[unofficial translation]

Pursuant to Article 44 paragraph 2 item 3 of the Central Bank of Montenegro Law (OGM 40/10, 6/13, 70/17, 125/23), and Article 34 paragraph 6 of the of the Law on the Development Bank of Montenegro (OGM 99/24), the Council of the Central Bank of Montenegro, at its meeting held on 25 July 2025, passed the following

DECISION
ON LARGE EXPOSURES OF THE DEVELOPMENT BANK OF MONTENEGRO

I BASIC PROVISION

Subject matter

Article 1

This decision shall govern the method for calculating large exposures of the Development Bank of Montenegro (hereinafter: the Development Bank), the criteria for identifying connectedness with a single person or a group of connected persons, credit risk mitigation techniques, and the reporting on large exposures.

II CALCULATION OF LARGE EXPOSURES

Calculation of the total exposure value

Article 2

(1) The exposure means any asset or off-balance sheet item of the Development Bank which is determined in accordance with paragraphs (2) and (3) of this Article.

(2) The exposure value of an asset item shall be its accounting value reduced by the value adjustments, necessary reserves and other deductions from own funds related to that asset item.

(3) The exposure value of an off-balance sheet item shall be the amount of its nominal value after the reduction of provisions for off-balance sheet items and the amount of necessary reserves multiplied by the corresponding conversion factor as established by the regulation governing the capital adequacy of the Development Bank.

(4) The exposure of the Development Bank to a single person or a group of connected persons shall be deemed a large exposure where its value equals to or exceeds 10% of Tire 1 capital of the Development Bank.

(5) The total exposure to a single person shall be the sum of exposures in the trading book and the exposures in the non-trading book.

(6) The total exposure to a group of connected persons shall be the sum of exposures to persons belonging to that group of connected persons.

(7) The group of connected persons shall be considered to be:
1) two or more natural or legal persons who, unless it is proven otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other person or other persons;
2) two or more natural or legal persons between whom there is no relationship of control referred to in item 1) of this paragraph, but who are to be regarded as constituting a single risk because they are so interconnected that, if one of such persons were to experience financial problems, in particular funding or repayment difficulties, the other person or all of the other persons would also be likely to encounter funding or repayment difficulties.

Identifying group of connected persons

Article 3

(1) For the purpose of identifying a group of connected persons, the Development Bank shall determine whether two or more natural or legal persons constitute a single risk in accordance with paragraphs (2) to (7) of this Article and the criteria set forth in Annex 1 provided in the annex to this Decision which forms an integral part thereof.

(2) Two or more natural or legal persons shall constitute a single risk where one of them, directly or indirectly, has control over another person or persons in at least one of the following situations:
1) where, in accordance with the law governing the accounting or International Accounting Standards/International Financial Reporting Standards, one of such persons is required to compose consolidated financial statements that include another person or other persons;
2) where the natural or legal person holds the majority of voting rights in another person or other persons;
3) where the natural or legal person has the right or the ability to appoint or remove the majority of the members of the management, governance or supervisory body of another person or other persons;
4) where the natural or legal person is in a position to exercise dominant influence over another person or other persons pursuant to the law, contract or memoranda or articles of association;
5) where the natural or legal person has the right or ability to decide on the strategy or to direct the business activities of another person or persons;
6) where the natural or legal person has the right or ability to decide on important transactions, including the transfer of profit or losses of another person or other persons;
7) where the natural or legal person has the right or ability to coordinate the management of one or more legal person.

(3) Two or more natural or legal persons shall constitute a single risk where economic dependency exists in a way that, where one of them were to experience financial problems, in particular funding or repayment difficulties, the other, or the others would also be likely to encounter financial problems, in any of, but not limited to the following circumstances:

1) where the bankruptcy or default of one person is likely to result in the bankruptcy or default of another person or other persons;
2) where a natural or legal person has fully or partly guaranteed the exposure of another natural or legal person and the exposure is so significant for the guarantor that the guarantor is likely to experience financial problems if a claim occurs;
3) where a significant part of a natural or legal person's gross profit or gross expenditures is derived from transactions with another natural or legal person that cannot be replaced in a timely manner without excessively increased costs;
4) where a significant part of the goods produced or services offered by a natural or legal person is sold or supplied to another natural or legal person and that relationship cannot be replaced in a timely manner without excessively increased costs;
5) where a significant part of the receivables or liabilities of a natural or legal person is to another natural or legal person;
6) where the expected source of funds to repay the loans of two or more natural or legal persons is the same and none of these persons has another independent source of income from which the loan may be serviced and fully repaid, and the expected source of funds cannot be replaced in a timely manner without excessively increased costs;
7) where it is expected that the financial problems of one natural or legal person would cause difficulties for another natural or legal person to fully and timely repay its liabilities, because the persons are legally or contractually jointly liable to the Development Bank;
8) where two or more natural or legal persons rely on the same source for the majority of their funding and, in the event of bankruptcy or default of that source of funding, that source of funding cannot be replaced in a timely manner without excessively increased costs;
9) where two or more legal persons are managed on a unified basis;
10) where the management body of two or more legal persons consists for a major part of the same natural persons;
11) where the majority of voting rights in two or more legal persons are held by the same natural or legal persons.

(4) By way of derogation from paragraphs (2) and (3) of this Article, where the Development Bank may demonstrate that two or more natural or legal persons do not constitute a single risk, it is not required to identify these persons as a group of connected persons.

(5) Three or more natural or legal persons shall constitute a single risk, when two or more of these persons, in accordance with paragraph (2) of this Article, constitute a single risk by means of control relationship (control group), and one or more natural or legal persons are connected to one or more of the persons being part of the control group by means of economic dependency in accordance with paragraph (3) of this Article.

(6) Where the person that is connected by means of economic dependency in accordance with paragraph (3) of this Article is part of another group of connected persons, all persons, either being controlled by that economically dependent person

or being themselves economically dependent on that person, shall constitute a single risk with the persons of the control group.

(7) By way of derogation from paragraphs (5) and (6) of this Article, where the Development Bank may demonstrate that no single risk prevails with regard to three or more natural or legal persons, it is not required to identify these persons as a group of connected persons.

Treatment of a group of persons connected with the central government

Article 4

(1) Where a central government has direct or indirect control over or is directly or indirectly interconnected with more than one person referred to in Article 2 paragraph (7) of this Decision, the Development Bank need not treat a group consisting of the central government and those persons as a group of connected persons.

(2) The central government referred to in paragraph (1) of this Article shall be the state administration bodies, government agencies and other entities whose powers cover the entire territory of the state, and which are, in accordance with the regulation governing the statistical reporting, classified as the central government.

(3) In the case referred to in paragraph (1) of this Article, the Development Bank may assess the existence of a group of connected persons formed by the central government and other persons separately for each person for which the existence of a single risk has been identified, including the central government.

(4) For the purposes of paragraph (3) of this Article, the Development Bank shall, when identifying a group of connected persons formed by the central government, apply the criteria laid down in Annex 1 to this Decision.

Items not included in the calculation of exposures

Article 5

(1) When calculating large exposures, the Development Bank shall not take into account the following items:

1) in the case of foreign exchange transactions (FX transactions), exposures incurred in the ordinary course of settlement which does not exceed two working days following the payment date;
2) in the case of transactions for the purchase or sale of securities, exposures incurred in the ordinary course of settlement which does not exceed five working days following payment or delivery of the securities, whichever the earlier;
3) in the case of the provision of payment services, clearing and settlement in any currency and correspondent banking services or financial instruments clearing, settlement and custody services to clients, delayed receipts in funding and other exposures arising from client activity which do not last longer than the following business day;
4) in the case of the provision of money transmission services, including the execution of payment, clearing and settlement services in any currency and

correspondent banking, intra-day exposures to institutions providing those services;

5) exposures deducted from Common Equity Tier 1 capital or Additional Tier 1 capital or other reductions of Tier 1 capital for deductible items specified in the regulation governing the capital adequacy of the Development Bank.

(2) By way of derogation from paragraph (1) of this Article, the transactions referred to in paragraph (1) items 3) and 4) of this Article, may be excluded when determining large exposures provided that the exposure:

1) originates from ensuring specific types of services;
2) originates from client's activities, or exposures to institutions providing services, for the transactions referred to in paragraph (1) item 4) of this Article;
3) does not last longer than the following business day for the transactions referred to in paragraph (1) item 3) of this Article, or exposures originate during the day for the transactions referred to in paragraph (1) item 4) of this Article;
4) represents a short-term exposure that does not last longer than one day or exposures which are reduced during the day.

(3) Specific services referred to in paragraph (2) item 1) of this Article shall be payment services, clearing and settlement services in any currency and correspondent banking services.

(4) Activities of a client referred to in paragraph (2) item 2) of this Article mean direct and indirect activities, e.g., activities on the client's initiative, but also indirect activities in the form of payment to agents and partners based on the contract entered into between the client and those persons, as well as inflow of monetary funds from those persons, including borrowings and lending, payments, fees and interest as well as providing or withdrawing cash collateral resulting in the occurrence of exposure based on unexpected inflows and outflows, where, due to technical reasons, the Development Bank is unable to reduce those exposures by the end of the business day.

(5) The Development Bank shall use the procedures and control mechanisms established in accordance with the Law on the Development Bank of Montenegro (OGM 99/24) – (hereinafter: the Law) to ensure the fulfilment of the requirements referred to in paragraph (2) of this Article, and it shall provide evidence that the excluded exposures fully arise from the activities of the client.

III MANAGING LARGE EXPOSURES

Capacity to identify and manage large exposures

Article 6

The Development Bank shall, in accordance with the Law, put in place sound administrative and accounting procedures and adequate internal control mechanisms for the purpose of identifying, managing, monitoring, reporting and recording large exposures and subsequent changes to them, in accordance with the provisions of this Decision.

Limits to large exposures

Article 7

The Development Bank shall operate in accordance with the exposure limits to a single person or a group of connected persons prescribed by the Law, after taking into account the effects of credit risk mitigation techniques calculated in accordance with Articles 10 to 12 of this Decision in the following manner:

1) 20% of Tier 1 capital of the Development Bank, except in cases referred to in items 2) and 3) of this Article;
2) 50% of own funds for exposures to a credit institution operating in Montenegro and persons connected to that credit institution;
3) 75% of own funds for an exposure to a single person and the persons connected to it that relates to the project of local, regional and state importance, together with other exposures to those persons, only with the prior consent of the Government of Montenegro in accordance with the Law.

Compliance with the large exposure requirements

Article 8

(1) Where, in an exceptional case, the Development Bank exceeds the exposure limits referred to in Article 7 of this Decision, it notify the Central Bank of Montenegro (hereinafter: the Central Bank) without delay of the amount of the breach, the name of the person concerned and, where applicable, the name of the group of connected persons concerned.

(2) The notification referred to in paragraph (1) of this Article shall, in particular, contain the following information:

1) the amount of the breach in relation to Tier 1 capital or own funds, depending on the applicable limit;
2) the name of the client due to which the breach occurred or, where applicable, the name of the group of connected persons concerned;
3) date of the occurrence of the breach;
4) description of available collateral regardless of its eligibility for credit risk mitigation;
5) a detailed explanation of the reasons for the breach;
6) remedial actions implemented or planned by the Development Bank to remove the breach; and
7) expected time needed to return to compliance with the large exposure limits.

(3) The Central Bank may request the Development Bank to provide further information and explanations of reasons, if it is not satisfied that the information provided is sufficient to allow for a comprehensive assessment of the specific circumstances of the breach.

Exposures to which large exposure limits are not applied

Article 9

(1) The provision of Article 7 of this Decision shall not apply to the following exposures:

1) asset items constituting claims on central governments, central banks or public sector entities which, unsecured, would be assigned a 0 % risk weight under the provisions of the regulation governing capital adequacy of the Development Bank on the calculation of capital requirement for credit risk;
2) asset items constituting claims on international organisations or multilateral development banks which, unsecured, would be assigned a 0% risk weight under the provisions of the regulation governing capital adequacy of the Development Bank on the calculation of capital requirement for credit risk;
3) asset items constituting claims carrying the explicit guarantees of central governments, central banks, international organisations, multilateral development banks or public sector entities, where unsecured claims on the entity providing the guarantee would be assigned a 0% risk weight under the provisions of the regulation governing capital adequacy of the Development Bank on the calculation of capital requirement for credit risk;
4) other exposures attributable to, or guaranteed by central governments, central banks, international organisations, multilateral development banks or public sector entities, where unsecured claims on the entity to which the exposure is attributable or by which it is guaranteed would be assigned a 0% risk weight under the provisions of the regulation governing capital adequacy of the Development Bank on the calculation of capital requirement for credit risk;
5) asset items and other exposures secured by collateral in the form of cash deposits placed with the Development Bank or with the credit institution to the benefit of the Development Bank.

IV MITIGATION OF EXPOSURES APPLYING CREDIT RISK MITIGATION TECHNIQUES

Credit risk mitigation techniques

Article 10

(1) The Development Bank may use a credit risk mitigation technique in the calculation of an exposure where it has used that technique to calculate capital requirements for credit risk in accordance with the regulation governing capital adequacy of the Development Bank.

(2) Where the Development Bank uses funded or unfunded credit protection, this shall be subject to compliance with the eligibility requirements and other requirements set out in the regulation governing capital adequacy of the Development Bank.

(3) The Development Bank shall analyse, to the extent possible, its exposures to collateral issuers, providers of unfunded credit protection for possible concentrations and where appropriate take action and report findings thereof to the Central Bank.

Calculating the effect of the use of credit risk mitigation techniques

Article 11

(1) When calculating the value of exposures for the purposes of Article 7 of this Decision, the Development Bank may use the fully adjusted exposure value as calculated in accordance with the provisions of the regulation governing capital

adequacy of the Development Bank, taking into account the credit risk mitigation techniques.

(2) After calculating the value of exposures referred to in Article 7 of this Decision, the Development Bank shall conduct periodic stress tests of their credit-risk concentrations, including stress tests of the exposure value that may be collected by realisation of collateral.

(3) The periodic stress tests referred to in paragraph (2) of this Article shall address risks arising from potential changes in market conditions that could adversely impact the Development Bank's own funds adequacy, as well as risks arising from the realisation of collateral in specific stress events.

(4) The Development Bank shall include the following in its internal acts to address concentration risk:

1) policies and procedures to manage risks arising from maturity mismatches between exposures and any credit protection on those exposures;
2) policies and procedures relating to concentration risk arising from the application of credit risk mitigation techniques, in particular from large indirect credit exposures, for example, exposures to a single issuer of securities taken as collateral, and
3) defined exposure limits to credit protection providers (according to geographic positions, industry, etc.), the method to monitor those limits, as well as activities in the case of excess of the defined exposure limits.

(5) Where the Development Bank reduces an exposure to a client using a credit risk mitigation technique, it shall treat the part of the exposure by which that exposure has been reduced as having been incurred for the protection provider rather than for the client.

Substitution approach

Article 12

(1) Where an exposure to a client is guaranteed by a third party or is secured by collateral issued by a third party, the Development Bank shall:

1) treat the portion of the exposure which is secured by a guarantee or other surety of a third party as an exposure to the protection provider rather than to the client, provided that, in accordance with the regulation governing capital adequacy of the Development Bank in the part pertaining to the calculation of capital requirement for credit risk, the unsecured exposure to the protection provider would be assigned a risk weight that is equal to or lower than the risk weight of the unsecured exposure to the client;
2) treat the portion of the exposure collateralised up to the market value of recognised collateral as exposure to the collateral provider rather than to the client, provided that in accordance with the regulation governing capital adequacy of the Development Bank in the part pertaining to the calculation of capital requirement for credit risk, the collateralised portion of the exposure would be assigned a risk weight that is equal to or lower than the risk weight of the unsecured exposure to the client.

(2) The Development Bank shall not use the provision of paragraph (1) item 2) of this Article where there is a mismatch between the maturity of the exposure and the maturity of the protection.

(3) Where the Development Bank applies the provision of paragraph (1) item 1) of this Article, the Development Bank:
1) shall, where the guarantee or other surety is denominated in a currency different from that in which the exposure is denominated, calculate the amount of the exposure that is deemed to be covered, in accordance with the regulation governing capital adequacy of the Development Bank in the part pertaining to the treatment of currency mismatch for unfunded credit protection;
2) shall treat any mismatch between the maturity of the exposure and the maturity of the protection in accordance with the regulation governing capital adequacy of the Development Bank in the part pertaining to the treatment of maturity mismatch set;
3) may recognise partial coverage in accordance with the treatment set out in the regulation governing capital adequacy of the Development Bank in the part pertaining to the credit risk mitigation techniques.

V REPORTING

Reporting on large exposures

Article 13

The Development Bank shall report on large exposures to the Central Bank in accordance with the decision governing the reporting to the Central Bank.

VI FINAL PROVISION

Entry into force

Article 14

This Decision shall enter into force on the eighth day following that of its publication in the "Official Gazette of Montenegro".

THE COUNCIL OF THE CENTRAL BANK OF MONTENEGRO

Decision number: 0101-5891-7/2025 **CHAIRPERSON**
Podgorica, 25 July 2025 **G O V E R N O R**

Irena Radović, m.p.

ANNEX 1

Identifying interconnectedness of persons within the group of connected persons

When determining interconnectedness of persons within the group of connected persons within the meaning of Article 3 of this Decision, the criteria referred to in this Annex shall apply.

I Groups of connected persons based on control relationship

1. Where the Development Bank is able to demonstrate that no single risk exists within the meaning of Article 2 paragraph (7) item 1) of this Decision, despite the existence of a control relationship among certain persons, it should document the non-existence of that risk. For example, in specific cases where a special purpose entity (SPE) that is controlled by another person (e.g., an originator) is fully ring-fenced and bankruptcy remote – so that there is no possible channel of contagion, and hence no single risk, between the special purpose entity and the controlling entity – it may be possible to demonstrate that no single risk exists (see Scenario C 1 of this Annex).

2. The Development Bank should apply the concept of control relationship referred to in Article 3 paragraph (2) of this Decision as follows:

- in relation to clients that prepare their consolidated financial statements in conformity with the International Accounting Standards/International Financial Reporting Standards, the Development Bank shall treat the control relationship between a parent undertaking and its subsidiary undertakings within the meaning of those accounting standards and group them accordingly on the basis of their consolidated financial statements;
- in relation to persons to which indent 1 of this paragraph does not apply (e.g., natural persons, the central government, and clients of the Development Bank that prepare consolidated financial statements in accordance with the accounting rules of a third country, wherein the third country shall mean a foreign country that is not an EU Member State and a EU Member State until Montenegro's accession to the European Union), the Development Bank should deem to be control relationships those between any natural or legal person that are similar to the parent undertaking/subsidiary undertaking relationships defined in indent 1 of this paragraph.

3. When conducting this assessment, the Development Bank shall deem any of the following criteria to constitute a control relationship:

- holding the majority of the shareholders' or owners' voting rights in another entity;
- right or ability to appoint or remove a majority of the members of the bodies performing supervisory or management function of another entity;
- right or ability to exercise a dominant influence over another person pursuant to a contract, or articles of incorporation.

4. Other indicators of control relationship that the Development Bank should consider in its assessment may include the following:

- power to decide on the strategy or direct the activities of an entity;
- power to decide on crucial transactions, such as the transfer of profit or loss;
- right or ability to coordinate the management of an entity with that of other entities in pursuit of a common objective (e.g., where the same persons are involved in the management or supervisory board of two or more business entities);
- holding more than 50% of the shares of capital of another entity.

5. Given that the decisive factor for the assessment of the existence of a control relationship is the accounting criteria or indicators of control relationship set out in item 2 indent 1 of this Chapter, the Development Bank shall group two or more persons on account of a relationship of control, also in the case where these persons are not included in the same consolidated financial statements because exemptions apply to them under the relevant accounting rules.

6. The Development Bank shall group two or more clients into a group of connected persons on account of a relationship of control among these persons regardless of whether or not the exposures to these persons are fully or partially exempted from the application of the large exposures limit under Article 9 of this Decision.

II Alternative approach for exposures to central government

1. In line with the provisions of Article 4 of this Decision, the Development Bank may assess the existence of a group of connected persons separately for each of the persons directly controlled by or directly interconnected with the central government (hereinafter: the alternative approach).

2. The Development Bank may partially apply the alternative approach, assessing separately the natural or legal persons directly controlled by or directly interconnected with the central government (see scenario CG1 of this Annex). The provision also makes clear that:

- the central government is included in each of the groups of connected persons identified separately for the natural or legal persons directly controlled by or directly interconnected with the central government (see scenario CG2 of this Annex).
- each group of connected persons under indent 1 of this paragraph also includes persons controlled by or interconnected with the person who is directly controlled by or directly interconnected with the central government (see scenario CG3 of this Annex).

3. Where the entities directly controlled by or directly interconnected with the central government are economically dependent on each other, they should form separate groups of connected persons (excluding the central government), in addition to the groups of connected persons formed in accordance with the alternative approach (see scenario CG4 of this Annex).

III Establishing interconnectedness based on economic dependency

1. Interconnectedness among the Development Bank's clients based on economic dependency, in accordance with Article 2 paragraph (7) item 2) of this Decision, should take into account the specific circumstances of each case, in particular whether the financial difficulties or the failure of a single person would lead to funding or repayment difficulties for another person (see scenarios E1, E2, E3 and E4 of this Annex).

2. Where the Development Bank is able to demonstrate that the financial difficulties or the failure of a person would not lead to financial problems for another person, these persons do not need to be treated as a single risk. In addition, two persons do not need to be considered a single risk if a person is economically dependent on another person to the extent that enables its replacement.

3. The Development Bank shall consider, in particular, the following situations when assessing economic dependency:

- where a person has fully or partly guaranteed the exposure of another person and the exposure is such that the guarantor will experience financial problems if a claim occurs;
- where a person is liable as a member in an entity (for example a general partner in a limited partnership), and the exposure is such that the person is will experience financial problems if a claim against the entity occurs;
- where a significant part of a person's annual gross profit or gross expenditure is derived from transactions with another person (e.g., the owner of a residential/commercial property the tenant of which pays a significant part of the rent) that cannot be easily replaced;
- where a significant part of a person's production/output is sold to another client of the Development Bank, and the production/output cannot easily find another client (buyer).
- where the expected source of funds to repay the loans of two or more persons is the same and none of the persons has another independent source of income from which the loan may be serviced and fully repaid;
- other situations where persons are jointly liable for obligations to the Development Bank (e.g., a debtor and their co-borrower, or a debtor and their spouse/partner);
- where a significant part of the receivables or liabilities of a person is to another person.
- where persons have common owners, or shareholders or management bodies. For example, horizontal groups where a person is related to one or more other persons because they all have the same shareholder structure except for a single controlling shareholder or because they are managed on a unified basis. This management may be pursuant to a contract concluded between the persons, or to provisions in the memoranda or articles of association of those persons, or if the management or supervisory structures of the persons consist for the major part of the same persons.

4. Where the Development Bank's client is economically dependent on more than one persons which are not dependent on each other, the Development Bank shall include the latter persons in separate groups of connected persons (together with the dependent person).

5. The Development Bank shall form a group of connected persons where two or more of their persons are economically dependent on an entity, even if this entity is not a client of the Development Bank.

6. The Development Bank should group two or more connected persons into a group of connected persons on account of economic dependency among these persons, regardless of whether or not the exposures to these persons are exempted from the application of the large exposures limit under Article 9 of this Decision.

7. The Development Bank should consider situations where the funding problems of one person are likely to spread to another on account of the dependency on the same funding source. This does not include cases where persons get funding from the same market (e.g., the market for commercial paper) or where persons' dependency on their existing source of funding is caused by the persons' deteriorating creditworthiness, such that they cannot easily replace that source of funding.

8. The Development Bank should consider cases where the common source of funding depended on is provided by the Development Bank itself, or its connected persons (see scenario E5 of this Annex). Being persons funded by the Development Bank, does not in itself create a requirement to group the persons if the Development Bank providing funding can be easily replaced.

9. The Development Bank should also assess any contagion or idiosyncratic risk that could emerge from the following situations:

- use of one funding entity;
- use of similar structures;
- reliance on commitments from one source (e.g., sureties, credit support in structured transactions or non-committed liquidity facilities), taking into account its solvency, especially where there are maturity mismatches and the frequency of the refinancing needs.

IV Relation between interconnectedness through control and interconnectedness through economic dependency

1. The Development Bank should first identify which persons are connected via control relationship in accordance with Article 2 paragraph (7) item 1) of this Decision, and which persons are connected via economic dependency in accordance with Article 2 paragraph (7) item 2) of this Decision, and subsequently, it shall assess whether the identified groups of connected persons need to be connected themselves (e.g. whether groups of persons connected on account of economic dependency need to be grouped together with a control group).

2. In its assessment of interconnectedness, the Development Bank should consider each case separately, i.e., identify the possible chain of contagion ('domino effect') based on the individual circumstances (see scenarios C/E 1 and C/E 2 of this Annex).

3. Where persons that are part of different control groups are interconnected via economic dependency, all entities for which a chain of contagion exists need to be grouped into one group of connected persons. Downstream contagion should always be assumed when a person is economically dependent and is itself the head of a control group (see scenario C/E 3 of this Annex).

4. Upstream contagion of persons that control an economically dependent entity should be assumed only when this controlling person is also economically dependent on the entity that constitutes the economic link between the two controlling groups (see scenario C/E 4 of this Annex).

V Control and management procedures for identifying connected persons

1. The Development Bank should have a thorough knowledge of their clients and their clients' relationships.

2. Identification of possible connections among persons should be an integral part of the Development Bank's credit granting and surveillance process. The management board and senior management of the Development Bank should ensure that adequate processes for the identification of connections among persons are documented and implemented.

3. The Development Bank should identify all control relationships among their clients and document as appropriate. The Development Bank should also investigate, and document as appropriate, any potential economic dependencies among their clients, and take reasonable steps and use readily available information to identify these connections. If, for example, the Development Bank becomes aware that persons have been considered interconnected by another credit institution, it should take into account that information.

4. The efforts that the Development Bank puts into the investigation of economic dependencies among its clients should be proportionate to the size of the exposures, particularly taking into account exposures to one individual person exceeding 5% of Tier 1 capital.

5. To assess grouping requirements based on a control and economic dependency relationships, the Development Bank should collect information on all entities forming a chain of contagion. If the Development Bank cannot identify all persons that constitute a single risk, but becomes aware of interconnections that stem from entities that are not in a business relationship with the Development Bank (see scenario Mm 1 of this Annex), it should use this information when assessing connections.

6. The internal document identifying the connected persons should be subject to periodic review. The Development Bank should also monitor changes to interconnections, particularly in the case of their periodic loan reviews and a substantial increase to a loan is planned.

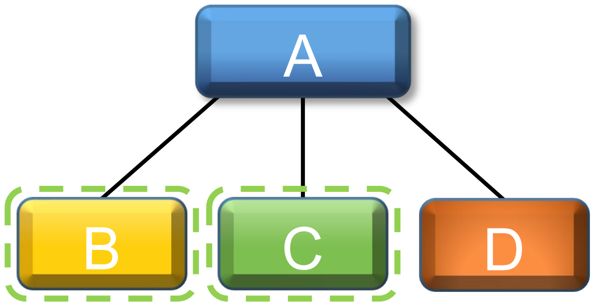
Examples of interconnectedness in the group of connected persons

The scenarios included in this Annex illustrate the application of the guidelines to groups of connected persons falling under the definition in Article 2 paragraph (7) items 1) and 2) of this Decision.

Groups of connected persons based on control

Scenario C1: Exceptional case (no single risk exists despite the existence of control function of one person over another)

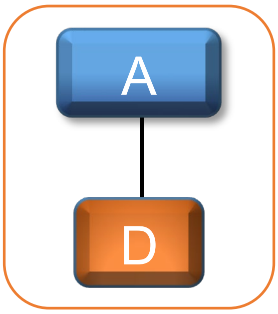
The Development Bank has exposures to all entities shown below (A, B, C and D). Entity A has control over entities B, C and D. The entities B, C and D are special purpose entities.



To assess if there is no single risk, despite the existence of a control relationship, the Development Bank should assess in relation to each of the SPEs (entities B, C and D in this scenario) the absence of economic interdependence or any other factors that could be indicative of a material positive correlation between the credit quality of the parent undertaking A and the credit quality of the SPE (B, C or D).

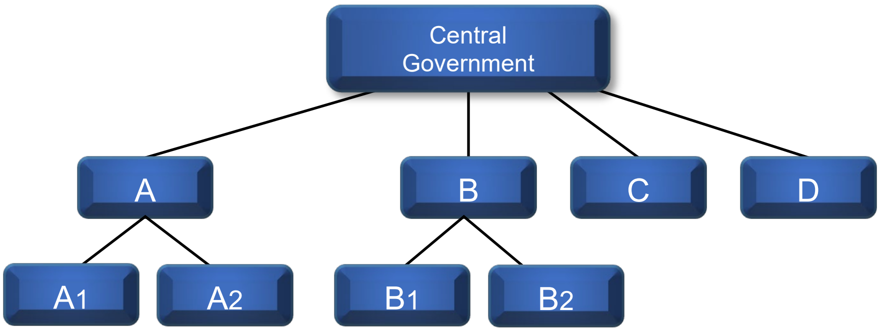
Among other factors, potential reliance on parent undertaking A for funding sources and some of the criteria preventing the deconsolidation of the SPE or the derecognition of securitised assets under the applicable accounting rules have to be assessed as potential signs of material positive correlation.

Having assessed all of these elements, the Development Bank could conclude that, for example, subsidiary undertakings B and C do not constitute a single risk with parent undertaking A. As a result, the Development Bank should consider that a group of connected persons is composed only of person A and D. The Development Bank should document these assessments and its conclusions in a comprehensive way.



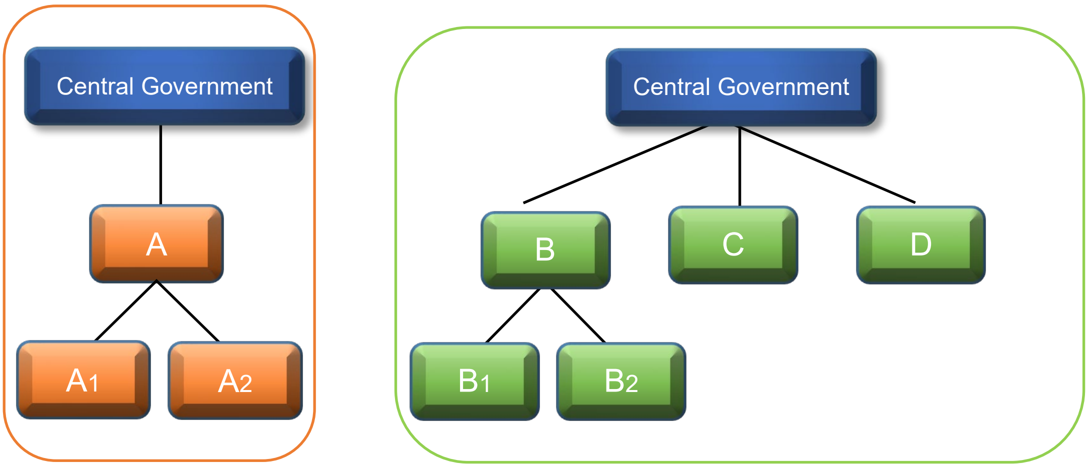
Alternative approach for exposures to central governments

To illustrate the possible scenarios, the following general scenario is used: the central government directly controls four legal persons (A, B, C and D). Entities A and B themselves have direct control over two subsidiary undertakings each (A1/A2, B1/B2). The Development Bank has exposures to the central government and all of the entities shown.

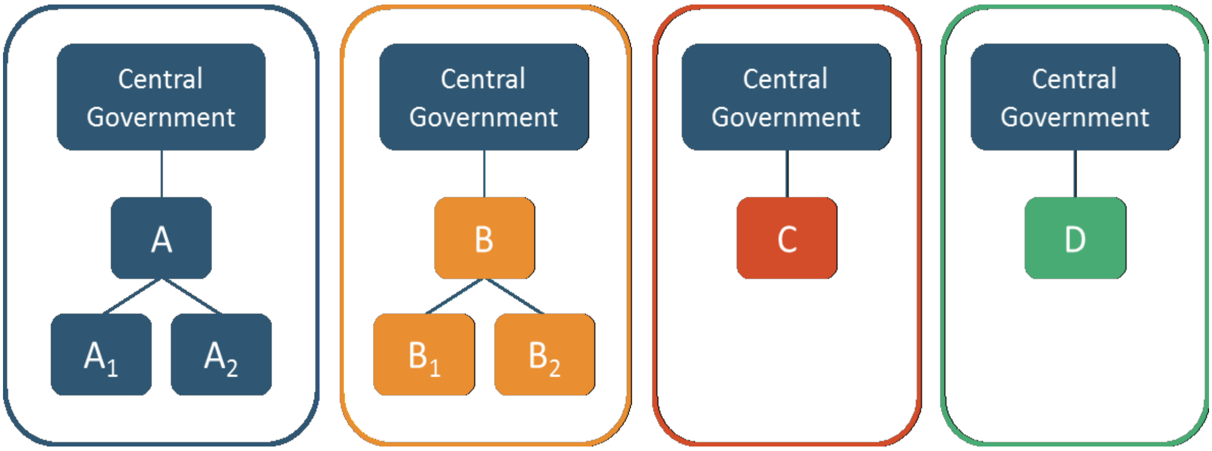


<u>Scenario CG1</u>: Alternative approach – partial use

The Development Bank could carve out only one group (‘central government / A /all controlled or dependent entities of A’) and keep the general treatment for the rest (‘central government /B, C and D /all controlled or dependent entities of B’):

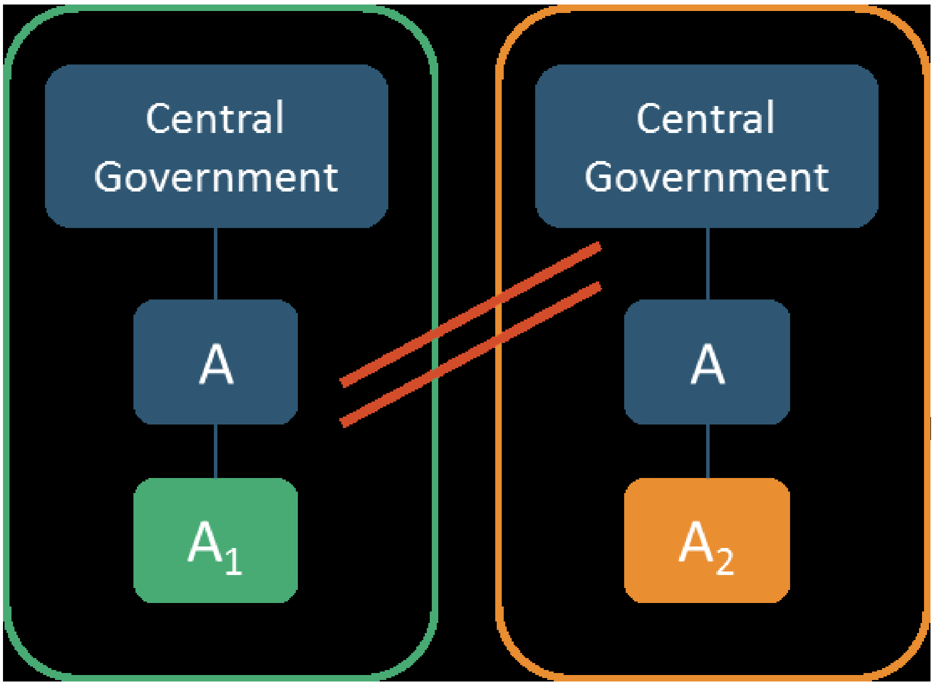


<u>Scenario CG 2</u>: Alternative approach – used for all directly dependent entities

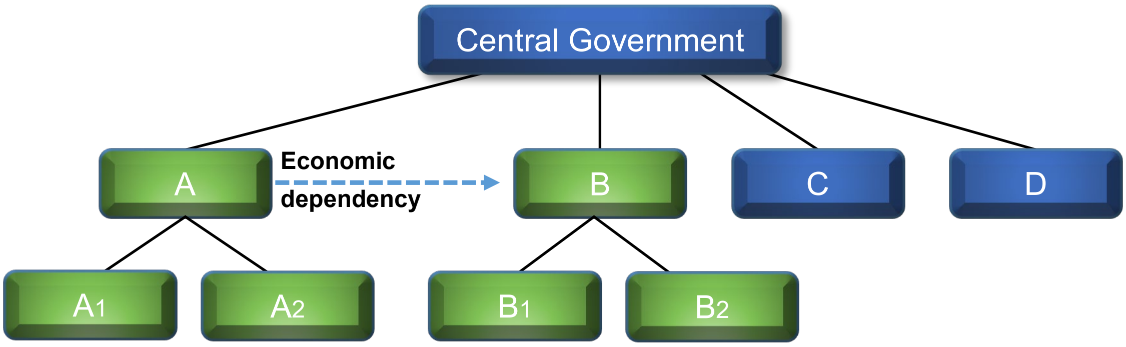


<u>Scenario CG 3</u>: Alternative approach – applicable on "first/second level", not below

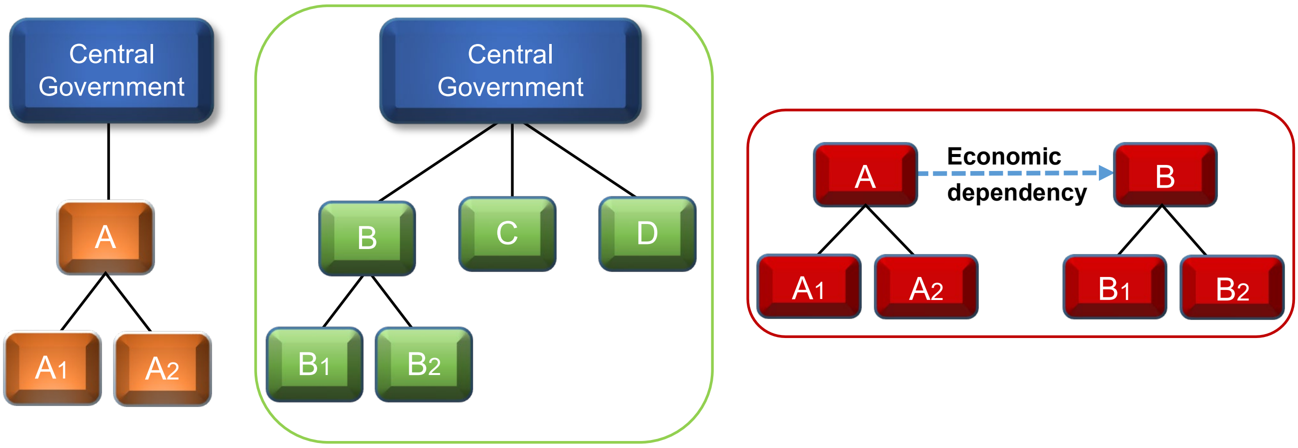
In the first and second scenarios, entities A, B, C and D constitute the 'second level', i.e., the level directly below the central government ('first level'). Here, a carve-out from the overall group of connected persons is possible. However, entities A1, A2, B1 and B2 are only indirectly connected to the central government. A carve-out on their level is not possible (e.g., both A1 and A2 need to be included in the group 'central government/A'):



In a variation on the general scenario above, entities A and B are economically dependent (payment difficulties for B would be contagious to A):



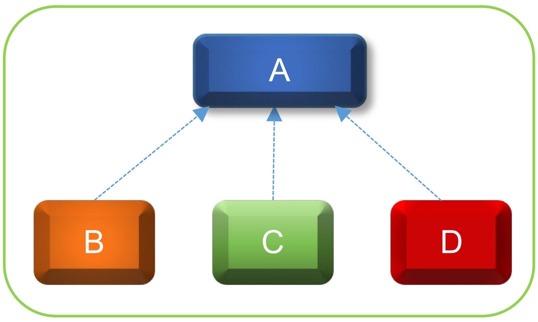
Assuming that the Development Bank uses the alternative approach only in part, as described in scenario CG 1 above, the following groups of connected persons need to be considered:



Establishing interconnectedness based on economic dependency

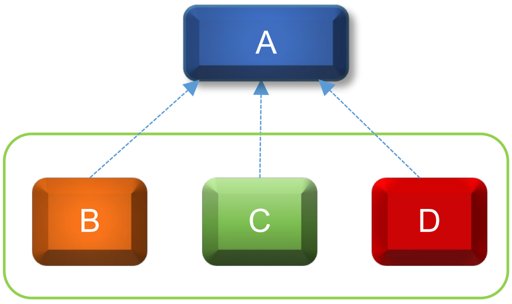
<u>Scenario E1</u>: Main case

The Development Bank has exposures to all entities shown below (A, B, C and D). B, C and D rely economically on A. Hence the underlying risk factor for the Development Bank is in all cases A. The Development Bank has to form one comprehensive group of connected persons, not three individual ones. It is irrelevant that there is no dependency among B, C and D.



<u>Scenario E2</u>: Variation on main case (no direct exposure to source of risk)

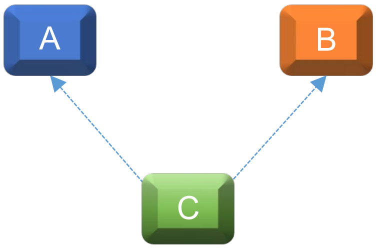
There is a grouping requirement even if the Development Bank does not have a direct exposure to A, but is aware of the economic dependency of each person (B, C and D) on A. If the possible payment difficulties for A are contagious to B, C and D, they will all experience payment difficulties if A gets into financial trouble. Therefore, they need to be treated as a single risk.



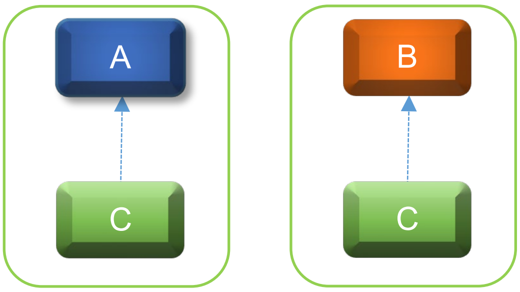
As in scenario E 1, it does not matter that there is no dependency among B, C and D. A causes the grouping requirement, although it is not a client itself and thus is not part of the group of connected persons.

Scenario E3: Overlapping groups of connected persons

If an entity is economically dependent on two or more other entities (note that the payment difficulties of one of the other entities (A or B) might be sufficient to result in C being in difficulty),



it has to be included in the groups of connected persons of both (all such) entities:



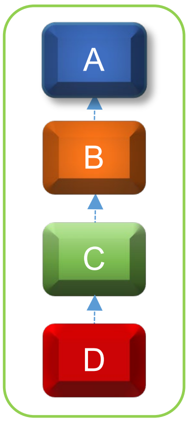
The argument that the exposure to C will be double-counted is not valid because the exposure to C is considered a single risk in two separate groups.

The large exposure limit applies separately (i.e., the limit applies once to exposures to group A/C and once to exposures to group B/C).

As there is no dependency between A and B, no comprehensive group (A + B + C) needs to be formed).

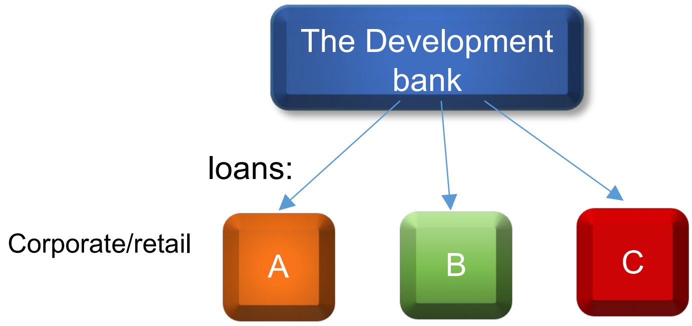
<u>Scenario E4</u>: Chain of dependency

In the case of a 'chain of dependency', all entities that are economically dependent (even if the dependency is only one way) need to be treated as one single risk. It would not be appropriate to form three individual groups (A + B, B + C, C + D).



<u>Scenario E5</u>: The Development Bank as source of funding (no grouping requirements)

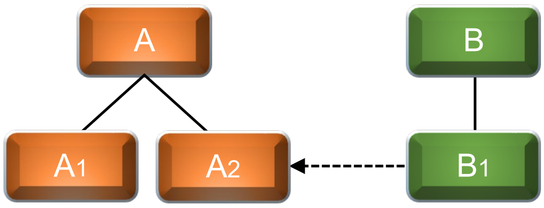
In the following scenario, the Development Bank is the sole provider of funds for three clients. It is not an 'external funding source' that connects the three persons and it is a funding source that can normally be replaced.



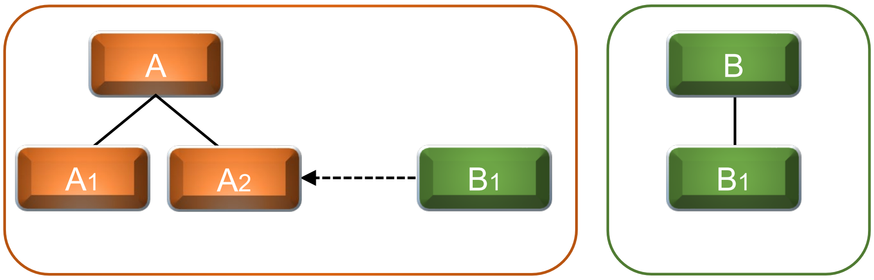
Relation between interconnectedness through control and interconnectedness through economic dependency

<u>Scenario C/E 1:</u> Combined occurrence of control and economic dependency (one-way dependency)

In the following scenario, the Development Bank has exposures to all entities shown in the diagram below. A controls A1 and A2, B controls B1. Furthermore, B1 is economically dependent on A2 (one-way dependency):



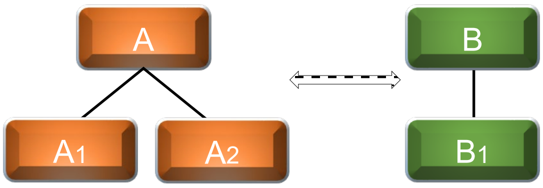
<u>Grouping requirement:</u> In this scenario, the Development Bank should come to the conclusion that B1 is in any case to be included in the group of connected persons of A (the group thus consisting of A, A1, A2 and B1) as well as of B (the group thus consisting of B and B1):



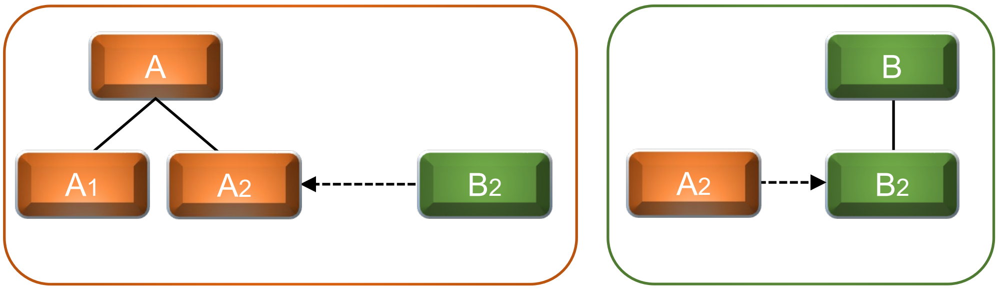
In case of financial problems for A, A2 and ultimately B1 will also experience financial difficulties on account of their legal (A2) and economic (B1) dependency respectively. The forming of three different groups (A + A1 + A2, A1 + B1, B + B1) would not be sufficient to capture the risk stemming from A, because B1, although dependent on A2 and thus on A itself, would be carved out of the single risk of group A.

<u>Scenario C/E 2</u>: Combined occurrence of control of one person over another and economic dependency (two-way dependency)

In this scenario, the economic dependency of A2 and B1 is not only one way but mutual:

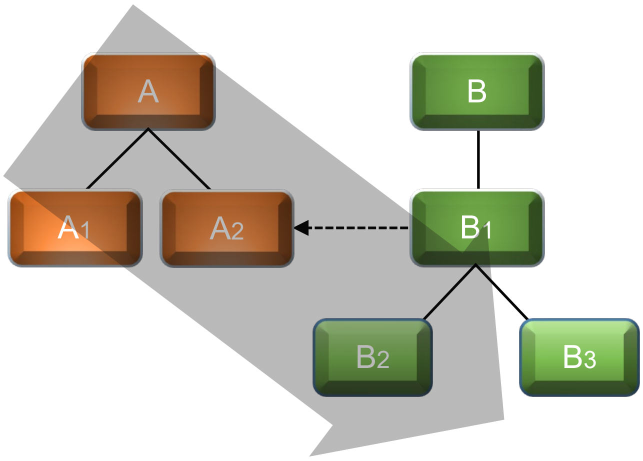


Grouping requirement: A2 would need to be included additionally in group B, and B1 would need to be included additionally in group A:

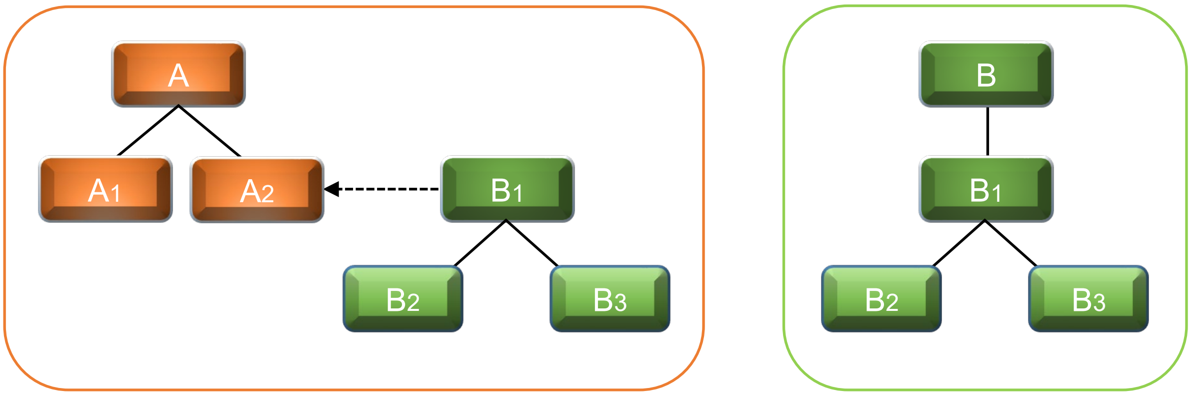


Scenario C/E 3: Downstream contagion

In a variation on scenario C/E 1 above, B1 also controls two entities (B2 and B3). In this case, the financial difficulties of A will pass through A2 and B1 down to the two subsidiaries of B1 ('downstream contagion').



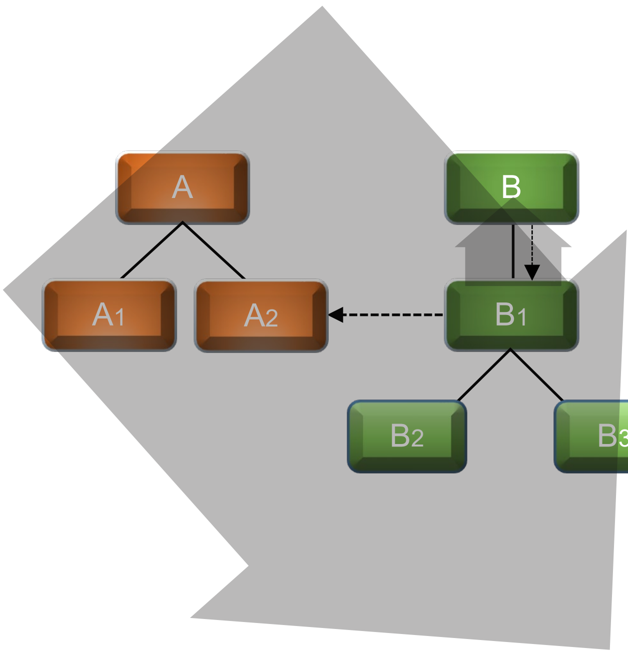
Grouping requirement:



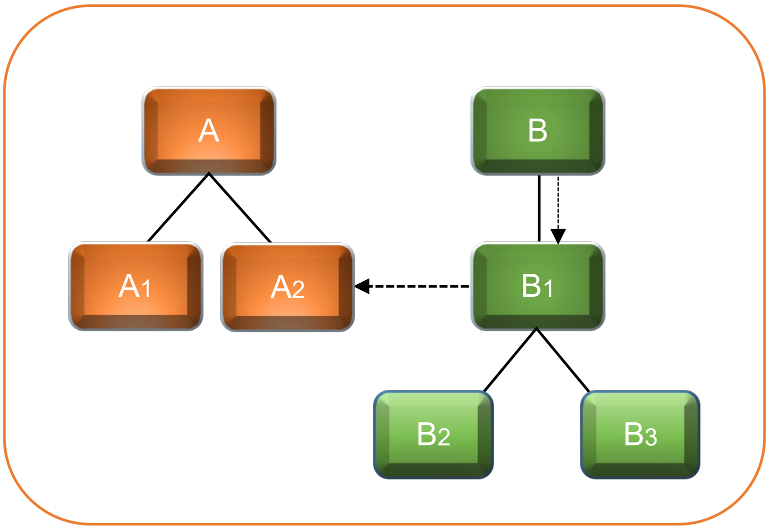
<u>Scenario C/E 4</u>: Upstream contagion

The control relationship between B and B1 does not automatically lead to including B in the group of connected persons of A, as financial problems for A are not likely to result in financial difficulties for B.

However, the entity B is a parent company, it needs to be included in the group of A if B1 forms such an important part of group B that B is economically dependent on B1. In this case, the financial difficulties of A will proceed not only downwards but also upwards to B, causing payment difficulties for B (i.e., all entities now form a single risk).



Grouping requirement:



Control and management procedures for identifying connected persons

Scenario Mm 1: Limits to the identification of a chain of contagion

Further developing the scenario above (C/E 4), the Development Bank has exposures only to entity A and entity B3. In such a case, it is recognised that it might not be possible for the Development Bank to become aware of the chain of contagion and the group of connected persons might not be correctly formed.