Pursuant to Article 44 paragraph (2) item 3) of the Central Bank of Montenegro Law (OGM 40/10, 06/13, 70/17) and Article 44 paragraph (5) of the Law on Resolution of Credit Institutions (OGM 72/19, 08/21), the Council of the Central Bank of Montenegro, at its meeting held on 28 April 2021, passed the following

DECISION ON DETAILED MANNER OF VALUATION OF ASSETS AND LIABILITIES BEFORE TAKING RESOLUTION ACTION OR EXERCISING THE POWER TO WRITE DOWN OR CONVERT RELEVANT CAPITAL INSTRUMENTS

I. BASIC PROVISIONS

Subject matter

Article 1

This Decision shall regulate in more detail the manner of valuation (hereinafter: the valuation) of assets and liabilities of a credit institution, or a legal person referred to in Article 3 items 2), 3), and 4) of the Law on Resolution of Credit Institutions (OGM 72/19, 08/21) – (hereinafter: the Law), before taking resolution action or exercising the power to write down or convert relevant capital instruments.

Definitions

Article 2

Terms used in this Decision shall have the following meaning:

1) **valuation** means either the assessment of assets and liabilities of a credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law, performed by an independent valuer in line with Article 44 paragraphs (1) and (2) of the Law or the provisional valuation carried out by the Central bank of Montenegro (hereinafter: the Central Bank) or an independent valuer, pursuant to Article 46 of the Law;
2) **independent valuer** means a valuer within the meaning of this Decision governing conditions to be fulfilled by a person performing valuation of assets and liabilities of a credit institution under resolution means, or the Central Bank when it, as a resolution authority, performs provisional valuation in line with Article 46 paragraph (2) of the Law;
3) **fair value** means the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the valuation date, as defined in the relevant accounting framework.

4) **hold value** means the present value, discounted at an appropriate rate, of cash flows that the credit institution or a person referred to in Article 3 items 2), 3) and 4) of the Law can reasonably expect under fair, prudent and realistic assumptions from retaining particular assets and liabilities, considering factors affecting customer or counterparty behaviour or other valuation parameters in the context of resolution.
5) **disposal value** means the measurement basis referred to in Article 13 paragraphs (5) to (7) of this Decision;
6) **franchise value** means the net present value of cash flows that can reasonably be expected to result from the maintenance and renewal of assets and liabilities or businesses and includes the impact of any business opportunities, as relevant, including those stemming from the different resolution actions that are assessed by the valuer. Franchise value may be higher or lower than the value arising from the contractual terms and conditions of assets and liabilities existing at the valuation date;
7) **equity value** means an estimated market price, for transferred or issued shares, that results from the application of generally accepted valuation methodologies. Depending on the nature of the assets or business, equity value may comprise franchise value;
8) **measurement basis** means the approach for determining the monetary amounts at which assets or liabilities are presented by the independent valuer;
9) **resolution date** means the date on which the decision to open resolution proceedings is adopted.

General criteria

Article 3

(1) When performing the valuation the independent valuer shall consider circumstances affecting the expected cash flows of, and discount rates applicable to assets and liabilities, and shall aim to fairly represent the financial position of the credit institution, or legal person referred to in Article 3 items 2), 3) and 4) of the Law, in the context of the opportunities and risks it deals with.

(2) The independent valuer shall disclose and justify the key assumptions used in the valuation. Any significant deviation in the valuation from the assumptions used by the management body of the credit institution, or legal person referred to in Article 3 items 2), 3) and 4) of the Law in the preparation of financial statements and in the calculation of the own funds and capital requirements of the credit institution, or legal person referred to in Article 3 items 2), 3) and 4) of the Law shall be supported by the best available information.

(3) The independent valuer shall provide the best point estimate of the value of a given asset, liability, or combinations thereof. Where appropriate, the results of the valuation shall also be provided in the form of value ranges.

(4) Criteria for the measurement of individual assets and liabilities of a credit institution, or legal person referred to in Article 3 items 2), 3) and 4) of the Law, as determined by this Decision shall also apply to the measurement of portfolios or groups of assets or combined assets and liabilities, businesses, or the credit institution, or legal person referred to in Article 3 items 2), 3) and 4) of the Law considered as a whole, as the circumstances require.

(5) The valuation shall subdivide creditors in classes according to their priority ranking during bankruptcy proceedings, and shall include the following estimates:

1) the value of claims of each class according to the applicable bankruptcy law and, where relevant and feasible, according to the contractual rights conferred on claimants;
2) the proceeds each class would receive if bankruptcy proceedings were opened against the credit institution, or legal person referred to in Article 3 items 2), 3) and 4) of the Law;

(6) When calculating the estimates pursuant to paragraph (5) of this Article, the independent valuer may apply the criteria set out in Article 5 of the Decision on the methodology for valuation of assets of a credit institution under resolution following the transfer of part of rights, assets and liabilities or after the implementation of bail-in instrument (OGM 122/20, 124/20).

(7) Where appropriate and feasible, taking into account timing and credibility of the valuation, the Central bank, as the resolution authority, may request several valuations. In that case, it shall establish the criteria to determine how these valuations shall be used for the purposes set out in Articles 44 to 47 of the Law.

Valuation date

Article 4

The valuation date, within the meaning of this Decision, shall be one of the following dates:

1) the reference date as determined by the independent valuer on the basis of the date as close as possible before the expected date of a decision to initiate resolution proceedings of a credit institution or a legal person referred to in Article 3 items 2), 3) and 4) of the Law, or to write-down or to convert capital instruments;
2) the date of the adoption of the decision to initiate resolution proceedings, in case of ex post valuation of assets and liabilities of a credit institution, or a legal person

referred to in Article 3 items 2), 3) and 4) of the Law, pursuant to Article 47 paragraphs (1) to (4) of the Law;

3) the date determined pursuant to Article 9 of the Decision on methodologies and criteria for determining the amount of liabilities arising from derivatives (OGM 116/20), where they are subject to valuation of liabilities arising from derivative contracts.

Sources of information

Article 5

(1) The valuation shall be based on any information pertinent to the valuation date which is deemed relevant by the independent valuer.

(2) In addition to the financial statements of the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law, reports of independent external auditor and regulatory reporting as of a period ending as close as possible to the valuation date, relevant information referred to in paragraph (1) of this Article may include the following:

1) the updated financial statements and regulatory reporting prepared by the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law, as close as possible to the valuation date;
2) an explanation of the key methodologies, assumptions and judgements used by the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law in order to prepare the financial statements and regulatory reporting;
3) data contained in the records of the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law;
4) relevant market data;
5) conclusions drawn by the independent valuer from discussion with management and auditors;
6) where available, supervisory assessments of the financial condition of the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law, including information acquired pursuant to Article 289 paragraph (1) item 7) of the Law on credit institutions (OGM 72/19, 82/20, 08/21);
7) industry-wide assessments of asset quality, where relevant to assets of a credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law, as well as stress test results;
8) valuations of comparable credit institutions, or legal persons referred to in Article 3 items 2), 3) and 4) of the Law, adequately adjusted to capture the specific circumstances of the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law;
9) historical information, adequately adjusted to eliminate factors that are no longer relevant, and to incorporate other factors that did not affect the historical information; or

10) trend analyses, adequately adjusted to reflect specific circumstances of the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law.

Impact of arrangements on intra-group financial support

Article 6

(1) Where the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law forms part of a group, the independent valuer shall take into account the impact that existing contractual intra-group support arrangements can have on the value of the assets and liabilities where, on the basis of the circumstances, it is probable that those arrangements will be put into effect.

(2) The independent valuer shall only take into account the impact of other formal or informal arrangements within the group where, on the basis of the circumstances, it is probable that those arrangements shall remain in place in the context of a group's stressed financial condition or in resolution.

(3) The independent valuer shall determine whether the resources of a credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law within the group are available to meet losses of other group entities.

Valuation report

Article 7

The independent valuer shall prepare a valuation report to the Central Bank, as a resolution authority, which shall include at least the following elements:

1) except in case of provisional valuation referred to in Article 46 paragraphs (1) and (3) of the Law, the information referred to in Article 45 paragraph (5) items 1) to 3) of the Law;
2) except in case of provisional valuation in line with Article 46 paragraphs (1) and (3) of the Law, the information referred to in Article 45 paragraph (7) of the Law;
3) the valuation of the liabilities arising from derivatives carried out in accordance with the Decision on methodologies and criteria for determining the amount of liabilities arising from derivatives (OGM 116/20);
4) a summary of the valuation including an explanation of best point estimate, value ranges and sources of valuation uncertainty;
5) an explanation of the key methodologies and assumptions used by the independent valuer when performing the valuation, how sensitive the valuation is to the choices of methodologies and assumptions and, where feasible, an explanation of how those methodologies and assumptions differ from those used for other relevant valuations including any preliminary resolution valuations;

6) any additional information which in the independent valuer's opinion would assist the Central Bank – and its resolution and supervision functions for purposes of Articles 44 to 47 of the Law.

II. CRITERIA FOR THE VALUATION FOR THE PURPOSE OF ARTICLE 44 PARAGRAPH (3) ITEM 1) OF THE LAW

General principles

Article 8

(1) The valuations for the purpose of application of Article 44 paragraph (3) item 1) of the Law shall be based on fair and realistic assumptions and shall seek to ensure that losses under the appropriate scenario are fully recognised.

(2) Where valuation referred to in paragraph (1) of this Article is available, the Central Bank – its supervisory or resolution function shall receive information used to determine that a credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law is "failing or likely to fail" as referred to in Article 34 paragraph (1) item 1) of the Law.

(3) Based on existing supervisory guidance or other generally recognised sources setting out criteria conducive to the fair and realistic measurement of different types of assets and liabilities, the independent valuer may challenge the assumptions, data, methodologies and judgements on which a credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law based its valuations for financial reporting obligations or for the calculation of own funds and capital requirements and disregard them for the purposes of the valuation.

(4) The independent valuer shall determine the most appropriate valuation methodologies which may rely on internal models of a credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law, where the independent valuer deems it appropriate taking into account the nature of the risk management framework of the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law, and the quality of data and information available.

(5) The valuations shall be consistent with the applicable accounting and prudential regulatory framework.

Areas requiring particular attention in the valuation

Article 9

(1) The independent valuer shall particularly focus on areas subject to significant valuation uncertainty which have a significant impact on the overall valuation.

(2) The independent valuer shall provide the result of valuation referred to in paragraph (1) of this Article in the form of best point estimates and, where appropriate, value ranges, as laid down in Article 3 paragraph (3) of this Decision.

(3) Areas referred to in paragraph (1) shall include:
1) loans or loan portfolios, the expected cash flows of which depend on a counterparty's ability, willingness or incentive to perform on its obligation, where those expectations are driven by assumptions relating to delinquency rates, probabilities of default, loss given default, or instrument characteristics, especially where evidenced by loss patterns for a portfolio of loans;
2) repossessed assets, the cash flows of which are affected by both the asset's fair value at the time of the foreclosure on the related security or lien, and the expected evolution of such value after foreclosure;
3) instruments measured at fair value where the determination of that fair value in accordance with accounting or prudential requirements on their marking to market or marking to model is no longer applicable or valid taking into account the circumstances;
4) goodwill and intangibles, where the impairment test may depend on subjective judgement, including as regards the reasonably attainable cash flow stream, discount rates, and the perimeter of cash generating units;
5) legal disputes and regulatory actions, the expected cash flows of which may be subject to varying degrees of uncertainty relating to their amount and/or timing;
6) items including pension assets and liabilities and deferred tax items.

Factors affecting the valuation

Article 10

(1) The independent valuer shall take into account general factors that may affect the key assumptions on which the values of assets and liabilities in the areas referred to in Article 9 of this Decision are based, including the following factors:
1) the economic and industry circumstances affecting the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law, including relevant market developments;
2) the business model of the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law, and changes in its strategy;
3) the asset selection criteria of the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law, including loan underwriting policies;
4) circumstances and practices that are likely to lead to payment shocks;
5) circumstances affecting the parameters used to determine risk weighted assets for the calculation of minimum capital requirements;
6) the impact of the financial structure of the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law on its capacity to retain assets for the expected holding period and the ability of the credit institution, or a legal

person referred to in Article 3 items 2), 3) and 4) of the Law to generate predictable cash flows;

7) general or specific liquidity or funding concerns with respect to the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law.

(2) The independent valuer shall clearly separate any material unrealised gains identified in the valuation process, to the extent that those gains have not been recognised in the valuation, and shall provide adequate information in the valuation report of the exceptional circumstances that have led to those gains.

III. CRITERIA FOR THE VALUATION FOR THE PURPOSE OF ARTICLE 44 PARAGRAPH (3) ITEMS 2) TO 7 OF THE LAW AND ARTICLE 46 PARAGRAPH (3) OF THE LAW

General principles

Article 11

(1) The independent valuer shall assess the impact on the valuation of each resolution action that the Central Bank may adopt in line with Article 44 paragraph (3) items 2) to 7) of the Law.

(2) Without prejudice to the independent valuer's independence, the Central Bank may consult with the independent valuer in order to identify the range of resolution actions being considered, including actions contained in the resolution plan or, if different, any proposed resolution scheme.

(3) To ensure a fair, prudent and realistic valuation, the independent valuer shall, where appropriate and in consultation with the Central Bank, present separate valuations that reflect the impact of a sufficiently diverse range of resolution actions.

(4) The independent valuer shall ensure that when the resolution tools are applied or when the power to write-down or convert relevant capital instruments is exercised, any losses on the assets of the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law are fully recognised under scenarios that are relevant to the ranges of resolution actions being considered.

(5) Where the values of the valuation diverge significantly from the values presented by the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law in the financial statements, the independent valuer shall use the assumptions of that valuation, to inform the adjustments to the assumptions and to the accounting policies necessary for the preparation of the updated balance sheet and report on financial position referred to in Article 45 paragraph (5) of the Law, in a way consistent with the applicable accounting framework.

(6) As regards losses identified by the independent valuer which cannot be recognised in the updated balance sheet, the independent valuer shall specify the amount, describe the reasons underlying the determination of the losses and the likelihood and time horizon of their occurrence.

(7) Where capital instruments or other liabilities are converted to equity, a valuation shall provide an estimate of the post-conversion equity value of new shares transferred or issued as consideration to holders of converted capital instruments or other creditors. That estimate shall form the basis for the determination of the conversion rate or rates pursuant to Article 101 of the Law.

Selection of the measurement basis

Article 12

(1) In selecting the most appropriate measurement basis or bases, the independent valuer shall take into account the range of resolution actions to be examined according to Article 11 paragraphs (1) and (2) of this Decision.

(2) The independent valuer shall determine the cash flows that the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law can expect on the basis of fair, prudent and realistic assumptions from existing assets and liabilities following adoption of the examined resolution action or actions, discounted at an appropriate rate as determined in accordance with paragraph (7) of this Article.

(3) Cash flows shall be determined at the appropriate level of aggregation, ranging from individual assets and liabilities to portfolios or businesses, with due consideration to differences in the risk profiles.

(4) Where the resolution actions referred to in Article 11 paragraphs (1) and (2) of this Article require that assets and liabilities are to be retained by a credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law that continues to be a going concern institution, the independent valuer shall use the hold value as the appropriate measurement basis. The hold value may, if considered fair, prudent and realistic, anticipate a normalisation of market conditions.

(5) The hold value shall not be used as the measurement basis where assets are transferred to an asset management vehicle pursuant to Article 90 of the Law or to a bridge institution pursuant to Article 79 of the Law, or where a sale of business tool pursuant to Article 73 of the Law is used.

(6) Where the resolution actions referred to in Article 11 paragraphs (1) and (2) of this Decision envisage the sale of assets the expected cash flows shall correspond to the disposal values envisaged for the expected disposal horizon.

(7) The discount rates shall be determined having regard to the timing of cash flows, risk profile, financing costs and market conditions as appropriate to the asset or liability being measured, the disposal strategy considered and the post-resolution financial position of the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law.

Specific factors relating to the estimation and discounting of expected cash flows

Article 13

(1) For the purpose of estimating cash flows, the independent valuer shall apply their expert judgement in determining key characteristics of the assets or liabilities being measured. The independent valuer shall also apply their expert judgement in determining how the continuation, potential renewal or refinancing, run-off or disposal of those assets or liabilities, as envisaged in the examined resolution action, affect those cash flows.

(2) Where the resolution action envisages a credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law holding an asset, maintaining a liability, or continuing a business, the independent valuer may take into account factors potentially affecting future cash flows, including the following:

1) changes in assumptions or expectations, as compared to those prevailing as of the valuation date, consistent with long-term historical trends and a reasonable horizon consistent with the contemplated holding period of assets or for the recovery of the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law; or
2) additional or alternative valuation bases or methodologies that are considered appropriate by the independent valuer and consistent with this Decision, including in the context of assessing the post-conversion equity value of shares.

(3) As regards groups of assets and liabilities or businesses envisaged to be run off, the independent valuer shall take into account workout costs and benefits.

(4) Where the situation of a credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law prevents it from holding an asset or continuing a business, or where the sale is otherwise considered necessary by the Central Bank to achieve the resolution objectives, the expected cash flows shall be referenced to disposal values expected within a given disposal period.

(5) The disposal value shall be determined by the independent valuer on the basis of the cash flows, net of disposal costs and net of the expected value of any guarantees given,

that the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law can reasonably expect in the currently prevailing market conditions through an orderly sale or transfer of assets or liabilities.

(6) Where appropriate, having regard to the actions to be taken under the resolution scheme, the independent valuer may determine the disposal value by applying a reduction for a potential accelerated sale discount to the observable market price of that sale or transfer.

(7) To determine the disposal value of assets which do not have a liquid market, the independent valuer shall consider observable prices on markets where similar assets are traded or model calculations using observable market parameters, with discounts for illiquidity reflected as appropriate.

(8) The independent valuer shall have regard to factors that might affect disposal values and disposal periods, including the following:

1) the disposal values and disposal periods observed in similar transactions, adequately adjusted to take into account differences in the business model and in the financial structure of the parties to those transactions;
2) advantages or disadvantages of a particular transaction that are specific to the parties involved or to a subset of market participants;
3) particular attributes of an asset or business that may only be relevant to a potential purchaser, or to a subset of market participants;
4) the likely impact of expected sales on the franchise value of the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law.

(9) When assessing the value of businesses for purposes of the use of the sale of business or of the bridge credit institution tool, the independent valuer may take into account reasonable expectations for franchise value, and such expectation for franchise value shall include that resulting from a renewal of assets, from a refinancing of an open portfolio, or from a continuation or resumption of business in the context of the resolution actions.

(10) An independent valuer assessing that no realistic prospect for the disposal of an asset or business can reasonably be expected, shall not be required to determine the disposal value, but shall estimate the related cash flows on the basis of the relevant prospects for continuation or run-off, whereat this provision shall not apply to the asset separation tool or to the sale of business tool.

(11) For parts of a group of assets or of a business that are likely to be liquidated under ordinary insolvency procedures, the independent valuer may consider the disposal values and disposal periods observed in auctions involving assets of a similar nature and condition, and when determining the expected cash flows, they shall take into account

illiquidity, the absence of reliable inputs for the determination of disposal values, and the resulting need to rely on valuation methodologies based on unobservable inputs.

Methodology for calculating and including an additional capital for additional losses

Article 14

(1) To address the uncertainty of provisional valuations conducted in accordance with Article 44 paragraph (3) items 2) to 7) of the Law, the independent valuer shall include in the valuation an additional capital to reflect facts and circumstances supporting the existence of additional losses of uncertain amount or timing.

(2) In order to avoid double counting of uncertainty of provisional valuation referred to in paragraph (1) of this Article, the assumptions supporting the calculation of the additional capital shall be adequately explained and justified by the independent valuer.

(3) In order to determine the size of additional capital, the independent valuer shall identify factors that may affect expected cash flows as a result of resolution actions likely to be adopted.

(4) For the purposes of paragraphs (2) and (3) of this Article, the independent valuer may extrapolate losses estimated for a part of assets of the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law, to the remainder of the balance sheet of the credit institution, or a legal person referred to in Article 3 items 2), 3) and 4) of the Law, and where available, average losses estimated for assets of peer competitors may also be extrapolated, subject to the necessary adjustments for differences in the business model and financial structure.

IV. FINAL PROVISION

Entry into force

Article 15

This Decision shall enter into force on the eighth day following that of its publication in the Official Gazette of Montenegro, and it shall apply from the date of application of the Law on Resolution of Credit Institutions (OGM 72/19, 08/21).

THE COUNCIL OF THE CENTRAL BANK OF MONTENEGRO

CHAIRMAN
GOVERNOR,

Decision number: 0101-2837-3/2021
Podgorica, 28 April 2021

Radoje Žugić, m.p.