Crnogorska komercijalna banka AD Podgorica

Public Disclosure of Data

According to Central Bank's Decision on Public Disclosure of Data by the Banks

Podgorica
31/05/2012

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1. Financial reports

Financial reports with independent auditor's opinion are already published on Bank's official internet site as part of Annual Report for 2011.

2. Risk Management Strategy and Policies

Strategic orientation of the Bank is to focus on its core business, value creating activities. Those activities could be classified in three main business segments that the Bank is planning to maintain and develop: Retail, SME, and Corporate and Municipal business segments. As to the Project finance segment, the Bank will engage in those activities only to a limited extent as a member of the syndicate sponsored by the holding company – OTP Hungary. Due to its strategic orientation to core commercial banking activities, and undeveloped capital and financial markets in Montenegro, the Bank does not plan to engage in investment banking and proprietary trading activities.

On the basis of the Business strategy, the Risk Management strategy describes the type, source, size as well as risk tolerance taking into account the Banks risk-bearing-capacity. The risk-bearing capacity represents the capacity to absorb losses stemming from risks the Bank is exposed to in its day-to-day operations, without an immediate threat to the Bank's continued existence. The risk-bearing capacity represents the total amount of regulatory capital available to cover all losses while risk tolerance level defines the amount of capital the Bank is planning to set aside to cover major types of risks it is facing.

The risk capital could be subdivided into three parts:

a) capital for planned risk - earmarked for covering existing risk and planned change in business orientation defined in the Business strategy;
b) capital for new risk – set aside in order to account for potential increase in risk in case the actual portfolio overshoots the planed volume;
c) capital for risk hard to quantify – reputation, legal and other risks hard to quantify.

Capital for planned risk is in turn allocated to the five major risk types the Bank is predominantly exposed to:

a) Credit risk - consisting of risk from on and off-balance sheet assets
b) Market risk – consisting predominantly of FX risk
c) Operational risk
d) Country risk
e) Other risk – interest rate risk from the banking book and liquidity risk

The defined risk tolerance level is translated into risk tolerance limits set out in corresponding risk management procedures for major types of risk. The set up risk-bearing capacity and corresponding risk-tolerance level is reviewed on an annual basis.

Credit risk

Credit risk is defined as a risk of loss due to a client's failure to honor its obligations towards the Bank.

The goal of credit risk management is to maximize the bank's risk adjusted rate of return by maintaining credit risk exposure within acceptable parameters. The bank should have a system in place to manage the credit risk inherent in the portfolio as well as risk in individual credits and transactions. The effective management of credit risk is a critical component of the comprehensive approach to risk management and essential to the successful banking activity.

The credit risk management in the bank strategically incorporates areas and functions as follows:

a) Establishing appropriate credit risk environment,
b) Operating under a sound credit granting process,
c) Maintaining an appropriate credit administration, measurement and monitoring process,
d) Ensuring adequate controls over credit risk.

The fundamental objectives of credit risk management are:

a) To keep balance between earnings and risk,
b) Potential losses should be always proportionate to the load-bearing capacity of the Group, CKB is belonging to.
c) The bank should develop and operate a risk management process which ensures that the bank complies with the Basel Conventions and local regulations ,
d) The bank must adjust its risk appetite and tolerance to the changes of the economic environment.

The strategic goal in terms of credit risk management in coming 3 year period will be to improve the quality of the credit portfolio and strict control of risk-cost. Therefore the risk management shall further tighten the conditions for loan approvals and further improve and put more serious emphasis on the monitoring of the existing placements.

The following principles form a cornerstone of credit risk management in the Bank and implemented in regulations, processes, governing activities of the bank:

1. The Board of Directors is responsible for establishing an appropriate credit risk environment by approving and periodically reviewing the Risk Strategy and significant credit risk policies of the

bank. The credit risk strategy is contained in the Risk Management Strategy of CKB document, while significant credit risk policies are described in Annual Credit Policy of CKB.

2. Credit risk Strategy approved by the Board of Directors establishes the objectives guiding the bank's credit granting activities, reflects the bank's tolerance for risk and the level of profitability the bank expects to achieve for incurring such risk, contains the necessary policies and procedures for conducting lending activities.
3. The bank should operate within sound, well-defined credit granting criteria. These criteria include a clear indication of the bank target markets, counterparty and exposure limits, approval authorities.
4. The bank should have a clearly established process in place for approving new credits as well as amendment, renewal and restructuring of existing credits.
5. The Management of the bank must develop policies and procedures for identifying, measuring, monitoring and controlling credit risk. Such policies and procedures should address credit risk in all of the bank's activities and both individual and portfolio levels.
6. The bank should be able to identify and manage credit risk inherent in all products and activities. The management should ensure that the risks of products and activities new to them are subject to adequate risk management procedures and controls.
7. The bank must maintain an appropriate credit administration, measurement and monitoring process, including client rating and asset classification system, determining the adequacy of provisions and reserves.
8. The bank should have an information system for monitoring the overall composition and quality of the credit portfolio and concentration of risk.
9. The Management should ensure adequate control over credit risk, with ongoing assessment of the credit management process and portfolio. Internal controls should ensure that exposures are kept within level consistent with prudential standards and internal limits.

Operational risk

Strategic goal of operational risk management in the Bank is to develop and implement an efficient operational risk management system and to raise operational risk awareness of employees. To that end, operational risks have to be identified and mitigated in a manner consistent with a principle that costs of mitigation shouldn't exceed potential losses caused by risk events. In addition, the Bank shall create an adequate response to eventual crisis situations that could pose a threat to continuity of the Bank's business by developing an adequate Business Continuity Framework.

The Bank attempts to minimize the risks arising from improperly working internal systems, processes, human error and external adverse effects, by developing an appropriate control environment and introduction of operational risk management culture in the organization. The remaining operational risk should be taken into account in pricing decisions or covered by insurance.

Operational risk is managed in a decentralized manner, whereby organizational units where operational risk is encountered are responsible for its management, in cooperation with the Risk Management Analysis and Regulations Department (RMARD), which is in charge of providing support in identification, measuring, mitigating and monitoring risks as well as providing the methodology that helps the executive officers in managing risks in systematic and timely manner.

The Bank puts an emphasis on a proactive approach in managing operational risks, meaning identification and measurement of potential risks preceding mitigation measures and monitoring activity. The instruments established for managing operational risks create a framework designed to filter out erroneous practices and processes and strengthen and introduce appropriate controls for risk mitigation, through the following cyclical phases:

a) Identification of current risks (loss data collection) and the risks that may arise from new business products or activities (risk self assessment);
b) Measurement of risks through establishing the mechanisms and the procedures for the accurate and timely assessment of risks, by taking into account the probability and the impact of potential risks;
c) Monitoring and analysis,
d) Control of risks by limiting and minimizing risks.

Market risk

The purpose of the market risk management system in the Bank is to minimize the risk stemming from:

a) Positions in the trading book
b) FX transactions
c) Counterparty and settlement risk

One of the major principles in market risk management is a separation of risk taking and risk monitoring and control functions, coupled with introduction of adequate internal controls and their continuous improvement.

The Bank is aiming to achieve balanced FX position. Open positions are created only with the goal of servicing client's orders and are always kept with the limits defined by the mother bank (OTP group) and in compliance with CBCG regulations. Keeping open FX positions in order to profit from specific FX rates dynamics, shall not be conducted.

Counterparty and settlement risk should be minimized by entering into agreements only with the most creditworthy counterparties and only to the extent necessary to support core business and liquidity needs. Group level position limits as well as limits provided by CBCG regulations shall be strictly observed.

Country risk

Strategic country risk management goals are determined by the Bank's core business activity plans as well as by liquidity management performed centrally by OTP headquarters in Hungary. To that end the bank will accept only low level of country risk exposure necessary of unhindered development of core commercial banking activities.

In order to minimize the level of country risk the Bank has developed a rating and limit setting methodology for country risk exposures. The rating as well as limit setting is conducted at the group level by OTP Hungary in order to minimize the level of country risk in excess of the level needed for performing core banking activities.

The rating methodology takes into consideration the following factors:

1. Different country characteristics such as geopolitical position, world market weight, development of economy, level of development of bank sector, etc.)
2. Social and institutional framework, macro-economic trends and vulnerability (external ratings, growth and balance of payment indicators)
3. Shorter term political and economic developments that could have an impact on market sentiment
4. The Group-level limits and distribution of limits to group members is set up by the holding company – OTP Hungary.

Liquidity risk

The main objective of liquidity risk management strategy is to establish a system of monitoring the bank's liquidity and its quality, composition, maturity and deposit variability and sources of funds, and based on that, achieve a stable and safe business operation of the bank.

The objectives of liquidity management strategy include:

a) providing liquidity in the short and long term;
b) strategies to maintain liquidity;
c) instruments to maintain liquidity;
d) compliance with legally prescribed standards

In order to maintain short-term liquidity, liquidity risk is measured by the following liquidity ratios:

a) cash and cash on accounts in the country and abroad (excluding mandatory reserve) in the amount of minimum 10% of short-term resources;
b) secondary liquidity reserves in the amount of up to 10% of total short-term resources;
c) total liquidity reserves are determined at the level of minimum 25% of short-term obligations.

In order to maintain long-term liquidity, liquidity risk is measured by the following liquidity ratios:

a) Cash / current liabilities in the amount of minimum 15%;
b) Current assets / total liabilities in the amount of minimum 20%;
c) Liquid assets / short-term liabilities in the amount of minimum 40%;
d) Loans / deposits in the amount of maximum 80%;
e) Short-term liabilities / total liabilities (monitored at regular intervals).

In order to maintain optimal liquidity the Bank will:

a) perform the analysis of maturities by which the dynamic matching of incoming cash and outgoing cash of the bank is monitored for a period of 15, 30, 90, 180, 360 and over 360 days and by which possible mismatch in cash flows is revealed. Based on the results of the maturity analysis, the action plan for resolving determined mismatch positions is prepared;
b) monitor changes on the accounts of 10 largest depositors and try to obtain as much information as possible in order to predict accurately the future changes on their accounts

Interest rate risk from the banking book (IRRBB)

The bank seeks to minimize interest rate risk form banking book. To that end, the Bank will not deliberately take positions to benefit from a particular movement in interest rates.

Interest rate risk form the banking book arises due to changes in:

a) Repricing or maturity mismatch between assets and liabilities (repricing risk)
b) Shift in reference rates for assets and liabilities (basis risk)
c) Change in the shape of yield curve (yield curve risk)
d) Exercise of imbedded options in loans contracts (option risk)

Considering the complexity of its activities, the Bank has identified repricing risk as a major source of interest rate risk while impact of other sources is immaterial.

For measuring interest rate risk, the Bank is using maturity gap reports as well as duration models. To evaluate the potential impact of interest rate risk management on its operations the Bank is considering the affect on both its earnings (earnings-accounting perspective) and its economic value of equity (economic capital perspective).

Risk Management System in the Bank

Given the scope and complexity of its operations, the Bank has developed and is continuously working on maintaining and improving an effective risk management system capable of responding to needs of ever-changing business environment. To that end the Bank is constantly managing all relevant risks in accordance with the Law and CBCG regulations as well as taking into account OTP Group level risk management standards.

The risk management system consists of the following elements:

a) Appropriate strategy for risk management;

b) Adopted policies and processes for risk management;

c) Clearly defined powers and responsibilities for risk management;

d) Efficient and safe information technology system;

e) Contingency plans;

f) Stress testing.

Adopted Risk Management policies and procedures

Risk management Policies and procedures define a framework necessary for achieving strategic risk management goals on a daily basis. Those documents regulate and define processes, policies, tasks and functions pertaining to all levels of risk management throughout the organization. The following regulations represent a framework for risk management in the Bank:

1. **Client Rating Regulation** (identification and measurement of individual client/client group risk, methods, indicators and timeframes for measurement);
2. **Risk Assumption Regulation** (risk assumption process, limits and control procedures of individual and overall exposures);
3. **Collateral Evaluation Regulation** (types of risk mitigation tools, accepted securities as collateral, their measurement and registration);
4. **Credit Policy** (the main document relating to credit risk, including target clients, principles and criteria of risk taking, conditions of products both for corporate and retail clients, prepared annually);
5. **Asset classification and impairment regulation** applying local and IFRS standards (identification of risk bearing and risk free items, classification criteria, classification groups, impairment methodologies, provisioning policies, debt write-offs);

6. **Operational Risk Management Policy** (includes policies and procedures related to operational risk management issues, Business Continuity plan - BCP), Business Impact Analyses - BIA);
7. **Country and counterparty risk management regulations;**
8. **Liquidity, Interest rate and Market risk Regulation**;
9. **General regulation on operation of Credit Approval Departments;**
10. **General Regulation on operations of Monitoring Department;**
11. **General Regulation on operation of Work-out Department);**
12. Powers and responsibilities in risk management process including decision-making are regulated in the **Rules of Organization and Operation of CKB**, approved by the BoD and detailed procedures are contained in relevant Rules (Rules on procedure on Credit and Limit Committee, Rules on Procedure on Work-out Committee).

Powers and Responsibilities in Risk Management

Board of Directors

The Board of Directors is responsible for approving and periodically reviewing the Risk management Strategy of the bank as well as all risk related policies and regulations. The BoD has a crucial role in overseeing the whole risk management system of the bank, adopting its elements and exercising control over implementation of high level principles and practices. The Board of Directors is the body to approve the business strategy of the bank, defining at the same time the risk appetite and risk tolerance at a level which is commensurate with its sound operation and strategic goals. The BoD takes also primary responsibility for the ICAAP.

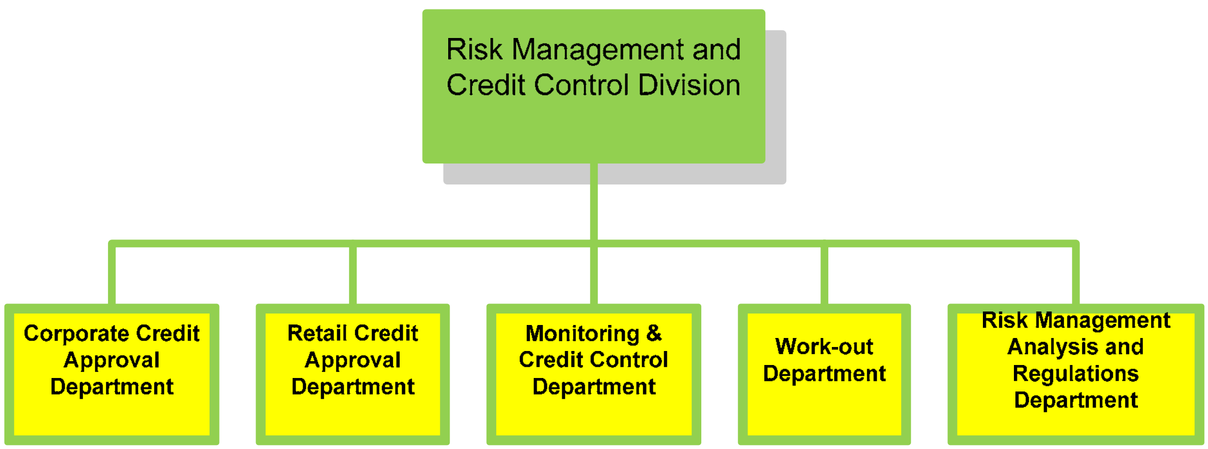
Management Committee

The Management Committee of the bank is responsible for implementing the Risk Management Strategy, policies and procedures approved by the BoD, including the set up of a risk averse organization. The Management Committee is responsible for establishing sound business practices and strategic planning. Business plans adopted by the management should take into account all relevant risks. It is of the utmost importance that the management body in carrying out both its management and supervisory functions has collectively full understanding of the nature of the business and its associated risks. The Senior management has crucial role in developing a risk-averse culture in all field of activity of the bank. The management has to ensure that risk culture extends across all of the organization’s units and business lines. The Management should ensure that the bank sets trading, credit, liquidity and other risk limits that are consistent with the bank’s risk appetite and risk tolerance, even in stressed economic environment. The Management should ensure that the allocation of resources to the risk management function is sufficient in amount and quality to allow fulfilling its mission. The responsibility of the Management Committee includes implementation of ICAAP in the bank.

Risk Management function

One of the prerequisites for creating a risk culture is the establishment of a comprehensive and independent risk management function across the entire organization under the direct responsibility of the Executive Director in charge of Risk Management and Credit Control Division who is playing the role of the Chief Risk Officer (CRO). The CRO should have sufficient independence and seniority to enable him to challenge and veto the decision-making process in the bank. The CRO plays a key role in identifying, measuring and assessing the overall risks faced by the bank. His responsibilities include elaboration of risk management strategy and policies, proposal for creation of appropriate risk management system, overseeing and approving internal rating systems and risk assessment models, and analyzing and approving risks of new products. The CRO can exercise veto right but should be at arm's length from decision-making functions.

Figure 1 Risk Management Organizational Structure



Decision making system

The bank must operate a decision-making system within its organizational structure depending on the size and complexity of the bank's operations. Risk related decisions should be made by powers and responsibilities, delegated by the Board of Directors to bodies, consisting of experts, who have the experience, knowledge and background to exercise prudent judgment in assessing, approving and managing risks. The process of decision making as well as levels of delegated powers should be stipulated in internal regulations, approved by the BoD.

Monitoring and reporting

The bank should have a system in place to monitor and control all risks the bank is exposed to. Limits, set by relevant regulations must be observed and regularly reported to the BoD. Risk analyses and monitoring represents a core function of the risk management system.

Information technology system

The bank should establish and maintain reliable information system that adequately ensures gathering and processing information, as follows:

a) Measurement and monitoring of risk exposures on daily basis and in other determined periods,
b) Monitoring if the established limits for risk management are met,
c) Creation of reporting formats for bank bodies and other parties included in risk management process.
d) Internal procedures and information systems should be consistent in the bank and reliable so that all sources of relevant risks can be identified, measured and monitored on an aggregate basis and also by segments and portfolio.

Contingency plans

The Bank has developed a comprehensive Business Continuity Planning System aimed at identifying core value creating processes and preserving their continuity in the event of a crisis situation.

Contingency/crisis plans should specify resources needed as well as alternative procedures in order to preserve the continuity of important processes during a crisis. Those plans should constantly be enhanced and reviewed on a regular basis – at least annually. All the personnel involved in the process should be properly trained for implementing contingency plans and their knowledge and skills should be regularly tested.

Stress testing

The bank should conduct stress test exercises, testing the bank's sensitivity to individual types of risks and on an aggregate basis. Stress scenario shall include assumptions of extreme changes of market and other factors, which may have significant material impact on bank's performance.

Since credit and liquidity risk are the most important type of risks faced by the Bank, stress testing frameworks for those risks should be developed with special attention to analysis of the Bank's ability to absorb shocks emanating from stress scenarios and preserving financial soundness.

Risk reporting and measurement system

Credit risk

Credit risk measurement and assessment is conducted on an obligor and portfolio level simultaneously.

Obligor level consists of determination of potential riskiness of a client based on a set of risk characteristics. For retail clients those characteristics comprise socio-demographic and behavioral characteristics, while for corporate and SME clients the creditworthiness and potential credit risk is determined based on a set of financial risk parameters (pertaining to the financial condition of a client) as well as business and industry risk. Based on the analysis of historic data, the importance of a particular risk characteristic for predicting the client's riskiness is determined. Summing up all risk characteristics weighted by their predictive power yield an overall risk measure for a particular obligor.

In parallel the Bank is measuring credit risk on a portfolio level also. To that, based on historical data the Bank is calculating and monitoring NPL ratios, probability of default (PD) and loss given default (LGD) for a portfolio segments with similar risk characteristics.

Details on measurement and assessment methodology can be found in the Bank's Risk Assumption Regulation, Client Rating Regulation, Risk Management Strategy and Credit Policy.

Comprehensive credit risk reports with special focus on risk concentration, sector and regional exposures as well as deals with increased risk are submitted to the management on a monthly and quarterly basis.

Liquidity risk

The Bank is measuring liquidity risk based on projection of net cash flows, calculating liquidity ratio and using a liquidity gap reports on a daily, ten days and quarterly basis.

Net cash flows are calculated as a difference between cash inflows and cash outflows for a particular time period. In defining cash inflows and outflow the Bank is using a set of assumptions as defined in the CBCG decision on minimum standards for the management of liquidity risk in banks.

Liquidity ratio represents the ratio of short-term assets to short-term liabilities as defined in the CBCG decision on minimum standards for the management of liquidity risk in banks.

Liquidity gap report represents an overview of cash inflows and outflows across different maturity bands. In order to comply with the CBCG requirements, the Bank is using the following maturity spectrum:

- 1-7 days
- 8-15 days

- 16-30days
- 31-90 days
- 91-180 days
- 181-365 days
- 1-5 years
- Over 5 years

Mismatch between cash inflows and outflows are shown for each maturity band separately and on a cumulative basis across the entire maturity spectrum.

The management is informed about liquidity risk and position on a monthly basis through liquidity reports submitted to the Assets/Liabilities Committee (ALCO).

CBCG is informed about liquidity position and liquidity risk through reports submitted on a daily basis and every 10 days.

Market risk

The Bank is measuring the level of foreign exchange (FX) risk by calculating a net open position for all currencies separately and on a cumulative basis for the entire FX portfolio of the Bank, assuming normal and extreme movements in FX rates. The net open position is calculated as a difference between long and short FX position. A long FX position is defined as a sum of all FX assets and positive FX off-balance sheet positions, while a short FX position represents a sum of all FX liabilities and negative FX off-balance sheet positions.

The management is informed about the level of FX on a quarterly basis through FX risk report containing overview of long, short and open positions in foreign currencies alongside with CBCG set exposure limits, as well as minimum capital requirements for FX risk.

Operational risk

The Bank is measuring operational risk by analyzing collected operational risk loss data. The Bank is in the process of introducing a system of operational risk self-assessment whereby it will measure the impact of operational risk against the probability of its occurrence in order to better evaluate potential operational risk.

Report on operational risk losses are presented to the management every six months. With the introduction of operational risk self assessment system in 2012, operational risk exposure by the means of operational risk matrix will be presented to the management on a yearly basis.

Country risk

For measuring country risk the Bank has developed an internal country rating methodology as set forth in the Bank's Procedure for the Management of Country Risk. The methodology assigns a rating on a 1 to 7 scale to each country exposure based on various country risk scores obtained from the relevant international sources such as:

a) The country ranks published in the journals Euromoney, issued by Euromoney Institutional Investor Plc, London and Institutional Investor, issued by Institutional Investor Inc., New York, as well the ones disclosed by Economist group's economic research institute, the Economist Intelligence Unit (EIU).
b) Country analyses and ratings of the international rating agencies (Moody's, Fitch, Standard and Poor's)
c) The country classifications of Dun & Bradstreet.
d) The ratings of the OECD Country Risk Classification.
e) Country analyses prepared by the Institute of International Finance.
f) International statistical publications and databases.
g) Country reports of international financial institutions.
h) Country reports of foreign banks.
i) News of the international press agencies, and other media (with special regard to the information obtainable from Factiva).

On the basis of information obtained for those sources, the Bank is calculating a country rating using the following set of weights for particular information:

a) Euromoney rating system: 40%,
b) Averages of the scores given by Institutional Investor and Economist Intelligence Unit (EIU): 10%
c) Moody's, Fitch and S&P country ratings: 30%
d) Dun & Bradstreet ratings: 10%
e) OECD Country Risk Classification ratings: 10%
f) Subjective rating that could modify the total scores by ± 10 points.

Country risk reports are presented to the management on a quarterly basis. The report contains overview of exposure according to CBCG defined risk categories as well as break down of exposures according to internally assigned country risk ratings alongside corresponding exposure limits. In addition, the report contains information on minimum capital requirements for country risk.

Interest rate risk form the banking book (IRRBB)

Interest rate risk form the banking book represents a risk of incurring losses in bank's operations due to the interest rate changes for balance sheet and off balance sheet items that are not intended for trade.

To quantify the bank's interest rate risk form the banking book exposure, the Bank is using a repricing-maturity gap reports. The impact of 200 bps parallel yield curve shock (standardized rate shock) is assessed on the net interest income (NII) up to one year across four maturity bands: 1-30 days, 31-90 days, 91-180 days and 181-365 days. The impact of the standardized rate shock on the Bank's NII is determined using the following formula:

(Periodic gap) x (Standardized IR shock) x (time over which the periodic gap is in effect) = change in NII

The report on IRRBB containing impact of standardized interest rate shock of +/- 200 bps on the Bank's annualized net interest income is submitted to the management on a quarterly basis. The report also contains information on minimum capital requirements for IRRBB.

Risk mitigation

Credit risk

Credit risk in the Bank is controlled and mitigated on a portfolio and obligor level by observing strict position and credit risk limits designed to achieve strategic risk management goals defined in the Bank's Risk Management Strategy.

Besides exposure limits defined in CBCG laws and by-laws, the bank has set up its internal credit risk limits on a portfolio and obligor level. Obligor level credit risk limits are set in terms of the following parameters:

a) Prescreening creditworthiness limits in the credit adjudication process
b) Cut-off client ratings for different client groups in the credit adjudication process
c) Overcollateralization and haircut rules.

On the portfolio level, the level of credit risk is controlled and mitigated in a systematic way in different portfolio segments. Different limits in terms of several credit risk parameters are set in each portfolio segment in order to comport with the Bank's Risk Management Strategy. The following risk parameters are used for setting up adequate risk limits given the desired risk cost, NPL rates and coverage ratios defined in the Risk Management Strategy:

a) Default rate (DPD 90+/total portfolio)
b) Risk cost rate

c) Approval rate
d) Scoring rejection rate
e) Proportion of exception approval cases
f) Portfolio at risk
g) Percentage of restructured loans (CPP)
h) Proportion of loans with residual maturity over 5 years
i) Proportion of newly approved loans with residual maturity over 5 years

Liquidity risk

To control and mitigate liquidity, The Bank is observing strict liquidity risk limits set forth in relevant CBCG by-laws.

Market risk

To control and mitigate market risk in its treasury and commercial banking activities, The Bank is observing strict FX position limits set forth in relevant CBCG by-laws. To that end the Bank is not engaging in any bet on FX movement designed to exploit profit from those strategies.

Operational risk

Operational risk is controlled and mitigated at the level of all organizational units of the Bank. By analyzing collected data on operational risk losses, measures aimed at introducing ever more effective and adequate controls environment are undertaken. To that end, the Bank’s processes are monitored and improved in order to prevent reoccurrence of operational risk losses. With the planned introduction of operational risk self-assessment system, the Bank will bring this process on a higher level by proactively assessing potential risks.

Country risk

In order to effectively control and mitigate country risk exposure, the Bank has developed an elaborate country risk exposure limit system that is administered at the level of the banking group (OTP Hungary). To that end, the Bank is calculating a maximum country risk exposures to particular countries taking into account the Bank’s own funds, the particular county’s risk rating and the particular country’s macroeconomic coefficient summarizing the country’s level of economic development and financial soundness.

The details on the methodology could be found in the Bank's Policy and Procedure for the Management of Country Risk.

Interest rate risk form the banking book (IRRBB)

The Bank is controlling and mitigating interest rate risk from the banking book, by seeking to match interest rate sensitive assets to interest rate sensitive liabilities. In order to minimize IRRBB, the Bank will not deliberately take positions to benefit from a particular movement in interest rates.

3. Consolidation

The accompanying financial statements are the Bank's stand-alone financial statements. Due to its immateriality, management chose not to consolidate its investment in "Moneta", over which it exercises effective control. In these stand alone financial statements associates are accounted for in accordance with IAS 39, at fair value through profit or loss.

4. Own Funds

This table is taken from Quarterly Report to Central Bank as of 31st December 2012. Name of table is Own Funds Report (Izvještaj o sopstvenim sredstvima -SSB).

(000 €)

Basic Elements of Own Funds	Iznos
Paid-in share capital by nominal value, excluding cumulated prefered shares	106.876
Total	**106.876**
Reducted items from Tier 1 capital	
Loss from previous years	49.669
Loss from current year	19.043
Intangible assets (goodw ill, licenses, patents, trademarks, concessions)	3.711
Total	**72.423**
Tier 1 capital (basic elements of own funds minus reducted items)	**34.453**
Tier 2 capital	
Subordinated debt (w hich fulfill conditions from article 3 of Decision)	16.800
Revalorisation reserves	921
Total	**17.721**
Own funds (Tier 1 + Tier 2)	**52.174**
Reducted items from own funds	
Direct or indirect investments in other bank or other credit or financial institution in amount more than 10% of that institutions' equity.	222
Total reductions of own funds	**222**
Own funds (own funds - total reducted items from gross own funds)	**51.952**
Investments in real estate and fixed assets more than 40% of banks' ow n funds (Decision on Minimal Standards for Banks' Investments in Real Estate and Fixed Assets)	
Own funds of the bank	**51.952**

5. Capital Requirements and Estimation of Internal Capital Adequacy

Internal capital adequacy assessment process (ICAAP) is established in the bank according to the Capital Adequacy Decision of Central Bank of Montenegro, with the aim to assess overall capital adequacy of the bank in relation to its risk profile arising from its business strategy and in line with its performance. The process, approved and controlled by the Board of Directors captures methodologies the bank applies in assessing the capital need to cover all risks the bank is exposed to, including:

1. capital requirement for credit risk for all exposure classes,
2. capital requirement for operational risk
3. capital requirement for other type of risks.

To measure capital requirement the bank applies all methodologies and measurerement techniques described in the Capital Adequacy Decision of Central Bank of Montenegro.

6. Credit Risk

1. Definition of overdue payments and non-performing loans (assets classified as category "C" or lower)

In accordance with the Central Bank regulations, non-performing loans include all on and off balance sheet assets classified as C, D and E category:

1. group C – „substandard"- with subgroups C1, C2, C3 and C4, in which are classified asset items involving high probability of loss due to clearly identified weaknesses that jeopardize the repayment of those asset items;
2. group D – doubtful" in which are classified asset items for which collection in full, considering borrower's credit capacity, collateral value and realization, is highly improbable;
3. group E – „loss" in which are classified asset items which will be fully uncollectible or collectible only to an insignificant amount.

In accordance with the Decision on Capital Adequacy of banks, overdue payments are considered bank's outstanding for which the borrower is in delay more than 90 days.

2. Impairment Review Process and Provisioning Methodology

Pursuant to provisions of IAS 39, upon initial recognition, loans and receivables are measured at their fair value adjusted for transaction costs. After the initial recognition, loans and receivables are carried at amortized cost using the effective interest method. Subsequently, at each reporting date, the Bank is carrying out an impairment review of its loans and receivables. A financial asset or a group of financial assets is impaired and impairment loss is incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) must have a reliably measurable effect on the present value of estimated future cash flows and be supported by current observable data.

The following is considered to be objective evidence of impairment:

a) Significant financial difficulty of the issuer or obligor;
b) Breach of contract, such as a default or delinquency in interest or principal payments, or non-compliance with other conditions;
c) The lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
d) High likelihood that the borrower will enter bankruptcy or another financial reorganization process;
e) Disappearance of an active market for that financial asset because of financial difficulties;
f) Observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets.

The impairment review process is conducted simultaneously on individual and group level depending on whether a loan is designated as individually significant. All loans in excess to EUR 300 thousand should be considered individually significant and assessed for impairment individually.

1. Individual impairment review

Financial assets that are considered to be individually significant are assessed for impairment individually based on whether objective evidence of impairment exists.

The determination of impairment amount entails the assessment of the future cash flow of the reviewed instrument that has to be discounted using the effective interest rate for that particular instrument in order to calculate the present value of the particular instrument. The impairment amount is then calculated as a difference between the carrying value (contractual amount outstanding) of the loan as of the date of the review and the present value of the instrument.

$$impariment\ loss = carrying\ value - present\ value(PV)$$

$$PV = \sum_{t=1}^{n} \frac{\exp ected\ CF_t}{\left(1 + r_{effective}\right)^t}$$

2. Collective (group-based) assessment for impairment

Assets that are not found to be individually significant are also assessed for impairment. They may be assessed individually or collectively - on a group basis. All assets that have been individually assessed for impairment, whether significant or not, but for which there is no objective evidence of impairment, are included within a group of assets with similar credit risk characteristics and collectively assessed for impairment. The underlying reason for reviewing for impairment the loans that haven't been found to be impaired on an individual basis is that even though the impairment couldn't be found on an individual level it may be found on a portfolio basis. The Bank qualifies the following group of assets as exposures that are not individually significant:

a) Retail loans
b) Micro and small enterprise loans
c) Loans and exposures that do not reach the significance limit in the corporate and municipal business lines

For the purpose of collective evaluation of impairment, financial assets should be grouped on the basis of similar credit risk characteristics that are indicative of the debtor's ability to pay all amounts due according to the contractual terms. Those characteristics may include:

a) the type of the asset;
b) the industry of the debtor;
c) geographical location;
d) the type of the security;
e) previous payment delinquencies;

If an entity does not have a group of similar risk characteristics, it should individually assessed for impairment and if the impairment has not been found, no provisions should be set aside for that exposure.

As soon as information that could indicate to impairment of a particular asset within a group of assets is available, that particular assets should be removed from the group and assessed for impairment individually.

This method of impairment/provision allocation calculation reviews how the transactions within the portfolio migrate between two dates among the individual default categories. The portfolio of loans is broken down with respect to regularity in payment during one quarter i.e. Days Past Due (DPD). The final product of a transition matrix represents the extent of the lending loss expected in a particular portfolio segment expressed as a percentage of the amount outstanding of the loans in each DPD category.

Details pertaining to calculation of transition matrices are considered to be "protected information" pursuant to Article 2 of the CBCG Decision on Public Disclosure of Data by Banks.

3. Total amount of exposures after accounting netting and without taking in account credit risk mitigation techniques effect and average amount of exposures during reporting period divided by different categories of exposures

(000 EUR-a)

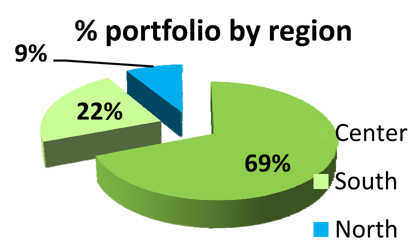
Nb	Type of Exposure	**Average net exposure during 2011	*Total net exposure as of 31.12.2011
1.	Exposures to central and local governments, central banks and government bodies	53.417	58.497
2.	Exposures to clients	410.304	293.277
	TOTAL	**463.721**	**351.774**
	Other exposures	4.046.815	4.066.616

*net exposure is difference between debt statement (gross exposure) and calculated risk provisions without taking in account of collaterals

**average of total exposures for 4 quarters of 2011

4. Overview of credit risk exposures according to geographic distribution

Region	Portfolio (000)	% portfolio
Center	256.916	69%
South	82.404	22%
North	32.195	9%
Total	**371.515**	**100%**



Region	Municipality	Portfolio (000)
Center	Cetinje	2.694
	Danilovgrad	1.205
	Niksic	15.989
	Podgorica	237.027
South	Bar	14.529
	Budva	20.452
	Herceg Novi	32.371
	Kotor	6.957
	Tivat	2.388
	Ulcinj	5.707
North	Andrijevica	3
	Berane	8.524
	Bijelo Polje	8.563
	Kolasin	801
	Mojkovac	2.061
	Plav	1.102
	Pljevlja	4.474
	Rozaje	5.767
	Zabljak	902
Total		**371.515**

5. Overview of credit risk exposures according to industry sectors

Industry sector	Portfolio
Agriculture, hunting, fishing	2.855
Mining industry	147
Production	7.669
Energetic	13.047
Construction	113.576
Trading	35.399
Tourism, Services, Restaurants	9.517
Transportation and telecommunication	3.876
Financing	776
Real estate trading	12.434
Administration and public services	168.756
Others	3.461
Retail	2.855
Total	**371.515**

6. Classification by Remain Maturity

I	Financial Assets in Balance Sheet	Up to one year	More than one year	TOTAL
1.	Cash and deposits to deposits' institutions	264.250	40.669	**304.919**
2.	Assets available for trading and available for sale, except shares			**0**
3.	Securities bought by repurchase agreement			**0**
4.	Loans and other receivables	95.712	244.041	**339.753**
5.	Hold to maturity securities	17.241		**17.241**
6.	Other financial assets including investment in shares (including factoring, forfeting and receivables from custody business)	7.350	21.147	**28.497**
	Total :	**384.553**	**305.857**	**690.410**

7. Changes in Risk Provisions for Non Performing Assets

	31/12/2010	Change	31/12/2011
Risk provisions calculated for assets classified in C or lower categories	76.489	-37.695	38.794

7. Operational Risk

For the purpose of calculating minimum capital requirements for operational risk, the Bank is using Simple methodology as provided for in the CBCG Decision on capital adequacy of banks.

8. Ongoing Investments in Corporate Shares

Bank on 31.12.2011 had shares available for trading and shares available for sale.

Available for trading shares portfolio contains shares that are on stock exchange quotation. During 2011 Bank had unrealized profits and loss according to changes in market value of available for trading shares and those changes were booked in P&L.

Available for sale shares portfolio includes investments in shares that are not on stock exchange quotation. During 2011 Bank had immaterial unrealized profit on these items that was treated as increasing of revalorization reserves.

(000 €)

Securities type	Issuer	End of 2011	End of 2010	Difference	Treatment of difference
Available for trading	Shares on quotation	810	698	113	Unrealised profit included in P&L
Available for sale	Shares that are not on quotation	381	379	2	Unrealised profit booked as incereasing of revalorisation reserves
Total		**1191**	**1077**	**114**	

The Bank determined the fair value based on the number of shares and share par value, if the quoted market price of shares is not available.

9. Exposure to Interest rate Risk from Banking Book (IRRBB)

In determining the impact of the standardized interest rate shock of +/- 200 bps on the level of the Bank's net interest income, different elasticity of interest sensitive assets and liabilities are taken into account according to following table:

Percentage of loans that will be repriced by the Bank if marekt rates rise

31-90 days	91-180 days	181-365 days	Over 1 year
0%	10%	30%	80%

Percentage of deposits that will be repriced by depositors if market rates rise

31-90 days	91-180 days	181-365 days	Over 1 year
0%	10%	50%	80%

Percentage of loans that will be refinanced by borrowers if marekt rates fall

31-90 days	91-180 days	181-365 days	Over 1 year
0%	10%	50%	80%

As of the end of 2011 the Bank was running matched position of its interest sensitive assets and liabilities with residual maturity of up to one year, which immunized its NII form the changes in the level of interest rates.

INCREASE IN RATES IN THE QUARTER ENDING 31-DEC-11

(in EUR'000)	1-30 days	31-90 days	91-180 days	181-365 days	> 1 year	TOTAL
INTEREST SENSITIVE ASSETS	341,588	18,241	166,500	25,732	70,624	622,685
INTEREST SENSITIVE LIABILITIES	308,970	85,735	106,925	61,882	16,751	580,262
GAP	32,618	-67,494	59,575	-36,149	53,873	42,423
Time over which gap is in effect (years)	0.96	0.84	0.63	0.26		
Cumulative gap	32,618	-34,876	24,699	-11,450	42,423	84,846
Impact on annualized NII	626	-1,128	751	-188		
Total impact on annualized NII	60					

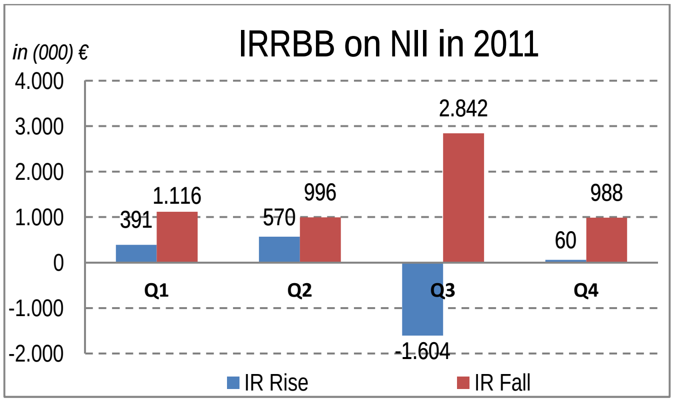
If rates rise by 200bps, the Bank's annualized NII would increase by 60,000€

FALL IN RATES IN THE QUARTER ENDING 31-DEC-11

(in EUR'000)	1-30 days	31-90 days	91-180 days	181-365 days	> 1 year	TOTAL
INTEREST SENSITIVE ASSETS	216,641	17,505	166,500	29,394	192,645	622,685
INTEREST SENSITIVE LIABILITIES	218,117	85,735	113,593	122,723	40,094	580,262
GAP	-1,476	-68,230	52,907	-93,329	152,551	42,423
Time over which gap is in effect (years)	0.96	0.84	0.63	0.26		
Cumulative gap	-1,476	-69,706	-16,799	-110,128	42,423	84,846
Impact on annualized NII	28	1,140	-667	486		
Total impact on annualized NII	988					

In rates fall by 200bps, the Bank's annualized NII would increase by 998,000€

With the exception of Q3 2011 the Bank has been interest rate risk neutral for most of the year as can be seen from the table below, summarizing the effects of the standardized interest rate shock of +/- 200 bps on annualized NII.



10. Securitization

Bank didn't have any securitization.

11. Risk Mitigation Techniques

- Policies and procedures for collateral management and acceptance

Policies and procedures pertaining to collateral management are set forth in the Bank's Collateral Evaluation Regulation.

Collateral management as a risk mitigation technique employed by the Bank is defined by the following considerations:

- Acceptable legal form and types of collateral
- Criteria used in evaluating collateral by its type
- Legal enforceability
- Collateral evaluation techniques
- Assessment of collateral adequacy
- Procedures for collateral management in case of sudden changes in its value, availability or enforceability
- Monitoring collateral value

Collateral Evaluation Regulation defines the principles for collateral evaluation in CKB as well as responsibilities and authorities of bodies in the collateral evaluation process. The Regulation shall cover all client segments.

All disbursed loans should be recovered primarily from the company operation (cash-flow), the budget of the municipality or from the debtor revenues.

Secondary source of repayment of debt is collateral.

The Bank shall accept as risk mitigating factors those collaterals which are sufficiently liquid, whose value over time is stable and which are enforceable within a reasonable timeframe if there is any negative change in the payment behavior of the debtor.

- Description of basic collateral type

Collaterals which can be accepted by the Bank:

- Cash collateral;
- Pledge on movables;
- Mortgage on immovables;
- Other material collateral (insurance policy..);
- Promissory note;
- Authorization of collection;
- Guarantees, sureties.