest income (gross book value or net book value).

According to the methodology, the Bank performs the segmentation of financial instruments in three ways:

1. Portfolio - Depending on the type of client, product type and bucket group ("bucket");
2. Stage – Classification into one of three "Stages";
3. Method of assessment –Allowance for impairment is assessed on an individual or collective basis.

Segmentation of financial instruments that show common credit risk characteristics is carried out according to the following criteria:

- Client type (legal entity, natural person, state and bank)
- The type of product (given the fact that the Bank does not have a long enough business history, segmentation by product type is not performed when estimating the amount of waiver)
- Bucket (time category that classifies receivables in 8 categories on the basis of a days of delay).

Segmentation of financial instruments is a subject of regular periodic consideration and may be subject to updating especially in the long run as the existing portfolio by product types increases and the Bank introduces new types of products.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial Instruments (Continued)

3.5.4. Expected Credit Loss (ECL) Calculation (Continued)

As defined in the methodology, when determining the cash flows that the Bank expects to receive, marginal losses are used, whereby the total expected loss is calculated as a sum of marginal losses occurring at certain time points during the life of the financial asset.

Estimated Default Probability ("PD") is an estimate obtained on the basis of statistical models that observe historical transition of placements and clients from "performing" to "non-performing" status. By conducting projections from historical data and adapting them to anticipated macroeconomic impacts at certain times of the time (Forward looking (FL)), the Bank assesses the default probability (PD) for financial resources.

The Bank is not currently able to estimate its own PD factors due to the lack of historical data. Therefore, for the purpose of calculating the PD factor, it uses the available monthly cross-currency data between the Montenegrin banking classification categories as defined 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) where A, B1 and B2 are "performing" ratings, while C1, C2, C3, C4, D and E are "non performing".

EAD (exposure at default) is an estimate of the exposure including repayments of principal and interest and expected drawdowns on committed facilities. EAD is specified as the gross carrying amount at time while using the effective interest rate to discount cash flows to a present value at the reporting date for unexpired exposures. For exposures that are provided, the net amount of EAD is calculated, which represents a reduction for the expected collection from the provisioning assets discounted to the present value on the reporting date using the effective interest rate. During the estimation of off-balance sheet exposure, the Bank uses the Credit Conversion Factor (CCF) in accordance with the Decision on Capital Adequacy in Central Bank of Montenegro (CBM).

Loss Given Default ("LGD") is an estimate of economic loss under non-fulfillment of liabilities. Namely, in its estimate of credit losses measured in accordance with the methodology, the Bank estimates the expected cash flows after the non-performance of the obligation based on experience, not taking into account the expected collection from collateral. The Bank is not currently able to estimate its own LGDs due to lack of historical data and applies a 45% LGD rate for exposures up to 180 days (60% for delayed exposures up to 270 days, 80% for delayed exposures up to 360 DPDs, or 100% for exposures over a delay of 360 days).

At the reporting date, an estimate of whether there has been a significant increase in credit risk with respect to the date of initial recognition or whether it has defaulted ("default") to determine the applicable provisioning (ECL for 12 months or for the entire lifetime of the asset).

Financial assets are classified in Stage 1, provided the conditions for Stage 2 or Stage 3 are not met.

A Significant Increase in Credit Risk (SICR) involves the determination of quantitative (over 30 days) and qualitative criteria to determine whether the credit risk of the financial asset is significantly increased in relation to initial recognition, which would Classify it in "stage 2". Non-performing is a deterioration to the point when credit losses arise, i.e. if the client is not expected to fulfil the contractual obligations without taking into account the payment from the security or guarantee and/or the client is in a default for more than 90 days.

Forward Looking (FL) is involved by the Bank while adjusting the PD for certain macroeconomic variables through the calculated corrective factor (c) that is determined by placing the ratio of projected amount of non-performing loans (NPL) over the next three years and the historic amounts of NPL loans to the Montenegrin banking sector.

The provision for credit losses is calculated on a quarterly basis.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial Instruments (Continued)

3.5.5. Provisions and Allowance for Impairment

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:

- 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;
- Group B - "assets with special note" - with subgroups B1 and B2; here the Bank 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;
- Group C "substandard assets" - with subgroups C1, C2; here the Bank classifies loans for which there is a high probability of incurring loss, due to clearly identified weaknesses, jeopardizing collection of those assets;
- Group D - "doubtful assets"; here the Bank classifies the loan for which the collection, taking into consideration the debtor's creditworthiness, value and marketability of collaterals, is highly unlikely;
- Group E - "loss"; here the Bank classifies the loans which will not be collected at all or will be collected in the insignificant amount.

The amount of provision for potential losses is not envisaged for placements of the Bank classified in the group A. The estimated amount of the provision for potential losses is calculated using the percentages of 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.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.5. Financial Instruments (Continued)

3.5.6. First application of IFRS 9

The reclassification and IFRS 9 first-time effects are presented in the table below:

	Balance as of December 31, 2017	Reclassification under IFRS 9	Reclassified balance as of December 31, 2017*	Remeasurement	Balance as of January 1, 2018**
ASSETS					
Cash and deposits accounts held with central banks	2,955	-	2,955	(5)	2,950
Loans and receivables from banks at amortized cost	2,363	-	2,363	-	2,363
Other financial assets	5	-	5	-	5
Loans and receivables from clients at amortized cost	44,194	-	44,194	(340)	43,854
Investment securities Available for sale	2,250	(2,250)	-	-	-
Securities at fair value through other comprehensive income	-	2,250	2,250	-	2,250
Property, plant and equipment	300	-	300	-	300
Intangible assets	600	-	600	-	600
Other financial receivables	11	-	11	-	11
Other accounts receivable	15	-	15	-	15
TOTAL ASSETS	**52,693**	-	**52,693**	**(345)**	**52,348**
LIABILITIES					
Deposits of clients measured at amortized cost	25,303	-	25,303	-	25,303
Loans of banks and central banks at amortized cost	20,089	-	20,089	-	20,089
Reserves	10	-	10	63	73
Deferred tax liabilities	27	-	27	-	27
Other liabilities	201	-	201	-	201
Total liabilities	45,630	-	45,630	63	45,693
EQUITY		-		-	
Share capital	10,000	-	10,000	-	10,000
Accumulated losses	(2,222)	-	(2,222)	(415)	(2,637)
Current year loss	(865)	-	(865)	-	(865)
Other and revaluation reserves	150	-	150	7	157
Total equity	7,063	-	7,063	(408)	6,655
TOTAL EQUITY AND LIABILITIES	**52,693**	**-**	**52,693**	**(345)**	**52,348**

* The balance is reclassified according to IFRS 9 and refers to the reclassification of bonds.

** This condition includes the effects of first-time application of IFRS 1 on January 1, 2018.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)
3.5. Financial Instruments (Continued)
3.5.7. Adjustment of Comparative Data

	Adjusted balance as of December 31, 2107	Adjustment of comparative dana under CBM regulations	Adjusted initial balance as of December 31, 2017*
ASSETS			
Cash and deposits accounts held with central banks	2,955		2,955
Loans and receivables from banks at amortized cost	2,368	(5)	2,363
Loans and receivables from clients at amortized cost	44,194		44,194
Other financial receivables at amortized cost	-	5	5
Investment securities available for sale	-		-
Securities at fair value through other comprehensive income	2,250		2,250
Property, plant and equipment	300		300
Intangible assets	600		600
Other financial receivables	11	(11)	-
Other accounts receivable	15	(15)	-
Other assets	-	26	26
TOTAL ASSETS	**52,693**	**-**	**52,693**
LIABILITIES			
Deposits of clients measured at amortized cost	25,303	-	25,303
Loans and receivables from banks at amortized cost	20,089	-	20,089
Reserves	10	-	10
Deferred tax liabilities	27	-	27
Other liabilities	201	-	201
Total liabilities	45,630	-	45,630
EQUITY			
Share capital	10,000	-	10,000
Accumulated losses	(2,222)	-	(2,222)
Current year loss	(865)	-	(865)
Other and revaluation reserves	150	-	150
Total equity	7,063	-	7,063
TOTAL EQUITY AND LIABILITIES	**52,693**	**-**	**52,693**

* The balance was reclassified as a result of the amendment to the regulation of the Central Bank of Montenegro issued in 2018.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.6. Property and Equipment

As of December 31, 2018, 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 2018 compared to 2017.

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

3.7. Intangible assets

3.7.1. *Licenses*

Acquired licenses are recorded at historical cost. Licenses have a time-limited 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.

3.7.2. *Computer software*

Computer software costs 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.

3.8. 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 repayment amounts 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 in accordance with defined plans of contributions 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. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 in the subsequent events note.

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 contractual liability as a result of past events;
- There is a likelihood that the settlement of the liability will require an outflow of funds, which generate economic benefits;
- When the amount of the liability 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.

3.13. 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;

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.14. Transactions with the Bank's related parties (Continued)

- 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 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).

3.15.1. 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.

3.15.2. 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. Thus, an adjustment of the depreciation rate is made, which affects the overstated or understated costs. If the carrying amount of a fix asset is higher 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.

3.15.3. 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 these purposes fair value is defined as the value to be paid for the sale of assets or payments to settle the obligation in a regular transaction between the market participants on the day of measurement in the given triennial circumstances.

Bank's obligation is to disclose all information relating to fair value of 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.

4.1. 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 opinions proposal 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 liquidity risk and other risks that the Bank is exposed to in its operations, managing the Bank's capital.

4.3. Credit Risk

The management of price policy and the regulation of the value of internal indicators as well as the limits of allowed deviations from the indicators on the basis of which the structure of the balance sheet 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.

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 contractual obligations towards the Bank.

The Bank manages the credit risk it undertakes by placing limits in relation to large loans, single borrowers and related parties.

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 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 creditworthy categories, the transitional matrix, the percentage of cover reserves, coverage ratio);
- portfolio structure by timelyness of settlement of liabilities;
- portfolio structure by industries;
- concentration in clients with of so-called large exposures (clients or group of related clients in which the exposure is higher 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.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

4. RISK MANAGEMENT (Continued)

4.3. 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.

4.3.1. Loans commitments and contingent liabilities

Commitments are instruments that provide funds to customers when 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 fulfilment 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.

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

		In thousands of EUR
	December 31, 2018	December 31, 2017
Assets		
Loans and receivables due from banks	739	2,363
Loans and receivables due from customers	54,251	44,194
Securities available for sale	3,322	-
Financial assets at fair value through other comprehensive income	1,112	2,250
Other financial receivables	6	5
	59,430	**48,812**
Off-balance sheet items		
Payable guarantees to corporate customers	7,127	1,241
Performance bonds to corporate customers	662	45
Irrevocable liabilities for loans approval	3,435	2,034
	11,224	**3,320**
Total credit risk exposure	**70,665**	**52,143**

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.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

4. RISK MANAGEMENT (Continued)
4.3 Credit Risk (Continued)
4.3.2. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items (Continued)

Loans and advances are presented in the following tables:

In thousands of EUR
December 31, 2018

Description	Not matured not collectively impaired	Matured 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	**675**	**-**	**21,991**	**22,666**	**119**	**14**	**133**	**22,533**
Loans to Government	-	-	21,991	21,991	119	-	119	21,872
Units of local self-government – long-term	675	-	-	675	-	14	14	661
Retail loans	**1,020**	**33**	**-**	**1,053**	**-**	**8**	**8**	**1,046**
Cash loans	431	33	-	464	-	7	7	457
Housing loans	586	-	-	586	-	1	1	585
Overdrafts on bank accounts	3	-	-	3	-	-	-	3
Corporate loans	**4,083**	**208**	**26,519**	**30,810**	**196**	**92**	**288**	**30,522**
For permanent working capital	325	-	18,402	18,727	144	-	144	18,583
Overdraft	2,194	-	-	2,194	-	41	41	2,153
Revolving	1,440	-	3,938	5,378	27	48	75	5,303
Investment loan	30	-	1,679	1,709	11	-	11	1,698
Special purpose loan	94	208	2,500	2,802	14	3	17	2,785
Loans and receivables due from customers (gross)	**5,778**	**241**	**48,510**	**54,530**	**315**	**114**	**429**	**54,101**
Interest receivables	-	-	-	11	-	-	-	11
Accruals	-	-	-	139	-	-	-	139
Total loans and receivables due from customers	**5,778**	**241**	**48,510**	**54,680**	**315**	**114**	**429**	**54,251**
Loans and receivables due from banks	**-**	**-**	**740**	**740**	**1**	**-**	**1**	**739**
	5,778	**241**	**49,250**	**55,420**	**316**	**114**	**430**	**54,990**

4. RISK MANAGEMENT (Continued)
4.3. Credit Risk (Continued)
4.3.2. Maximum Exposure to Credit Risk per Balance and Off-Balance Sheet Items (Continued)

In thousands of EUR
December 31, 2017

Description	Not matured not collectively impaired	Matured 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
	247	-	-	247	-	-	-	247
Cash loans	380	-	-	380	-	-	-	380
Housing loans	4	-	-	4	-	-	-	4
Overdrafts on bank accounts								
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 loan	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	-	-	-	190	-	-	-	139
Total loans and receivables					-			
due from customers	**43,978**	**37**		**44,216**		**22**	**22**	**44,194**
Loans and receivables due					-			
from banks	-	-	-	**2,363**		-	-	**2,363**
	43,978	**37**	**-**	**46,579**	-	**22**	**22**	**46,557**

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

4. RISK MANAGEMENT (Continued)
4.3. Credit Risk (Continued)
4.3.3. Matured, collectively not impaired loans and placements

December 31, 2018	Up to 30 days	From 31 to 60 days	Total
Cash loans	33	-	33
Investment loan	-	-	-
Special purpose loan	208	-	208
Total	**241**	**-**	**241**

December 31, 2017	Up to 30 days	From 31 to 60 days	Total
For permanent working capital	9	-	9
Investment loan	20	-	20
Special purpose loan	8	-	8
Total	**37**	**-**	**37**

4.3.4. The fair value of collaterals up to the level of placements secured by those collaterals

		In thousands of EUR
	December 31, 2018	December 31, 2017
Mortgages	4,844	1,913
Pledge/other	208	702
Pledge deposit	51	7
Bank guarantee	13,170	13,948
Contract on Cession	661	255
Total	**18,934**	**16,825**

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.

4.3.5. Restructured Loans and Placements

The bank restructured a borrower's loan if due to the borrower's creditworthiness deterioration occurred the following:

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.

When restructuring the loan, the Bank performs a financial analysis of the borrower and estimates the borrower's ability to repay the loan after the loan restructuring to realize cash flows that will be sufficient to repay the principal and interest on the loan.

At the end of 2018, the Bank had no restructured loans.

4. RISK MANAGEMENT (Continued)
4.3. Credit Risk (Continued)
4.3.6. Classification and valuation of financial assets and liabilities

Compliant with IFRS 9 classification and valuation of financial assets depends on two basic criteria:

- a business model on the basis of which the Bank manages the financial asset
- the characteristic of contracted cash flows (the so-called SPPI criterion).

The business model reflects the way 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 the past experience of selling financial assets as well as future expectations in this respect.

Other relevant and objective information such as: the risks effecting the success of a business model and how these risks are managed, the manner of assessing the success of a business model, the manner of assessing the financial assets within the framework of this model and evaluating the Bank's management and other shall be taken into account.

The analysis is based on reasonably anticipated scenarios without taking into account the worst scenarios or stress scenarios, accordingly the Bank has defined the following business models:

- held to collect the cash flows.
- held to collect the cash flows and for sale and
- other business models (eg. held for sale).

If there is a change in the business model on which the financial asset is managed, a reclassification of the financial asset shall be performed.

Reclassification is performed prospectively or from the first day of the next reporting period.

The Bank expects no frequent changes in business models. The Bank shall re-evaluate the business model at least once a year.

If a business model of „holding to collect the cash flow" or „holding to collect the cash flows and for sale", an estimate is made whether the cash flows represent only the payment of principal and interest (the so-called „SPPI test).

In accordance with the basic credit arrangement, interest includes the compensation for the time value of the money, the accepted credit risk level of the borrower and other basic lending risks including the appropriate margin.

If agreed terms include exposure to risks that are not in accordance with the core credit arrangement, the financial asset is classified and measured at fair value through profit or loss, independent of the business model.

Based on conducted analysis of business models and features of contracted cash flows, the Bank, starting from January 1, 2018, classifies all financial assets in the following asset classes:

- Financial assets at amortized cost.
- Financial assets at fair value through other comprehensive income and
- Financial assets at fair value through profit and loss.

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

4. RISK MANAGEMENT (Continued)
4.3. Credit Risk (Continued)
4.3.7. Impairment of financial instruments in accordance with IFRS 9

Expected credit losses are recalculated at each reporting date in order to reflect the change in credit risk from initial recognition of a financial instrument.

This approach results in earlier recognition of credit losses by requiring that twelve months of expected credit losses be recalculated for all credit exposures.

Calculation of expected credit losses for the entire life expectancy is necessary for all credit exposures where there is a significant deterioration in credit risk relative to the moment of recognition of the asset.

The Bank uses future information and macroeconomic factors in calculating the expected credit losses, i.e. the Bank does not only consider historical information adapted to reflect the effects of current conditions and information that provide objective evidence that financial assets are reduced by losses, but understandable and supportive information include projections of future economic conditions in calculating expected credit losses both on an individual and on a group basis.

The level of loss provisioning will grow as the projected economic conditions deteriorate, i.e. the projected economic conditions become more favourable.

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

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

- Stage 1 covers all new financial assets at the time of initial recognition and instruments that do not have a significant deterioration in credit quality from the time of initial recognition, or these instruments are in the category of low credit risk;
- Stage 2 covers financial instruments that have a significant deterioration in credit quality since the initial recognition date, but there is no objective evidence of impairment on the basis of loan losses;
- Stage 3 covers financial assets with objective impairment indicators at the reporting date.

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

For financial instruments in Stage 1, the estimated 12-month loan losses are calculated.

For financial Instruments in Stage 2, the expected loan losses for the entire lifetime of the instrument shall be calculated.

For financial instruments in Stage 3, expected loan losses shall be calculated for the entire lifetime of the instrument and interest income shall be calculated on net exposure.

In accordance with its accounting policies, the Bank recognizes the interest income on Instruments in Stage 3 at the time of collection.

4. RISK MANAGEMENT (Continued)

4.3. Credit Risk (Continued)

4.3.7. Impairment of financial instruments in accordance with IFRS 9 (continued)

The gross exposure according to IFRS 9 is shown in the following table:

Description	Stage 1	Stage 2	Stage 3	Total Allowance for Impairment	Individual Allowance for Impairment	Collective Allowance for Impairment	Total Allowance for Impairment
Loans and receivables due from customers	**22,666**	**-**	**-**	**22,666**	**21,991**	**675**	**22,666**
Loans to Government	21,991	-	-	21,991	21,991	-	21,991
Units of local self government	675	-	-	675	-	675	675
Retail loans	**1,039**	**14**	**-**	**1,053**	**-**	**1,053**	**1,053**
Cash loans	450	14	-	464	-	464	464
Housing loans	586	-	-	586	-	586	586
Overdrafts on bank accounts	3	-	-	3	-	3	3
Corporate loans	**29,322**	**1,489**	**-**	**30,811**	**26,520**	**4,291**	**30,811**
For permanent working capital	18,729	-	-	18,729	18,402	326	18,729
Overdraft	2,194	-	-	2,194	-	2,194	2,194
Revolving	4,178	1,200	-	5,378	3,938	1,440	5,378
Investment loan	1,628	81	-	1,709	1,680	29	1,709
Special purpose loans	2,593	208	-	2,801	2,500	303	2,801
Loans and receivables due from customers*	**53,027**	**1,503**	**-**	**54,530**	**48,511**	**6,019**	**54,530**
Cash and deposits accounts held with central banks	6,095	-	-	6,095	6,095	-	6,095
Loans and receivables due from banks	740	-	-	740	740	-	740
Securities	4,453	-	-	4,453	4,453	-	4,453
TOTAL:	**64,315**	**1,503**	**-**	**65,818**	**59,795**	**6,019**	**65,818**

Description	Stage 1	Stage 2	Stage 3	Total Allowance for Impairment	Individual Allowance for Impairment	Collective Allowance for Impairment	Total Allowance for Impairment
Total guarantees	**5,348**	**2,440**	**-**	**7,789**	**5,277**	**2,511**	**7,789**
Payable guarantees to corporate customers	4,686	2,440	-	7,127	5,277	1,849	7,127
Performance bonds to corporate customers	662	-	-	662	-	662	662
Unused liabilities for loans issuance	3,435	-	-	3,435	1,500	1,935	3,435
Unused documentary letters of credit	-	-	-	-	-	-	-
TOTAL:	**8,783**	**2,440**	**-**	**11,223**	**6,777**	**4,446**	**11,223**

* Loans and receivables do not include interest receivable in the amount of EUR 11 thousand

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

4. RISK MANAGEMENT (Continued)
4.3. Credit Risk (Continued)
4.3.7. Impairment of financial instruments in accordance with IFRS 9 (continued)

The allowance for impairment of the values in accordance with IFRS 9 is shown in the following table:

Description	Stage 1	Stage 2	Stage 3	Total Allowance for Impairment	Individual Allowance for Impairment	Collective Allowance for Impairment	Total Allowance for Impairment
Loans and receivables due from customers	**133**	**-**	**-**	**133**	**119**	**14**	**133**
Loans to Government	119	-	-	119	119	-	119
Units of local self government	14	-	-	14	-	14	14
Retail loans	**8**	**-**	**-**	**8**	**-**	**8**	**8**
Cash loans	7	-	-	7	-	7	7
Housing loans	1	-	-	1	-	1	1
Overdrafts on bank accounts	0	-	-	-	-	-	-
Corporate loans	**280**	**9**	**-**	**289**	**196**	**92**	**288**
For permanent working capital	144	-	-	144	144	-	114
Overdraft	41	-	-	41	-	41	41
Revolving	69	7	-	76	27	48	76
Investment loan	9	2	-	12	11	-	11
Special purpose loan	17	-	-	17	14	3	17
Loans and receivables due from customers	**421**	**9**	**-**	**431**	**315**	**114**	**429**
Cash and deposits accounts held with central banks	4	-	-	4	4	-	4
Loans and receivables due from banks	1	-	-	1	1	-	1
Securities	24	-	-	19	24	-	24
TOTAL:	**450**	**9**	**-**	**455**	**344**	**114**	**458**

Description	Stage 1	Stage 2	Stage 3	Total Allowance for Impairment	Individual Allowance for Impairment	Collective Allowance for Impairment	Total Allowance for Impairment
Total guarantees	**50**	**14**	**-**	**64**	**46**	**18**	**64**
Payable guarantees to corporate customers	43	14	-	57	46	11	57
Performance bonds to corporate customers	7	-	-	7	-	7	7
Unused liabilities for loans issuance	64	-	-	64	21	43	64
Unused documentary letters of credit	-	-	-	-	-	-	-
TOTAL:	**114**	**14**	**-**	**128**	**67**	**61**	**128**

4. RISK MANAGEMENT (Continued)
4.3. Credit Risk (Continued)
4.3.7. Impairment of financial instruments in accordance with IFRS 9 (continued)

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	-	9	730	-	739
Loans and receivables due from clients	32,954	-	16,539	4,759	54,251
Securities	1,112	-	3,322	-	4,434
December 31, 2018	**34,066**	**9**	**20,591**	**4,759**	**59,424**
December 31, 2017	33,128	749	13,197	1,738	48,812

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 300%.

As of December 31, 2018, 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, B&H and Kosovo and it had securities in its portfolio issued by the Ministry of Finance of the Republic of Turkey.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

4. RISK MANAGEMENT (Continued)
4.3. Credit Risk (Continued)
4.3.8. 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	Securities	Total
Manufacturing	2,407	-	-	2,407
Construction	1,747	-	-	1,747
Wholesale and retail trade and repair of motor vehicles and motorcycles	2,388	-	-	2,388
Accommodation and meals services	2,722	-	-	2,722
Financial and insurance activities	14	-	-	14
Professional, scientific and technical activities	-	-	-	-
Public administration, defence and mandatory social insurance	22,533	-	1,112	23,645
Other services	-	-	-	-
Individuals – residents	993	-	-	993
Non-residents	21,297	739	3,322	25,359
TOTAL	**54,101**	**739**	**4,434**	**59,275**
Interest receivables and impairment of interest receivables	11	-	-	11
Accruals of interest and fees and impairment	139	-	-	139
December 31, 2018	**54,251**	**739**	**4,434**	**59,425**
December 31, 2017	**44,194**	**2,955**	**2,250**	**48,812**

4.3.9. 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, 2018
In thousands of EUR

	Irrevocable liabilities for loans approval	Guarantees	Uncovered letters of credit	Total
Up to 1 year	3,435	7,706	-	11,141
From 1 to 5 years	-	83	-	83
	3,435	7,789	-	11,224

December 31, 2017
In thousands of EUR

	Irrevocable liabilities for loans approval	Guarantees	Uncovered letters of credit	Total
Up to 1 year	2,024	906	2,930	5,860
From 1 to 5 years	10	380	390	780
	2,034	1,286	3,320	6,640

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

4. RISK MANAGEMENT (Continued)

4.4. Credit Risk (Continued)

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

The financial position and cash flows of the Bank are exposed to the effects of currency exchange changes.

The exposure to foreign exchange risk is regularly monitored by harmonizing 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, 2018 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	44	1	45		
Loans and receivables due from banks					
Total assets	44	1	45		
LIABILITIES					
Deposits due to customers	75				
Borrowings due to banks					
Total liabilities	75		75		
Net exposure to foreign currency:					
- December 31, 2018	(31)	1	(30)		
- December 31, 2017	(59)	-	(59)		

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, 2018, it had foreign currency funds in USD in the amount of 44 thousand and liabilities in the same currency in the amount of 55 thousand, resulting in a net short position of 11 thousand.

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, 2018 it amounted to 1% of own funds).

All other positions of financial assets and liabilities as of December 31, 2018 were stated in EUR (December 31, 2017: USD 59 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 alike.

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.

The Bank uses a simple method for calculating the required capital for operational risk and as of December 31, 2018 it amounted EUR 217 thousand.

As of December 31, 2018, the Bank allocated provisions for potential operational risk losses in the amount of EUR 6 thousand (Note 21).

4. RISK MANAGEMENT (Continued)

4.4. Market risk (Continued)

4.4.3 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, 2018:

In thousands of EUR

	Interest bearing	**Non-interest bearing**	**Total**
ASSETS			
Cash and deposits held with central banks	726	5,365	6,091
Loans and receivables due from banks		739	739
Loans and receivables due from customers	54,251		54,251
Securities at amortized cost	4,435		4,435
Other financial receivables	11		11
Total assets	**59,423**	**6,104**	**65,527**
LIABILITIES			
Deposit due to customers	23,113	37	23,150
Loans to banks and central banks	28,906		28,906
Other financial liabilities	137		137
Total liabilities	**52,156**	**37**	**52,193**
Exposure to interest rates changes:			
- December 31, 2018	**7,267**	**6,067**	**13,334**
- December 31, 2017	**1,499**	**4,685**	**6,173**

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 4,435 thousand.

As of December 31, 2018, most of the portfolio of debt securities relates to securities issued by the Ministry of Finance of the Republic of Turkey in the amount of EUR 3,323 thousand, which are classified as available for sale.

Also, the Bank in its portfolio has EUR 1,112 thousand of securities issued by the Ministry of Finance of Montenegro, which are also measured at fair value through other comprehensive result.

Based on the monitoring and measurement of the basic liquidity indicators (daily and decade liquidity coefficients), determined coefficients show that, during 2018, 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, 2018, the daily liquidity ratio amounted to 2.99 (December 31, 2017: 5.44), 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.

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	Tota
December 31, 2018									
ASSETS									
Cash and deposits held with central banks	**5,369**						**726**		**6,095**
Cash and cash equivalents	4,643	-	-	-	-	-	-	-	4,643
Allocated mandatory reserve funds	726						726		1,452
Funds held with banks	**739**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**739**
Loans and receivables due from customers	**5**	**17**	**66**	**1,172**	**16,352**	**17,772**	**17,796**	**1,071**	**54,251**
Securities available for sale			**-**	**58**	**118**	**-**	**2,055**	**2,203**	**4,434**
Other receivables	**35**		**-**	**-**	**-**		**-**	**-**	**35**
Total assets	**6,148**	**17**	**66**	**1,230**	**16,470**	**17,772**	**20,577**	**3,274**	**65,554**
LIABILITIES									
Total deposits, funds on esc. account and liabilities for interests and accruals	**7,714**	**-**	**30**	**169**	**897**	**634**	**13,664**	**-**	**23,108**
Demand deposits	5,704	-	-	-	-	-	-	-	5,704
Time deposits	2,010	-	30	169	897	634	13,664	-	17,404
Liabilities for interests and accruals		-	-	-	-	-	-	-	
Total borrowings	**16,037**	**-**	**8,000**	**-**	**-**	**5,000**	**4**	**-**	**29,041**
Borrowings from other credit and financial institutions	15,900	-	8,000	-	-	5,000	-	-	28,900
Liabilities for interests and accruals	-	-					-	-	
Other due liabilities	137		-	-	-		4	-	141
Total liabilities	**23,751**	**-**	**8,030**	**169**	**897**	**5,634**	**13,668**	**-**	**52,149**
Maturity gap as of 12/31/2018									
Maturity gap	**(17,603)**	**17**	**(7,964)**	**1,061**	**15,573**	**12,138**	**6,909**	**3,274**	**13,405**
Cumulative gap	**(17,603)**	**(17,586)**	**(25,550)**	**(24,489)**	**(8,916)**	**3,222**	**10,131**	**13,406**	**-67,385**
% of total funds sources	**(33,8%)**	**(33,7%)**	**(49,0%)**	**(47,0%)**	**(17,1%)**	**6,2%**	**19,4%**	**25,7%**	
Maturity gap as of 12/31/2017	493	(982)	(4,353)	1,137	10,763	(19,143)	17,083	1,161	6,159
Maturity gap	493	(489)	(4,842)	(3,705)	7,058	(12,085)	4,998	6,159	(2,413)
Cumulative gap	1,1%	(1,1%)	(10,6%)	(8,1%)	15,5%	(26,5%)	11,0%	13,5%	-

% of total funds sources

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 fulfil its due liabilities within the deadline, depends on one side of the balance sheet structure, and on the other side, the compliance of inflows and outflows of funds.

The structure of financial assets and liabilities as of December 31, 2018 indicates the existence of a maturity mismatch between the remaining maturity of assets and liabilities from 1 to 180 days.

During 2018, the Bank did not have problems with maintaining its liquidity. The daily liquidity ratio as of December 31, 2018 was 2.99% (December 31, 2017: 5.44%), while the decade liquidity ratio as of December 31, 2018 was 3.65% (December 31, 2017: 3.39%).

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	
	2018	**2017**	**2018**	**2017**
Financial assets				
Loans and receivables due from banks	739	2,368	739	2,368
Loans and receivables due from customers	54,251	44,194	54,251	44,194
Securities at amortized cost	4,434	2,250	4,434	2,250
Other financial receivables	11	11	11	11
Financial liabilities				
Deposits due to clients	23,150	25,303	23,150	25,303
Loans to banks and central banks	28,906	20,089	28,906	20,089
Other liabilities	137	201	137	201

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.

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

4. RISK MANAGEMENT (Continued)

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

4.6.1. Loans and placement to 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 balance sheet date.

4.6.2. *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.

The Bank's management believes that the Bank's interest rates do not deviate significantly from the prevailing market interest rates in the Montenegrin banking sector and accordingly fair value of loans to customers calculated as the present value of future cash flows discounted by applying the applicable market rates or average weighted interest rates for the banking sector does not significantly change of the stated carrying amount of the loan at the balance sheet date.

In management's opinion, the financial statements reflect the real value that is most credible and useful in the given circumstances for financial reporting purposes.

4.6.3. Financial assets available for sale

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

4.6.4. Deposits and loan liabilities

For demand deposits, as well as deposits with a residual maturity of less than one year, it is assumed that the estimated fair value does not deviate significantly from the 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.

4.6.5. Fair Value of Financial Instruments Measured at Fair value

a) 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.

4. RISK MANAGEMENT (Continued)

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

4.6.5. Fair Value of Financial Instruments Measured at Fair value

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

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. The Bank considers available market prices where possible. As of December 31, 2018 the market price of securities valued at fair value in the Bank's portfolio were available.

December 31, 2018	**Level 1**	**Level 2**	**Level 3**	**Total**
Securities at amortized cost	1,112	-	-	1,112
Total assets	1,112	-	-	1,112

December 31, 2017	**Level 1**	**Level 2**	**Level 3**	**Total**
Securities at amortized cost	2,250	-	-	2,250
Total assets	2,250	-	-	2,250

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

The fair value for financial assets available for sale is based on market prices. If market price information is not readily available, the market prices of quoted securities with similar characteristics are used. As of December 31, 2018, for securities measured at fair value in Bank’s portfolio, market prices were available.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018
4. RISK MANAGEMENT (Continued)

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

4.6.5. Fair Value of Financial Instruments Measured at Fair value (Continued)

c) 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, 2018	Level 1	Level 2	Level 3	Total	Carrying value
Cash and deposits held with central banks	-	6,091	-	6,091	6,091
Loans and receivables due from banks	-	739	-	739	739
Loans and receivables due from customers	-	54,251	-	54,251	54,251
Other financial receivables	-	11	-	11	11
Total assets	-	61,092	-	61,092	61,092
			-		
Deposits due to customers	-	23,150	-	23,150	23,150
Borrowings due to banks	-	28,906	-	28,906	28,906
Total liabilities	-	52,056	-	52,056	52,056

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	-	45,392	-	45,392	45,392

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

The fair value of financial instruments that are not valued at fair value is calculated only for the purposes of disclosing without effects to the balance sheet position or profit or loss 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.

4. RISK MANAGEMENT (Continued)

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

4.6.5. Fair Value of Financial Instruments Measured at Fair value (Continued)

d) Valuation techniques and assumptions used for valuation techniques for financial instruments not measured at fair value (Continued)

Under these 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
- To maintain a strong capital base to support the development of the Bank's further business.

Own assets of the Bank comprise the following:

- Core capital (paid-in share capital, retained earnings from prior years, profit for the year decreased for current year losses);
- Supplementary capital (reserves from profit after taxation: statutory and other 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.

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 obliged to align its business scope with the prescribed indicators, i.e. to align the scope and structure of its risk placements with the Banking Law and the Central Bank of Montenegro regulations.

On December 31, 2018, capital adequacy ratio calculated by the Bank for financial statements was 28.08%.

4. RISK MANAGEMENT (Continued)

4.8. Risk Exposure Analysis

4.8.1. Risk Exposure Analysis (Foreign Currency Risk)

Foreign currency risk exposure management, in addition to analyzing the Bank's receivables and liabilities denominated in foreign currency, includes sensitivity analysis on foreign currency exchange rate fluctuations. The following table shows the scenario of exchange rate changes ranging from + 10% to -10% compared to EUR.

In thousands of EUR

	Total	Amount in foreign currency	Change in exchange rate 10%	Change in exchange rate (10%)
ASSETS				
Cash and deposits held with central banks	6,091	24	2	(2)
Loans and receivables due from banks	739	20	2	(2)
Total assets	**6,830**	44	4	(4)
LIABILITIES				
Deposits due to customers	23,150	54	5	
Other liabilities	137			
Total liabilities	**23,287**	**54**	5	(5)
Net exposure to foreign currency risk:				
- December 31, 2018			1	(1)
- December 31, 2017			6	(6)

As of December 31, 2018, 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 1 thousand (December 31, 2017: profit would increase or decrease by EUR 6 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)

During the process of risk management from the change in interest rates, the Bank performs the sensitivity analysis of changes in receivables and liabilities with variable interest rates.

The following table shows the effect of fluctuations in interest rates on the Bank's receivables and liabilities denominated in EUR and foreign currency in the range from +0.4 b.p. to - 0.4 b.p. respectively.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

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

		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	6,091		
Loans and receivables due from banks	739	3	(3)
Loans and receivables due from customers	54,251	217	(217)
Securities available for sale	4,435	18	(18)
Other financial receivables	11		
	65,527	**238**	**(238)**
LIABILITIES			
Deposits due to customers	23,150	93	(93)
Borrowings due to banks	28,906	116	(116)
	52,056	**209**	**(209)**
Net exposure to interest rate risk			
- December 31, 2018		29	(29)
- December 31, 2017		14	(14)

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 29 thousand (December 31, 2017: the respective decrease would amount to EUR 14 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 AND EXPENSES

5.1. Interest income and similar income

	In thousands of EUR	
	Year ended December 31,	
	2018	2017
Loan interest income:		
- state organization	869	840
- Corporate customers	1,022	782
- Retail customers	44	29
- Other	34	44
	1,969	**1,695**
Securities available for sale	149	96
	2,118	**1,791**

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

5. INTEREST INCOME AND EXPENSES (Continued)

5.2. Interest expenses and similar expenses

	In thousands of EUR Year ended December 31, 2018	2017
Interest expense from deposits due to:		
- Financial institutions	-	55
- Corporate customers	117	51
- Retail customers	33	6
- Other	58	53
	208	**165**
Liabilities on loans and other borrowings:		
- Financial institutions	304	510
	304	**510**
	512	**675**

6. ALLOWANCE FOR IMPAIRMENT AND PROVISION EXPENSES

6.1. Impairment expenses, net

	In thousands of EUR Year ended December 31, 2018	2017
Loan impairment expenses	68	3
Expenses of impairment of off-balance items/(cancellation)	60	(1)
Securities impairment expenses	17	-
Interests impairment expenses	1	-
	146	**2**

6.2. Provision expenses

	In thousands of EUR Year ended December 31, 2018	2017
Provision for other liabilities	-	6
	-	**6**

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

7. FEES INCOME AND EXPENSES

7.1. Fee and Commission income

	In thousands of EUR Year ended December 31, 2018	2017
Fees from operations with loans	56	35
Fees from off-balance items	58	30
Bank charges	88	75
Fees for cards and e-banking	12	2
Other fees and commissions	10	6
	224	**148**

7.2. Fee and Commission Expenses

	In thousands of EUR Year ended December 31, 2018	2017
Fees to Central Bank of Montenegro	29	25
Bank charges	2	2
Deposit insurance premium fees	125	56
Fees for cards and ATM operations	34	5
Other fees and commissions	38	14
	228	**102**

8. STAFF COSTS

	In thousands of EUR Year ended December 31, 2018	2017
Net salaries	520	490
Taxes and contributions related to salaries	368	348
Fees to members of Board of Directors	80	93
Taxes and contributions related to fees to members of Board of Directors	10	12
Business trips expenses	12	17
Employees trainings	1	3
	991	**963**

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

9. GENERAL AND ADMINISTRATIVE EXPENSES

	In thousands of EUR Year ended December 31, 2018	2017
Rental expenses	141	132
Security	38	37
Property maintenance	171	174
Insurance services	5	5
Cleaning services	15	14
Audit expenses	131	121
Sponsorship and donations	3	4
Advertising	5	22
Electricity and fuel	19	18
Entertainment	16	24
Telecommunication and postal costs	57	54
Office material	5	4
Professional services	25	41
Public utilities services	4	3
Expenses related to capital increase	34	-
Court expenses	1	-
Other expenses	22	19
	692	**672**

10. OTHER INCOME AND EXPENSES

10.1. Other income

	In thousands of EUR Year ended December 31, 2018	2017
Other income	19	-
	19	**-**

10.2. Other expenses

	In thousands of EUR Year ended December 31, 2018	2017
Tax and other duties of local self-government units	42	33
	42	**33**

11. INCOME TAX

11.1. Income tax components

	In thousands of EUR Year ended December 31, 2018	2017
Deferred tax income	15	9
	15	**9**

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

11. INCOME TAX (Continued)

11.2. Reconciliation of income tax from Income Statement and results before taxation and prescribed tax rate

	In thousands of EUR Year ended December 31, 2018	2017
Loss before taxation	(648)	(874)
Income tax at the prescribed rate of (9%)	(58)	(78)
Income tax at the prescribed rate of (9%) on capital losses	-	-
Tax effects of expenses not recognized for tax purposes	1	2
Difference between the present value of fixed assets and intangible assets recognized in the financial statements and their value for tax purposes	15	9
Tax effects of current year tax losses carried forward	41	76
Other	16	-
Income tax stated in income statement	15	9

11.3. Deferred tax liabilities

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

In thousands of EUR

	Year ended December 31, 2018			Year ended December 31, 2017		
	Assets	Liability	Net amount	Assets	Liability	Net amount
Amortization of fixed assets	24	(21)	**3**	9	(21)	**(12)**
Change in fair value of the securities available for sale	4	(11)	**(7)**	8	(23)	**(15)**
Deferred tax assets/ (liabilities)	28	(32)	**(4)**	17	(44)	**(27)**

11.4. Unused operating tax losses that can be carried forward

Year of Inception	Year of Expiry	In thousands of EUR
2015	2020	1,269
2016	2021	1,165
2017	2022	752
2018	2023	458
		3,644

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, 2018, 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.

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

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

12. CASH AND DEPOSITS HELD WITH CENTRAL BANKS

	In thousands of EUR	
	December 31, 2018	December 31, 2017
Cash in hand in EUR	1,196	452
Cash in hand in foreign currencies	24	12
Cash in ATMs	69	19
Gyro account balance	3,355	1,311
Obligatory reserve held with the Central Bank of Montenegro	1,451	1,161
Less: Allowance for impairment of cash and deposits held with central banks	(4)	-
	6,091	**2,955**

The Bank's obligatory reserve as of December 31, 2018 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 FROM BANKS AND OTHER FINANCIAL ASSETS

13.1. Loans and receivables due from banks

	In thousands of EUR	
	December 31, 2018	December 31, 2017
Correspondent accounts held with foreign banks	740	2,363
	740	**2,363**
Less: Allowance for impairment of receivables with foreign banks	(1)	-
Total loans and receivables from banks	**739**	**2,363**

13.2. Other financial assets

	In thousands of EUR	
	December 31, 2018	December 31, 2017
Settlement account - Master Card	11	5
Other financial assets total	**11**	**5**

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

14. LOANS AND RECEIVABLES DUE FROM CUSTOMERS

In thousands of EUR

	December 31, 2018	**December 31, 2017**
Loans:		
Privately owned corporate customers	30,811	17,171
Government of Montenegro	21,991	25,268
Retail customers	1,053	631
Local self-government units	675	945
Out of which:		
Short-term loans:	**3,929**	**16,589**
Privately owned corporate customers	3,886	6,599
Government of Montenegro		9,970
Retail customers	43	20
Long-term loans:	**50,601**	**27,426**
Privately owned corporate customers	26,925	10,571
Government of Montenegro	21,991	15,298
Retail customers	1,010	612
Local self-government units	675	945
Total	**54,530**	**44,015**
Interest receivables:	**11**	**11**
Loans	11	11
Accruals	**141**	**190**
Loan interest	354	249
Loan fees	(213)	(59)
TOTAL GROSS LOANS AND RECEIVABLES	**54,682**	**44,216**
Less: Allowance for impairment on loans	(429)	(22)
Less: Allowance for impairment on interests	(2)	-
TOTAL LOANS AND RECEIVABLES	**54,251**	**44,194**

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

14. LOANS AND RECEIVABLES DUE FROM CUSTOMERS (Continued)

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

		In thousand of EUR
	December 31, 2018	**December 31, 2017**
Manufacturing	2,426	2,040
Construction of residential and non-residential units	1,776	1,341
Wholesale and retail trade	2,450	947
Accommodation and meal services	2,738	
Information and communication		500
Engineering activities and technical advisory	-	146
Public administration	22,666	26,212
Other services	14	4
Individuals – residents	1,001	598
Non-residents	21,459	12,227
	54,530	**44,015**

Loans to legal entities were approved at the following interest rates:

- Short-term loans with fixed interest rate: 2.99% - 7.75%
- Long-term loans with a fixed interest rate: 3.90% - 8.50%

The active interest rates applied to approved loans to legal entities during 2018 were as follows:

Type of loan	**Interest rate**
For permanent working capital	3.90% - 7.25%
Overdraft	3.30% - 7.75%
Revolving	2.99% - 7.00%
Investment loan	6.00% - 7.25%
Special purpose loan	4.00% - 7.25%

The active interest rates applied to approved loans to individuals during 2018 were as follows:

Type of loan	**Interest rate**
Cash loans	5.80% - 8.50%
Housing loans	3.99% - 5.50%
Overdrafts at bank accounts	9.00% - 12.00%

Changes in accounts of loans impairment (excluding interest receivables)

	Total
Balance, as of January 1, 2018	22
IFRS 9 application effect	339
Balance, as of January 1, 2018	361
Impairment and provisions during the year-NET	68
Balance, as of December 31, 2018	**429**

15. INVESTMENT SECURITIES

15.1. Financial assets at amortized cost

	In thousands of EUR December 31, 2018	December 31, 2017
Financial assets at amortized cost		
Securities	3,341	-
Less: Impairment of securities	(19)	**-**
	3,322	**-**

As of December 31, 2018, the Bank has in its portfolio the state bonds of:

The Republic of Turkey ISIN XS1057340009 in the amount of EUR 1,042 thousand traded as at October 5, 2015 with the maturity date of April 11, 2023.

- The Republic of Turkey ISIN XS1629918415 in the amount of EUR 483 thousand traded as at May 24, 2018 with the maturity date of June 14, 2025.
- The Republic of Turkey ISIN XS1629918415 in the amount of EUR 1,816 thousand traded as at June 25, 2018 with the maturity date of June 14, 2025.

15.2. Financial assets at fair value through other comprehensive income

	In thousands of EUR December 31, 2018	December 31, 2017
Financial assets at fair value through other comprehensive income		
Securities	1,112	2,250
	1,112	**2,250**

As of December 31, 2018, the Bank has in its portfolio the state bonds of Montenegro ISIN XS1377508996 in the amount of EUR 1,112 thousand (December 31, 2017 in the amount of EUR 2,250 thousand), traded as at March 29, 2016 with the maturity date of March 10, 2021.

In 2017, the Bank held and measured treasury bills of the Republic of Turkey ISIN XS1057340009 at a value of EUR 1,102 thousand, traded on October 5, 2015 with the maturity date on April 11, 2023.

The same government bonds were reclassified as Financial assets at amortized cost in 2018.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

16. PROPERTY AND EQUIPMENT

	In thousands of EUR Equipment and facilities adaptation
Cost	
Balance as of January 1, 2017	572
Additions during the year	32
Balance as of December 31, 2017	604
Additions during the year	242
Balance as of December 31, 2018	846
Accumulated amortization	
Balance as of January 1, 2017	174
Charge for the year	130
Balance as of December 31, 2017	304
Charge for the year	138
Balance as of December 31, 2018	442
Carrying value as of:	
- December 31, 2018	**404**
- December 31, 2017	**300**

As of December 31, 2018 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 2018 are shown in the following table:

	In thousands of EUR Software and Licenses
Cost	
Balance as of January 1, 2017	984
Additions	149
Balance as of December 31, 2017	1,133
Additions	1
Balance as of December 31, 2018	1,134
Accumulated amortization	
Balance as of January 1, 2017	283
Charge for the year	250
Balance as of December 31, 2017	533
Charge for the year	283
Balance as of December 31, 2018	816
Carrying value as of:	
- Balance as of December 31, 2018	**318**
- Balance as of December 31, 2017	**600**

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

18. OTHER ASSETS

		In thousands of EUR
	December 31, 2018	December 31, 2017
Other receivables for fees and commissions	6	1
Fees for maternity leave/sick leave, which are claimed from the state	-	4
Given advances	6	6
Prepaid expenses	13	15
	25	**26**
Less: Allowance for Impairment	**(1)**	**-**
	24	**26**

19. DEPOSITS OF BANKS AND CENTRAL BANKS

		In thousands of EUR
	December 31, 2017	December 31, 2017
Demand deposits		
Privately owned banks	21	-
	21	**-**

20. DEPOSITS DUE TO CUSTOMERS

		In thousands of EUR
	December 31, 2018	December 31, 2017
Demand deposits		
Corporate customers	4,138	855
Entrepreneurs	5	2
State funds	40	12
NGOs and other non-profit organizations	127	59
Individuals	1,374	1,084
Other	-	6
	5,684	**2,018**
Short-term deposits		
State owned and privately owned funds	-	3,000
Corporate customers	550	415
NGOs and other non-profit organizations	-	1,000
Individuals	824	553
	1,374	**4,968**
Long-term deposits		
State owned and privately owned funds	3,000	-
Corporate customers	6,165	18,165
Individuals	6,864	117
	16,029	**18,282**
Interest payables	-	3
Accruals	63	32
	23,150	**25,303**

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

20. DEPOSITS DUE TO CUSTOMERS (continued)

The passive interest rates applied to received deposits of companies during 2018 were as follows:

Type of deposit	Interest rate
Short-term deposits	0.90%-2.30%
Long-term deposits	1.15%-2.60%

The passive interest rates applied to received deposits of individuals during 2018 were as follows:

Type of deposit	Interest rate
Demand deposits	0.01%
Time deposits in EUR:	
- three months	
- six months	1.00%-1.10 %
- 12 months	0.90% - 2.30%
- 24 months	1.15% - 2.30%
- 36 months	1.65% - 2.60%

21. LOANS OF BANKS AND CENTRAL BANKS

In thousands of EUR

	Currency	December 31, 2018	December 31, 2017
Liabilities for taken loans:			
TURKIYE CUMHURIYETI ZIRAAT BANKASI A.S.	EUR	15,900	-
T.C. ZIRAAT BANKASI ATHENS CENTRAL BRANCH	EUR	-	4,000
Ziraat Bank International AG	EUR	-	-
T.C. ZIRAAT BANKASI LONDON	EUR	8,000	4,000
T.C. ZIRAAT BANKASI - SOFIA BRANCH	EUR	-	5,000
UT Bank JSC	EUR	-	4,000
ZIRAAT BANK BAHRAIN BRANCH	EUR	-	3,000
Hipotekarna banka AD	EUR	5,000	-
		28,900	**20,000**
Liabilities for calculated investment and fees:			
TURKIYE CUMHURIYETI ZIRAAT BANKASI A.S.	EUR	3	-
T.C. ZIRAAT BANKASI - SOFIA BRANCH	EUR	-	2
UT Bank JSC	EUR	-	45
ZIRAAT BANK BAHRAIN BRANCH	EUR	-	17
T.C. ZIRAAT BANKASI LONDON	EUR	1	25
Hipotekarna banka AD	EUR	2	-
		6	**89**
		28,906	**20,089**

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

In thousands of EUR

	Currency	Currency date	Maturity date	December 31, 2018
TURKIYE CUMHURIYETI ZIRAAT BANKASI A.S.	EUR	28.12.2018	04.01.2019	15,900
T.C. ZIRAAT BANKASI LONDON	EUR	28.12.2018	28.01.2019	8,000
Hipotekarna banka AD	EUR	21.12.2018	20.12.2019	5,000
				28,900

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

2. PROVISIONS

	In thousands of EUR	
	December 31, 2018	December 31, 2017
Balance as of January 1, 2018	10	5
Effects of IFRS 9 application	64	-
Balance as of January 1, 2018	74	5
Provision for potential losses on off-balance items	60	(1)
Provision for potential losses on operational risk	-	6
	134	**10**

23. OTHER LIABILITIES

	In thousands of EUR	
	December 31, 2018	December 31, 2017
Other tax liabilities	4	1
Liabilities to suppliers	31	11
Card operations liabilities	3	-
Accrued liabilities	99	189
	137	**201**

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

24. EQUITY

As of December 31, 2018, the Bank's share capital comprised 18,000 ordinary shares (December 31, 2017: 10,000 ordinary shares) with nominal value of 1 thousand EUR each. All issued shares have been fully paid.

On June 26, 2018, the Bank increased the capital by registering 8,000 ordinary shares with CDA with a nominal value of EUR 1 thousand each. Thus, the share capital of the Bank is increased by EUR 8,000,000.

The capital increase was made by majority shareholder TURKIYE CUMHURIYETI "ZIRAAT BANKASI ANONIM SIRKETI".

Total subscribed capital as of December 31, 2018 amounted to EUR 18,000 thousand.

As of December 31, 2018, 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, 2018, the Bank was obliged to maintain a minimum capital solvency ratio of 10%.

December 31, 2018, the Bank's solvency ratio was 28.08%.

24.1. 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.

24. EQUITY (Continued)

24.1. Own funds (Continued)

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 issuance premiums; reserves that are formed at the expense of profit after taxation (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, 2018, 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%.

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, 2018, the solvency ratio of the Bank was 28.08% and it exceeded the limit of 10% determined by the Law on Banks.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018
24. EQUITY (Continued)
24.1. Own funds (Continued)

The own funds of the Banks as of December 31, 2018 comprise the following:

	In thousands of EUR	
	December 31, 2018	December 31, 2017
Basic elements of own funds		
Paid-up share capital at nominal value, excluding cumulative preferential shares	18,000	10,000
Reserves that are formed at the expense of profit after taxation (statutory and other reserves)	149	150
Retained earnings from previous years for which the Shareholders' Assembly has made a decision is included in the core capital, decreased for the income tax and other expected expenses	(415)	-
Amount to mitigate the negative effects on the Bank's own assets as a result of transition to measurement of assets items under IFRS 9, determined in accordance with paragraphs 5 and 6 of Article 4 of the Capital Adequacy Decision of Banks	394	-
	18,128	**10,150**
Deduction items in the calculation of core capital		
Losses carried forward	3,087	2,222
Losses from current years	648	865
Intangible assets	318	600
Unrealized loss on the basis of value adjustments of financial assets available for sale at fair value	80	-
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	534	42
	4,665	3,729
Core capital	**13,463**	**6,421**
OWN FUNDS	**13,463**	**6,421**

24.2. 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 solvency 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:

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

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018
24. EQUITY (Continued)
24.2. Bank's solvency ratio (Continued)

As of December 31, 2018, according to the Bank's calculations, the solvency ratio equalled as follows:

		In thousands of EUR
	December 31, 2018	**December 31, 2017**
Core capital	13,463	6,421
Weighted balance assets	34,953	19,113
Weighted off-balance sheet items	5,698	1,024
Amount to mitigate the negative effects on the Bank's own assets as a result of transition to measurement of assets items under IFRS 9, determined in accordance with paragraphs 5 and 6 of Article 4 of the Capital Adequacy Decision of Banks (Article 14 of Capital Adequacy Decision)	394	
Total weighted balance assets	**41,045**	**20,137**
Capital required for operational risk	217	70
Capital required for country risk	4,734	2,242
Solvency ratio of the Bank	**28.08%**	**27.82%**

25. OFF- BALANCE SHEET ITEMS

		In thousands of EUR
	December 31, 2018	**December 31, 2017**
Guarantees:		
Payable guarantees to corporate customers	7,127	1,241
Performance bonds to corporate customers	662	45
	7,789	**1,286**
Collaterals:		
- cash deposit	40	17
- agreement on cession	1,200	-
- insurance policy	6,691	-
- other	201	-
- bills of exchange and administrative bans	61,866	-
- mortgages	16,922	2,867
- pledge/other	1,140	2,126
- pledge deposit	113	40
- bank guarantee	16,132	14,141
	104,305	**19,191**
Other off-balance items:	**3,435**	**2,034**
- irrevocable liabilities from loans approval	3,435	2,034
Total	**115,529**	**22,511**

26. 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.

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

26. RELATED PARTY TRANSACTIONS (Continued)

The overview of receivables and liabilities to related parties as of December 31, 2018 is given in the following table:

	In thousands of EUR	
	December 31, 2018	**December 31, 2017**
Cash		
TURKIYE CUMHURIYETI ZIRAAT BANKASI A.S.	731	1,614
ZIRAAT BANK INTERNATIONAL AG	1	2
	732	1,616
Loans:		
- to employees	296	301
TOTAL RECEIVABLES	**1,028**	**1,917**
Borrowings		
TURKIYE CUMHURIYETI ZIRAAT BANKASI A.S.	15,902	-
T.C.ZIRAAT BANKASI ATHENS CENTRAL BRANCH	-	4,000
T.C.ZIRAAT BANKASI LONDON	8,001	4,025
T.C. ZIRAAT BANKASI - SOFIA BRANCH	-	5,002
UT-BANK JSC	-	4,045
ZIRAAT BANK BAHRAIN BRANCH	-	3,017
	23,903	**20,089**
Deposits		
- due to employees	114	83
TOTAL LIABILITIES	**24,017**	**20,172**
NET LIABILITIES	**(22,989)**	**(18,255)**
Off-balance sheet items		
Received guarantees:		
- TURKIYE CUMHURIYETI ZIRAAT BANKASI A.S.	16,131	14,141
- Overdrafts on bank accounts of employees	3	4
Total off-balance items	**16,134**	**14,145**

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 6.50 % to 6.90%. Long-term loans to employees include loans for the purchase of housing units with a nominal interest rate of 3.99% to 5%.

Exposure to parties related to the Bank as of December 31, 2018 amounted to EUR 1,908 thousand and did not exceed the limit of 200% of the Bank's own funds.
Income and expenses from transactions with related parties during 2018 and 2017 were as follows:

	In thousands of EUR	
	December 31, 2018	**December 31, 2017**
Interest income (from employees):	15	12
Total income	**15**	**12**
Interest expenses		
ZIRAAT BANK BAHRAIN BRANCH	19	17
ZIRAAT BANK INTERNATIONAL AG	-	215
T.C.ZIRAAT BANKASI LONDON	98	120
T.C. ZIRAAT BANKASI - SOFIA BRANCH	27	23
UT-BANK JS	61	45
TURKIYE CUMHURIYETI ZIRAAT BANKASI A.S.	80	90
ZIRAAT BANK BH	25	-
T.C. ZIRAAT BANKASI-NEW YORK BRANCH	-	-
Total expenses	**310**	**510**
Net expenses	**(295)**	**(498)**

26. RELATED PARTY TRANSACTIONS (Continued)

In 2018, 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	152	234	-	386
Fees for membership in the boards	-	-	90	90
Total	**152**	**234**	**90**	**476**

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**

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

	In thousands of EUR	
	December 31, 2017	December 31, 2017
Cash in hand and ATMs (Note 12)	1,289	483
Bank account (Note 12)	1,451	1,311
Mandatory reserve with the Central Bank of Montenegro (Note 12)	3,355	1,161
Correspondent accounts with foreign banks (Note 13)	740	2,363
Settlement account - Master Card	-	5
	6,835	**5,323**

28. LITIGATIONS

As of December 31, 2018, there were neither litigations against the Bank nor the Bank was in the process of litigation against third parties.

29. COMPLIANCE WITH INDICATORS OF THE CENTRAL BANK OF MONTENEGRO

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

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2018

29. COMPLIANCE WITH INDICATORS OF THE CENTRAL BANK OF MONTENEGRO (Continued)

Compliance with the performance indicators prescribed by the Central Bank of Montenegro as of December 31, 2018 is presented as follows:

	Prescribed limit of CBM	Achieved performance indicators as of December 31 2018	2017
Bank solvency coefficient	min 10%	28.08%	27.82%
Bank Exposure to one party or group of related party	max 25%	24.85%	24.92%
Summary of great exposures	max 800%	263.79%	186.67%
Total exposure to parties related to the Bank	max 200%	14.17%	113.16%
Total exposure to persons employed with the Bank	max 1%	0.49%	1.09%
Bank liquidity coefficient	min 1%	2.99%	3.39%

30. 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.

31. FOREIGN EXCHANGE RATES

The official exchange rates used in the translation of foreign currency balance sheet items in EUR as of December 31, 2018 and 2017 were as follows:

	December 31, 2018	December 31, 2017
USD	1,1454	1,1993
TRY	6,0400	4,54640

32. 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, 2018 was 38
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
membe	Berrin MAHMUTOGLU
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	18,000

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

During 2018, there were no trading in the Bank's shares.

33. SUBSEQUENT EVENTS

There were no adjustable subsequent events that could have an impact on the financial position and the result of the Bank as of December 31, 2018.

ANNUAL MANAGEMENT REPORT
FOR 2018

Podgorica, April 2019

This Report is translation of the Annual Management Report issued in the language officially used in Montenegro. In the case of any discrepancy between the version in language officially used in Montenegro and English version, the version in the language officially used in Montenegro 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 December 2018, the Bank opened two universal-type branch offices, one in Bar, at: Bulevar Revolucije B-11 and the other in Budva, at: Ulica mediteranska bb. The branch offices were registered with the Central Registry of Business Enterprises on December 24, 2018.

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 CBM 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.

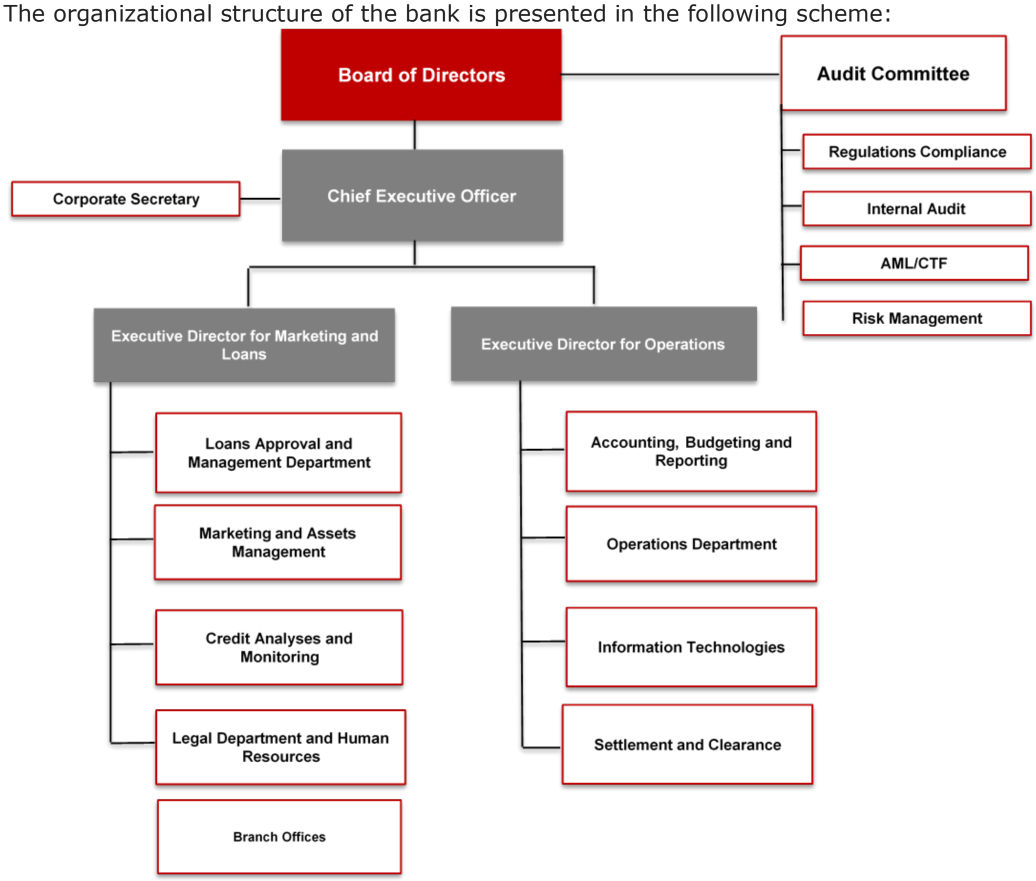
The Bank is registered with the Securities Commission in the Register of Securities Issues under the number 02/10e-5/2-15 as at May 8, 2015 (Decision No. 02/10e-5/2-15).

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, 2018, the Bank had 38 employees, out of which 36 employees worked on the basis of a labour contract with an indefinite period of time agreed, while 2 employees had a labour contract with an definite period of time agreed on.

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



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 St. Slobode No. 84 and performs its activities through its branch offices in Bulevar Ivana Crnojevića No. 101, Podgorica, in Bulevar revolucije B-11 in Bar and in Ulica Mediteranska bb in Budva.

1.9. Ownership and capital structure

As of December 31, 2018, the Bank's share capital comprised 18,000 ordinary shares (December 31, 2017: 10,000 ordinary shares) with a nominal value of EUR 1,000 each. All issued shares are fully paid.

On June 26, 2018, the Bank increased the capital by registering 8,000 ordinary shares with CDA with nominal value is EUR 1 thousand each. Thus, the Bank's share capital increased by EUR 8,000,000.

The capital increase was carried out by the majority shareholder, TURKIYE CUMHURIYETI "ZIRAAT BANKASI ANONIM SIRKETI".

As of December 31, 2018, the total inscribed capital amounted to 18,000,000 EUR.

As of December 31, 2018, the 100% shareholder of the Bank was TURKIYE CUMHURIYETI "ZIRAAT BANKASI ANONIM SIRKETI".

1.10. Workforce Capacities

As of December 31, 2018, the Bank had 38 employees, out of which 36 employees worked on the basis of a labour contract with an indefinite period of time agreed, while 2 employees had a labour contract with an definite period of time agreed on.

Out of 38 employees, 33 employees have university degrees of education, while 5 employees have secundary education degree.

Out of the total number of employees in the Bank, 21 employees i.e. 55% are men while 17 employees i.e. 45% are women.

The Branch Office in Podgorica has 6 employees, Branch Office in Bar has 3 employees, Branch Office in Budva has 3 employees while 26 employees are employed in the headquarters.

2. ANALYSIS OF FINANCIAL POSITION AND RESULTS FROM OPERATIONS

BALANCE SHEET

In thousand of EUR

ASSETS	2017	2018
Cash and deposits held with central banks	2,955	6,091
Financial assets at amortized cost	46,562	58,323
Loans and receivables due from banks	2,363	739
Loans and receivables due from customers	44,194	54,251
Securities	-	3,322
Other financial assets	5	11
Financial assets at fair value through other comprehensive income	2,250	1,112
Properties, plant and equipment	300	404
Intangible assets	600	318
Other assets	26	24
TOTAL ASSETS	52,693	66,272
LIABILITIES	**2017**	**2018**
Financial assets at amortized cost	45,392	52,077
Deposits of banks and central banks	-	21
Deposits of clients	25,303	23,150
Loans of banks and central banks	20,089	28,906
Reserves	10	134
Deferred tax payables	27	4
Other liabilities	201	137
Total Liabilities	**45,630**	**52,352**
EQUITY		
Share capital	10,000	18,000
Accumulated Losses	(2,222)	(3,502)
Loss of the current year	(865)	(648)
Other reserves	150	70
Total equity	7,063	13,920
TOTAL LIBILITIES AND EQUITY	**52,693**	**66,272**
OFF-BALANCE SHEET ITEMS	22,511	115,529

INCOME STATEMENT

In thousand of EUR

ITEM	2017	2018
Interest income and similar income	1,791	2,118
Interest expenses and similar expenses	(675)	(512)
Net interest income	**1,116**	**1,606**
Fee and commission income	148	224
Fee and commission expense	(102)	(228)
Net fee and commission income	**46**	**(4)**
Net gains on foreign currency exchange	20	8
Other income	0	19
Staff costs	(963)	(991)
Depreciation expenses	(380)	(421)
General and administration expenses	(672)	(692)
Net income/(expense) of impairment of financial instruments not measured at fair value through profit and loss	(2)	(146)
Provision expenses	(6)	0
Other expenses	(33)	(42)
LOSS BEFORE TAXATION	**(874)**	**(663)**
Income tax	(9)	(15)
LOSS	**(865)**	**(648)**

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 thousand of EUR

ROE (Return on Equity)	2017	2018
Net loss after taxation	(865)	(648)
Share capital	10,000	18,000
Net loss after taxation / Share capital	**(8.65)%**	**(3.60)%**

ROA (Return on assets)	2017	2018
Net loss after taxation	(865)	(648)
Total assets	52,693	66,272
Net loss after taxation / Total assets	**(1.64)%**	**(0.98)%**

Interest margin	2017	2018
Interest income	1,791	2,118
Interest expenses	675	512
Total assets	52,693	66,272
(Interest income – Interest expenses) / Total assets	**2.12%**	**2.42%**

Financial position indicators

In thousand of EUR

S1	2017	2018
Share capital	10,000	18,000
Total assets	52,693	66,272
Share capital / Total assets	**18.98%**	**27.16%**

S2	2017	2018
Total liabilities	45,630	52,352
Total assets	52,693	66,272
Total liabilities / Total assets	**86.60%**	**79.00%**

S3	2017	2018
Profit from operations (interest +fee)	1,939	2,342
Loss from operations (interest +fee)	777	740
Profit from operations / Loss from operations	**249.55%**	**316.49%**

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 thousand of EUR

Description	12/31/2017	12/31/2018	Banking sector as of 12/31/2018
Liquid assets (LA)	4,742	6,109	994,600
Total loans	44,194	54,251	2,930,201
Total assets (TA)	52,693	66,272	4,407,224
Total equity and liabilities (TEL)	52,693	66,272	4,407,224
Total deposits	25,303	23,150	3,459,237
Demand deposits	2,018	5,705	2,220,830
Total borrowings	20,089	28,906	297,265
Total deposits + borrowings	45,392	52,056	3,756,502
Total liabilities	45,630	52,352	3,890,385
Other assets	900	722	
Total equity	7,063	13,920	516,839

Liquidity indicators			
Liquid assets/deposits	18.74%	26.39%	28.75%
Liquid assets /total liabilities	10.39%	11.67%	25.57%
Loans/deposits	174.66%	234.35%	84.71%
Loans/deposits + borrowings	97.36%	104.22%	78.00%
Structure of assets and equity and liabilities:			
Liquid assets / total assets	9.00%	9.22%	22.57%
Loans/ total assets	83.87%	81.86%	66.49%
Fixed assets/ total assets	1.71%	1.09%	
Other assets/ total assets	1.57%	1.37%	
Equity/ total assets	13.40%	21.00%	11.73%
Structure of equity and liabilities:			
Deposits/total equity and liabilities	48.02%	34.93%	78.49%
Borrowings/ total equity and liabilities	38.12%	43.62%	6.74%
Deposits+ borrowings/ total equity and liabilities	86.14%	78.55%	85.24%

At the end of 2018, the loans/deposits ratio amounted to 234.12%, which represents a decrease by 59.50% when compared to 2017. The reason for such a decrease is the increase in deposits compared to 2017 by 8.50%, followed by the increase in loans by 22.75%.

The liquid assets/total assets ratio as of December 2018 was 9.22%. This ratio registered a decrease by 0.22% when compared to 2017.

Share capital/total assets ratio as of December 31, 2018 registered a decrease by 7.60% when compared to December 31, 2017. Such a decrease resulted in a decrease in share capital and an increase in total assets as of December 31, 2018. The Bank is well capitalized and the Bank's solvency ratio is 28.08%, i.e. significantly higher than 10% that is the minimum prescribed by the Law on Banks.

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.

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 on Banks.

2.2. Data on corporate governance bodies (Continued)

Appointment of Executive Directors

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 Senior 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 Senior 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;
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.

2.2. Data on corporate governance bodies (Continued)

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.

2.2. Data on corporate governance bodies (Continued)

Scope of work and competences of Credit Committees

The Board of Directors, pursuant to its legal competencies, has appointed the Senior 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 Senior 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 Senior 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	Berrin MAHMUTOGLU

Audit Committee	Name and Surname
Chairman	Dr.Sinan SAHIN
member	Aykut ARSLAN
member	Cetin TURAN

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

Credit Committee	Name and Surname
Chairman	Mustafa ŞENMAN
member	Vanja KIKOVIĆ

Senior Credit Committe	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

In 2019 and the forthcoming period, the Bank will continue to increase the credit and deposit bases as well as through further optimization and diversification, while maintaining a high level of liquidity and solvency as well as improved key business indicators.

One of the main intentions of the bank is to efficiently use newly opened branches in Bar and Budva with the aim of increasing its portfolio with the clients from neighboring towns and municipalities.

The Bank will analyze the market conditions in order to further expand its business network and increase the clients base.

Ziraat Bank Montenegro operates as a part of the Ziraat Finance Group and the Bank’s strategy in 2019 will be further strengthening the synergy achieved through close cooperation with the parent bank and other members of the Ziraat Finance Group in the field of asset and liability management, coordination in the field of liquidity improvement, new technologies.

The Bank’s orientation is to continue with the introduction of new products and services based on state-of-the-art technologies, in line with the latest market trends and customer needs.

The Bank has already established and will continue to maintain a comprehensive and stable risk management system that is integrated in all the Bank’s business activities.

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, 2018, the Bank allocated EUR 1,000 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.

6. INFORMATION ON REDEMPTION OF OWN SHARES, I.E. STAKES

As of December 31, 2018, the 100% shareholder of the Bank was TURKIYE CUMHURIYETI ZIRAAT BANKASI ANONIM SIRKETIU. The share capital of the Bank comprises 18,000 ordinary shares with nominal value of EUR 1,000 each. All issued shares have been fully paid.

As of December 31, 2018, the Bank did not redempt its shares/stakes in 2018.

7. BUSINESS UNITS

Immediately 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. Banka je tokom decembra 2018. godine otvorila još dvije ekspoziture univerzalnog tipa u Baru, na adresi: Bulevar revolucije B-11 i u Budvi, na adresi: Ulica mediteranska bb. Ekspoziture su registrovane kod Centralnog registra privrednih subjekata 24.12.2018. godine.

Currently there are 12 employees in the branches, including Branch Managers.

8. DATA ON FINANCIAL INSTRUMENTS OF IMPORTANCE FOR THE ASSESSMENT OF FINANCIAL POSITION AND OPERATIONS PERFORMANCE

As of December 31, 2018, the Bank incurred a loss in the amount of EUR 648 thousand. As of December 31, 2018, the total own funds amounted to EUR 13,463 thousand, which represented a decrease by 109.67% in relation to own funds as of December 31, 2017 when those amounted to EUR 6,421 thousand.

This increase is the result of the Bank's capital increase, which occurred in 2018, in the amount of EUR 8,000 thousand.

Compared to December 31, 2017, as a result of increased loan activity, total loans increased by 22.67%. As of December 31, 2018, total loans amounted to EUR 54,251 thousand, while as of December 31, 2017, total loans amounted to EUR 44,194 thousand.

As of December 31, 2018, total assets amounted to EUR 66,272 thousand, which is an increase of 25.77% compared to 2017, when it amounted to EUR 52,693 thousand. This is a consequence of the increased credit activity in 2018.

As of December 31, 2018, the total liabilities of the Bank amounted to EUR 52,352 thousand, which is an increase of 14.73% compared to December 31, 2017 when those amounted to EUR 45,630 thousand.

As of December 31, 2018, the total amount of clients' deposits amounted to EUR 25,150 thousand, which is an increase by 8.51% if compared to December 31, 2017, when those amounted to EUR 25,303 thousand.

The total deposits of clients make 34.93% of the total assets of the Bank.

As of December 31, 2018, the borrowings due to banks amounted to EUR 28,906, which represented a decrease by 43.89% if compared to December 31, 2017, when it amounted to EUR 20,089 thousand.

Borrowed funds by the members of the Ziraat Group amounted to EUR 23,900 thousand and made 82.70% of the total borrowed funds, while 17.30% of the borrowed funds represent a loan received by Hipotekarna banka in the amount of EUR 5,000 thousand.

All funds borrowed made 43.62% 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.

Thus, 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 production 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.

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.

9.6. Information System (Continued)

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

Banka ima pouzdane, efikasne i svobuhvatne strategije i procese za kontinuiranu procjenu i 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 is the likelihood of losses in the bank's operations due to the debtor's non-settlement of liabilities towards the bank.

Concentration Risk - part of the credit risk associated with large (associated) individual exposures and significant exposures to groups of counterparties, whose common probability of defaults is determined by common basic factors (sector, economy, geographical area, etc.). Risk of concentration - for other risks, defines exposure or a set of exposures that are linked by common risk factors, which can lead to losses that could jeopardize the Bank's operations.

Residual Risk - a sub-category of credit risk and presents the risk that recognized risk measurement and mitigation techniques are used by the Bank less effective than expected.

Market Risk is the likelihood of incurring a loss in financial instruments in the balance sheet and off-balance sheet of the bank, caused by changes in interest rates, foreign exchange rates, prices, indices and/or other market factors affecting the value of financial instruments, as well as the risks associated with the trading of financial instruments in the market.

Position Risk is the risk of loss arising from a change in the cost of a financial instrument in the case of a derivative financial instrument from a change in price i.e. a variable. The position risk is divided into:

a. General Position Risk;
b. Specific Position Risk.

a. **The General Position Risk** is the risk of loss arising from a change in the cost of a financial instrument due to a change in the level of interest rates or changes in the capital market regardless of any specific characteristics of that financial instrument.
b. **The Specific Position Risk** is the risk of loss arising from a change in the cost of a financial instrument due to facts relating to its issuer, or in the case of a derivative financial instrument in relation to the issuer of the underlying financial instrument.

Exchange Rate Risk is the likelihood of losses on balance sheet and off-balance sheet items due to changes in exchange rates and/or mismatches in the level of assets, equity and liabilities and off-balance sheet items in the same currency.

Operational Risk is the likelihood of incurring a loss in the bank's operations due to inadequate internal systems, processes and controls, weaknesses and omissions in the performance of unlawful activities and external events that may expose the bank to a loss.

Interest Rate Risk on the Banking Book (interest rate risk that does not arise from the bank's trading activities) is the risk of loss in the bank's operations due to changes in interest rates of balance sheet and off-balance sheet items that are not held for trading.

Liquidity Risk is the probability that the bank will not be able to provide sufficient funds to settle its liabilities at the time of their maturity, or the probability that the bank will have to acquire cash with significant costs to settle its due liabilities.

Country Risk is the probability of a loss for the bank due to the inability to collect receivables from a party outside Montenegro for reasons related to the political, social and economic environment of the country in which the head office is located, i.e the place of residence, of the debtor, and includes the political, economic and transfer risks.

Strategy Risk is an existing or potential risk in relation to income and capital arising from 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 banksbelonging 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, 2018 is presented as follows:

Performance indicators prescribed by CBM	Prescribed limit	Achieved performance indicators as of December 31,	
	CBM	2018.	2017.
Solvency ratio of the bank	min 10%	28,08%	27,82%
The Bank's exposure to a single entity or group of related entities	max 25%	24,85%	24,92%
Sum of large exposures	max 800%	263,79%	186,67%
Total exposure to persons related to the Bank	max 200%	14,17%	113,16%
Total exposure to Bank's employees	max 1%	0,49%	1,09%
Liquidity ratio of the Bank	min 1%	2,99%	3,39%

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:

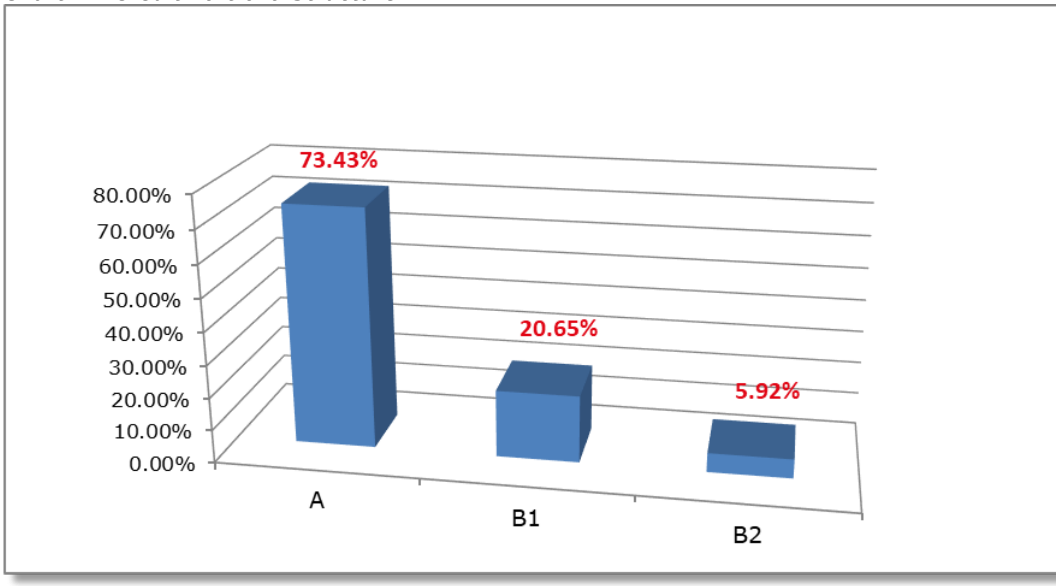
- Deposits;
- Pledges placed against industrial machines, securities, inventories and vehicles;
- Mortgages against property;
- Bills of exchange (corporate and personal);
- Authorizations for payments from the account;
- Administrative injunctions;
- Guarantors (for retail loans);
- Insurance policies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



In 2018, the Bank started applying the International Financial Reporting Standard IFRS 9, which entered into force on January 1, 2018, which is based on the model of expected credit losses and which replaced the model of losses incurred in accordance with IAS 39.

The basic principle of the model of expected credit losses is to present a general model of deterioration or improvement of the credit rating of financial instruments.

The amount of expected credit losses (ECL) that is recognized as provision expenses depends on the volume of credit impairment from initial recognition. There are two basis for calculation:

- Expected losses of 12 months ("Stage 1") applied to all financial assets (from initial recognition) until there is a significant deterioration in credit risk;
- Expected Losses in the Full Life Period of a Loan ("Stage 2" and "Stage 3") applied when there has been a significant increase in credit default, i.e. non-performing, on individual or collective basis.

Stages 2 and 3 differ in the manner of recognition of interest income. In Stage 2 interest income is accounted for gross book value. In Stage 3, interest income is accounted for as net book value.

At each reporting date, an assessment is made as to whether there was a significant increase in the credit risk from initial recognition or performance of non-performing status to assess the amount of default (ECL for 12 months or for the entire life of the asset) and the amount of the basis for recognition of interest income (gross book value or net book value).

Segmentation of financial instruments can change over time, especially over a long period of time, as new information on individual and collective financial instruments becomes available or the Bank's portfolio changes (for example, the introduction of a new type of loan product or the client's industry becomes more important in view of the risk characteristic, etc.). As a result, segmentation is subject to periodic re-consideration.

The parameters used in calculating the provision for credit losses (PD and LGD) are separately estimated by segment depending on the type of client and the time category (bucket).

At present, the Bank is unable to estimate the PD of life-time due to the lack of historical data.

Therefore, until the available amount of data allow the development of a collective assessment model, the Bank will use the data at the level of the Montenegrin banking system published by the CBM.

11.1. Credit Risk (Continued)

At the reporting date, an assessment is made as to whether there has been a significant increase in credit risk in relation to the date of initial recognition and whether the financial asset has been impaired in order to determine the applicable calculation of the provision (for 12 months or for the entire life of the asset).

A loan is granted in Stage 1, if the conditions for Stage 2 or Stage 3 are not met.

The following table presents the process of calculating the impairment.

Portfolio segmentation	Creditworthness assessment (classification groups)	Staging	Assessment method	
Corporate customers: Loans to corporate customers **Retail customers:** Loans to retail customers * In the future, depending on the development of the Bank's portfolio, additional segmentation is possible (which will take into account the credit risk characteristics)	**Time categories (buckets):** 1 (no default) 2 (1 to 30 days of default) 3 (31 to 60 days of default) 4 (61 to 90 days of default) 5 (91 to 120 days of default) 6 (121 to 180 days of default) 7 (181 to 360 days of default)	**Stage 3** - Days of default>90 - loan isimpaired **Stage 2** - Days of default >30 -Rating deterioration -Expert opinion **Stage 1** -All receivables not classified either in Stage 2 or Stage 3	Exposure of the client>= EUR 50 thousand Exposures that are not subject to individual assessment	**Individual assessment** **Collective assessment**

Stage	Total exposure
1	61.811.283
2	3.942.598
3	0
TOTAL:	**65.753.881**

Manner of Impairment	Total exposure
Individually	55.288.928
Collectively	10.464.954
TOTAL:	**65.753.881**

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.

11.2.1. 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, 2018, it had foreign currency funds in USD in the amount of 44 thousand and liabilities in the same currency in the amount of EUR 55 thousand, resulting in a net short position of EUR 11 thousands.
On the basis of the above, the Bank was not obliged to allocate capital based on the coverage of foreign exchange risk exposure, since the net foreign exchange position was less than 2% of its own funds (as of December 31, 2018 it amounted to 1% of own funds).
As of December 31, 2018, all other positions in financial assets and liabilities were in EUR currency (December 31, 2018 USD 59 thousand).

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.

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 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).
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.

11.3. Operational risk (Continued)

The Bank uses a simple method for calculating the required capital for Operational risk and it amounted to EUR 217 thousand as of December 31, 2018.

As of December 31, 2018, the Bank allocated provisions for potential operational risk losses in the amount of EUR 6 thousand (Note 21).

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 4,435 thousand. As of December 31, 2018, most of the portfolio of debt securities relates to securities issued by the Ministry of Finance of Montenegro in the amount of EUR 1,112 thousand, which are classified as available for sale.

Also, the Bank in its portfolio has EUR 3,322 thousand of securities issued by the Ministry of Finance of the Republic of Turkey, which are also classified as securities held to maturity.

Based on the monitoring and measurement of the basic liquidity indicators (daily and decade liquidity coefficients), determined coefficients show that, during 2018, 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, 2018, the daily liquidity ratio amounted to 2.99 (December 31, 2017: 5.44), while the minimum value of this coefficient defined by the Central Bank's decision was 0.9.

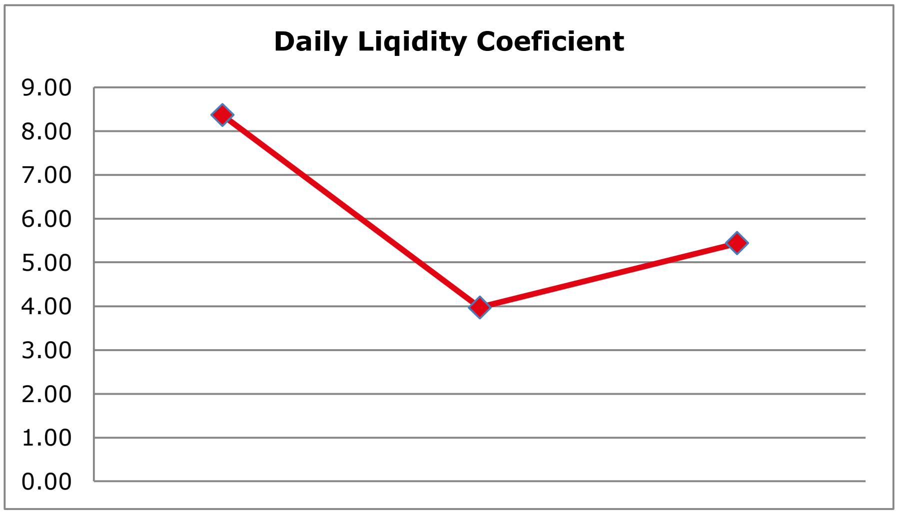
The Bank is obliged to maintain the liquidity level so that the liquidity ratio amounts at least:

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)

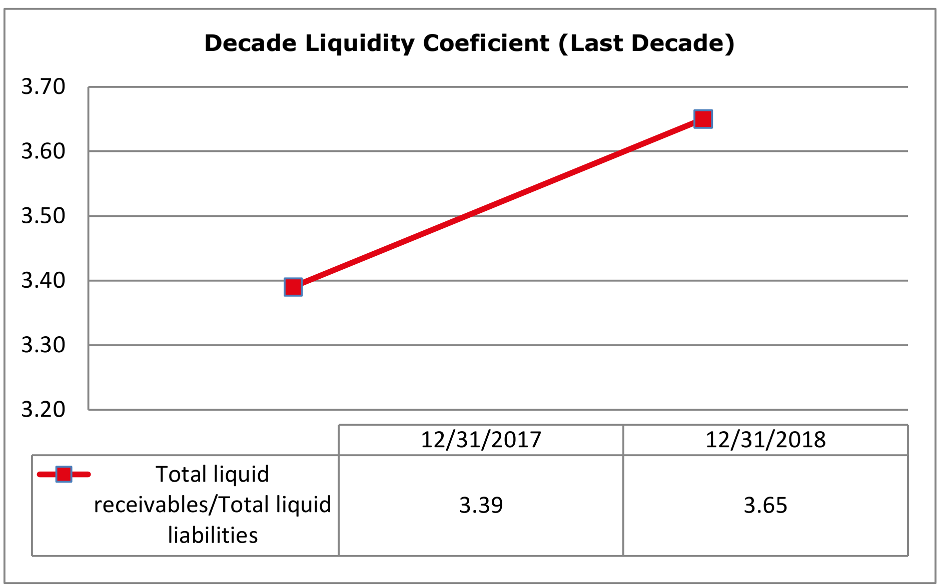
Daily liquidity coefficient for 2017 and 2018 is shown in the following chart:

Chart 2 - Daily liquidity coefficient



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

Chart 3 - 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, 2019

Signed on behalf of Ziraat Bank Montenegro AD by:

____
Mustafa Şenman
Chief Executive Officer

____
Goran Bakić
Executive Director

____
Jelena Božović
Head of Accounting, Reporting and Budgeting Department