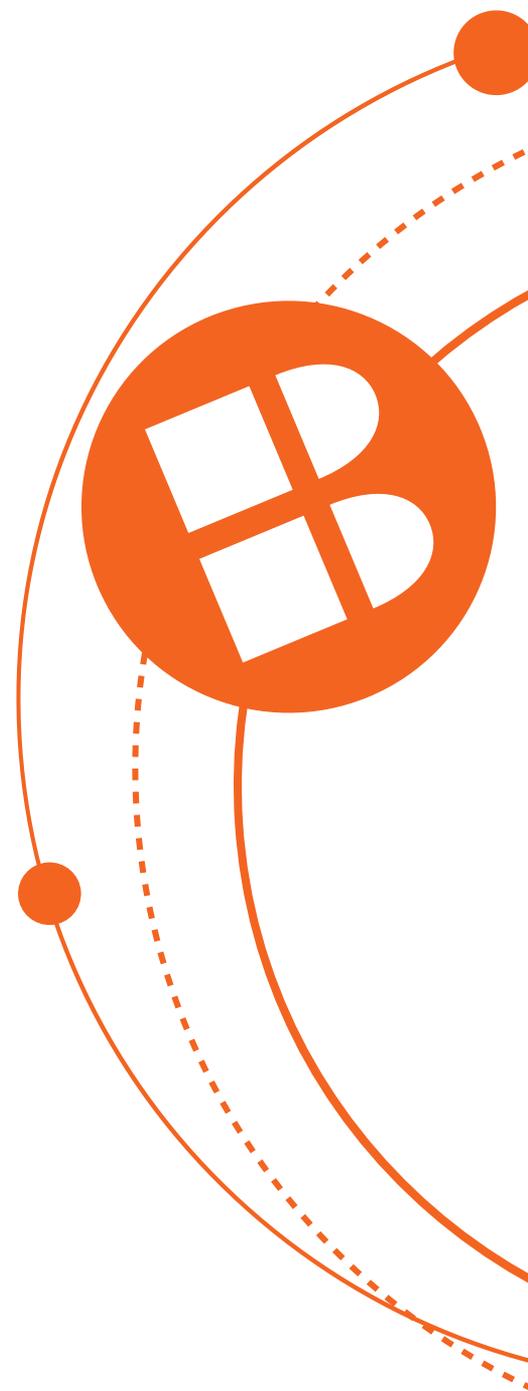


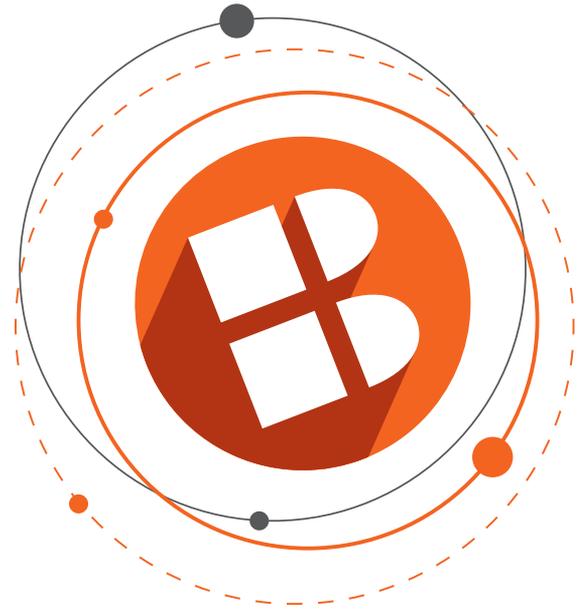
ANNUAL REPORT

2016

 **HIPOTEKARNA
BANKA**

Vama posvećena





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1 ORGANISATION AND WORKFORCE

ORGANISATION AND WORKFORCE

On 31 December 2016, the Bank had a workforce of 169 people holding the qualifications required and the IT skills needed for proper discharge of bank operations.

Continuous education and professional development are set as Bank priorities. In 2016, a large number of employees underwent training in both internal and external programmes on various areas important for the Bank business. The Bank recruits young professionals who will contribute to Bank's effective development.

Educational background of Bank workforce on 31/12/2016: 12 staff hold MSci, 90 hold a university and 33 a BSc degree, while 13 have two-year post-secondary and 50 a secondary school education.

BANK MANAGEMENT BODIES

The Bank management bodies are the General Assembly of Shareholders and the Board of Directors. The General Assembly of the Bank is composed of its shareholders. Members of the Board of Directors, as the Bank management body, are elected and appointed by the Assembly of Shareholders.

The Bank's largest shareholders as of 31 December 2016 are the following:

HB – Collective custody account 4 / Generali Financial Holdings FCP-FIS – Sub-Fund 2	16.8695 %
Cerere S.P.A. - Italy	13.9275 %
Lorenzo Gorgoni - Italy	12.9788 %
Antonia Gorgoni -Italy	10.0016 %
Miljan Todorović - Italy	7.3982 %
Podravska Banka Dd - Croatia	6.5389 %
Ibis Srl - Italy	4.8682 %
Dario Montinari - Italy	4.6159 %
Sigilfredo Montinari - Italy	4.6159 %
Piero Montinari - Italy	4.6127 %
Andrea Montinari - Italy	4.6126 %

The Bank Board of Directors has 5 members with the majority of them not being employed with the Bank.

The Bank Board of Directors standing bodies are as follows: The Audit Committee and the Credit Risk Management Committee.

List of Boards of Directors and its members, and of Bank executive directors

1.1. Hipotekarna Bank AD Podgorica Board of Directors:

- » Sigilfredo Montinari, Chairperson
- » Božana Kovačević, Deputy Chairperson
- » Renata Vinković, Member
- » Goran Varat, Member
- » Esad Zaimović, Member

1.2. Hipotekarna Bank AD Podgorica Audit Committee:

- » Draško Popović, Chairperson
- » Božana Kovačević, Member
- » Marko Žigmund, Member

1.3. Hipotekarna Bank AD Podgorica Credit Risk Management Committee:

- » Renata Vinković, Chairperson
- » Sigilfredo Montinari, Member
- » Esad Zaimović, Member

2. Hipotekarna Bank AD Podgorica executive officers:

- » Esad Zaimović, Chief Executive Officer
- » Aleksandar Mitrović, Executive Officer for Business Support Operations

Bank's Shareholders Assembly

The Bank's Shareholders Assembly had two sessions in 2016. One was held on 28/06/2016, that, given the nature of the material discussed and decided upon, had the character of a regular (annual) meeting, while the second, extraordinary, session was held on 28/08/2016.

At VIII regular meeting (held on 28/06/2016), Shareholders' Assembly reviewed the 2015 Hipotekarna Bank AD Podgorica annual report, together with the report of external auditors, and passed the Decision on profit allocation for 2015. It was established under that Decision that the Bank's profit after taxation amounted to € 2,729,160.02. On 31/12/2015, a provision gap was identified in accordance with Article 49 of the Decision on Minimum Standards for Credit Risk Management in Banks ("Official Gazette of Montenegro, No. 22/12 of 23/04/2012, No. 55/12 of 02/11/2012 and No. 57/13 of 16/12/2013") ("Decision"). Namely, there is a difference between the amount of reservations for potential losses and the sum of amounts of corrected values for the balance assets positions and reservations for off-balance items amounting to € 7,023,046.35. Following the Bank's obligations as set forth in Art. 49a of the Decision, part of 2015 profit amounting to 890,258.82 EUR has to be transferred onto the account for reservations for assessed losses in line with the regulatory requirement – account 3025 - to serve as coverage of part of the identified provision gap.

Also, at VIII regular meeting (held on 28/06.2016), the Bank's Shareholders' Assembly made a resolution of dissolution of the Hipotekarna Bank AD Podgorica Board of Directors because of the resignation of Miljan Todorović, a member of the Board of Directors, as well as a Resolution of appointment of the members of the Board of Directors of Hipotekarna Bank AD Podgorica, whereby in addition to the existing members Andrea Montinari was elected as a member of the Board of Directors instead of Miljan Todorovic, who had resigned. Under Art. 32, para. 1 of the Law on Banks, a request needs to be filed with the Central Bank of Montenegro to issue their approval for the election of Mr. Andrea Montinari as a member of the Board of Directors of Hipotekarna Bank AD Podgorica.

At the extraordinary meeting (held on 30/08/2016) the Bank's Shareholders Assembly adopted a Decision on the amendments to the Articles of Association of Hipotekarna Bank AD Podgorica, on the basis of which the number of members of the Board of Directors was reduced from 7 to 5, with at least two members of the Board being persons independent of the Bank. The Investment Committee (INKOKM) was introduced as a standing body of the Board of Directors, in line with the recommendations of the Central Bank of Montenegro, given the scope and significance of the function of the Investment Committee with respect to the decisions related to securities and other instruments, and in line with the increase of the Bank's securities portfolio.

Following the aforementioned facts, at the extraordinary meeting held on 30/08/2016, the Bank's Shareholders' Assembly adopted the Decision to dissolve the Board of Directors as well as a Decision to appoint 5 (five) members of the Board of Directors, namely: Sigilfredo Montinari, Božana Kovačević, Renata Vinković, Goran Varat and Esad Zaimović.

Board of Directors and Board of Directors Committees

In compliance with the Law on Banks ("Official Gazette of Montenegro" Nos.17/08, 44/10 and 40/11) the Board of Directors had 54 regular sessions in 2016 (there is a legal provision stipulating that the Board of Directors must convene at least once a month).

The Bank Board of Directors activities primarily focused on the implementation of tasks and objectives as set by the strategic and annual planning documents.

The Bank Board of Directors regularly discussed issues relevant to the Bank business operations (monthly business and financial statements, liquidity reports, risk reports and specifically analysed the reports on lending activity and collection of claims, as well as any other reports that covered the Bank's overall business). Also, when necessary, the Board adjusted interest rates, tariffs and other charges to the situation in the market relating to loan activities and other banking services and discussed other issues relating to Bank's day to day business operations and passed decision and conclusions accordingly.

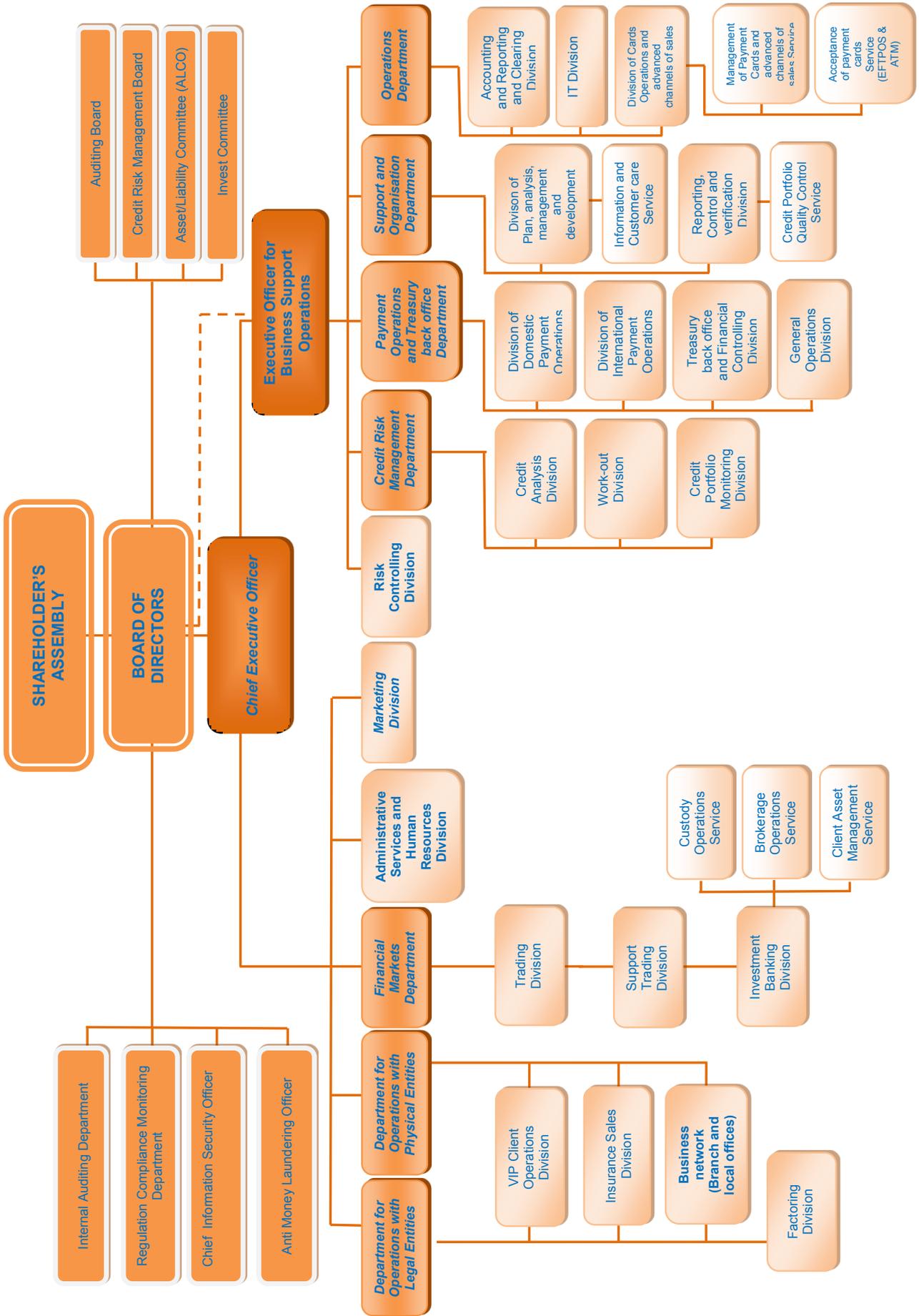
As the Board of Directors standing committees, the Audit Committee and Credit Risk Management Committee, regularly reported to the Board of Directors on issues within their authority.

In addition to the standing committees, the Committee on Asset and Liability Management (ALCO), the Committee on Development and Management of Information System, the Committee for Management of Card Business and Advanced Sales Routes and the Committee for Bank Development had at least monthly sessions and discussed issues within their sphere of competence and reported to the Board of Directors.

It is important to note here that the Board of Directors, at its session on 29/11/2016, adopted the Decision confirming the term of office to the members of the Audit Committee, members of the Credit Risk Management Committee, members of the Committee on Asset and Liability Management -ALCO, the members of the Committee on Development and Management of Information System, the members of the Committee for Management of Card Business and Advanced Sales Routes, members of the Investment Committee and members of the Committee for Bank Development. At the same session of the Board of Directors, a Decision was made to extend the term of office to the chief executive officer and executive officer for business support operations for another 4 (four) years.

In 2016, the attitude of the members of the Bank Board of Directors to their obligations and tasks as set by the legislation and Bank internal rules was based on their mutual cooperation, regular attendance and active participation in Board meetings. There were no conflicting situations or disputes when it came to agreeing on positions, decisions and implementation of Bank's business policy, and the quorum required was never challenged.

It may be concluded that in 2016, the Board of Directors was guided by clearly defined objectives in their work on examining the timeliness and reliability of financial reports, reports on managing the risks that the Bank is exposed to in its daily operation and on overseeing the compliance of Bank business with laws, regulations and internal plans, policies and procedures. In their work on the issues on the agenda, Board members acted with due diligence, care and in line with the rules of the profession and used their authority solely to the benefit of the Bank.



In accordance with Art. 15b of the Law on Takeover of Joint-Stock Companies (Official Gazette of Montenegro, No. 18/11 and 52/16):

1) Structure of Bank's capital:

- » Bank's equity is EUR 16,005,933.45, composed of 31,305 ordinary registered shares;
- » Par value of a single share is EUR 511.29;
- » Shares are dematerialized, transferrable without limitation, and registered on the name of the owner. The extract from the register with the Central Depository Agency AD Podgorica is the only proof of ownership over the shares;

A Bank's shareholder holding ordinary shares has the following rights:

1. right to attend Shareholders Assembly,
2. management rights, in proportion to the equity share for this class of shares,
3. right to dispose of the shares, in line with applicable regulations,
4. pre-emptive right of purchase for shares from new emissions,
5. right to shares free of charge in case the equity's increase from the Bank's own funds, in proportion to the share,
6. right to dividend, after the distribution of privileged shares to the owners, when the Shareholders Assembly takes a decision for the dividend to be paid out,
7. right of receipt, upon personal request, of a copy of the balance sheet and income statements, as well as of the external auditor's report,
8. right of inspection, thirty days before the Shareholders Assembly, as well as at the Assembly itself, of the financial reports, including the reports by the external auditor,
9. right to a proportional share in the assets in the event of the Bank's liquidation and other rights and privileges, in line with applicable regulations.

2) There are no limitations on the transfer of shares or of securities;

3) A significant direct and indirect share in equity:

HB - Collective custody account 4 / Generali Financial Holdings FCP-FIS - Sub-Fund 2	16.8695 %
Cerere S.P.A. - Italy	13.9275 %
Lorenzo Gorgoni - Italy	12.9788 %
Antonia Gorgoni -Italy	10.0016 %
Miljan Todorović - Italy	7.3982 %
Podravska Banka Dd - Croatia	6.5389 %
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Sigilfredo Montinari - Italy	4.6159 %
Piero Montinari - Italy	4.6127 %
Andrea Montinari - Italy	4.6126 %

- 4) There are no securities granting special control rights;
- 5) Acquisition of shares by staff is subject to applicable laws and other regulations;
- 6) There are no restrictions to the right of vote, such as the restriction of the voting rights of the owner of a certain percentage of securities, or a certain number of shares, deadlines for the exercise of the voting right, etc;
- 7) There is no agreement between the shareholders that the issuer is aware of and that may result in any restrictions on the transfer of securities and /or voting rights;
- 8) Appointment and removal of the members of the Board of Directors is defined by applicable laws and other regulations;
- 9) Powers of the members of the board of directors are defined by applicable laws and other regulations;
- 10) There are no material agreements that the issuer is a party to and that have legal effect, are amended or terminated after the takeover of issuer following the public bid for the takeover and their legal effects, unless where the agreements are of such nature that their publication could have significant harmful effects to the issuer, on condition that the issuer is under no explicit obligation to publish such data in accordance with the law;
- 11) Executive officers and individual directors of Bank's organizational units have contractual clauses that stipulate payment of a fee for the termination of office amounting from 6 (six) to 12 (twelve) monthly net pays.







2 BUSINESS OPERATIONS

BUSINESS OPERATIONS

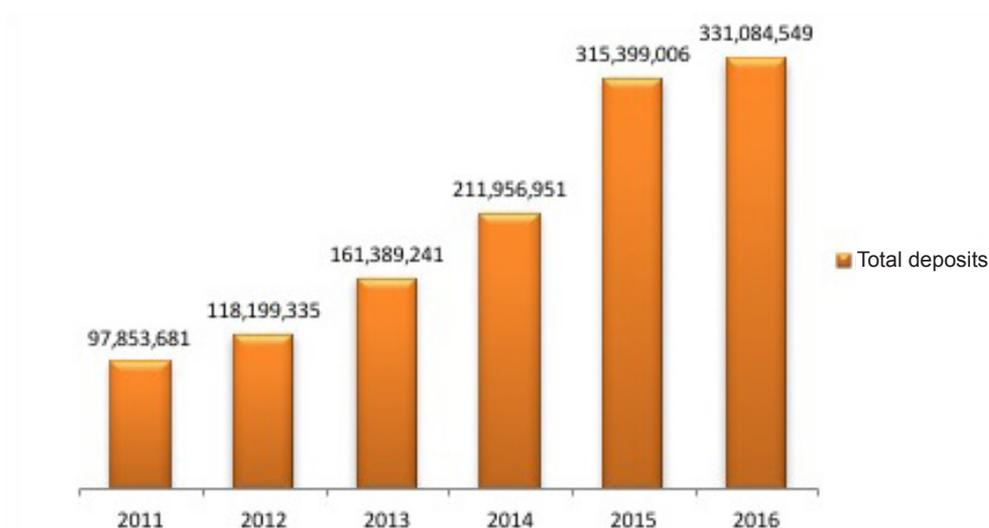
DEPOSITS

In 2016, compared against 2015, deposits went up BY 4.97%, which indicates that confidence of both citizens and business in Hipotekarna Bank saw a significant rise also in 2016 in spite of the high level of deposits seen also in the previous year. Time deposits increased by 1.65%, while sight deposits increased by 7.90%.

The Bank maintained an adequate time and sight deposits to overall deposits ratio.

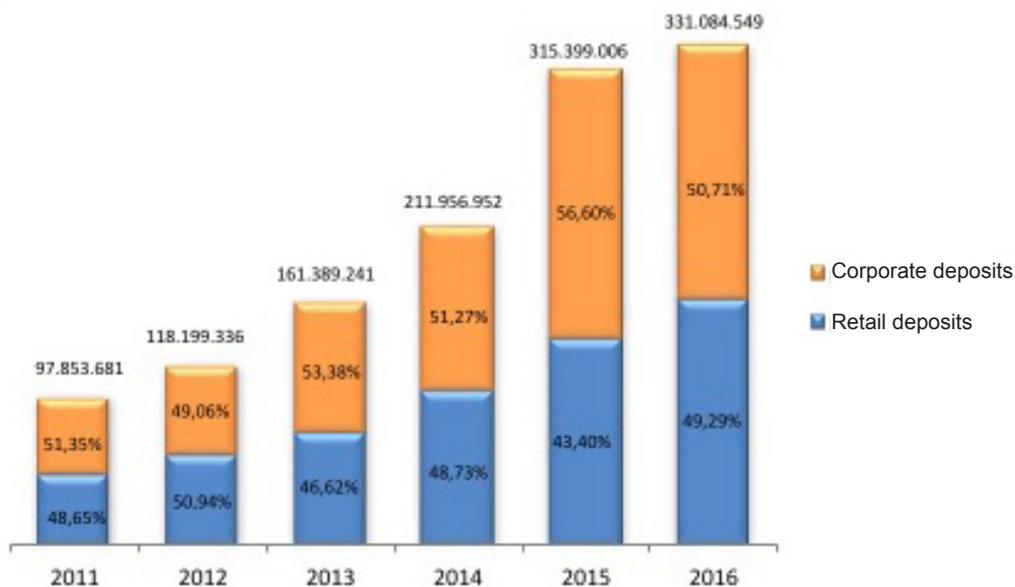
Total deposits

	Total deposits	% change
2012	118,199,335	20.79%
2013	161,389,241	36.54%
2014	211,956,951	31.33%
2015	315,399,006	48.80%
2016	331,084,594	4.97%



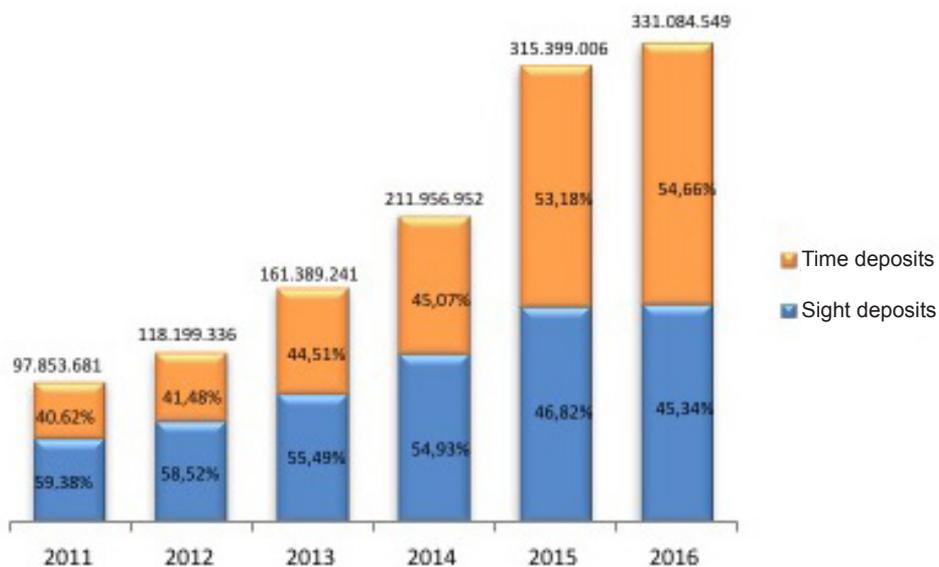
This increase in deposits resulted from the growing number of clients and their increased confidence in the Bank. Thanks to the Hipotekarna Bank's strengths, such as security, professionalism and the good quality of the services offered, we are recognised as a Bank worthy of confidence. As a result, the positive trends of deposit growth continued.

Corporate deposits accounted for 50.71%, and retail deposits for 49.29% of overall deposits, as shown in the graph below:



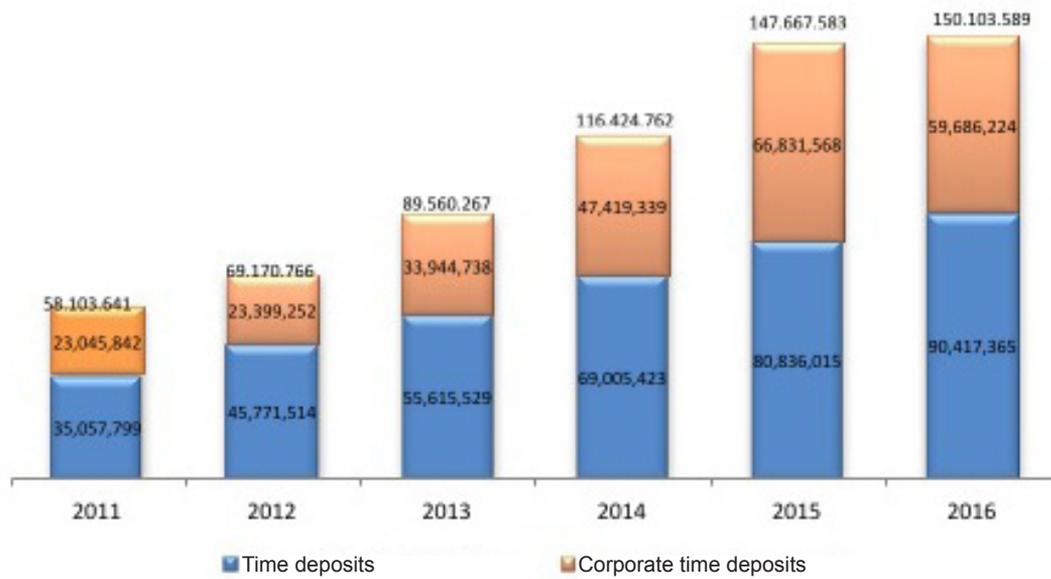
	2012	2013	2014	2015	2016
Retail deposits	60,204,983	75,236,948	103,276,531	136,890,858	163,175,605
Corporate deposits	57,994,353	86,152,293	108,680,421	178,508,148	167,908,944
Total	118,199,336	161,389,241	211,956,952	315,399,006	331,084,549

Time deposits accounted for 45.34%, and sight deposits for 54.66% of overall deposits

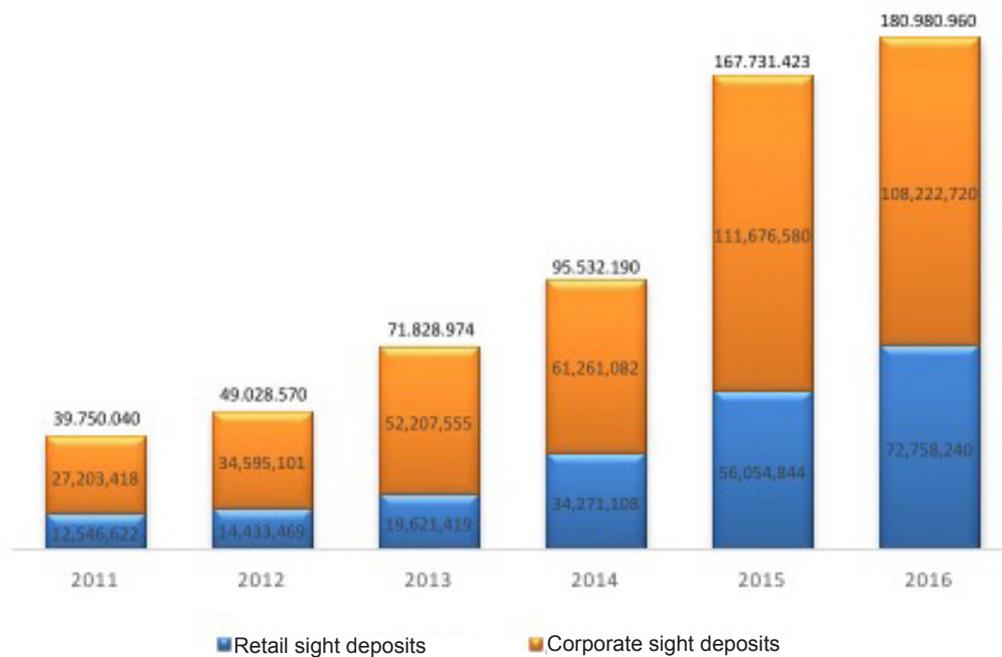


	2012	2013	2014	2015	2016
Time deposits	69,170,766	89,560,267	116,424,762	147,667,583	150,103,589
Sight deposits	49,028,570	71,828,974	95,532,190	167,731,423	180,980,960
Total	118,199,336	161,389,241	211,956,952	315,399,006	331,084,549

Following the overall deposit trend, both time and sight deposits recorded a growth in 2016 over 2015, as shown in the graphs below



	2012	2013	2014	2015	2016
Retail time deposits	45,771,514	55,615,529	69,005,423	80,836,015	90,417,365
Corporate time deposits	23,399,252	33,944,738	47,419,339	66,831,568	72,758,240
Total	69,170,766	89,560,267	116,424,762	147,667,583	163,175,605

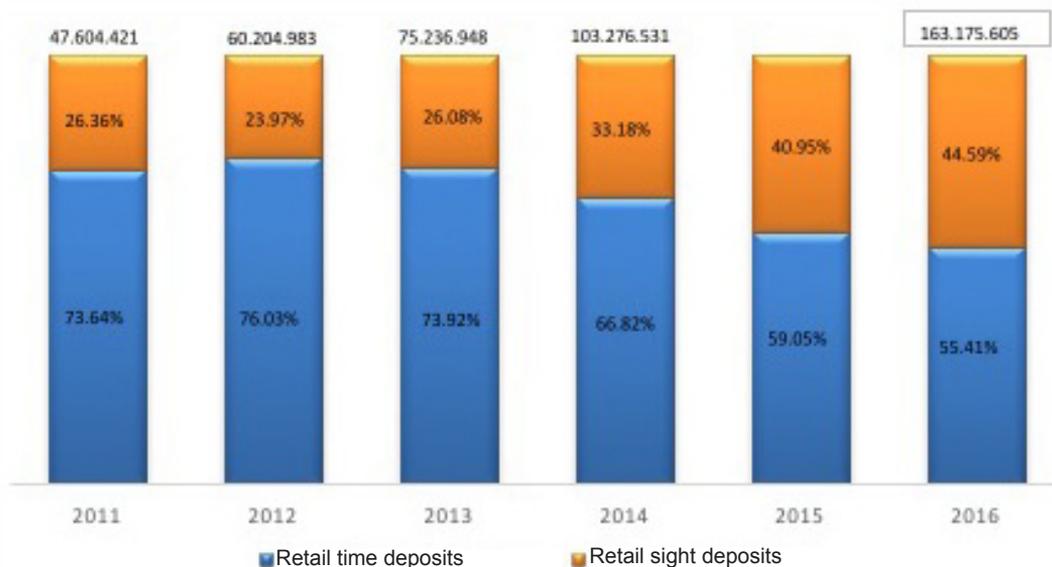


	2012	2013	2014	2015	2016
Retail sight deposits	14,433,469	19,621,419	34,271,108	56,054,844	72,758,240
Corporate sight deposits	34,595,101	52,207,555	61,261,082	111,676,580	108,222,720
Total	49,028,570	71,828,974	95,532,190	167,731,423	180,980,960

Retail deposits

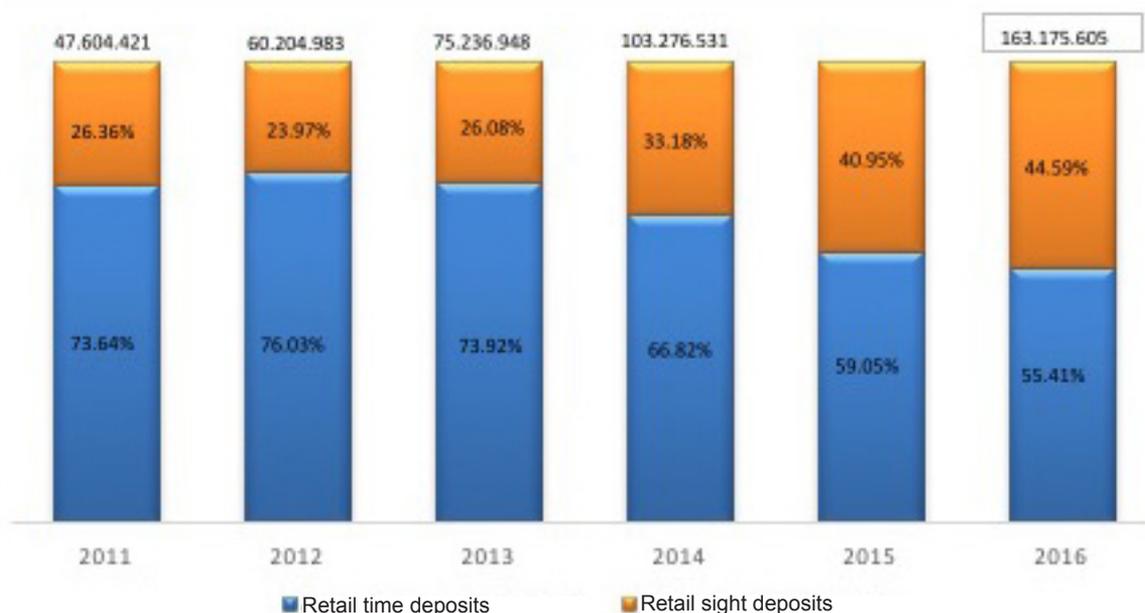
At the end of 2016, overall retail deposits recorded a 19.20% growth compared to 2015 in both sight and time deposits.

Sight deposits grew by as much as 29.80%, while the retail time deposits grew by 11.85%.



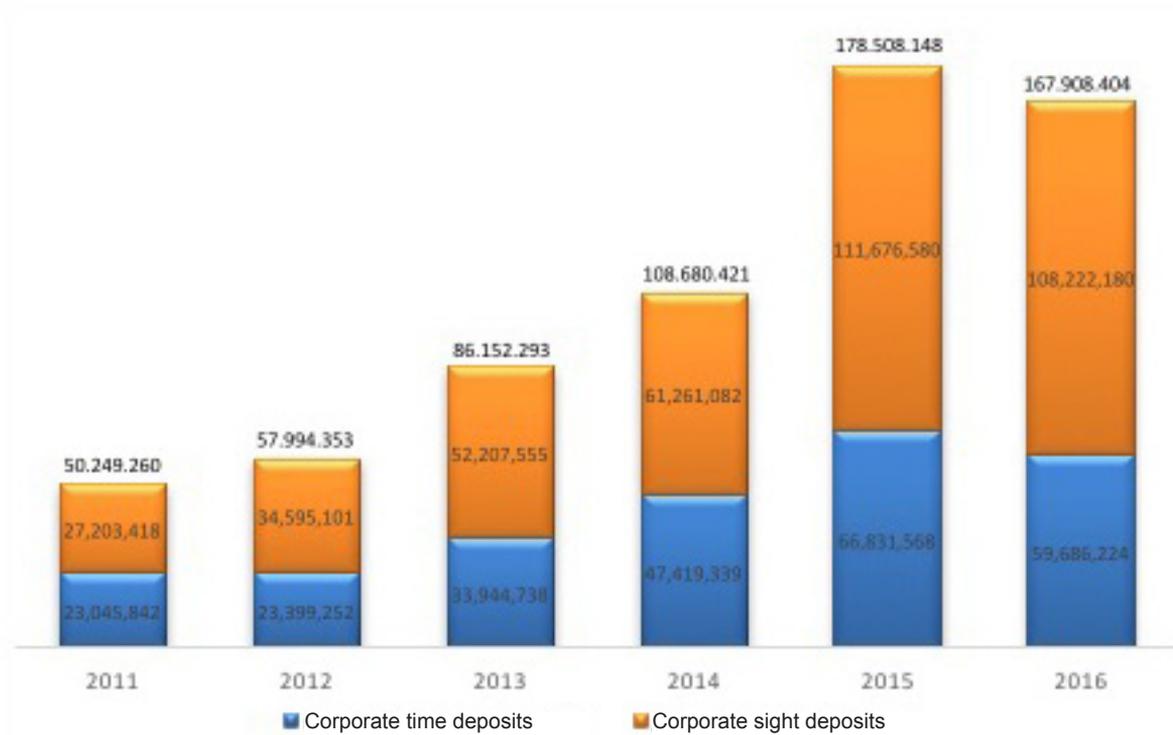
	2012	2013	2014	2015	2016
Retail time deposits	45,771,514	55,615,529	69,005,423	80,836,015	90,417,365
Retail sight deposits	14,433,469	19,621,419	34,271,108	56,054,844	72,758,240
TOTAL	60,204,983	75,236,948	103,276,531	136,890,858	163,175,705

In the overall structure of retail deposits, time deposits accounted for 55.41%, while sight deposits accounted for 44.59%.



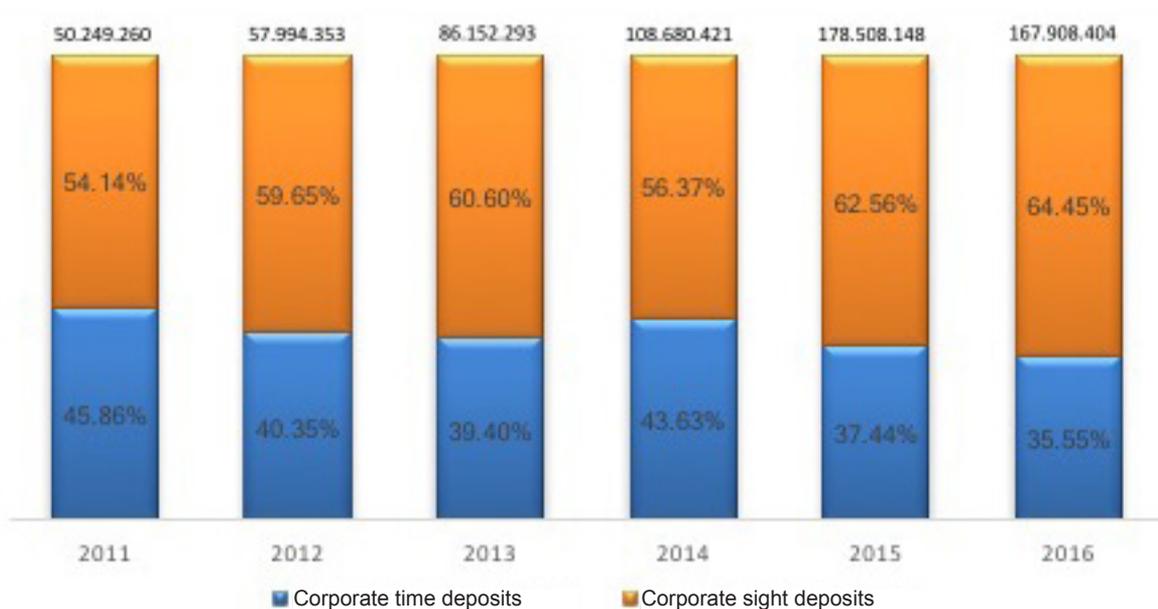
Corporate deposits

Overall corporate deposits were 167,908,404 as of 31/12/2016. The graphs below shows their structure by type of deposit:



	2012	2013	2014	2015	2016
Corporate time deposits	23,399,252	33,944,738	47,419,339	66,831,568	59,686,224
Corporate sight deposits	34,595,101	52,207,555	61,261,082	111,676,580	108,222,720
TOTAL	57,994,353	86,152,293	108,680,421	178,508,148	167,908,404

In the overall structure of corporate deposits, term deposits accounted for 35.55% and sight deposits for 64.45%.



LOANS

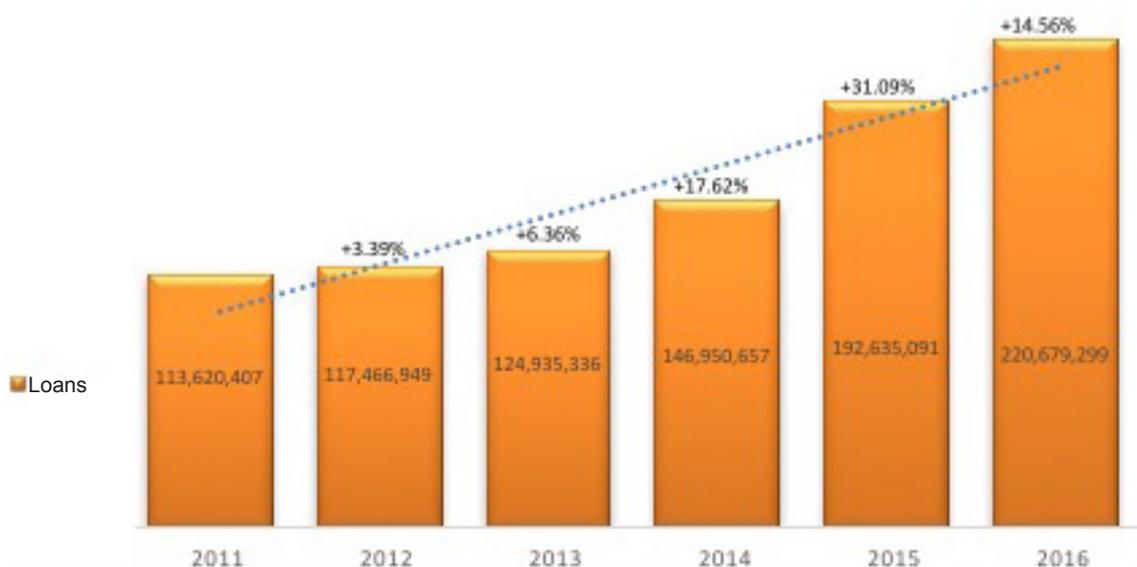
In 2016, Hipotekarna Bank continued its trend of providing loans to existing clients but also to a large number of new clients.

One of the Bank's recognisable features is that in addition to providing loans it also provides advisory services, all with a view to improving overall business operations and business results of both the Bank and its clients.

Despite the conservative loan policy that the Bank has pursued for years, total loans portfolio increased by 14.56% over the previous year.

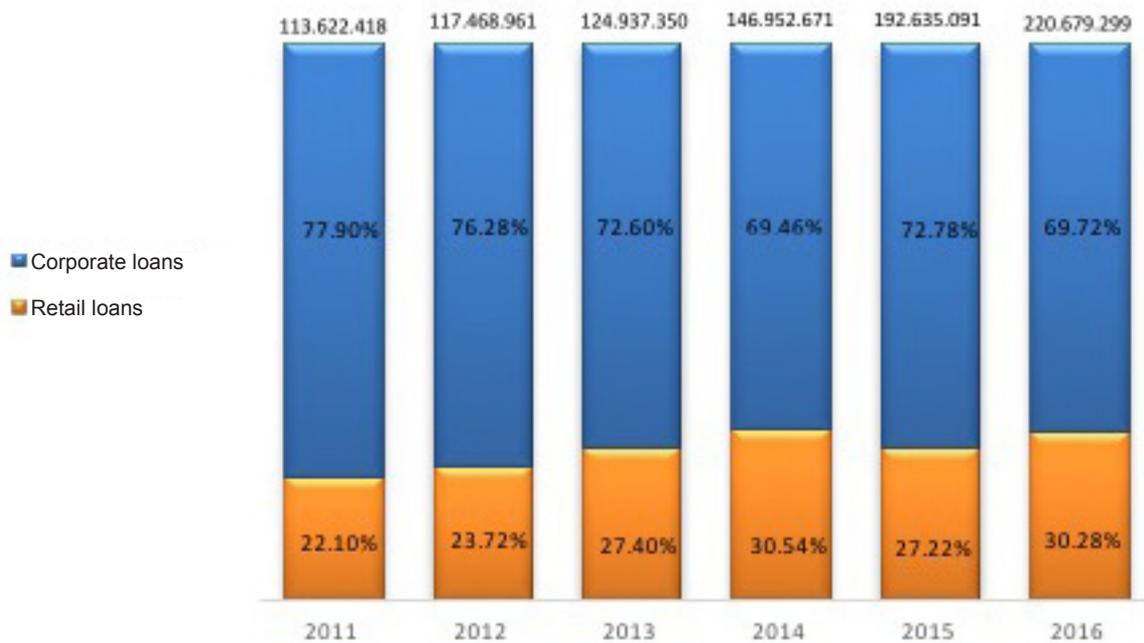
Total retail loans portfolio increased by 27.44%, while the corporate loans portfolio increased by 9.74%.

	Loans	Change in %
2012	117,466,949	3.39%
2013	124,935,336	6.36%
2014	146,950,657	17.62%
2015	192,635,091	31.09%
2016	220,679,299	14.56%

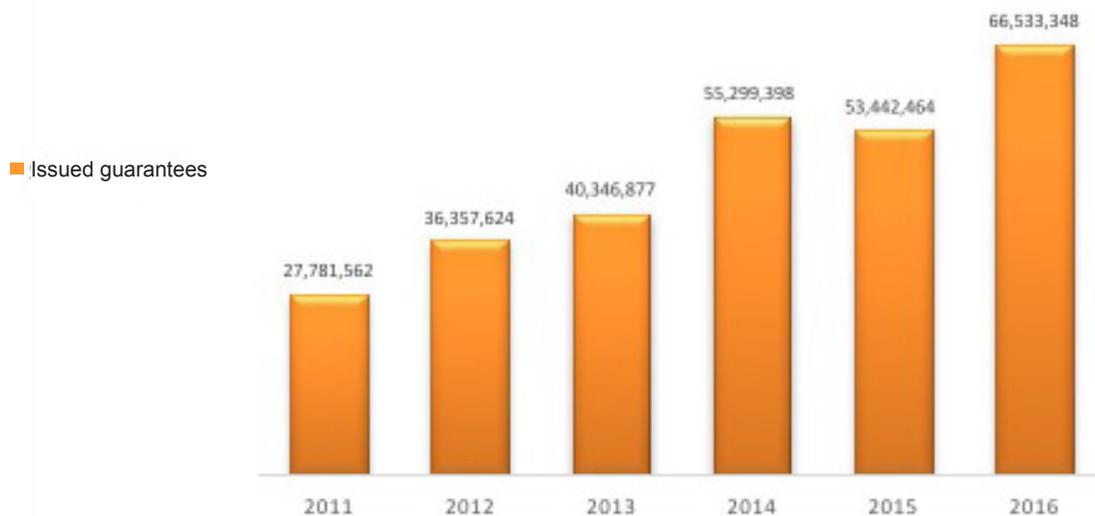


	2012	2013	2014	2015	2016
Retail loans	27,867,176	34,227,877	44,875,954	52,436,433	66,825,085
Corporate loans	89,599,773	90,707,460	102,074,703	140,198,658	153,854,215
Total	117,468,961	124,937,350	146,952,671	192,635,091	220,679,299

In the structure of overall loan portfolio, retail loans account for 30.28%, while corporate loans account for 69.72%.



Guarantees in 2016:



	2012	2013	2014	2015	2016
Issued guarantees	36,357,624	40,346,877	55,299,398	53,442,464	66,533,348

In 2016, the Bank continued its cooperation with the European Bank for Reconstruction and Development (EBRD) and provided loans to small and medium-size companies (SMEs) on terms that were preferential in both interest rates and repayment period.

The Bank continued its successful cooperation with Investment and Development Fund (IDF) to grant loans under preferential terms.

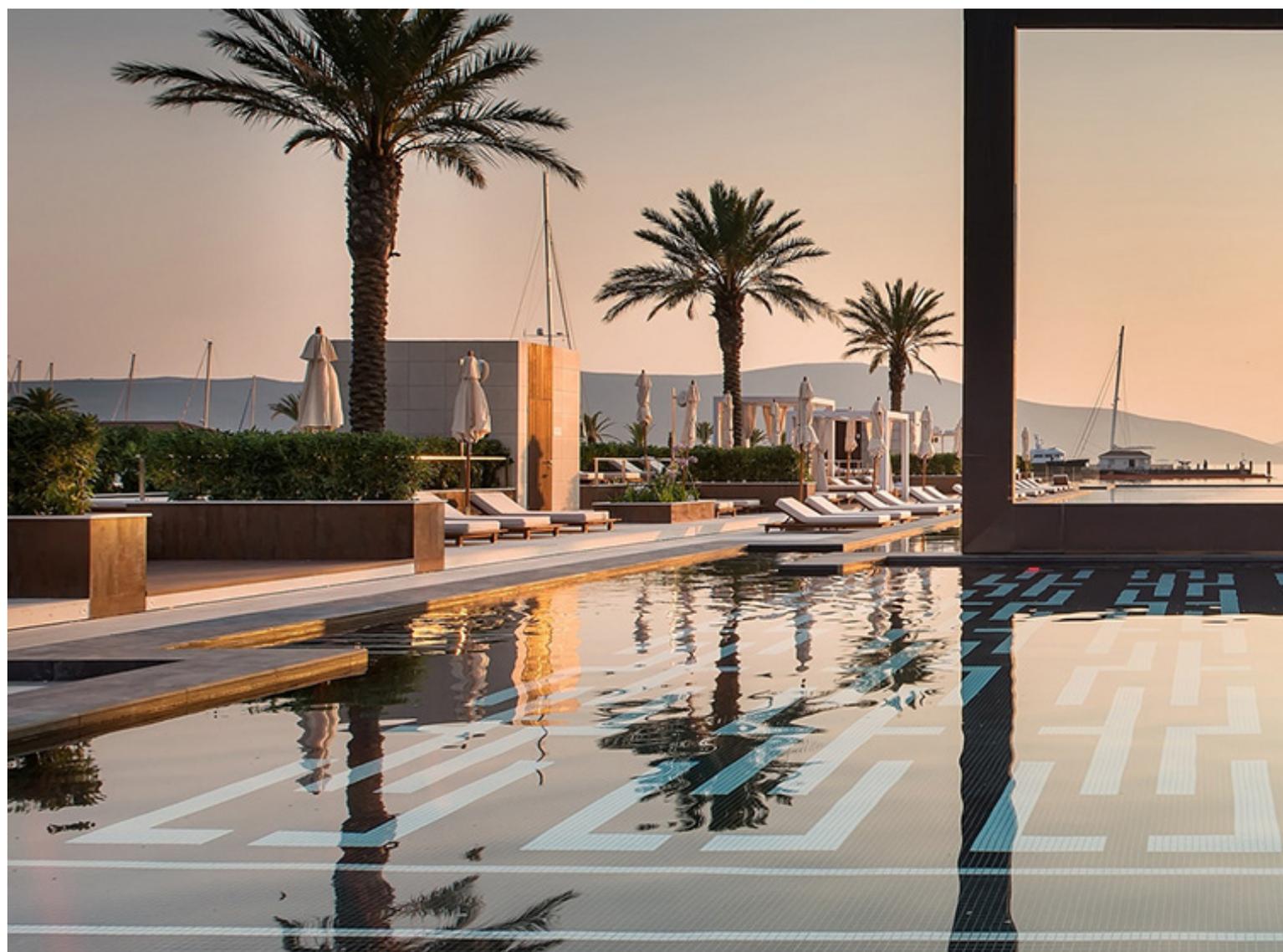
The Bank’s offer to corporate clients includes cash loans, revolving loans, loans intended for settlement of obligations towards suppliers, for car purchase, refinancing of debts with other banks, financing export liabilities, for purchase of equipment, refurbishment of office space, preparation for tourist season, overdraft loans, factoring, as well as all types of guarantees.

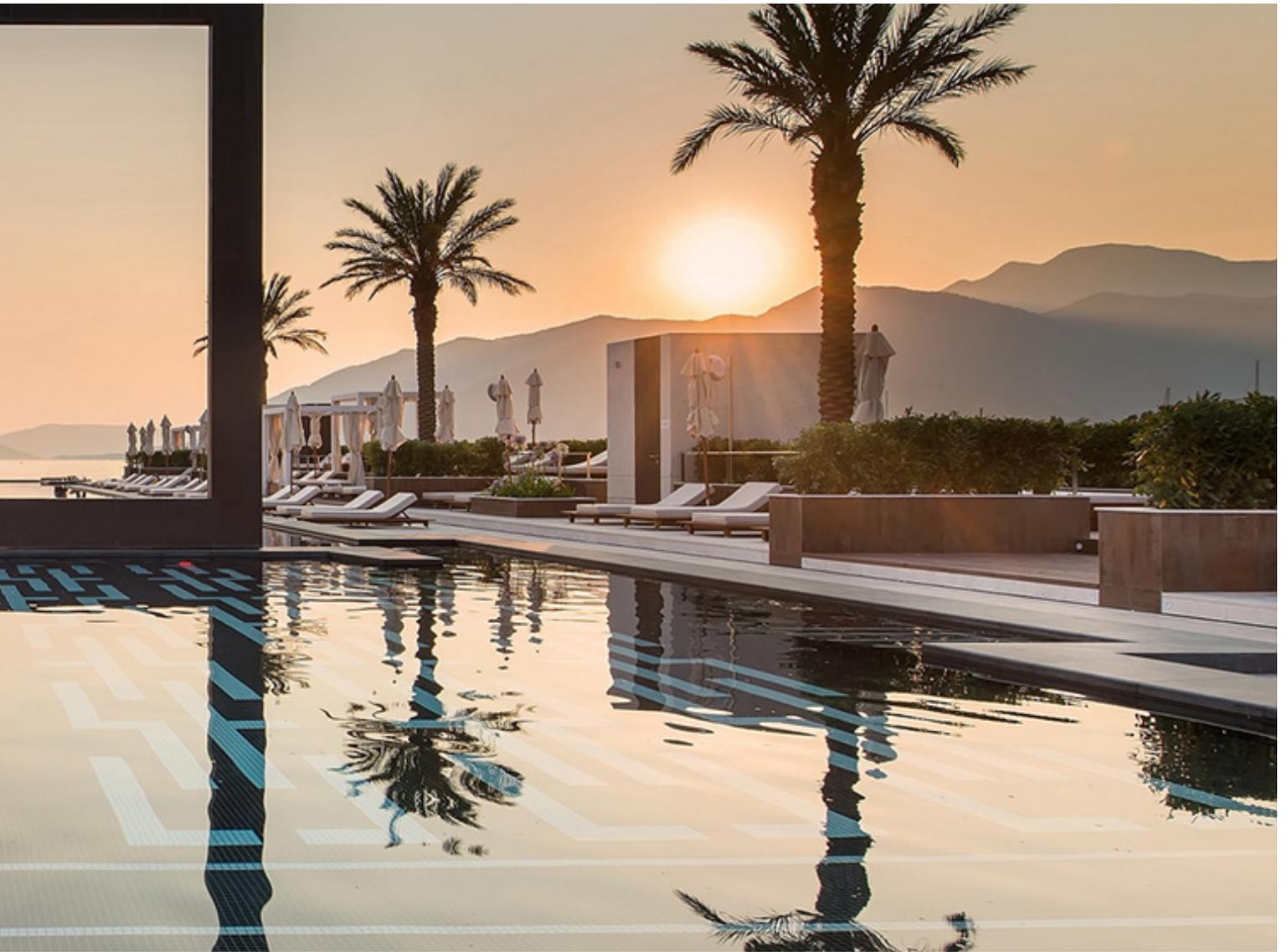
The Bank also offers a wide spectrum of retail loans: cash loans, specific purpose loans, student loans, car purchase loans, reconstruction and refurbishment loans, sailor loans, tourism loans, agriculture loans, overdraft loans, consumer installment loans, etc. as well as all types of guarantees.

PRODUCTS AND SERVICES

In 2016, the Bank continued improving its products and services. This year, the focus was on improving the quality of e-banking applications, information provided the clients and their adjustment to clients' specific needs.

In 2016, the Bank laid the foundation for a large number of development projects that are due to be launched in 2017.





3 PAYMENT OPERATIONS

PAYMENT OPERATIONS

The Bank overall payment operations in 2016 were characterized by the growth of all parameters defining business operations of this segment. All business plans previously set for business operations were achieved, which clearly demonstrates the Bank's efficiency and progress over the previous year.

Domestic payment operations

Overall domestic payment operations of the Bank recorded growth in 2016.

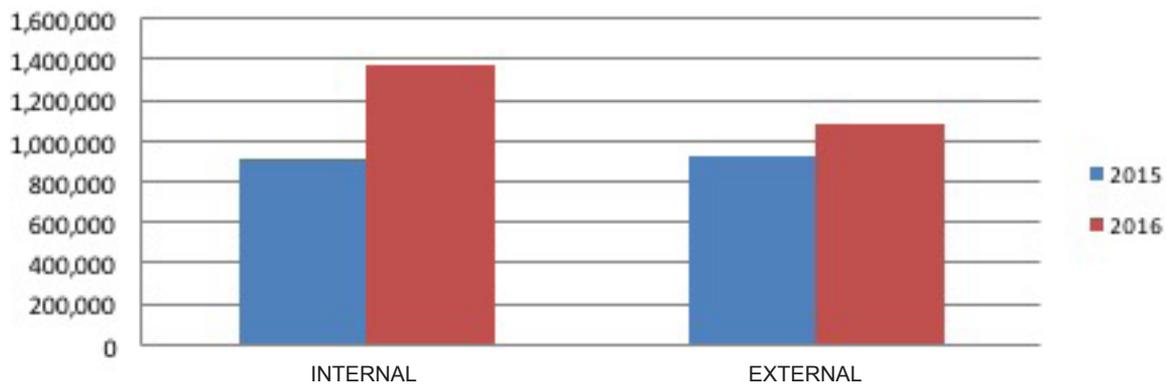
The total number of domestic payment transactions rose by 34% over 2015. Of this figure, the biggest growth was recorded in the number of internal transactions in the Bank. This growth was at 51% over the year before. External transactions also recorded a 16% growth over the previous year.

Within the external payment orders there was also a growth of 'small' payments (< EUR1.000, an increase of 18%) as well as 'high value' payments (> EUR1.000, 12% growth).

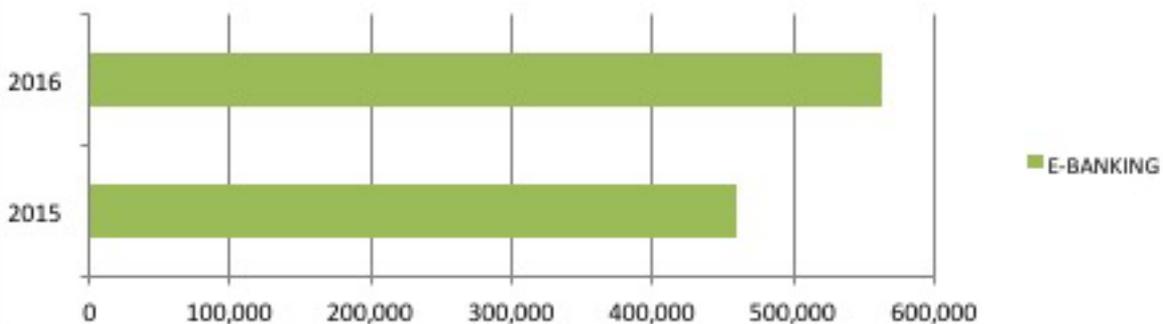
Incoming payments from other banks rose by 2% over the previous year.

A significant increase was also recorded in the number of electronic (e-banking) transactions, which means that clients are turning more and more to electronic applications and make payments by electronic orders. The number of domestic electronic payments grew by 23% over the previous year.

International payment transactions



International outgoing e-payment transactions

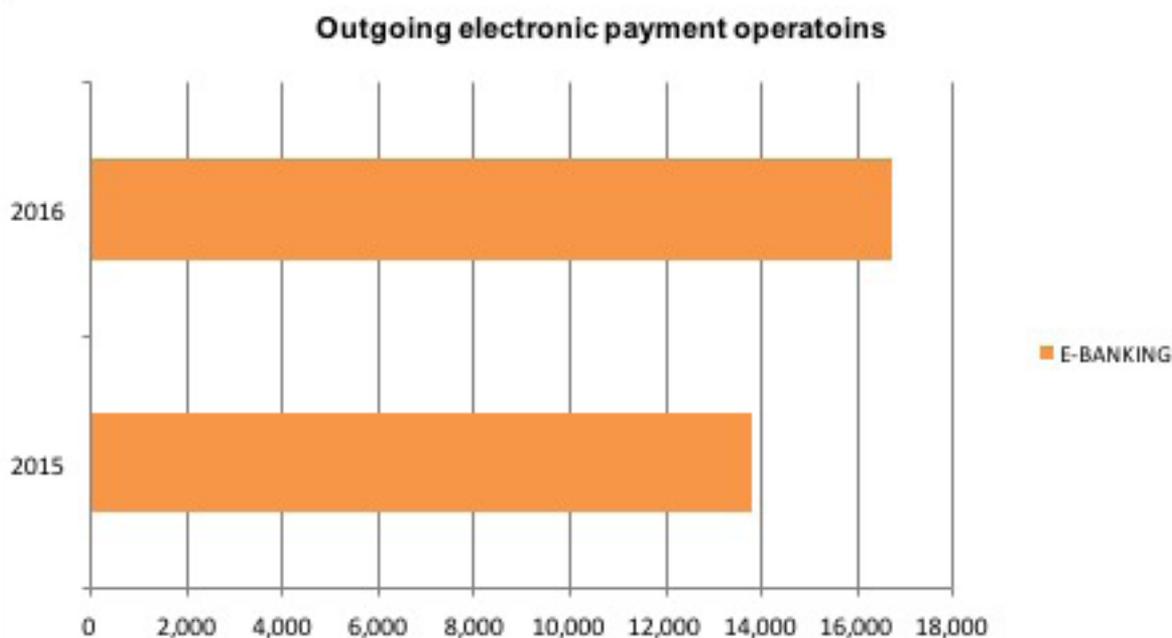
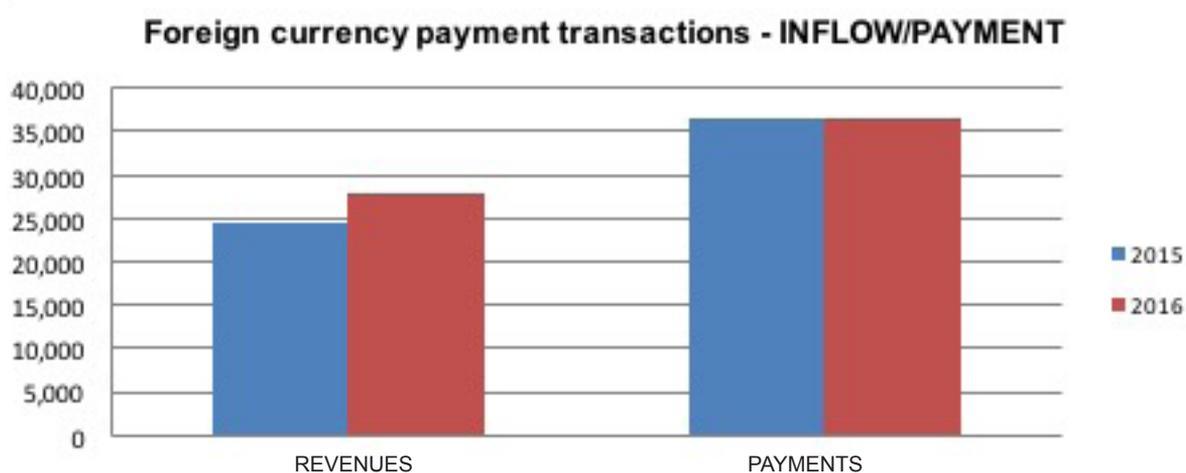


Foreign payment operations

Foreign payment operations in 2016 were characterized by the fact that a large number of payments was maintained, as well as by an increase in incoming payments and payments by e-banking, and other operations that make an integral part of foreign payment operations.

The Bank has long since been recognised by international banks as an efficient and reliable partner.

The number of outgoing payment operations was at the same level as the year before. The number of electronic outgoing payment transactions made by HB-klik (e-banking) rose by 21% over 2015. The number of incoming transactions rose by 14% over the previous year.



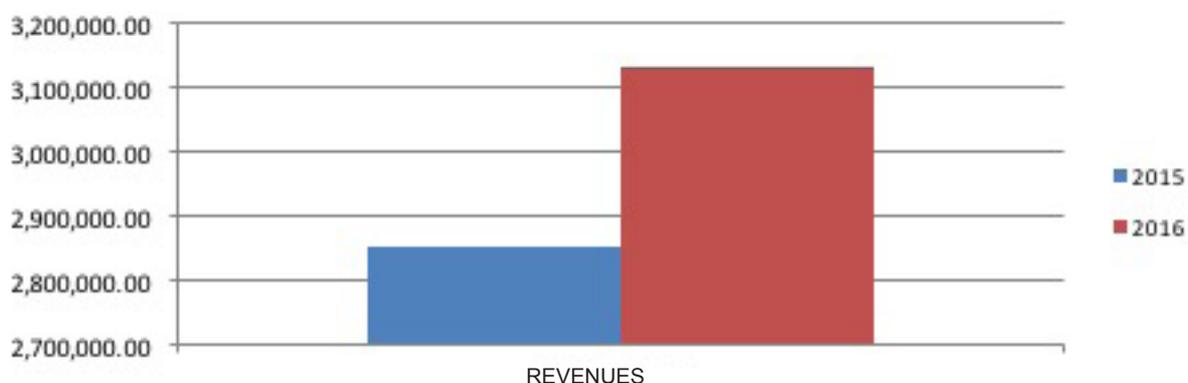
Total revenues from commissions on payment operations increased by 11% over 2015. The revenues from domestic payment operations rose by 18%, and from foreign payment operations by 3%.

Net revenues from overall payment operations rose by 10% over the previous year.

REVENUE FROM DOMESTIC AND FOREIGN PAYMENT OPERATIONS



NET REVENUES FROM PAYMENT OPERATIONS



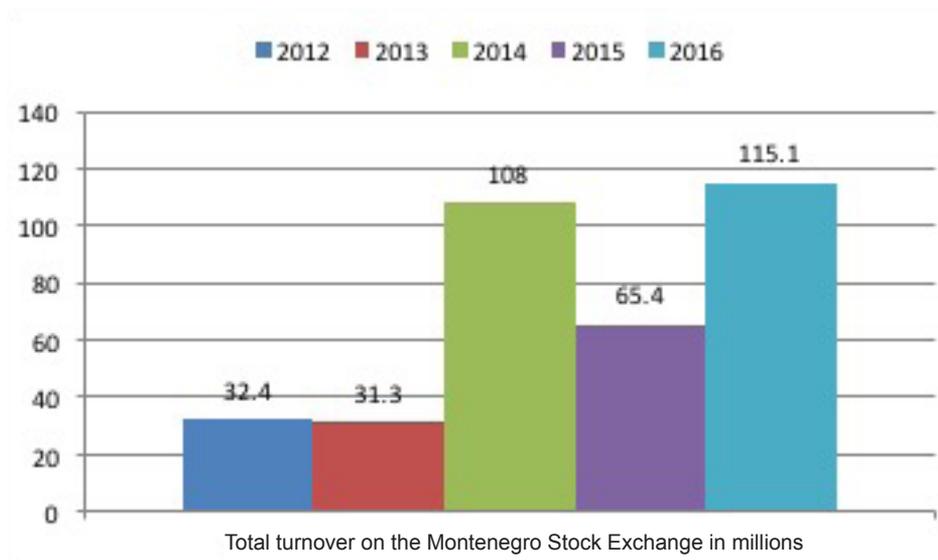
INVESTMENT BANKING

Montenegro stock exchange

The overall trading volume on Montenegro Stock Exchange in 2016 amounted to €115,174,714, around 76% over the turnover in 2015. The difference was caused by the primary issuance of bonds in November 2016 in the amount of € 80,410,000.

Hipotekarna Bank corporate bonds proved to be liquid in secondary markets, with a turnover of 1.09 million euro.

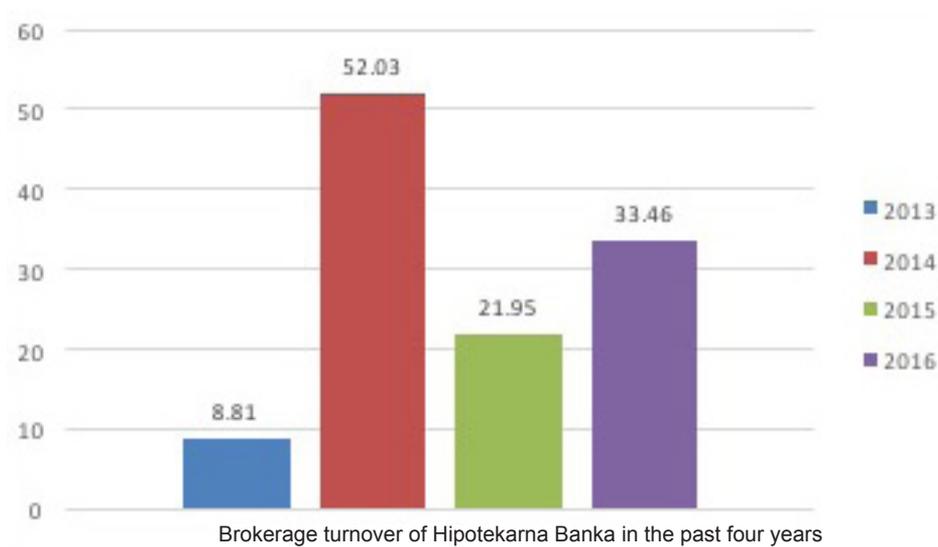
MONEX 10 recorded a drop of 1.15 % and on the last trading day was at 928.27 percentage points. On 11 January the index reached its maximum value of 1,050.11 points, while its lowest value in the previous year was recorded on 30 June and was at 854.16 points. MONEX recorded a drop by 5.09 % in the previous year, and was at 11,510.59 percentage points on the last trading day. The index reached its maximum value of 12,178.20 points on 11 January, while its lowest value in the previous year was recorded on 21 June, at 10,267.57 points.



Brokering

In 2016, the Brokerage Unit of Hipotekarna Bank generated a turnover of EUR 18.93 million at Montenegro Stock Exchange, with Hipotekarna Bank maintaining its position of one of the leaders in the Montenegrin capital market.

The turnover made by Hipotekarna Bank brokers in foreign markets was 14.53 million euros.



Dealer operations

Hipotekarna Bank total investments in equity securities were EUR 3.44 million as of 31/12/2016. Its revenues from dividend and realised capital gains was EUR154 thousand in 2016.

Custody operations

As of 31/12/2016, Hipotekarna Bank clients held 41.67 million eur worth of securities in custody of the Bank. Hipotekarna Bank remains the leading custody bank in Montenegro. The revenues of Custody Unit were EUR 123 thousand. The Unit's operating income was EUR 72 thousand.





4 RISK MANAGEMENT

RISK MANAGEMENT

The risk management department addresses risk centrally, at the level of the Bank. Risk management includes risk identification, measurement, monitoring and reporting. The department develops risk management policies and procedures as well as risk measurement methodologies and procedures.

The risk management department reports monthly to ALCO committee on the levels of risk taken by the Bank. Based on this information the Committee does evaluation of the management performance in risk management.

The risk management department develops reports on Bank's vulnerability to various types of risks and in this way informs the Committee decision setting the limits.

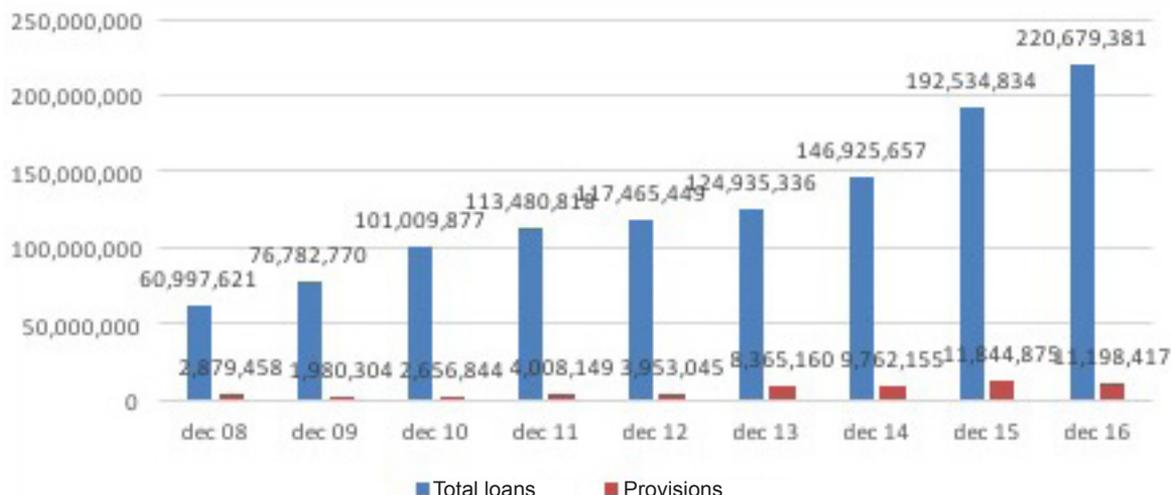
Credit risk

The Bank manages credit risk at both portfolio and individual levels.

Portfolio of Hipotekarna Bank on 31/12/2016 was €220,679,381 or bigger by €28,144,546, or 14.6% than in late 2015.

Provisions for loan losses on 31/12/2016 were €11,198,417. Compared to the end of 2015, the provisions rose by €646,458 or 5.46%.

Portfolio / provisions 2008-2016



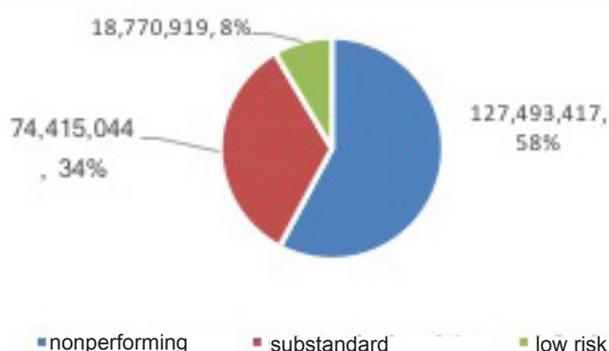
The provisions for loan losses on 31.12.2016 were €6,254,693. Compared to the end of 2015, the provisions dropped by €40,943, or 0.65%

Trends in provisions according to an internal model in 2016

MODEL	Mar 16	June 16	Sep 16	Dec 16
Reservations	196.303.669	212.594.175	196.196.949	220.679.381
Portfolio	6.189.901	6.570.417	6.239.788	6.254.693
	3,15%	3,09%	3,18%	2,83%

Out of the total loan portfolio of the Bank, 57.77% is made by quality assets (A and B1), 33.72% is substandard assets (B2) and 8.51% are NPLs (C, D and E rating grades).

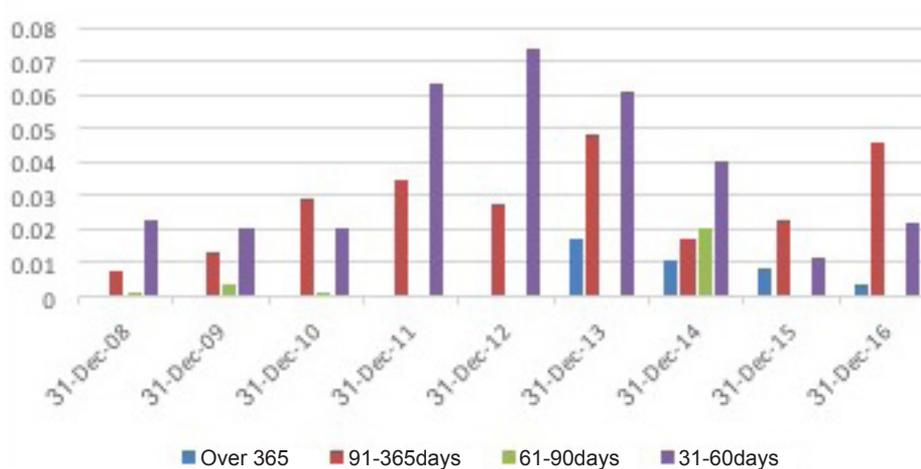
Assets by quality - Dec. 16



NPLs in arrears over 30 days amounted to €115,650,190, or 7.09% of Bank's total portfolio on 31/12/2016.

NPLs in arrears over 90 days amounted to €10,838,052, or 4.91% of Bank portfolio on 31/12/2016, while on 31/12/2015 they were €6,002,202, or 3.12% of Bank's overall portfolio.

Claims by arrears class / total loans



Clients migratory movement in December 2016 (%)

	A	B1	B2	C	D	E	(closed / internal)
A	96,45%	0,56%	0,03%	0,13%	0,00%	0,00%	0,00%
B1	1,29%	75,18%	0,00%	0,23%	0,00%	0,00%	0,00%
B2	0,06%	0,13%	93,66%	0,19%	0,00%	0,00%	0,00%
C	0,12%	0,28%	0,17%	98,38%	0,17%	0,00%	0,00%
D	0,17%	0,00%	0,00%	0,13%	83,02%	4,63%	0,00%
E	0,00%	0,00%	0,00%	0,00%	0,00%	97,81%	2,03%

SECURITIES – within credit risk

The Bank’s banking book was composed of equity based and debt based financial instruments on 31 Dec 2016. In December, all the positions in the banking book were within the limits set by law and bank internal rules. The total value of securities owned by Bank as of 31/12/2016 was € 91.266 million of which securities available for sale made € 74.487million, and € 16.779 million were securities kept to maturity.

Market risk:

In market risk, the Bank analyses the following: interest rate risk, currency risk and position risk.

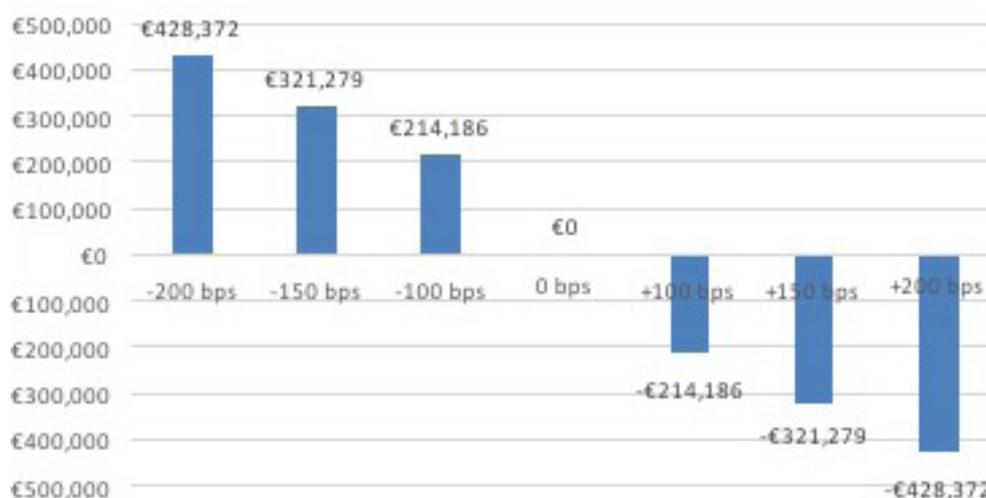
Interest rate risk:

The interest rate risk is analysed from two complementary perspectives: impact on economic value of Bank capital as well as on net revenues from interest.

The impact of banking book interest risk on Bank’s economic value was analysed using “duration gap”. The purpose of this method is to show the potential change in values of Bank’s future active and passive cash flows vulnerable to interest risk, their difference being the “economic value of Bank’s capital” (EVE). Unlike interest gap that measures the impact of interest risk on net interest revenue taking into account active and passive cash flows up to one year, the duration gap takes into account all cash flows.

If interest rates increase by 200 bps, the EVE of EUR 29.507 million as of 31/12/2016 would drop by EUR 428,372 or 1.45%. The calculated amount of the duration gap (or “risk weighted positions of banking book”) was 1.37% of Bank’s own funds on 31 Dec 2016, which is within the legal requirement of 20%.

Change of EVE for different changes in interest rates



Projections for withdrawals of sight deposits:

1-30 days	31-90 days	91-180 days	181-365 days	over 1 year
21%	15%	15%	21%	28%

*VULNERABILITY OF ASSETS AND LIABILITIES TO CHANGE OF INTEREST RATE
(in thousands EUR) – aggregate 31 Dec 2016*

VULNERABLE ASSETS		31-90 days	91-180 days	181-365 days	over 1 year	TOTAL
Interest bearing deposits in other institutions	7.631	-	1.489	-	-	9.120
Interest bearing securities	78.976	6.834	-	-	110	85.920
Loans and other payables	13.142	29.744	18.187	46.707	112.900	220.679
Other vulnerable assets	10	-	-	-	-	10
TOTAL	99.759	36.578	19.676	46.707	113.009	315.729
% of total interest bearing assets	32%	12%	6%	15%	36%	100%
VULNERABLE LIABILITIES	1-30 days	31-90 days	91-180 days	181-365 days	over 1 year	TOTAL
Interest bearing deposits	38.877	45.366	53.784	86.158	73.704	297.889
Interest bearing loans	1.058	235	764	1.920	31.263	35.240
Subordinated debt and bonds	-	-	-	-	10.000	10.000
Other vulnerable liabilities	554	389	4	12	56	1.015
TOTAL	40.489	45.990	54.552	88.090	115.023	344.144
% of total interest bearing liabilities	12%	13%	16%	26%	33%	100%
DIFFERENCE (GAP)	1-30 days	31-90 days	91-180 days	181-365 days	over 1 year	TOTAL
AMOUNT OF GAP	59.270	-9.412	-34.876	-41.384	-2.014	-28.415
Time of year when there is exposure to GAP	0,96	0,84	0,63	0,26		
Cumulative GAP	59.270	49.858	14.982	-26.401	-28.415	-56.829
Impact on net revenues from interest	-1.137	157	440	215		
Annual fluctuations of interest revenue (interest shock)	-324					
Cumulative GAP / Total assets	14%	12%	3%	-6%	-7%	-13%
Prescribed limits				54%		

If interest rates drop by 2 percentage points, the expected annual net income from interest will drop by EUR 324 thousand.

Currency risk

Currency risk has no impact on Bank's overall risk profile.

Foreign currency position – 31 Dec 2016 (converted into EUR)

Equity				€31,205,000	
Currency	Assets	Liabilities	Net position	Limit (% equity)	Realised
AUD	17.698	-18.030	-333	15%	0%
CAD	2.041	-1.089	952	15%	0%
DKK	7.918	-5.380	2.538	15%	0%
JPY	105	-86	19	15%	0%
KWD	0	0	0	15%	0%
NOK	23.184	-23.471	-287	15%	0%
SEK	12.925	-10.285	2.641	15%	0%
CHF	519.552	-539.278	-19.726	15%	0%
GBP	606.327	-601.337	4.990	15%	0%
USD	13.179.302	-13.539.115	-359.814	15%	1,15%
	14.369.052	-14.738.072	-369.020	20%	1,18%

Operational risk:

Operational risk management is regulated by Bank's internal rules and CGCG rules. The Bank identifies on a monthly basis the events created due to operational risk exposures. The

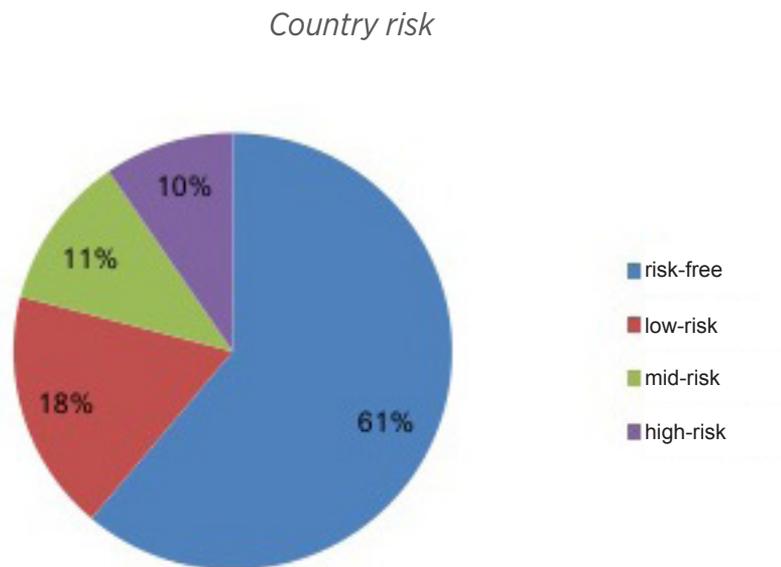
Board of Directors makes quarterly reports on identified risks, accrued losses, as well as the measures that need to be taken to resolve the problems identified.

Country risk:

The policy of country risk management is designed in compliance with the legislative framework, CBCG implementing regulations, and Bank internal rules (Procedures and Country Risk Management Policy). Internal rules define the following:

- » allowed country risk exposure limits, by individual countries and cumulatively
- » periodic review of country risk management adequacy
- » method of identification, measurement, monitoring and controlling of country risk
- » authority and responsibility of persons associated to country risk ownership and management
- » obligations relating to periodic review of Bank's exposure to country risk
- » classification of assets exposed to country risk and criteria for country rating

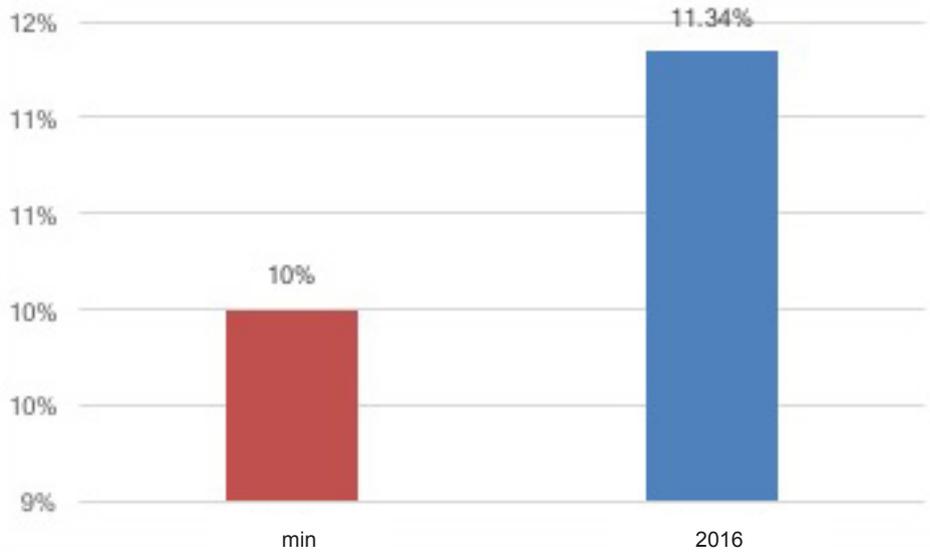
Na grafikonu ispod se vidi da se 61% izloženosti Banke odnosi na izloženost prema zemljama koje su klasifikovane kao nerizične, 18% na niskorizične, 11% na srednjerizične, a samo 10% na visokorizične zemlje iz čega se zaključuje da Banka dobro upravlja rizikom zemlje.



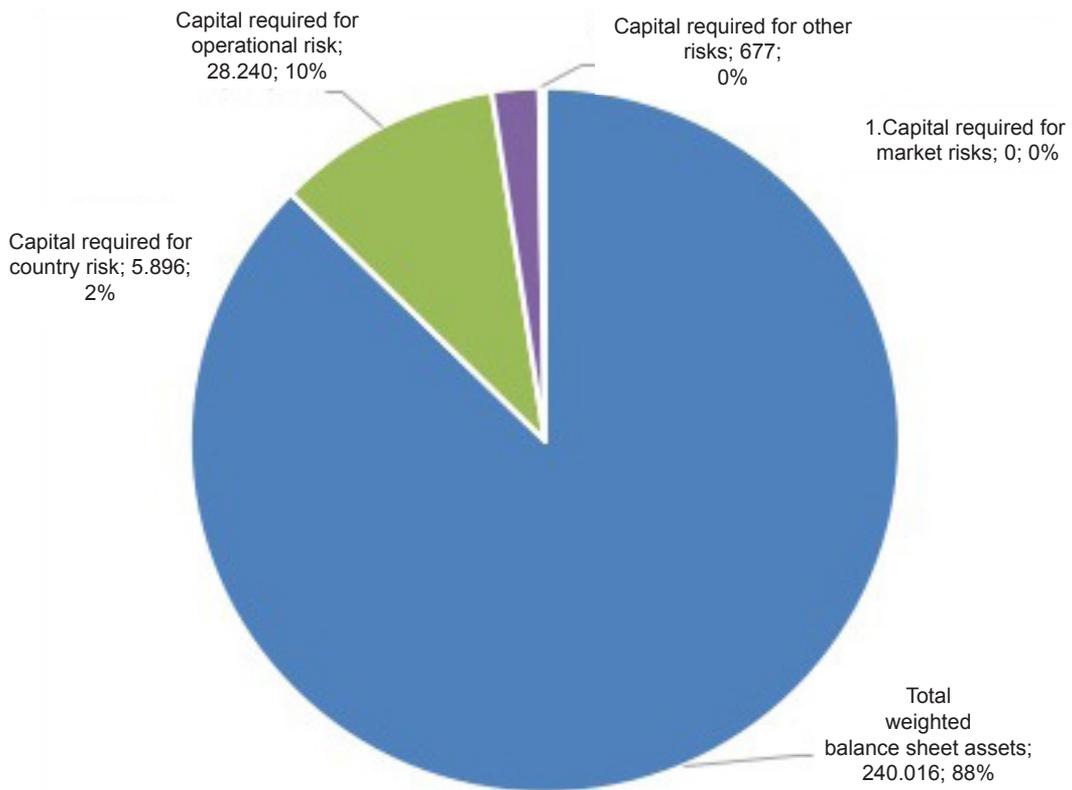
Solvency ratio:

On 31/12/2016, solvency ratio was above the statutory limit (10%), and amounted to 11.34%. Solvency ratio is the most important indicator of confidence in the Bank and serves as a protector of Bank's depositors, creditors, and business partners.

Solvency ratio for 2016



Structure of equity required to cover all the risks



Equity

The Bank's total equity was EUR 38.842 million on 31/12/2016. Equity increased by 12.90% over the year before. On 31 Dec 2016, the nominal value of shareholders' equity was EUR 16.006 million. Shareholders' equity consists of 31,305 shares, EUR 511.29 nominal value each. Corporate and retail clients account for 78% of Bank's ownership structure, while the remaining equity is held by domestic corporate and retail entities.

Profit and loss account

In 2016, the Bank earned a profit of EUR 3.624 million. Interest income rose by 2.11% over the previous year and amounted to EUR17,704 million, which came as a result of increased loan activity and larger investment into securities. Fee revenues rose by 15.24% over the previous year and amounted to EUR 10.644 million. Net fee revenues accounted for 40.97% of Bank's total net operating income.

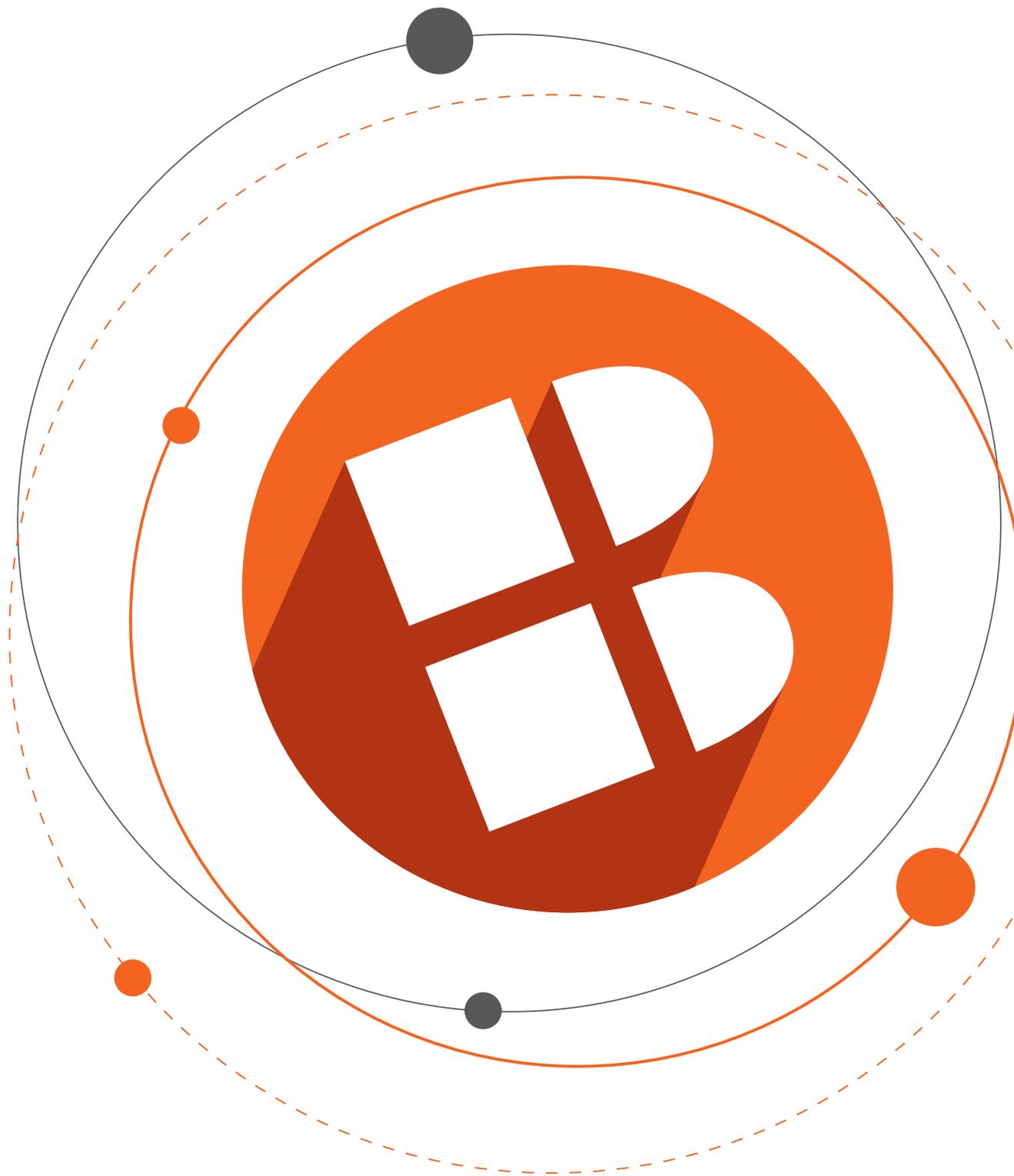
Other revenues rose by 26.74% over the previous year and amounted to EUR 1.595 million.

Operating expenses, including depreciation, were EUR 12,698 million and rose by 9.46% over the previous year.

The rise in operating expenses results from the expansion of network, new recruitments, as well as an increase in other expenses relating to Bank's growth and development. The assessment of credit risk, making provisions for risky loans and Bank's potential liabilities are based on the application of the principles of conservative policy and implementation of applicable regulations. Total allocated reserves for assets and liabilities amounted to EUR 12.462 million on 31 Dec 2016.

Profit distribution

The Board of Directors, upon the initiative of the Bank management, proposes to the Shareholders Assembly not to distribute the 2016 profit in order to increase the Bank's overall capital and cover the missing provisions for potential credit losses, as requested by the regulator, the Central Bank of Montenegro, in line with the applicable regulations governing banking operations.







5 FINANCIAL STATEMENTS

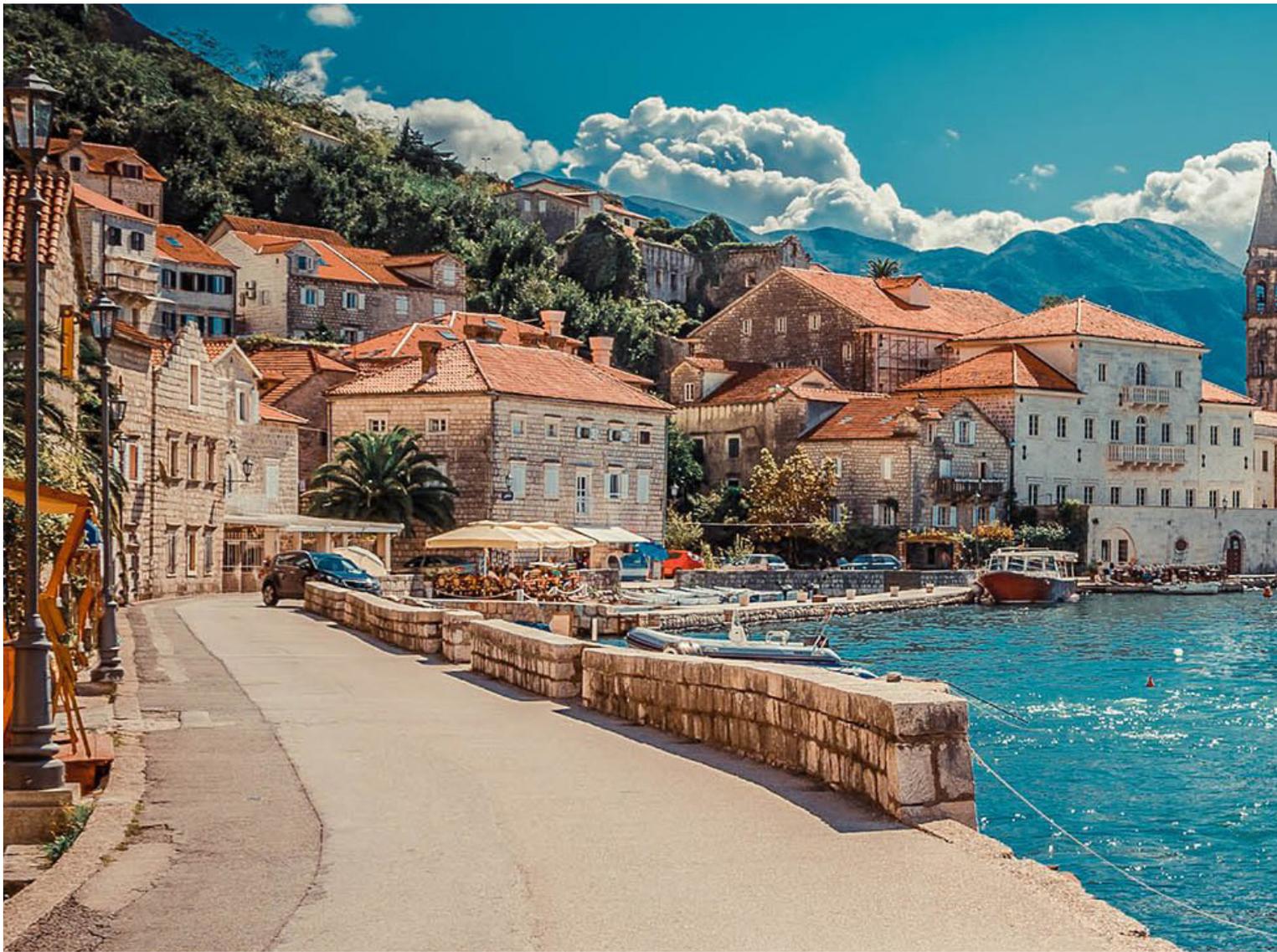
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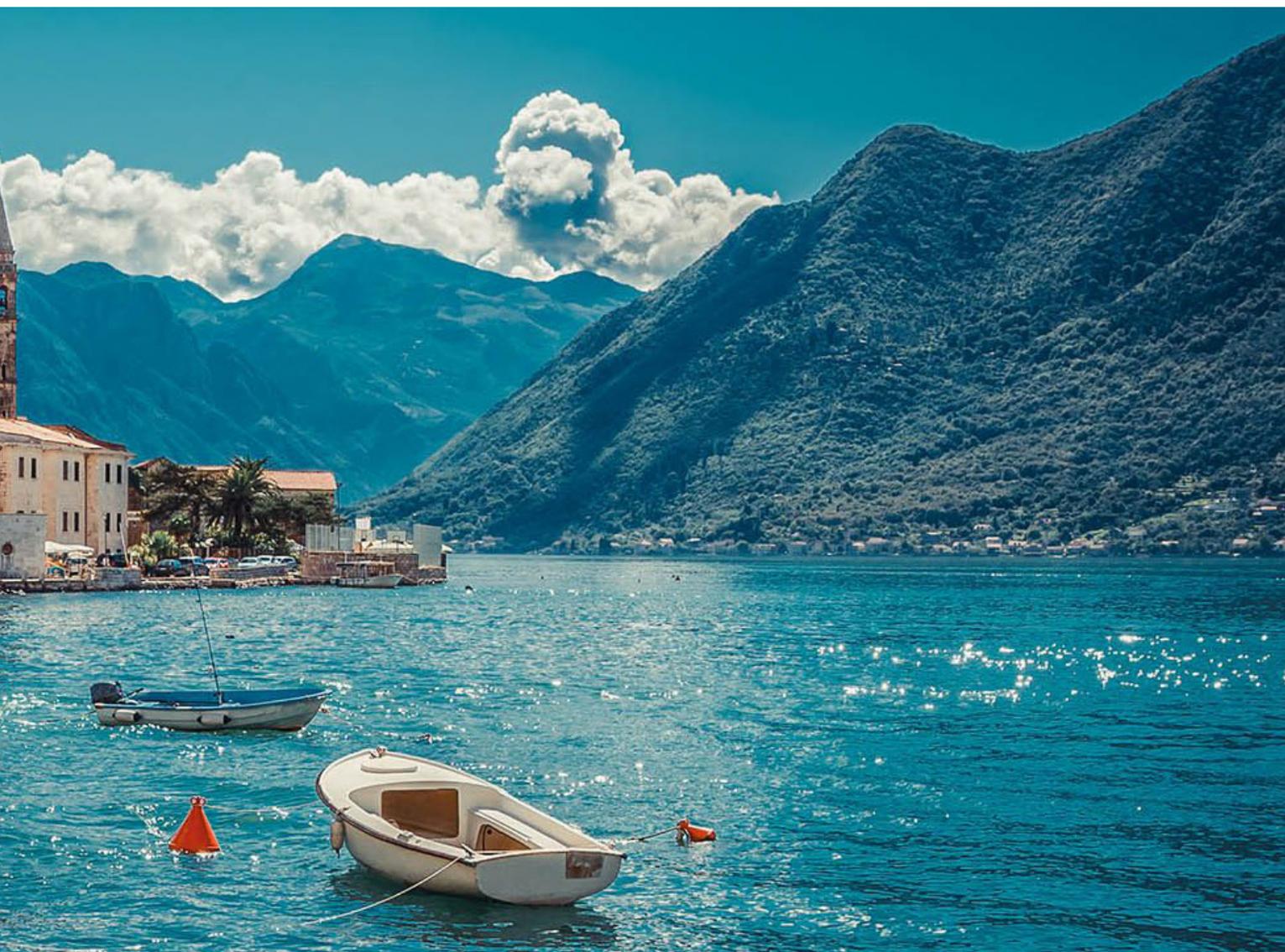
Financial statements for the year ended december 31, 2016 

or [HERE \(http://hipotekarnabanka.com/en/reports/financial-statements\)](http://hipotekarnabanka.com/en/reports/financial-statements)

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6 BANK PROFILE

BANK'S MANAGEMENT AND ORGANISATION CHART

BOARD OF DIRECTORS	Sigilfredo Montinari, Chairman Božana Kovačević, Deputy Chairman Renata Vinković, Member Goran Varat, Member Esad Zaimović, Member
AUDIT COMMITTEE	Draško Popović, Chairman Božana Kovačević, Member Marko Žigmund, Member
CREDIT RISK MANAGEMENT COMMITTEE	Renata Vinković, Chairman Sigilfredo Montinari, Member Esad Zaimović, Member
EXECUTIVE OFFICERS	Esad Zaimović, Chief Executive Officer Aleksandar Mitrović, Executive Officer for Business Support Operations
CHIEF INTERNAL AUDITOR	Veselin Ivanović
AUTHORISED COMPLIANCE OFFICER	Danka Dragičević
AUTHORISED AML AND TERRORIST FINANCE OFFICER	Mirjana Jovanović
HEAD OF IT SECURITY	Haris Dizdarević
SECTORS	Ana Golubović, Director of Corporate Sector Nikola Špadijer, Director of Retail Sector Jelena Vuletić, Director of Credit Risk Management Sector Nikola Milović, Director of Support and Organisation Sector Nataša Lakić, Director of Payment Operations and Asset Management Support

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