

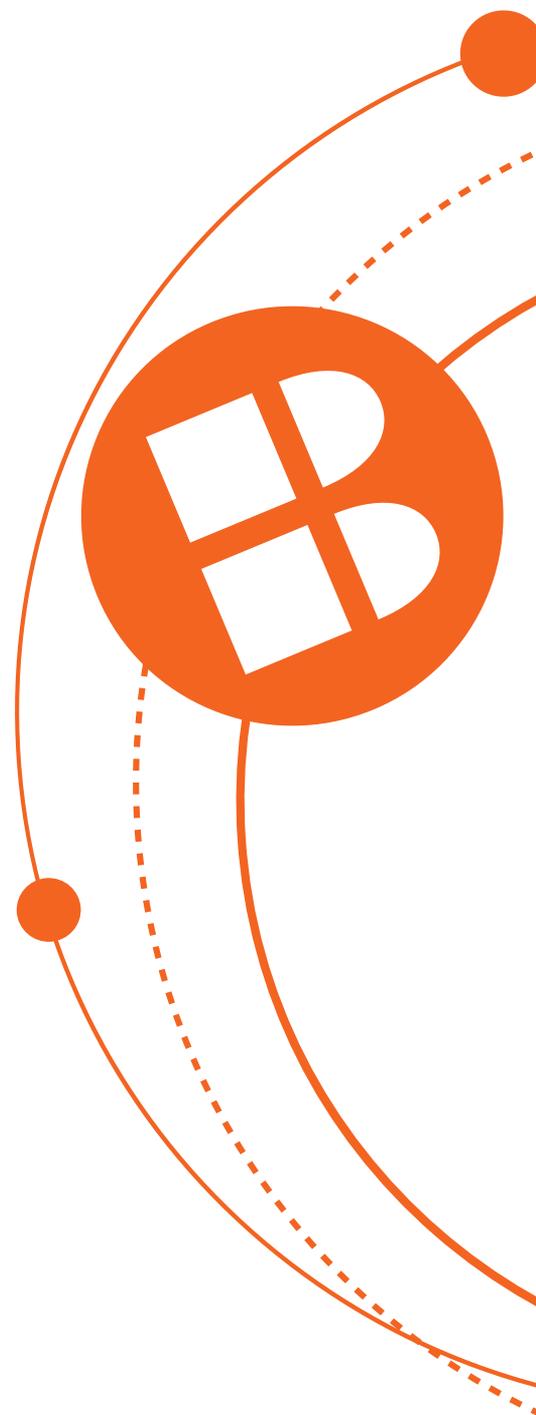
# ANNUAL REPORT

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2019

**■▶ HIPOTEKARNA  
■▶ BANKA**

*Vama posvećena*





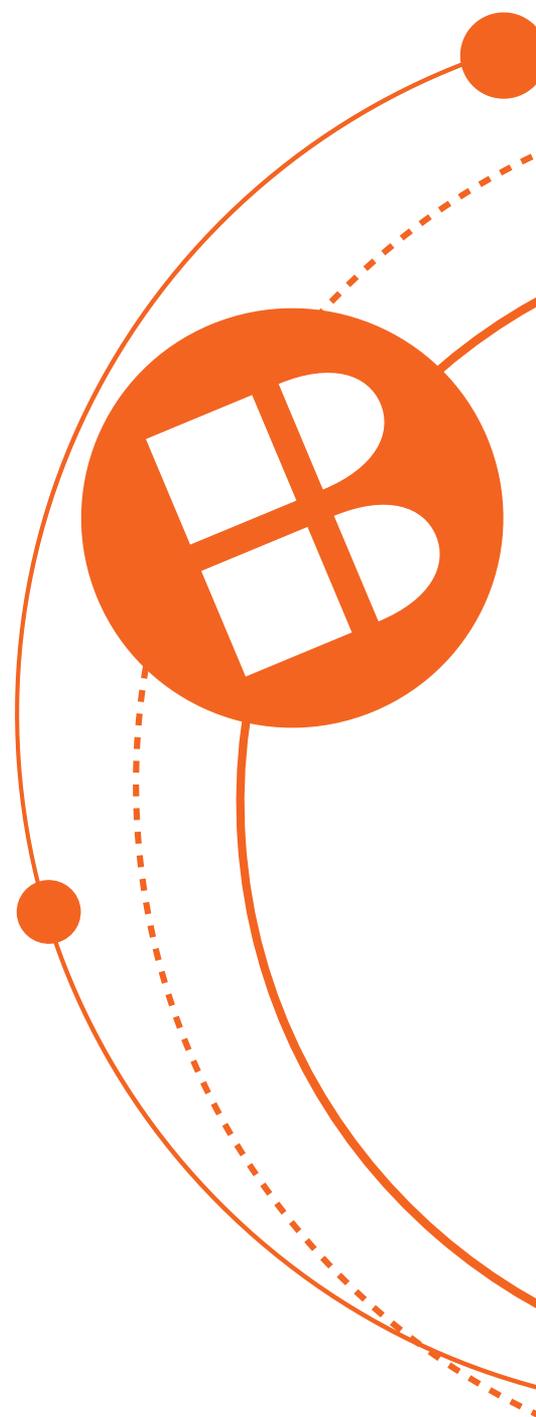
# ANNUAL REPORT

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2019

 **HIPOTEKARNA  
BANKA**

*Vama posvećena*



Dear Clients, Partners and Shareholders,

It is my honour to present to you, on behalf of the Board of Directors, Annual Report of Hipotekarna Banka AD Podgorica for 2019. The year behind us was full of challenges, which began with the bankruptcy of two Montenegrin banks. I am pleased with the fact that the banking system of Montenegro has shown its readiness to address the issue of distressed banks and has justified, through swift reaction, the confidence and security that have been built for years.

Over the past year, the Board of Directors has worked closely with the management team. To successfully execute our strategy, we focused on key market segments, customer care, efficient operations and decision-making in terms of risk and financing. The mechanisms and business philosophy set up in this way have enabled us to keep our place as one of the best financial companies in the country. We are pleased to have been able to increase our revenues, profit and market share.

In 2019, the profit of Hipotekarna Banka AD Podgorica hit a record high (4,863 million EUR, or 155,34 EUR per share). In terms of size of its assets (530,4 million EUR), the Bank kept its position among five leading banks of the Montenegro's banking system. It is important to point out that the Bank ranks third when it comes to the level of customers' deposits, which is the best confirmation of confidence the customers have in the Bank. The confirmation of confidence also came through the successfully issued third series of Bank's bonds (bonds worth 8 million EUR were issued in December). Together with the previous two issues, the total amount of issued bonds of the Bank is 22 million EUR, a great sign of confidence from local and foreign investors.

As at end-2019, capital totalled 51.9 million EUR, solvency ratio was at 16.29%; while the rate of return on capital amounted to 9.37%.

Having maintained a high level of solvency and liquidity, the Bank managed its assets and risk well, thereby contributing to the creation of successful sustainable long-term operations. In this way, the Bank ensured the creation of foundation for customer support in the future. The Bank's support in the future will not be lacking in terms of corporate social responsibility.

Hipotekarna Banka AD Podgorica will continue its corporate social responsibility in the upcoming period as well, which, due to Covid 19 pandemia, will be a real challenge for the world economic system, at the same time striving to provide professional banking services and commitment to customers, which represents a priority of our organisation.

Finally, I would like first to thank our employees for their work and results accomplished over the past year, as well as our clients who provide us with the opportunity to serve their needs. I would also like to thank the Bank's shareholders for their support and send them a message that their investments in the Bank's shares are secure, and that they will continue to be satisfied with the profitability and operations of the Bank in the forthcoming period.

Sigilfredo Montinari

## CHIEF EXECUTIVE OFFICER SPEECH

Esteemed Shareholders, Customers, and Colleagues,

On behalf of the management of the Hipotekarna Banka and myself, I am pleased to present successful business results achieved in 2019.

Looking at Montenegrin banking system, the challenging beginning of the last year reflected in the bankruptcy of two banks. The resulting circumstances did not disrupt the banking system in any segment, but once again confirmed that it is the healthiest and most regulated sector in Montenegro.

The net profit of the Bank hitting a record of about 4.8 million euros, a record high deposits of about EUR 419 million as at end of the year, as well as their stability, resulted in placing the Bank firmly among the leading banks in Montenegro. Its international recognisability came from receiving another award from the European Bank for Reconstruction and Development. In respect of financial markets, the Bank kept its leading position.

The previous year was also important for the Hipotekarna Banka AD Podgorica as it successfully issued the third series of subordinated bonds in the amount of EUR 8 million. This issue provided a substantial support to the capital of the Bank and ensured support to further development and placements.

Hipotekarna Banka has continued with the development and expansion of its business network. We have opened a modern branch in the prestigious Porto Novi Resort. We reached our customers in the north of Montenegro by opening our branch in Žabljak. In the previous year, we also continued to develop innovative products by launching Visa Infinite credit card and HB Concierge service. The promotion, automation and digitisation of the processes aimed at managing the bank in a qualitative manner continued in the last year, and we have successfully started the replacement of the main banking software that will enable additional security, efficiency and flexibility in our work.

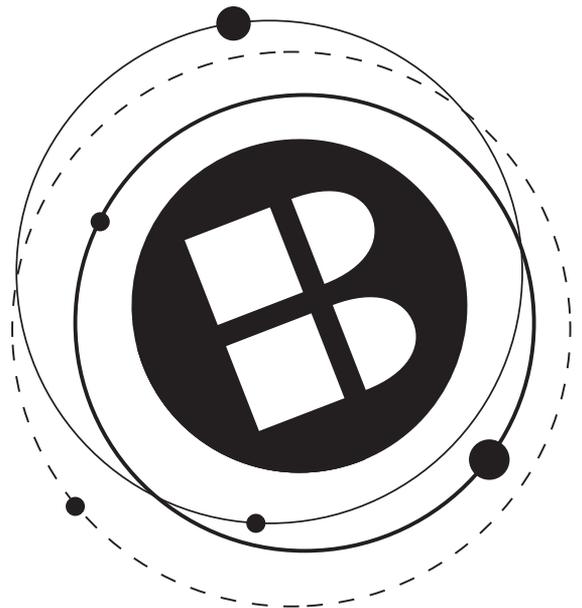
On behalf of the management of the Hipotekarna Banka and myself, I would like to express special gratitude to our distinguished customers for the trust they have shown, and to all associates and employees for their professionalism and cooperation.

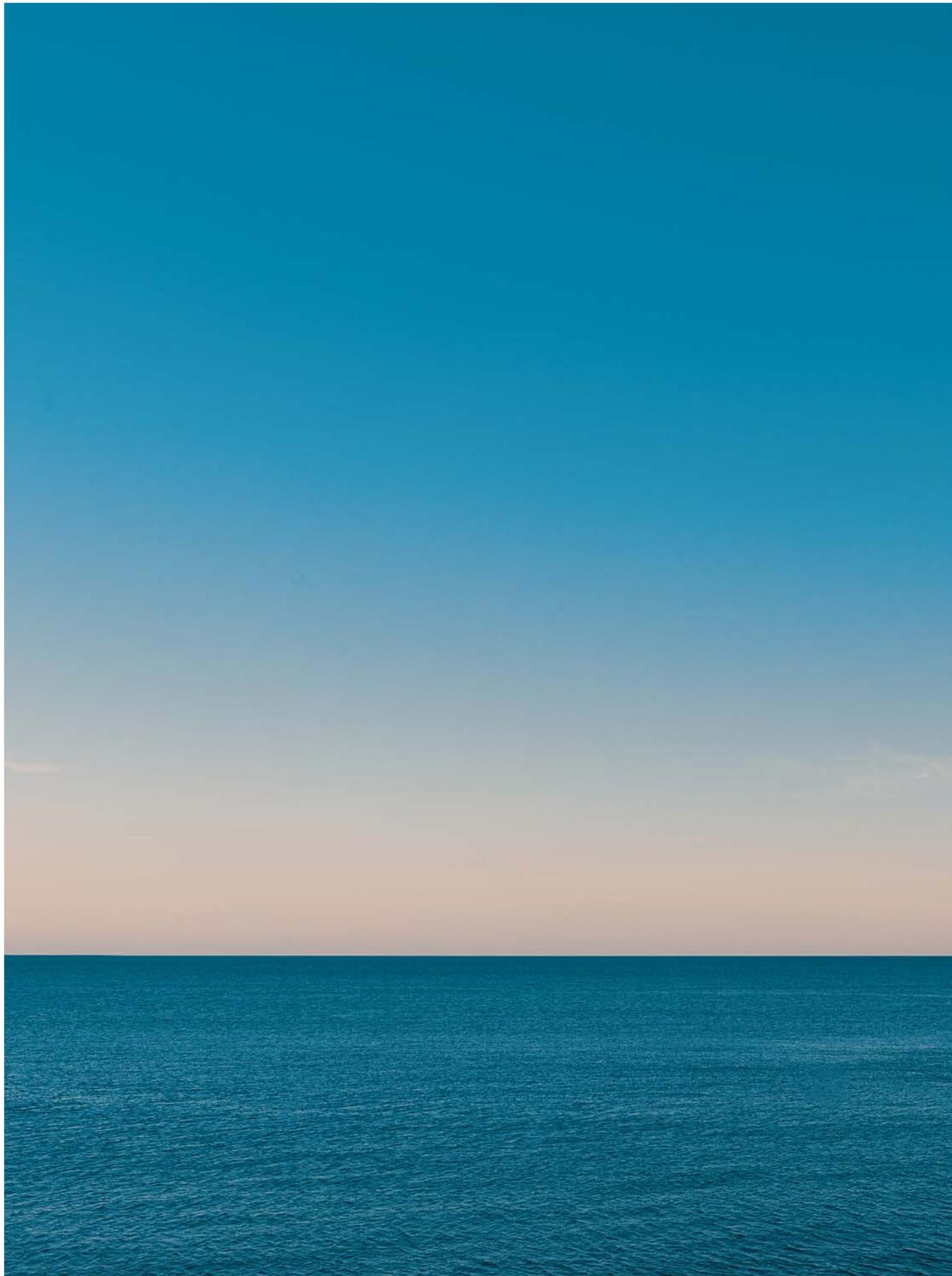
Esad Zaimović  
Chief Executive Officer

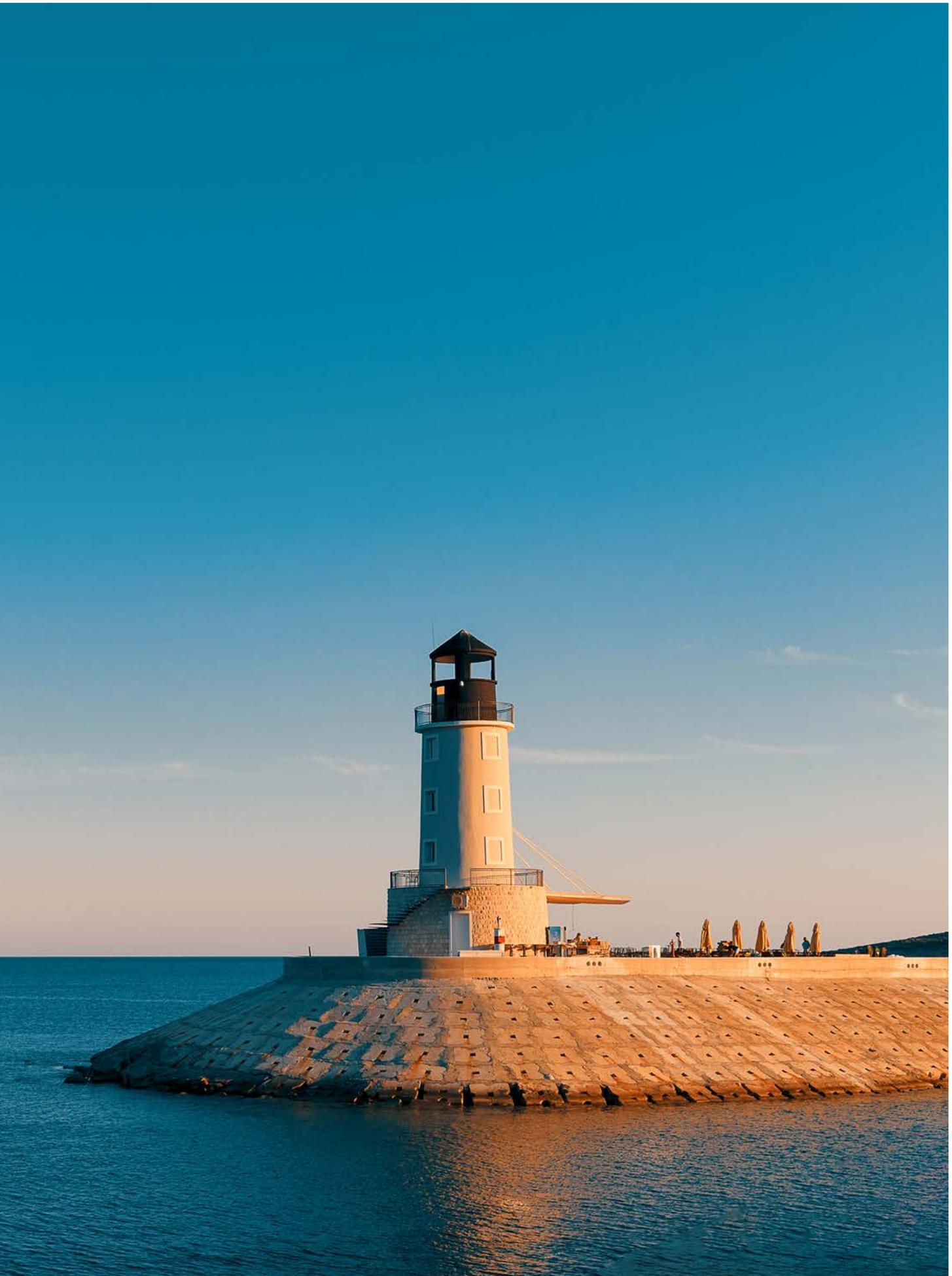


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FROM THE EXTERNAL  
AUDITOR'S REPORT



**Društvo za reviziju Crowe MNE d.o.o. Podgorica**

Žiro račun: 520-34559-91; Reg. broj: 5-0803037/1 PIB: 03152324; PDV: 30/31-17725-0  
Vučedojska 7, 81 000 Podgorica

**INDEPENDENT AUDITOR'S REPORT**

**To the Shareholders of Hipotekarna banka AD Podgorica**

**Opinion**

We have audited the accompanying financial statements of Hipotekarna Banka AD, Podgorica (hereinafter: "the Bank"), which comprise the balance sheet as at 31 December 2019, income statement, statement of other comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information (hereinafter 'financial statements').

In our opinion, the accompanying financial statements present truly and objectively, in all material respects, the Bank's financial position as of December 31, 2019, as well as its operating results and cash flows for the year ended that day, in accordance with the accounting regulations applicable in Montenegro and the regulations of the Central Bank of Montenegro governing the financial reporting of banks.

**Basis for opinion**

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

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

**Key Audit Matters**

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

<i>Key Audit Matters</i>	<i>Appropriate audit procedure</i>
<i>Impairment of given loans and receivables from clients</i> As at December 31 2019, the gross value of given loans and receivables from clients amounted EUR 243,316 thousand (31 December 2018: EUR 243,045 thousand), while the total amount of impairment of given loans and receivables from clients amounted EUR 14,404 thousand as od December 31 2019 (31 December 2018: EUR 12,732 thousand).	<i>clients and provisions for off-balance sheet items</i> Based on our risk assessment and industry knowledge we examined the cost of impairment of given loans, receivables from clients and provisions for off-balance sheet items and evaluated the applied methodology as well as used assumptions and in accordance with the key audit matter.

**INDEPENDENT AUDITOR'S REPORT (continued)**
**Key Audit Matters (continued)**

Key Audit Matters	Appropriate audit procedure
<p data-bbox="224 472 1377 507"><i>Impairment of given loans and receivables from clients and provisions for off-balance sheet items</i></p> <p data-bbox="224 534 792 810">The measurement of the cost of impairment of given loans and receivables from clients and provision for off-balance sheet items is considered key audit matter considering that the determination of the amount of provision for impairment requires the significant assessment by the management to determine the moment when the impairment is recognized as well as the impairment amount.</p> <p data-bbox="224 840 792 874">The most significant consideration relate to:</p> <ul data-bbox="277 904 792 1242" style="list-style-type: none"> <li>• Assumption that are used in the model of expected credit loss for the assessment od credit risk related to exposure and expected credit losses for future cash flow of the client.</li> <li>• Timely identification of the exposure with significant increase of exposure to the credit risk and credit impairment.</li> <li>• Valuation of collateral and assumptions of the future cash flow on individually estimated credit exposures.</li> </ul> <p data-bbox="224 1271 792 1425">The management disclosed the additional information about the impairment cost of the given loans and receivables from clients for off-balance sheet items in Notes 3.8, 5.2, 7, 17.2 and 23 of the financial statements.</p>	<p data-bbox="821 534 1187 569">Our audit procedures included:</p> <ul data-bbox="862 576 1393 1960" style="list-style-type: none"> <li>• The assessment of key controls over assumptions which are used in expected credit loss model for the assessment of the credit risk related to exposure and future expected cash flows of the client.</li> <li>• Collection and detailed testing of the evidence which support the assumptions used in the expected credit loss model which are applied in stage allocation, the assumptions which are applied to obtain the twelve-month lifelong probability of default and methods applied to obtain the probability of default based on inability to collect receivables.</li> <li>• Assessment of key controls over the timely identification of exposure with significant increase of the credit risk and exposure identification of the impairment.</li> <li>• Collection and detailed testing of the evidence about identification of exposure with significant increase of the credit risk and identification of exposure based on impairment od loans.</li> <li>• Collection and detailed testing which support the appropriate determination of the impairment cost of the loans and receivables including valuation of collateral and assumptions of future cash flow for individually assessed exposure of the loan impairment.</li> <li>• Assessment of key development of high-risk portfolio from the previous period with regard to industry standards and historical data.</li> <li>• Evaluation of applied methodologies using our knowledge and industry experience.</li> <li>• We included our IT experts and experts for credit risk in the areas that required specific expertise.</li> <li>• Assessment of the accuracy and completeness of disclosure in financial statements.</li> </ul>



**Društvo za reviziju Crowe MNE d.o.o. Podgorica**

Žiro račun: 520-34559-91; Reg. broj: 5-0803037/1 PIB: 03152324; PDV: 30/31-17725-0  
Vučedolska 7, 81 000 Podgorica

**INDEPENDENT AUDITOR'S REPORT (continued)**

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

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

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

The persons responsible for management are responsible for managing the financial reporting process that is established by the Bank.

***Auditor's Responsibilities for the Audit of the Financial Statements***

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

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

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

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

**INDEPENDENT AUDITOR'S REPORT (continued)*****Auditor's Responsibilities for the Audit of the Financial Statements (continued)***

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cause significant doubt on the Banks's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the basic transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged for managing with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be expected to affect on our independence, and where applicable, related protection measures.

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

**INDEPENDENT AUDITOR'S REPORT (continued)*****Report on other legal and law requirements***

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

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

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

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

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

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

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

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

Crowe MNE d.o.o. Podgorica

May 15, 2020. godine



  
Đorđe Dimić, Certified Auditor

(License no. 072 issued 9 March 2017)

## INCOME STATEMENT

For the period from January 1 to December 31,  
2019  
(in thousand EUR)

	Notes	(in thousand EUR)	
		2019.	2018.
Interest income	3.1, 6	19,741	18,768
Interest expenses	3.1, 6	(3,091)	(3,679)
<b>Net interest income</b>		<b>16,650</b>	<b>15,089</b>
Fee income	3.2, 9	16,989	14,489
Fee expenses	3.2, 9	(10,775)	(7,328)
<b>Net fee income</b>		<b>6,214</b>	<b>7,161</b>
Net profit/loss from derecognition of financial instruments not measured at fair value through income statement.		150	105
Net foreign exchange gains		788	698
Net income/(expenses) based on derecognition of other assets		311	78
Other income	13	246	278
Staff costs	10	(5,486)	(5,173)
Depreciation/amortization cost	12	(1,077)	(955)
General and administrative costs	11	(7,802)	(8,761)
Net income/(expenses) based on impairment of financial instruments not valued at fair value through income statement		(3,723)	(3,563)
Provision cost	3.8.8, 7 3.14, 8	(96)	(62)
Other expenses	14	(786)	(174)
<b>OPERATING PROFIT</b>		<b>5,389</b>	<b>4,721</b>
Income tax	3.6, 15	(526)	(411)
<b>NET PROFIT</b>		<b>4,863</b>	<b>4,310</b>
Earnings per share	32	155.34	137.68

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

These financial statements are approved on behalf of Board of Directors of Hipotekarna banka A.D., Podgorica, as at 3. February 2020 in Podgorica.

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

Esad Zaimović  
Chief executive officer

Ana Golubović  
Executive Director for Corporate

**STATEMENT OF OTHER COMPREHENSIVE  
INCOME**  
For the period from January 1 to December 31,  
2019

	Notes	(In thousand EUR)	
		2019	2018
<b>Net profit</b>		<u>4,863</u>	<u>4,310</u>
<b>Other comprehensive income</b>			
The effects of changes in the value of securities not measured at fair value through other comprehensive income		1.459	(1,321)
<b>Total other result for current year</b>		<u>1,459</u>	<u>(1,321)</u>
<b>TOTAL OTHER RESULT</b>		<u>6,322</u>	<u>2,989</u>

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

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Chief executive officer

\_\_\_\_\_  
Ana Golubović  
Executive Director for Corporate

\_\_\_\_\_  
Jelena Vuletić  
Executive Director for Risks

\_\_\_\_\_  
Nikola Špadijer  
Executive director for retail

**HIPOTEKARNA BANKA A.D., PODGORICA**

**BALANCE SHEET**  
As of December 31, 2019

	<u>Note</u>	<u>31 December 2019</u>	<u>(In thousand EUR)</u> <u>31 December 2019</u>
<b>ASSETS</b>			
Cash and deposit accounts held with Central Banks	3.7, 16	137,133	129,041
<b>Financial assets at amortized cost</b>		<b>251,741</b>	<b>257,271</b>
Loans and receivables from banks	3.8.3, 17.1	20,864	25,111
Loans and receivables from clients	3.8.3, 17.2	228,912	230,311
Other financial receivables		1,965	1,849
<b>Financial assets at fair value through other comprehensive income</b>		<b>134,758</b>	<b>114,461</b>
Securities	18.1	134,758	114,461
<b>Investments in associates and joint ventures at equity method</b>		<b>5</b>	<b>5</b>
<b>Property, Plants and Equipment</b>	3.10, 19	<b>2,352</b>	<b>2,061</b>
<b>Intangible assets</b>	3.10, 20	<b>2,037</b>	<b>1,761</b>
<b>Deferred tax assets</b>	15c	<b>24</b>	<b>30</b>
<b>Other assets</b>	21	<b>2,428</b>	<b>2,181</b>
<b>TOTAL ASSETS</b>		<b>530,478</b>	<b>506,831</b>
<b>LIABILITIES</b>			
<b>Financial liabilities at amortized cost</b>		<b>443,122</b>	<b>436,951</b>
Deposits due to banks and Central banks	22.1	1,148	1,410
Deposits due to clients	22.2	419,592	410,311
Borrowings from clients which are not banks	22.3	22,335	25,230
Other financial liabilities		47	-
<b>Reserves</b>	23	<b>1,535</b>	<b>1,831</b>
<b>Current tax liabilities</b>		<b>514</b>	<b>417</b>
<b>Deferred tax liabilities</b>	15c	<b>209</b>	<b>43</b>
<b>Other liabilities</b>	24	<b>11,148</b>	<b>7,970</b>
<b>Subordinated debt</b>	26	<b>22,050</b>	<b>14,039</b>
<b>TOTAL LIABILITIES</b>		<b>478,578</b>	<b>461,251</b>
<b>EQUITY</b>			
Share equity	25	16,006	16,006
Share issue premium		7,444	7,444
Retained earnings		20,541	16,235
Current year Profit/(Loss)		4,863	4,310
Other reserves		3,046	1,587
<b>TOTAL EQUITY</b>		<b>51,900</b>	<b>45,582</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>530,478</b>	<b>506,831</b>
<b>OFF – BALANCE SHEET</b>	28	<b>766,334</b>	<b>661,802</b>

Notes on the following pages  
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Signed and approved on behalf of Hipotekarne banke A.D., Podgorica:

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Chief executive officer

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Ana Golubović  
Executive Director for Corporate

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Jelena Vuletić  
Executive Director for Risks

\_\_\_\_\_  
Nikola Špadijer  
Executive director for retail

**STATEMENT OF CHANGES IN EQUITY**  
**For the period from January 1 to December 31, 2019**  
**(in thousand EUR)**

thousand EUR	Share capital	Share issue premium	Profit of the year	Other reserves	Total
Balance as of January 1, 2018	16,006	7,444	6,860	12,286	42,596
Change on the fair value of financial assets through other comprehensive income	-	-	-	(1,321)	(1,321)
Effects of securities on equity transfer of the profit	-	-	(3)	-	(3)
Profit of the current year	-	-	9,378	(9,378)	-
Balance as at 31 December 2018	16,006	7,444	4,310	-	4,310
	<b>16,006</b>	<b>7,444</b>	<b>20,545</b>	<b>1,587</b>	<b>45,582</b>
Balance as of January 1, 2019	16,006	7,444	20,545	1,587	45,582
Change on the fair value of financial assets through other comprehensive income	-	-	-	1,459	1,459
Impact of securities to the transfer of the profit	-	-	(4)	-	(4)
Profit of the current year	-	-	4,863	-	4,863
Balance as at 31 December 2019	16,006	7,444	25,404	3,046	51,900

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

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 Chief executive officer

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 Ana Golubović  
 Executive Director for Corporate

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 Jelena Vuletić  
 Executive Director for Risks

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 Executive director for retail

**STATEMENT OF CASH FLOWS**  
**In the period from 1 January to 31 December 2018**  
**(In thousand EUR)**

<b>DESCRIPTION</b>	<b>NOTE</b>	<b>2019</b>	<b>2018</b>
<b>Cash flows from operating activities</b>			
Inflows from interest and similar income		19,829	18,178
Outflows from interest and similar expense		(2,993)	(3,423)
Inflows from fees and commissions		16,988	15,966
Outflows from fees and commissions		(10,775)	(7,328)
Outflows based on earnings of the employees and costs for suppliers		(22,664)	(20,693)
Increase/decrease of the loans and other assets		(52)	(24,577)
Inflow/outflow based on deposits and other liabilities		18,995	15,837
Paid tax		(1,052)	(961)
Other income		(46,039)	(36,689)
<b>Net cash inflow / outflow from operating activities</b>		<b>(27,763)</b>	<b>(43,690)</b>
<b>Cash flows from investing activities</b>			
Purchase of property and equipment		(1,176)	(1,326)
Purchase of intangible assets		(768)	(430)
Receipt of treasury bills		35,616	15,534
Income from sale of tangible and fixed assets		26	67
<b>Net cash inflow / outflow from investing activities</b>		<b>33,698</b>	<b>13,845</b>
<b>Cash flows from financing activities</b>			
Increase in borrowings		(2,887)	(4,680)
<b>Net cash (outflow)/inflow from financing activities</b>		<b>(2,887)</b>	<b>(4,680)</b>
Effects of foreign exchange in cash and cash equivalents		788	698
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>3,836</b>	<b>(33,827)</b>
<b>Cash and cash equivalents, beginning year</b>		<b>149,169</b>	<b>182,996</b>
<b>Cash and cash equivalents, end of year</b>		<b>153,005</b>	<b>149,169</b>

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

These financial statements are approved on behalf of Board of Directors of Hipotekarna banka A.D., Podgorica, as at 3. February 2020 in Podgorica.

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

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 Esad Zaimović  
 Chief executive officer

\_\_\_\_\_  
 Ana Golubović  
 Executive Director for Corporate

\_\_\_\_\_  
 Jelena Vuletić  
 Executive Director for Risks

\_\_\_\_\_  
 Nikola Špadijer  
 Executive director for retail

TRANSLATION NOTE: This is a translation of the original document issued in the Montenegrin language. All due care has been taken to produce a translation that is as faithful as possible to the original. However, if any questions arise related to interpretation of the information contained in the translation, the Montenegrin version of the document shall prevail.











# 2 BUSINESS ACTIVITIES AND ORGANISATIONAL STRUCTURE OF THE BANK

## ABOUT THE BANK

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

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

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

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

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

As at 31 December 2019, the Bank had 218 employees, of which 65.68% has university degree.

## CORPORATE GOVERNANCE AND CORPORATE GOVERNANCE RULES

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

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

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

- Share capital of the Bank amounts to EUR 16,005,933.45 and it consists of 31,305 pieces of common shares issued in the name of the holder;
- Nominal value of one share is EUR 511.29;
- Shares are dematerialised, indefinitely transferrable and issued in the name of the holder. The excerpt from the registry with the Central Depository Agency AD Podgorica is the only evidence of the ownership of shares;
- A shareholder of the Bank, as the owner of common shares, has the following rights:
  1. right to attend the General Meeting of the Shareholders,
  2. right to manage proportionately to the share in capital of this class of shares,
  3. right to dispose of shares, in accordance with the applicable regulations,
  4. pre-emptive right to acquire new shares,
  5. right to acquire shares free of charge in case of the increase in share capital from the Bank's funds, proportionately to its investment,

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

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

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

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

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

3) Significant direct and indirect equity investments:

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

4) There are no securities giving special control rights;

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

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

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

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

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

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

11) Executive directors and individual directors of the organisational parts of the Bank have covenants which regulate the payment of fee for the termination of

term of office in the amount ranging from 6 (six) to 18 (eighteen) net monthly salaries.

Board of Directors of the Bank manages the Bank. Members of the Board of Directors are elected and appointed by the General Meeting of the Shareholders.

## THE STRUCTURE OF THE BOARD OF DIRECTORS AND ITS BODIES

### **1.1. Board of Directors of the Bank:**

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

### **1.2. Audit Committee of the Bank:**

- Draško Popović, Chair
- Božana Kovačević, Member
- Goran Knežević, Member

### **1.3. Credit Risk Management Committee of the Bank:**

- Renata Vinković, Chair
- Sigilfredo Montinari, Member
- Esad Zaimović, Member

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

During 2019, Board of Directors of the Bank passed decisions on the issues from within its competence, and it had continuously overseen the operations of the Bank by periodical review of the reports on the financial situation and operations. In addition, the Board of Directors regularly discussed the reports of standing and interim bodies of the Bank, control functions and the reports on the functioning of the internal controls system.

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

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

### **Executive directors of the Bank:**

Esad Zaimović, Chief Executive Officer

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

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

Jelena Vuletić, Executive Director for risks.

## CORPORATE GOVERNANCE RULES

### GENERAL MEETING BANK'S SHAREHOLDERS

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

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

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

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

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

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

## BOARD OF DIRECTORS AND EXECUTIVE DIRECTORS

### Board of Directors

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

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

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

### Executive Directors of the Bank

In accordance with the legal regulations and the Bank's Articles of Association, the executive directors organise and manage the Bank's operations and

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

The executive directors of the Bank, who are previously authorised by the Central Bank of Montenegro, are elected by the Board of Directors of the Bank. The executive directors of the Bank must meet the requirements prescribed by the Banking Law, the Law on Business Organisations, relevant Decision of the Central Bank of Montenegro, and the internal acts of the Bank. Since the executive directors of the Bank manage the Bank's business on a daily basis, they are also responsible for managing the risks to which the Bank is exposed in its operations.

When taking legal action on behalf and for the account of the Bank, the Chief Executive Officer must obtain a signature of another executive director.

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

## **STATEMENT ON THE APPLICATION OF THE CODE OF CORPORATE GOVERNANCE**

The Bank is a member of the Association of Montenegrin Banks, the Chamber of Commerce of Montenegro, the Union of Employers of Montenegro, and the codes of business conduct of these relevant organisations are published on their websites.

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

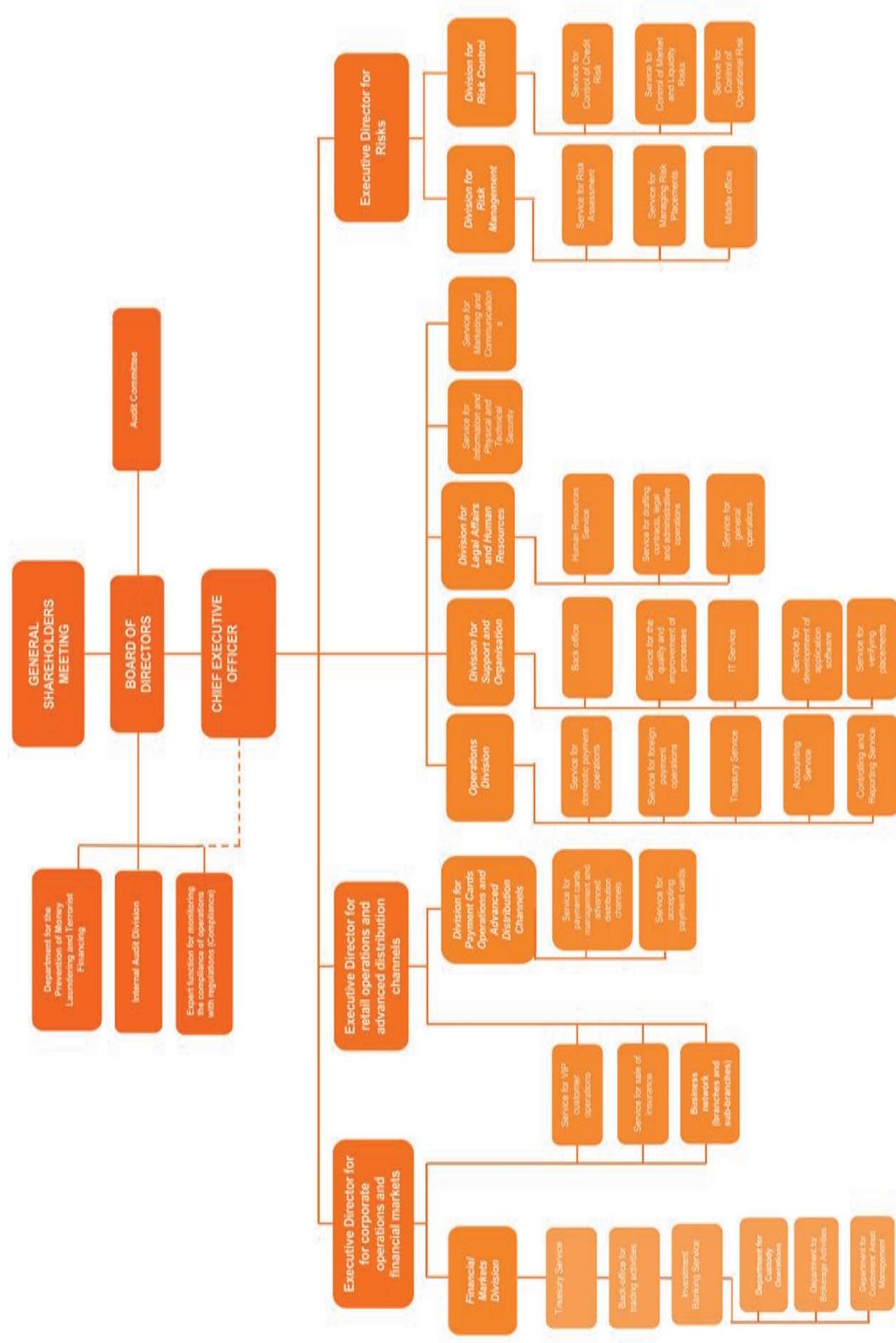
Code of Corporate Governance in Montenegro - the Code, adopted by the Board of Directors of Montenegro Stock Exchange AD Podgorica in 2019 intended for joint stock companies whose financial instruments are listed on the stock exchange, contains a set of rules and principles aimed at improving the corporate governance practice and its implementation is linked to the application of the rule "apply or explain".

Since the financial instruments issued by the Bank are listed at the Montenegro Stock Exchange, the rules and principles of the Code are implemented in Hipotekarna Banka, with an additional explanation of the method for preventing and resolving corporate conflicts.

Namely, in addition to regulating the issue of preventing and resolving conflicts of interest of employees, the Bank's Articles of Association also regulate the prevention and resolution of conflicts of interest of members of the Board of Directors. As the Board of Directors of the Bank manages the Bank, this, by analogy, implies also that it resolves issues of possible (corporate) conflicts that may arise between shareholders and the Bank.

In the same vein, the Board of Directors of the Bank is responsible for ensuring that the operations of the Bank are carried out in accordance with the law, other regulations and internal acts of the Bank, and thus for minimizing harmful consequences for the Bank, which may arise also from the relationship between the bank and its shareholders. No shareholder of the Bank has been in conflict with the Bank so far, nor did they file a lawsuit against the Bank.

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



EXECUTIVE DIRECTORS	Esad Zaimović, Chief Executive Officer Nikola Špadijer, Executive Director for retail operations and advanced sales channels; Ana Golubović, Executive Director for corporate operations and financial markets; Jelena Vuletić, Executive Director for risks.
INTERNAL AUDIT DIVISION	Veselin Ivanović, Chief Internal Auditor
EXPERT FUNCTION FOR MONITORING THE COMPLIANCE OF OPERATIONS WITH REGULATIONS (COMPLIANCE)	Danka Dragicevic
DIVISION FOR PREVENTION OF MONEY LAUNDERING AND TERRORIST FINANCING	Mirjana Jovanovic
DEPARTMENTS	Gojko Maksimović, director of the Financial Markets Department Sejad Šehić, Director of the Department for Payment Cards Operations and Advanced Distribution Channels Nataša Lakić, Director of the Department for Operations Nikola Milović, Director of the Department for Support and Organisation; Božo Đurašković, Director of the Department for Legal Affairs and Human Resources Goran Smolović, Director of the Department for Risk Control
INDEPENDENT SERVICES	Ana Ristić, Director of the Marketing and Communications Service, since 20 August 2018; Haris Dizdarević, Director of the Service for Information and Physical and Technical Security









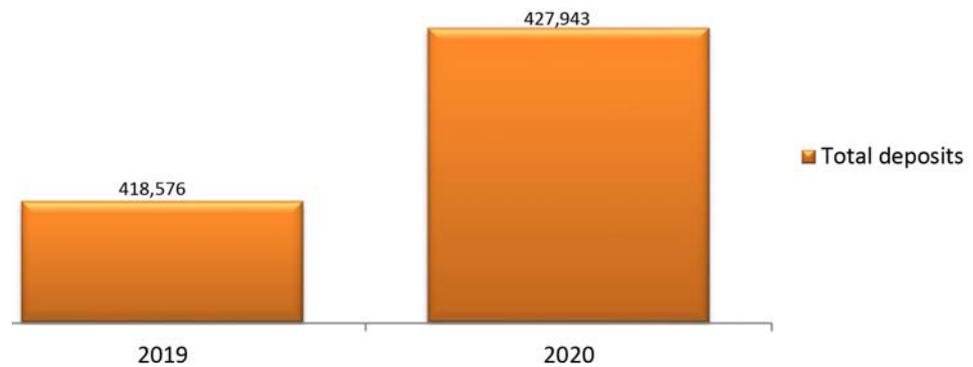
# 3 DEVELOPMENT, FINANCIAL POSITION AND BUSINESS RESULTS OF THE BANK

## DEPOSITS

In 2019, deposits saw a y-o-y growth of 2.22%, which indicates that in addition to high level of deposits in the previous year, the confidence of industries and economy in the Bank also grew in 2019. The growth in demand deposits of 8.66% was particularly important besides the stable growth of all types of deposits.

Total deposits:

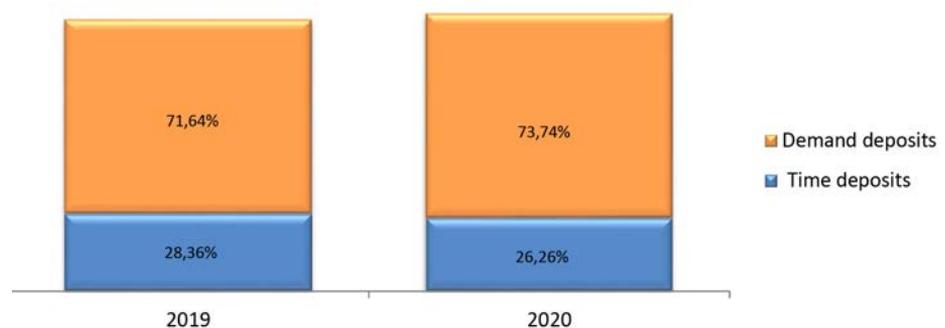
Year of change	Total deposits (EUR 000)	% of change
2018	409,481	-
2019	418,576	2.22%



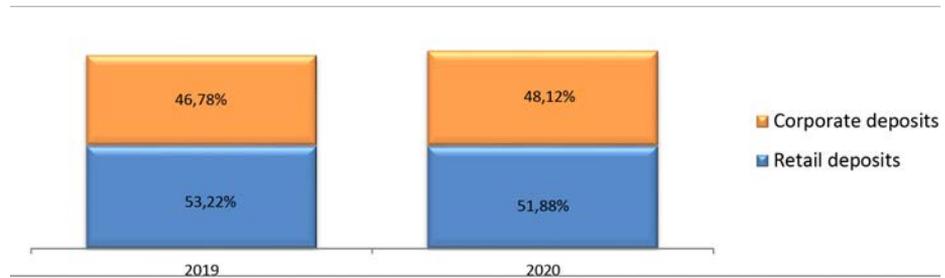
The increase in deposits resulted from the increase in the number of clients as well as the increase of confidence in the Bank.

Thanks to all the attributes that characterise the Bank, which are, first and foremost, security, professionalism and quality of the offer, we are recognised as a trustworthy bank, thus continuing the positive trend of deposit growth.

With regard to the share of time and demand deposits in total deposits, the Bank maintained adequate structure of deposits. Time deposits accounted for 28.36% in total deposits, while demand deposits accounted for 71.64%.



The share of corporate deposits accounted for 46.78% of total deposits, while retail deposits stood at 53.22%, as shown in the following graph:



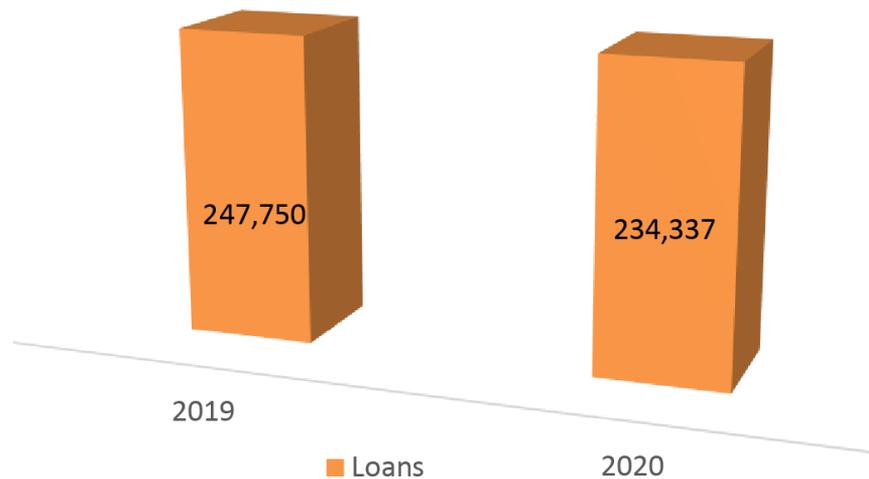
## LOANS

In 2019, as well as in the previous years, the Bank granted loans to a large number of new clients. An ongoing support and further development of the existing clients was an imperative for the Bank and the main focus of the employees has been always to anticipate the needs of the clients, optimise the structure of arrangements and tariffs for the existing clients.

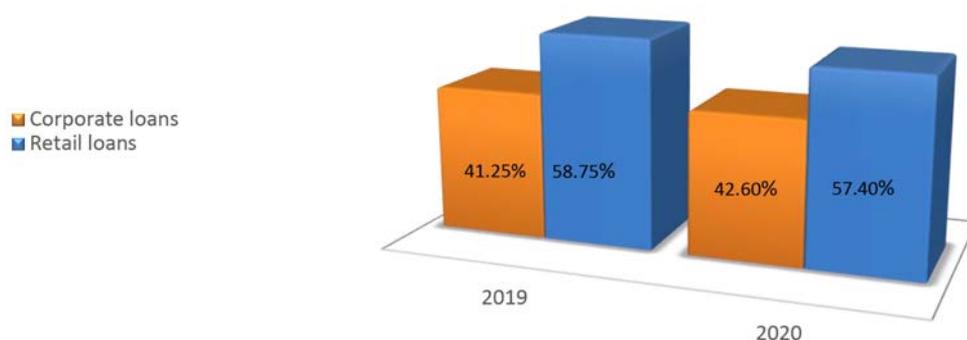
One of the distinctive features of the Bank is that, in addition to granting loans, it simultaneously provides advisory services to its clients, which is aimed at improving business operations and achieving better business results for both the Bank and its clients.

Despite the conservative lending policy the Bank has been traditionally pursuing, total amount of loan portfolio increased compared to the previous year, as it had occurred in the previous periods.

	Loans (EUR 000)	Change in %
2018	247,470	-
2019	247,750	0.11%



With regard to the structure of total loans, household loans made up 41.28%, while the share of corporate loans was 58.72% in total loan portfolio.



Overview of guarantees in 2019 (EUR 000):



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

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

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

## DEVELOPMENT OF NEW PRODUCTS AND SERVICES

In 2019, the Bank also maintained the expected continuity in launching new innovative products.

Launching of the most prestige global payment card from the VISA programme – VISA Infinite stands out among the new products. This payment card was launched in cooperation with the company Porto Novi. It enables global benefits for card owners such as the use of business lounge at international airports, concierge service, benefits and discounts worldwide.

Furthermore, the Bank has continued with the recognition of current products, primarily providing direct benefits to users of the prestigious application Moj novčanik (My wallet).

## PAYMENT OPERATIONS

In 2019, all indicators defining the payment operations of the Bank recorded growth. All payment operation plans that were set in the previous period were achieved, which proved the successfulness and efficiency of the Bank in the previous year.

### DOMESTIC PAYMENT OPERATIONS

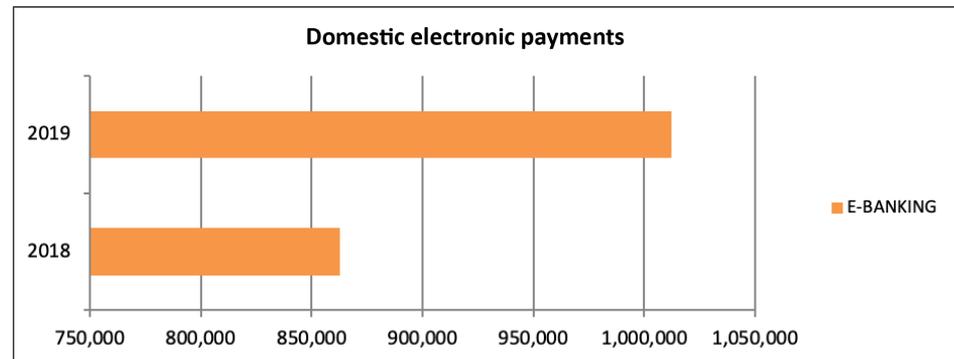
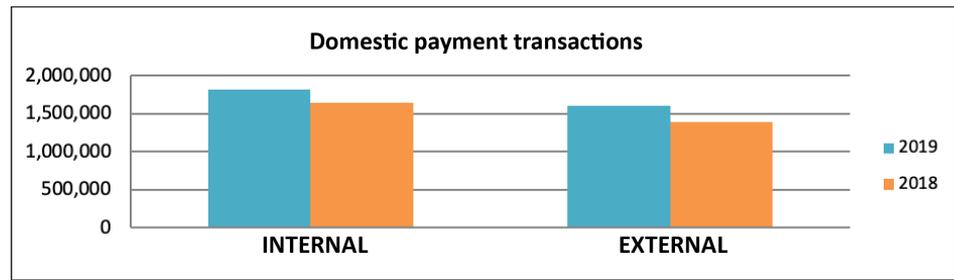
Overall domestic payment operations of the Bank recorded a growth in 2019.

Total number of transactions in the domestic payment operations recorded a y-o-y increase of 13%. Of this amount, a 11% y-o-y growth referred to internal transactions in the Bank. External transactions also saw a y-o-y increase of 16%.

With regard to the structure of external payment orders, the increase was recorded in both retail payments (< 1,000 euros, increase of 14%) and wholesale payment (>1,000 euros, increase of 19%).

The number of inflows from other banks also increased by 9% compared to the previous year.

A significant growth in the number of electronic (e-banking) transactions was also recorded, which indicates the increasing orientation of the clients towards electronic applications and the growing number of payments using electronic payment orders. The electronic transactions in domestic payment operations increased by 17% compared to the previous year.



## INTERNATIONAL PAYMENT OPERATIONS

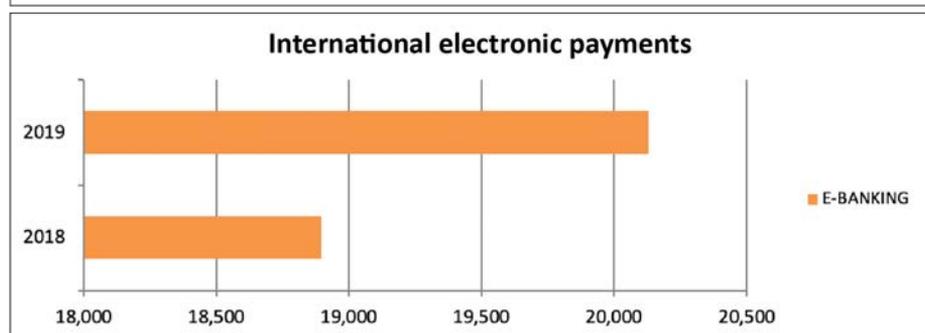
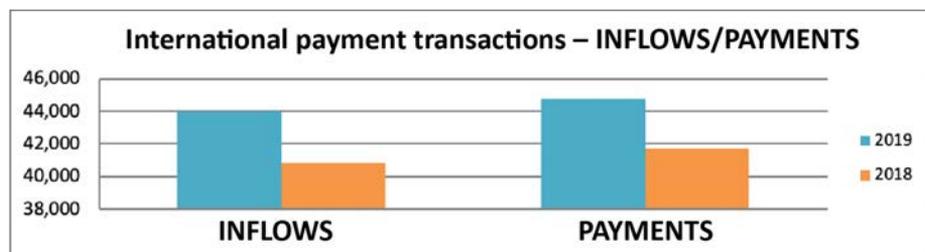
The main features of the international payment operations in 2019 were as follows: an ongoing trend of high number of payments was maintained, as well as the growth in incoming payments and payments executed via e-banking, and other operations that represent an integral part of the international payment operations.

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

The number of international payment transactions increased by 7% compared to the previous year.

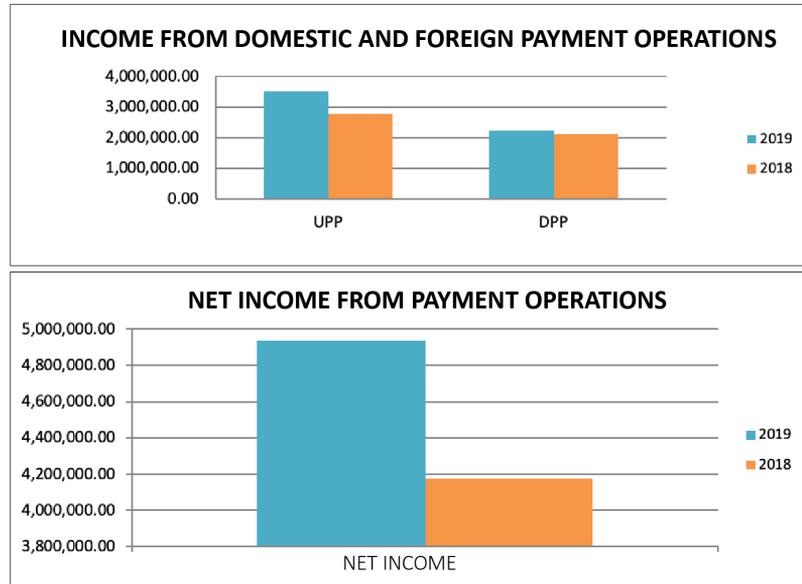
The number of international e-payments using the application HB-klik (e-banking) increased by 7%, y-o-y. The number of inflows grew by 8% compared to the previous year.

Total fees for the payment operations services showed a y-o-y growth of 17%.



This amount included increase in income from domestic payment operations in the amount of 26% and increase in income from international payment operations were in the amount of 5%.

Net income from total payment operations grew by 18% compared to the previous year.



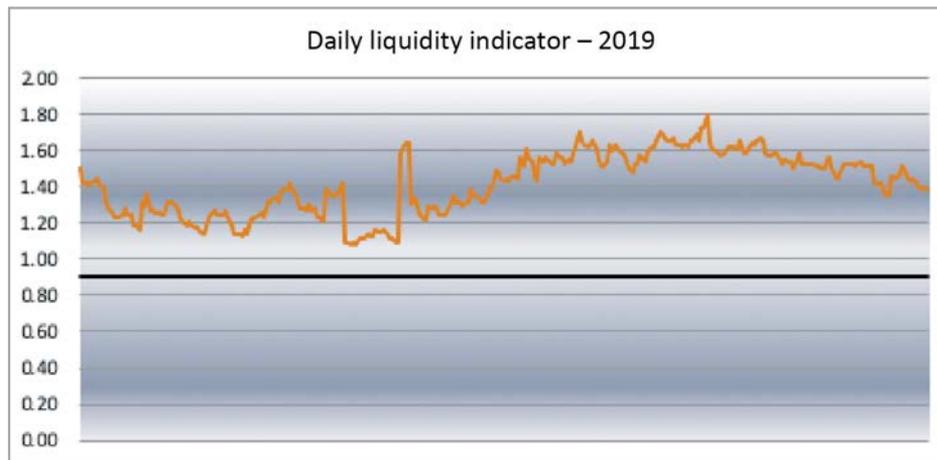
## ASSET MANAGEMENT

Providing optimal liquidity is a basic requirement for safe and efficient operations of each bank.

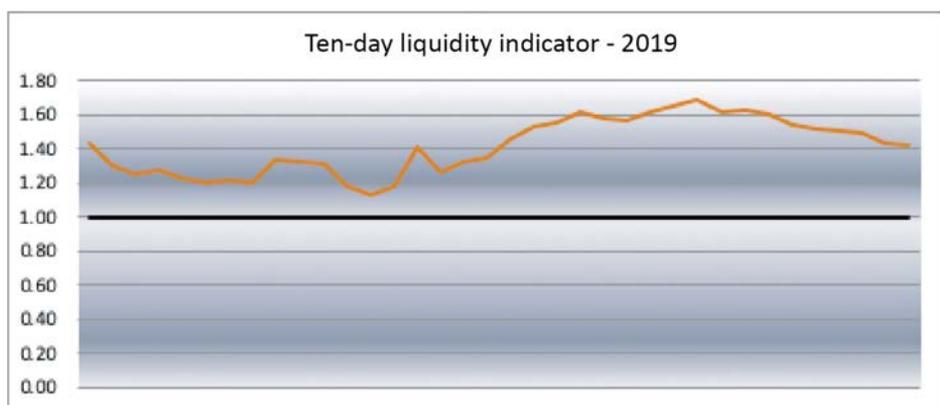
With the aim to maintain adequate liquid assets to total liabilities ratio, the Bank should provide the liquidity needed by applying rational assets and liabilities management.

In 2019, the Bank also put emphasis on stabilising domestic sources of funding, expanding its client base, and reducing short-term sources in favour of long-term sources of funding.

The Treasury service operating as part of the Financial Markets Department managed throughout 2019 to maintain the level of liquid assets and total liquid position of the Bank at the satisfactory level thanks to its balanced liquidity management. In addition, the Service reconciled funding sources with loans by daily, weekly, ten-day and monthly scheduling of available liquid assets. Adequate allocation of funds was performed through close cooperation with other departments and services in the Bank. This allowed the Bank to meet regularly its obligations towards creditors, as well as to accommodate client requests within the shortest terms possible.



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

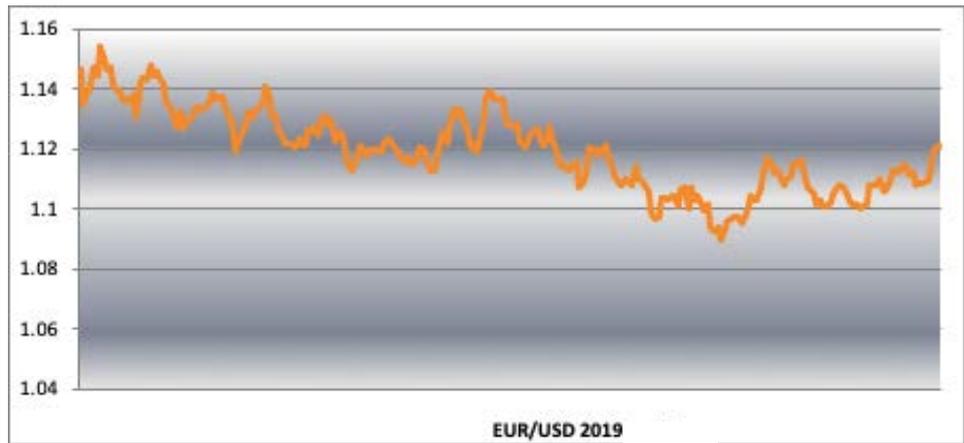


With the aim to manage liquidity within a period, the Bank regularly monitored indicators of the structural liquidity through maturity match of financial assets and liabilities, overview of maturity of large deposits, and by establishing a stable part of demand deposits using the internal model. The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

Given that 2019 saw a fall in interest rates on deposits of clients and the caution of clients in managing their own funds, it can be noted that the Bank was recognised even in these circumstances as one of the most reliable and most liquid banks in the banking system of Montenegro. This statement is supported by the 2018 year-end data that showed total deposits in the amount of EUR 410.32 million, and 2019 year-end data showing total deposits in the amount of EUR 419.59 million, which represented an increase of 2.26%. In addition to lending activity, surpluses of liquid funds were invested in marketable securities.

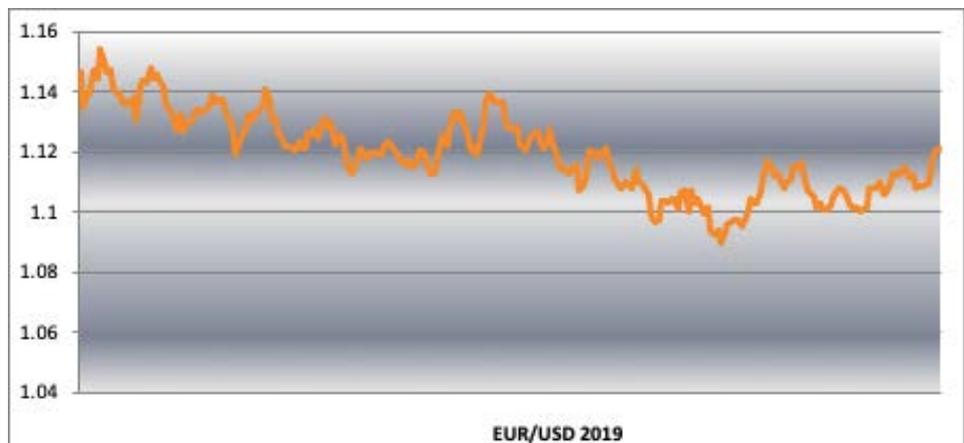
In 2019, the Bank actively participated in T-Bills auctions and made satisfactory returns. Also, through the activities of the Financial Markets Department, the Bank invested funds in securities both in Montenegro and the region.

Large exchange rate fluctuations were recorded in 2019, particularly in currency pair EUR/USD, which has the highest impact on the exposure of the Bank to foreign exchange risk.



In such circumstances, Treasury service managed to achieve a remarkable result based on income from differences in exchange rates, which was the result of adequate foreign exchange risk management.

Thus, at the end of 2019, total income from exchange rate differences amounted to 788 thousand euros, which significantly influenced the final financial result of the Bank.



Income from differences in exchange rates in 2019

## INVESTMENT BANKING

### Montenegro Capital Market

In 2019, total turnover recorded at the Montenegro Stock Exchange amounted EUR 318,175,436, which was a y-o-y growth of about 116%. The largest turnover was recorded in April and May when Montenegro issued two series of bonds at the domestic market in total amount of EUR 142,5 million. Looking at the data on number of concluded deals, some 13% less deals were concluded in 2019 as compared to 2018.

MONEX10 (index that following price trend in 10 most liquid companies) fell by 8% last year, and it was at 776.61 on the last trading day. In 2019, MONEX recorded growth of 6.542%, and it stood at 14.403 percentage points on the last trading day.

**BROKER AND  
CUSTODY  
OPERATIONS**

In 2019, the Bank's total turnover at the Montenegro Stock Exchange amounted to EUR 139.933.946, which made up 21.99% of total turnover. Observing the realised turnover, the Bank ranked second in terms of participation in the total turnover realised at the Montenegro Stock Exchange due to the fact that at the end of April Erste Bank participated in both the buying and selling side in the first block of transactions with shares of Electricity Company of Montenegro in this year and made turnover only in that transaction of about EUR 80 million.

With regard to significant transactions executed during 2019, we single out the participation in the primary issue of government bonds of Montenegro, which was performed on 22 and 23 April at the Montenegro Stock Exchange AD. In this issue, the Bank had the largest share in the purchase of seven-year bonds in the amount of EUR 37,5 million, i.e. 75% of the total amount of the issue, while in the purchase of five-year bonds, the Bank participated with EUR 3,06 million. The Bank participated in the entire issue with a purchase in the amount of about EUR 41 million (55% of the total issue), which once again stood out as the leading position in the debt securities market.

The total turnover in 2019, realised by trading in subordinated bonds HBO1, HBO2 and HBO3 amounted to EUR 1,597,588.50. The table below provides an overview of trading in the Bank's bonds.

Bond	Number of transactions	Turnover
HBO1	19	661.789,50
HBO2	11	655.799,00
HBO3	11	280.000,00
UKUPNO	27	1.597.588,50

Turnover at the international market made by the Bank's brokers amounted to EUR 10.4 million in 2019.

The table below provides an overview of concluded transactions at the international market in period 01 January – 31 December 2019.

<b>Total number of executed transactions</b>	<b>167</b>
Total value of executed transactions (EUR)	cca 2.600.000,00
Total value of executed transactions (USD)	cca 44.900.000,00

On 31 December 2019, the Bank's clients held securities with the Bank in the amount of about EUR 70 million, of which foreign securities amounted to about EUR 38 million.

Thus, the Bank remained one of the leaders in the field of custody operations in Montenegro.

## CAPITAL

As at 31 December 2019, total capital of the Bank amounted to EUR 51,900 million. Capital increased by 13.86% compared to the previous year.

As at 31 December 2019, the nominal value of the share capital amounts to EUR 16,006 million. The share capital consists of 31,305 shares, each with a nominal value of EUR 511.29.

The ownership structure of the Bank consists of foreign legal and natural persons that own 75% of the share capital, while the remaining share capital is owned by domestic legal and natural persons.

## PROFIT AND LOSS STATEMENT

In 2019, the Bank recorded profit of EUR 4,863 million. Interest income grew by 5.19% compared to the previous year and they amounted to EUR 19,741 million which was the result of the increase in lending activity of the Bank and intensified collection of doubtful arrangements where the calculation of interest was partially recorded in off-balance.

Fee income saw a y-o-y increase of 17.25% and they amounted to EUR 16,988 million. Net fee income amounted to 32.63% of net income arising from regular operations of the Bank.

Other income grew by 29.05% in the observed period and they amounted to EUR 1,495 million.

Expenses from regular operations, including depreciation, amounted to EUR 15,151 million and they increased by 0.58% compared to the previous year. Increase in expenses was due to the expansion of business network, new employees as well as the increase in other expenses following growth and development of the Bank.

Credit risk assessment and provisioning for risk loans and contingent liabilities of the Bank are based on the implementation of the principles of conservative policy and prevailing laws and regulations. As at 31 December 2019, total reserves for assets and liabilities positions amounted to EUR 17,730 million.

## DISTRIBUTION OF PROFIT

The Board of Directors, upon the proposal of the management of the Bank, proposed to the General Meeting of Shareholders not to distribute profit in 2019 in order to increase total capital of the Bank.

## INDICATORS

As at 31 December 2019, the position of the Bank in the Montenegrin banking system, according to the last, publicly known, data on financial reports of all banks in Montenegro was as follows:

- Market share: the Bank ranked 5th;
- Net profit: the Bank ranked 5th.

Financial indicators as at 31 December 2019:

- ROAA – 0.94%
- ROAE – 9.98%
- SSB – EUR 48,858 million
- Solvency ratio – 16.29%.

## ENVIRONMENTAL INVESTMENTS

The Bank continued to maintain values in this area. In that regard, the Bank provides, within its rights and obligations, environmental protection. In this context, the Bank is committed to preventing or limiting environmental impact, which results indirectly from its banking activities or directly from its operations.

Business practice: The Bank is not oriented towards financing or participating in projects that pollute or degrade the environment. However, the Bank finances and actively supports / participates in the financing of projects that provide environmental protection, in particular through the introduction of more energy efficient technologies. Also, the Bank's business practice is financing clients' projects / business goals, which pose the least possible environmental risk.

While carrying out its activities, the Bank takes care of the rational use of natural resources, that is, of providing environmental protection measures. Particular attention was paid to this segment when using loans from the credit lines of the European institutions, primarily the European Bank for Reconstruction and Development (EBRD).

## PLANNED FUTURE DEVELOPMENT

According to the available data in 2019, the Montenegrin banking sector was safe and sound, profitable and it recorded high liquidity and solvency.

Positive macroeconomic developments in the region in 2019 have been the encouraging assumptions for further growth and development in 2020. However, in addition to measures taken to mitigate potentially negative risks caused by the coronavirus pandemic in March 2020, there is a significant uncertainty considering the impact on further economic activities.

The operating results of the Bank in 2019 confirm that we have strengthened our position as one of the leading banks in Montenegro in terms of returns and value creation to our shareholders. Also in 2020, guided by our core values - safe, strong and recognizable bank, we will be focused on facilitating recovery from the pandemic, and thus even more persistent and innovative in achieving added value and benefits for our customers. Strong market position and competitive advantage encourage us to continue in 2020 with the trend of innovation in business activities and a policy of commitment to customer needs, to allow them the freedom to choose different models of financing, investment banking, benefits in the field of payment operations.

We are focused on modernising sales channels to increase the availability of products and services in order to adjust to the needs of the increasing number of clients.

We will continue to improve, in cooperation with our partners, the products / product packages / services, which will improve the quality and speed, with special emphasis on the benefits tailored to the customer experience.

In the period ahead, we are about to harmonise with the new, complex regulations, aligned with EU standards, but we are adapted not only to face challenges, but also to new opportunities.

In 2020, we will persevere with supporting the community in various fields - education, culture, especially health, which will contribute to social and economic recovery and progress.

We are aware that employees are a strong support for the development and growth of the Bank, so we expect that their professional work in 2020 will contribute to the success and reputation that the Bank has in the market.

## **RESEARCH, DEVELOPMENT AND INVESTMENT IN EDUCATION OF EMPLOYEES**

The Bank continuously monitors and participates in market research as well as in analyses published by reputable agencies, so that it uses the information obtained to position the brand.

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

## **BUYBACK OF SHARES**

In 2019, the Bank did not buy its shares back.

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

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

## **BANK BUSINESS NETWORK**

### **Call Centre (+382 202) 19905**

#### **Head office of Hipotekarna Banka**

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81000 Podgorica

E-mail: [hipotekarna@hb.co.me](mailto:hipotekarna@hb.co.me)

Tel: +382 (0) 77 700 001

Fax: +382 (0) 77 700 071

#### **Nikšić Branch**

Address: Trg Save Kovačevića bb

Phone: +382 19905

E-mail: [filijala.niksic@hb.co.me](mailto:filijala.niksic@hb.co.me)

#### **Bar Branch**

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#### **Budva Branch**

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#### **Kotor Branch**

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#### **Herceg Novi Branch**

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#### **Bijelo Polje Branch**

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#### **Ulcinj Branch**

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#### **Danilovgrad Branch**

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Phone: +382 19905

E-mail: [filijala.danilovgrad@hb.co.me](mailto:filijala.danilovgrad@hb.co.me)

#### **Sub-branch in Herceg Novi**

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naselje o4

Phone: +382 19905

E-mail: [filijala.hercegnovi@hb.co.me](mailto:filijala.hercegnovi@hb.co.me)

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Phone: +382 19905

E-mail: [ekspozitura.podgorica1@hb.co.me](mailto:ekspozitura.podgorica1@hb.co.me)

#### **Sub-branch in Podgorica**

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81000 Podgorica

E-mail: [ekspozitura.podgorica2@hb.co.me](mailto:ekspozitura.podgorica2@hb.co.me)

#### **Sub-branch in Podgorica**

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81000 Podgorica

E-mail: [ekspozitura.podgorica3@hb.co.me](mailto:ekspozitura.podgorica3@hb.co.me)

#### **Sub-branch in Podgorica**

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Delta City

Phone: +382 19905

E-mail: [ekspozitura.podgorica@hb.co.me](mailto:ekspozitura.podgorica@hb.co.me)

#### **Sub-branch in Cetinje**

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Phone: +382 19905

E-mail: [ekspozitura.cetinje@hb.co.me](mailto:ekspozitura.cetinje@hb.co.me)

#### **Sub-branch in Tivat**

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Phone: +382 19905

E-mail: [ekspozitura.tivat@hb.co.me](mailto:ekspozitura.tivat@hb.co.me)

#### **Sub-branch in Tivat – Porto Montenegro**

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Obala bb

Phone: +382 19905

E-mail: [ekspozitura.porto.montenegro@hb.co.me](mailto:ekspozitura.porto.montenegro@hb.co.me)

#### **Sub-branch in Žabljak**

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E-mail: [ekspozitura.zabljak@hb.co.me](mailto:ekspozitura.zabljak@hb.co.me)

## RISK MANAGEMENT

Two departments are responsible for risk management in the Bank:

- Risk Management Department, which has two services, Service for Risk Assessment and Service for Managing Risk Loans, both being responsible for risk assessment, identification, and measurement.
- Department for Control of Risk, which has a Service for Credit Risk Control, Service for Market and Liquidity Risks Control, and Service Operational Risk Control, and they are responsible for risk monitoring, control and reporting.

Special attention is paid to the policies and procedures related to risk management as well as the development of needed methodologies.

Both departments prepare monthly, quarterly and annual reports, and ALCO, Board of Directors and Credit Risk Committee are informed on all risk-related activities.

## CREDIT RISK

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

In December 2019, Bank's loan portfolio increased by EUR 279,237 y-o-y, and it amounted to EUR 247,749,409. In relative terms, the portfolio increased by 0.11%.

Bank's performing assets (A and B1) accounted for 59.76% of total portfolio, while substandard assets (B2) accounted for 32.22%, and non-performing assets (C, D and E) amounted to 8.02%.

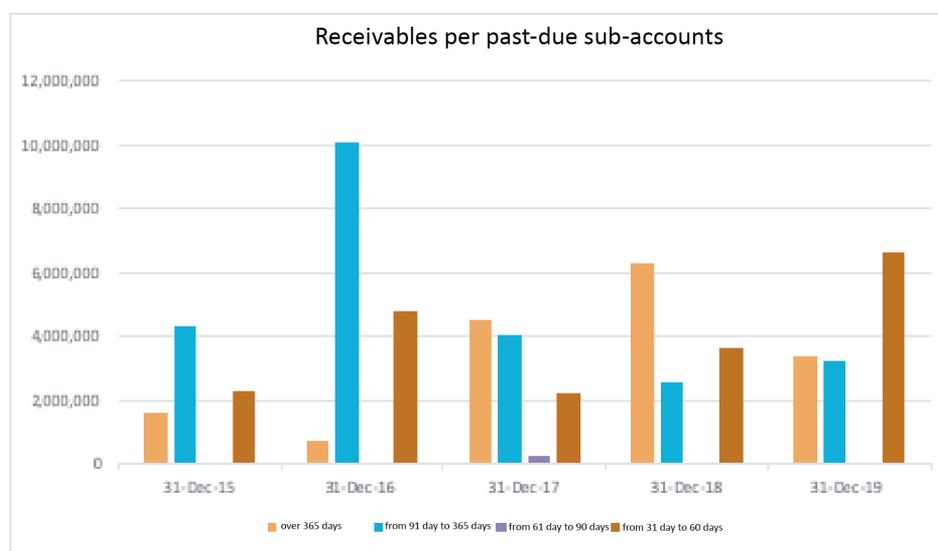


The main indicators of credit risk were: default in loan repayment, percentage of loan loss provisions, and share of non-performing assets in total portfolio (NPL%).

Default in loan repayment:

- As at 31 December 2019, past due loans over 30 days amounted to EUR 13,273,234 or 5.36% of total portfolio of the Bank, while as at 31 December

- 2018, they stood at EUR 12,596,713 or 5.09% of total portfolio of the Bank.
- With regard to the past due loans over 90 days as at 31 December 2019, they amounted to EUR 6,607,200 or 2.67% of total portfolio of the Bank, while as at 31 December 2018, they amounted to EUR 8,873,429 or 3.59% of total portfolio of the Bank.



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

- According to the CBCG methodology, as at 31 December 2019, loan loss provisions made up 5.71% of the portfolio or EUR 14,136,427. When compared to 2018 year-end, these provisions decreased by 14.05% or EUR 1,985,699.

Portfolio / provisions according to the CBCG

	31.12.2018.	31.03.2019.	30.06.2019.	30.09.2019.	31.12.2019.
Portfolio	247.470.172	255.575.371	256.811.730	241.586.062	247.749.409
Provisions	16.122.126	16.832.126	14.314.764	14.662.631	14.136.427
Provisions (%)	6,51%	6,59%	5,57%	6,07%	5,71%

- According to the internal methodology, as at 31 December 2019, value adjustments for loans amounted to EUR 14,158,649 or 5.71% of the portfolio. Y-o-y, the provisions increased by EUR 1,673,520 or 13.40%..

Portfolio / provisions based on internal methodology

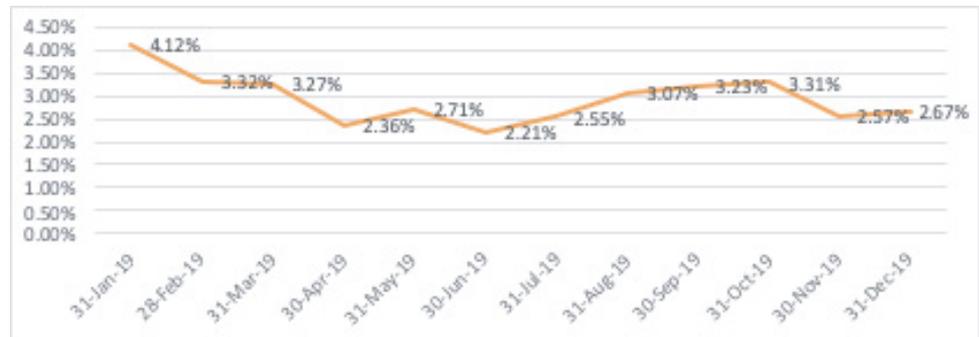
	31.12.2018.	31.03.2019.	30.06.2019.	30.09.2019.	31.12.2019.
Portfolio	247.470.172	255.575.371	256.811.730	241.586.063	247.749.409
Provisions	12.485.129	12.864.436	12.228.092	11.944.859	14.158.649
Provisions (%)	5,05%	5,03%	4,76%	4,94%	5,71%

The share of non-performing assets (NPLs) in total portfolio is monitored on the basis of the client's financial situation or category and past due days (over 90 days past due).

According to the categories, as at end-December 2019, NPLs amounted to EUR 19,873,167 or 8.02% of the portfolio, which represents an NPL decline of 2.09% compared to December 2018, when they amounted to EUR 20,297,486.



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



NPL based on past due days (over 90 days)

### Securities – within credit risk

As at 31 December 2019, Bank's banking book consisted of equity and debt financial instruments. In December, all positions in the banking book were within the statutory and internally defined limits. As at 31 December 2019, total securities owned by the Bank amounted to EUR 134,76 million and the entire amount referred to securities measured at fair value through other comprehensive income. Of that amount, debt securities amounted to EUR 128,35 million, and equity securities were EUR 6,40 million.



Graph: Equity securities and reserves



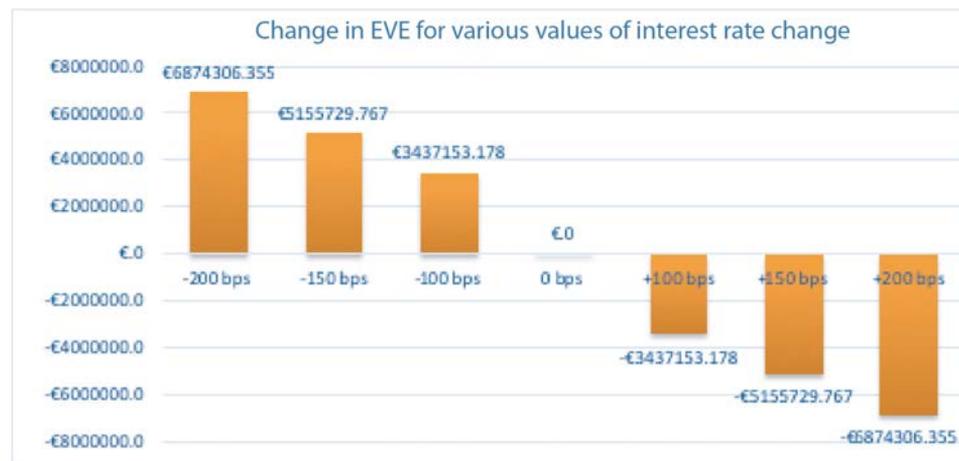
Graph: Debt securities and reserves

## MARKET RISK

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

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

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



In case of the increase of the level of interest rates by 200 basis points, as at 31 December 2109, the EVE of EUR 54,68 million would decrease by EUR 6,87 million or by 12.57%. As at 31 December 2019, the calculated amount of duration gap (or risk weighted position of the banking book) made up 14.07% of own funds of the Bank, which was within the statutory limit of 25%.

Projection of demand deposits withdrawal:

1-30 days	31-90 days	91-180 days	181-365 days	Over 1 year
20%	14%	14%	20%	32%

**ASSETS AND LIABILITIES SENSITIVE TO INTEREST RATE (in EUR thousand) –  
aggregate as at 31 December 2019**

<b>SENSITIVE ASSETS</b>	<b>1-30 days</b>	<b>31-90 dana</b>	<b>91-180 days</b>	<b>181-365 days</b>	<b>Over 1 year</b>	<b>TOTAL</b>
Interest-bearing deposits in other institutions	15.910					15.910
Interest-bearing securities	1.339	34.037	1.526	6.427	82.303	125.633
Loans and other receivables	22.115	19.983	18.575	61.244	124.981	246.898
Other sensitive assets	1.824					1.824
<b>TOTAL</b>	<b>41.188</b>	<b>54.020</b>	<b>20.102</b>	<b>67.671</b>	<b>207.284</b>	<b>390.265</b>
% of total interest-bearing assets	11%	14%	5%	17%	53%	100%
<b>SENSITIVE LIABILITIES</b>	<b>1-30 days</b>	<b>31-90 dana</b>	<b>91-180 days</b>	<b>181-365 days</b>	<b>Over 1 year</b>	<b>TOTAL</b>
Interest-bearing deposits	59.067	52.036	57.296	102.264	114.189	384.852
Interest-bearing borrowings	121		20	25	22.134	22.300
Subordinated debt and bond					22.000	22.000
Other sensitive liabilities	804					804
<b>TOTAL</b>	<b>59.992</b>	<b>52.036</b>	<b>57.316</b>	<b>102.289</b>	<b>158.323</b>	<b>429.956</b>
% of total interest-bearing liabilities	14%	12%	13%	24%	37%	100%
<b>DIFFERENCE (GAP)</b>	<b>1-30 days</b>	<b>31-90 dana</b>	<b>91-180 days</b>	<b>181-365 days</b>	<b>Over 1 year</b>	<b>TOTAL</b>
<b>GAP AMOUNT</b>	<b>-18.804</b>	<b>1.984</b>	<b>-37.214</b>	<b>-34.618</b>	<b>48.961</b>	<b>-39.691</b>
A part of the year in which there is GAP exposure	0,96	0,84	0,63	0,26		
Cumulative Gap	-18.804	-16.820	-54.034	-88.652	-39.691	-79.383
Impact on net interest income	-361	33	-469	-180		
Annual change in interest income (interest rate shock)	-977					
Cumulative Gap / Total assets	-4%	-4%	-11%	-19%	-8%	-17%
Prescribed limits	54%					

If interest rates drop by 2 percentage points, the expected annual net interest income would decline by EUR 977 thousand.

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

FX position – 31 December 2019 (converted in EUR)

<b>Own funds</b>			<b>EUR 48,858,000</b>		
<b>Currency</b>	<b>Assets</b>	<b>Liabilities</b>	<b>Net position</b>	<b>Limit (% of core capital)</b>	<b>Realised</b>
AUD	126.804	-135.892	-9.089	15%	0%
CAD	92.916	-80.365	12.551	15%	0%
DKK	34.491	0	34.491	15%	0%
JPY	0	-41	-41	15%	0%
KWD	0	0	0	15%	0%
NOK	16.524	-16.961	-438	15%	0%

SEK	16.598	-4.077	12.521	15%	0%
CHF	471.565	-474.731	-3.167	15%	0%
GBP	1.454.196	-1.451.739	2.457	15%	0%
USD	18.327.104	-18.062.959	264.145	15%	0,54%
	20.540.196	-20.226.766	313.430	20%	0,64%

## OPERATIONAL RISK

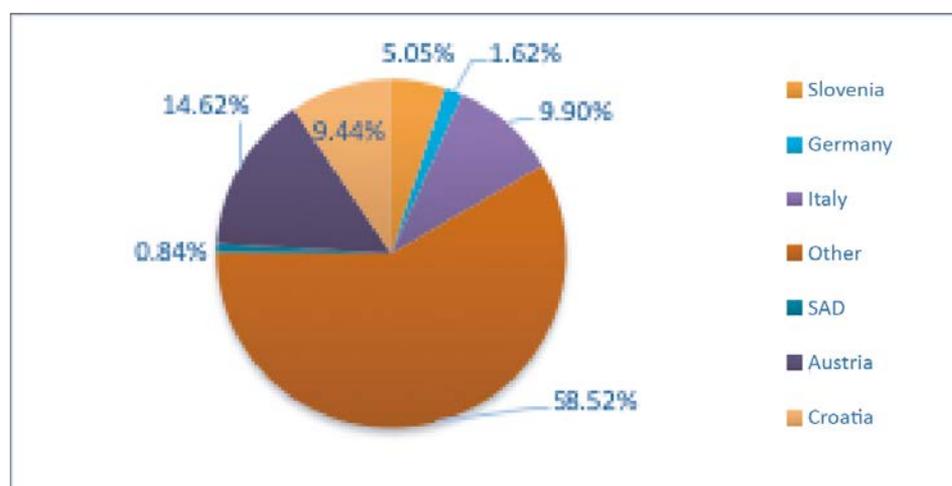
Operational risk management was regulated by the internal acts of the Bank as well as the CBCG acts. The Bank identifies events on monthly basis that occurred due to the exposure of the Bank to operational risks. Board of Directors is provided with the reports on quarterly basis on identified risks, losses incurred, as well as measures to be taken to resolve identified risks.

## COUNTRY RISK

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

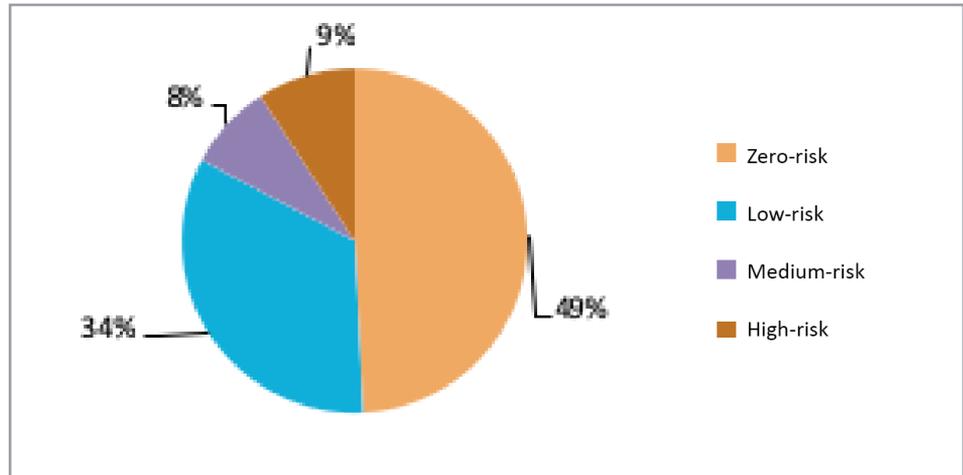
- Allowed limits of exposure to country risk, individually by countries and on aggregate basis;
- Periodical review of adequacy of country risk management system;
- Powers and responsibilities of persons related to the risk taking and risk management;
- The manner of identifying, measurement, monitoring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

The Bank is exposed to non-residents in total amount of EUR 63,053 million, of which, its largest exposure is to Austria in total amount of EUR 9,216 million.



Exposure structure to non-residents

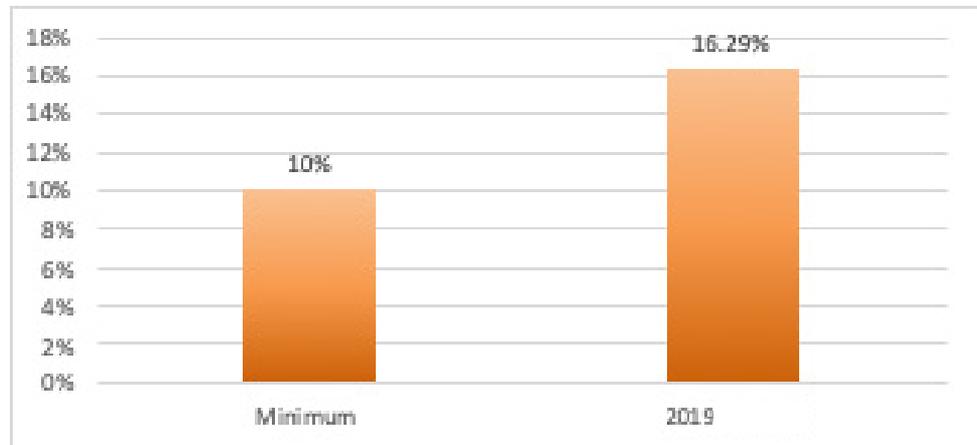
Graph above shows that 49% of exposure of the Bank referred to the exposure to countries classified as zero-risk countries, 34% referred to low-risk countries, 8% referred to medium-risk countries, and 9% referred to high-risk countries. It can be concluded that the Bank has good country risk management.



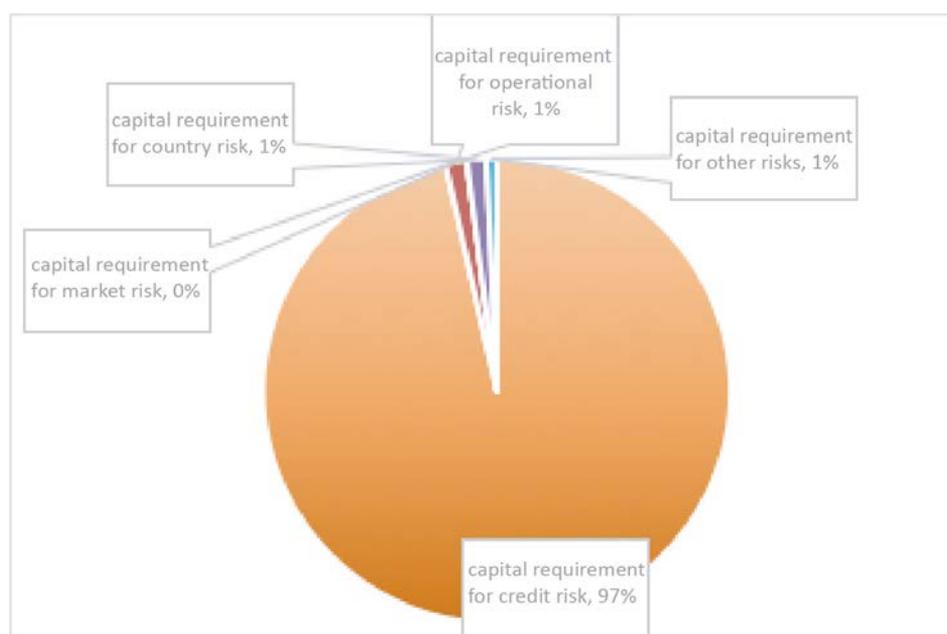
Exposure structure based on country classification

## SOLVENCY RATIO

As at 31 December 2019, solvency ratio was above the statutory limit (10%), and it amounted to 16.29%. Solvency ratio was the most important indicator of confidence in the Bank, and of the protection of depositors, creditors and business partners of the Bank.



## SOLVENCY RATIO FOR 2019



Structure of capital requirement for all risks

## HEDGING METHODS

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

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

Hedging against the risk at the account and portfolio levels is performed by collateralising the loans, in addition to the cash flow estimation (primary source of repayment), as the secondary sources of repayment: deposits, guarantees, sureties, co-debtors, guarantors, mortgages, cessions.

Several classes of risk are also monitored including:

1. Interest rate fluctuations,
2. Reinvestment risk,
3. Early repayment risk and call risk,
4. Liquidity risk,
5. Exchange rate risks,
6. Inflation risk,
7. Macroeconomic and external risks.

Hedging against them is performed as follows:

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

The opposite is happening when interest rate declines. It can be defined that there is a premium if interest rates are declining in the market, and the discount if interest rates are growing in the market.

The direction of interest rate trend and the size of change have effects on the value of the existing investments. There are two key factors: 1. maturity, long-term placements are more sensitive to pricing than short term investments; 2. change in interest rate (delta) has higher impact if the agreed rates are lower.

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

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

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

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

Exchange rate hedging is made by currency adjustment of loans with sources and by trying to have net open position at the lowest possible level. In doing so, the exchange rate fluctuations do not reflect on the profit and loss

statement; they have neutral position since the positive sign on the asset side is negative sign on the liabilities side and vice versa. Also, the Bank reviews the currency of the client in which it operates and has cash flow, and grants currency loans or make investments to these clients.

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

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

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

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

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Esad Zaimović,  
Chief Executive Officer

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Ana Golubović  
Executive Director for corporate operations  
and financial markets

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Jelena Vuletić  
Executive Director for risks.

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