

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 172 paragraph (10) of the Law on Credit Institutions (OGM 72/19, 8/21, 24/25), the Council of the Central Bank of Montenegro, at its meeting held on 25 July 2025, passed the following

## DECISION

### ON LARGE EXPOSURES OF CREDIT INSTITUTIONS

#### I. BASIC PROVISIONS

##### Subject matter

##### Article 1

This Decision shall govern the method for calculating large exposures of credit institutions, the criteria for identifying connectedness, credit risk mitigation techniques, the criteria for assessing the appropriate period to resolve the breach, the elements of the plan to return to compliance with the prescribed limits to a single person or a group of connected persons or to other credit institutions, and the reporting on large exposures.

##### Meaning of terms

##### Article 2

The terms used in this Decision shall have the following meaning:

- 1) **securities financing transaction** (hereinafter: SFT) means a repurchase transaction, a securities or commodities lending or borrowing transaction, or margin lending transaction;
- 2) **unknown client** means a hypothetical person to which a credit institution assigns all exposures for which it has not identified the debtor, provided that those exposures may not be assigned to the transaction of exactly specified person;
- 3) **credit intermediation activities** mean bank-like activities involving maturity transformation, liquidity transformation, leverage, credit risk transfer and similar activities which include at least those listed in Article 5 items 1) to 3), 5), 6) and 10) of the Law on Credit Institutions (hereinafter: the Law);
- 4) **shadow banking entities** mean entities which carry out banking activities outside a regulated framework;
- 5) **exposure value of an asset item** means the amount identified in accordance with Article 148 paragraph (1) of the Decision on Capital Adequacy of Credit Institution (hereinafter: Decision on Capital Adequacy);
- 6) **exposure value of an off-balance sheet item** means the amount identified in accordance with Article 148 paragraph (2) of the Decision on Capital Adequacy;
- 7) **undertaking for collective investment in transferable securities** (hereinafter: UCITS) means an open-ended investment fund with a public offering:
  - the objective of which is joint investment of capital collected from public into transferable securities or other liquid financial assets referred to in the law governing open-ended investment funds with a public offering, and which operates under the principle of risk diversification;

- the investment units of which are, at holder's request, redeemed or paid, directly or indirectly, out of the funds of the respective fund, and actions taken by the UCITS management company to ensure that the market value of an investment unit does not deviate materially from net value of assets per unit (unit price) shall be equal to the redemption of a unit;
- 8) **collective investment undertaking** (hereinafter: CIU) means an UCITS or an alternative investment fund (AIF) managed by the management company, established in Montenegro, the European Union or a third country, which is subject to regulations applicable in Montenegro, the European Union or a third country that applies prudential regulation equivalent to the regulation in Montenegro or the European Union;
- 9) **transaction** means securitisation position, exposure in the form of investment in CIU and other transactions with the exposure to underlying assets;
- 10) **tri-party agent** means a third party that executes collateral management services, which may include payments and/or delivery of securities, safekeeping and administration services of securities including collateral selection and custodianship for the account of the counterparties to a tri-party transaction;
- 11) **tri-party repurchase transaction** (hereinafter: tri-party transaction) means a repurchase transaction where the cash/collateral is received in deposit and managed by a tri-party agent.
- 12) **tri-party repurchase agreement** (tri-party repo) means a repurchase agreement whereby the counterparties appoint a tri-party agent to act as their agent and facilitate collateral management services during the execution of tri-party transactions.
- 13) **alternative treatment** means the approach whereby a credit institution replaces the total amount of the credit institution's exposures to a collateral issuer due to a tri-party repo facilitated by a tri-party agent with the full amount of the limits that that credit institution has instructed the tri-party agent to apply to the securities issued by the same collateral issuer in accordance with Article 27 paragraph (5) of the Decision.
- 14) **specified limits** mean the limits communicated by a credit institution to a tri-party agent, applicable to the securities issued by the collateral issuer in accordance with Article 27 paragraph (5) item 2) of the Decision.

## II. CALCULATION OF LARGE EXPOSURES

### Calculation of the total exposure value

#### Article 3

- (1) The total exposure to a group of connected persons shall be the sum of exposures to persons belonging to that group of connected persons.
- (2) 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.
- (3) When determining the total exposure to a single person, a credit institution shall include, in addition to the exposures arising from derivative contracts referred to in Article 148 paragraph (8) of the Decision on Capital Adequacy and credit derivative contracts that are directly entered into with the client of the credit institution, the

exposures arising from those derivatives that were not directly entered into with that client but the underlying debt or equity instrument was issued by that client.

(4) In order to determine the total exposure to a single person or a group of connected persons to which the credit institution has exposure through transactions representing securitisation positions and exposures in the form of units or shares in the CIU or through other transactions where there is an exposure to underlying assets, a credit institution shall assess its underlying exposures taking into account the economic substance of the structure of the transaction and the risks inherent in the structure of the transaction itself, in order to determine whether it constitutes an additional exposure.

(5) A credit institution shall assess whether a transaction creates additional exposure as defined in Article 15 of this Decision, while the effect of certain transaction to total exposure to a single person or a group of connected persons shall be determined in accordance with Articles 8 and 9 of this Decision.

(6) In order to determine total exposure to a debtor resulting from its exposure to a certain transaction with underlying assets, a credit institution shall determine its exposure to each individual exposure, whereat the sum of individual exposures resulting from the same underlying assets may not be higher than total exposure of the transaction. The credit institution shall determine for each underlying asset separately its exposure to this underlying asset in accordance with Article 8 of this Decision.

(7) The identification and calculation of the exposure value to a single person or a group of connected persons resulting from exposures to transactions referred to in paragraphs (3) and (4) of this Article shall not be dependent on whether these exposures are assigned to the trading book or the non-trading book, and therefore, the conditions and methodologies to be used for identifying the resulting exposures to underlying assets should be the same, irrespective of whether the exposure to are assigned to the trading book or the non-trading book of the credit institution.

## **Identifying group of connected persons**

### **Article 4**

(1) For the purpose of identifying a group of connected persons referred to in Article 3 paragraph (1) of this Decision, a credit institution shall, by applying the criteria set forth in Annex 1 that makes an integral part of this Decision, determine whether two or more natural or legal persons constitute a single risk in accordance with paragraphs (2) to (7) of this Article.

(2) Two or more natural or legal persons shall constitute a single risk because one of them, directly or indirectly, has control over another person or persons in at least one of the following situations, where:

- 1) in accordance with the law governing the accounting or the International Accounting Standards/International Financial Reporting Standards, one of such persons is required to compose consolidated financial statements that include another person or persons;
- 2) the natural or legal person holds the majority of voting rights in another person or persons;

- 3) the natural or legal person has the right or the ability to appoint or remove the majority of the members of the management, or governance or supervisory body of another person or persons;
- 4) the natural or legal person is in a position to exercise dominant influence over another person or persons pursuant to the law, contract or the provisions in memoranda or articles of association;
- 5) 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) 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 persons;
- 7) 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 when economic dependency exists among those persons 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 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 credit institution;
- 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, the credit institution shall not be required to treat two or more natural or legal persons as a group of connected persons, where it is able to demonstrate that these persons do not constitute a single risk.

(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 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 also constitute a single risk with the persons of the control group.

(7) By way of derogation from paragraphs (5) and (6) of this Article, the credit institution shall not be required to treat two or more natural or legal persons as a group of connected persons, where it is able to demonstrate that these persons do not constitute a single risk.

### **Identifying shadow banking entities**

#### **Article 5**

(1) A credit institution shall identify all individual exposures to shadow banking entities, all potential risks to the credit institution arising from those exposures and the potential impact of those risks.

(2) Exposure to shadow banking entities referred to in paragraph (1) of this Article means the exposure of the credit institution to individual shadow banking entities, after taking into account the effect of credit risk mitigation techniques equal to or in excess of 0.25% of the credit institution's Tier 1 capital;

(3) A credit institution shall identify shadow banking entities applying the criteria set forth in Annex 2 that makes an integral part of this Decision.

### **Items not included in the calculation of exposure**

#### **Article 6**

(1) In order to calculate large exposures, a credit institution shall not take into account the following items:

- 1) in the case of foreign exchange transactions, exposures incurred in the ordinary course of settlement during the two working days following the payment;
- 2) in the case of transactions for the purchase or sale of securities, exposures incurred in the ordinary course of settlement during five working days following the 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 including the execution of payment services, clearing and settlement 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 in accordance with the provisions of the Decision on Capital Adequacy or other deductions of Tier 1 capital for deductible items.

(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 exposures provided that the exposure:

- 1) originates from ensuring specific types of services;
- 2) originates from client's activities or exposure to institutions providing such services, for the transactions referred to in paragraph (1) item 4) of this Article; and
- 3) does not last longer than the following business day from the transactions referred to in paragraph (1) item 3) of this Article, or exposure originating 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:

- 1) payment services, clearing and settlement in any currency and correspondent banking services;
- 2) clearing, settlement and custody services to clients, where custody services include payments based on profit (dividend and interest payments), redemption of principal amounts and other payments arising from existence, change and termination of events connected with the financial instruments.

(4) Activities of a client referred to in paragraph (2) item 2) of this Article mean direct and indirect activities, for example, 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 a credit institution due to technical reasons is unable to reduce those exposures by the end of the business day.

(5) A credit institution shall establish adequate procedures and control mechanism to provide the fulfilment of the requirements referred to in paragraph (2) of this Article, and provide evidence that the excluded exposures fully arise from the activities of the client.

## **Identifying exposures for certain positions**

### **Article 7**

- (1) For exposures in the trading book, a credit institution may:
- 1) offset its long positions and short positions in the same financial instruments issued by a given client, with the net position in each of the different instruments being calculated in accordance with the provisions laid down in the Decision on Capital Adequacy governing the capital requirements for position risk;
  - 2) offset its long positions and short positions in different financial instruments issued by a given client, but only where the financial instrument underlying the short position is junior to the financial instrument underlying the long position or where the underlying instruments are of the same seniority.
- (2) For the purposes of paragraph (1) of this Article, a credit institution may allocate financial instruments into buckets on the basis of different degrees of seniority in order to determine the relative seniority of positions.
- (3) A credit institution shall calculate the exposure values of the derivative contracts listed in Article 148 paragraph (8) of the Decision on Capital Adequacy and of credit derivative contracts directly entered into with a client of the credit institution in accordance with the methods set out in Part Three Title 2 Subtitle 6 Sections 3, 4 and 5 of the Decision on Capital Adequacy, as applicable.
- (4) The large exposure value resulting from the transactions in which debt instruments, equity instruments, foreign currency and commodities are unsettled after their due delivery dates shall be calculated in the manner laid down in Articles 526, 527 and 528 of the Decision on Capital Adequacy.
- (5) A credit institution shall, for the derivative contracts referred to in paragraph (3) of this Article, where those contracts are allocated to the trading book, also comply with the provisions of Article 386 of the Decision on Capital Adequacy governing the calculation of capital requirements for counterparty credit risk for the items from trading book.
- (6) By way of derogation from paragraph (3) of this Article, a credit institution with the authorisation to use the methods referred to in the Decision on Capital Adequacy that refer to the identification of effects of credit risk mitigation techniques and the part that refers to the internal model method (IMM) for the calculation of capital requirements for counterparty credit risk may use those methods for calculating the exposure value for securities financing transactions.

## **Calculating the underlying exposures which themselves have underlying assets**

### **Article 8**

- (1) When assessing the underlying exposures of a transaction which itself has an underlying exposure to another transaction for the purpose of Article 9 of this Decision, a credit institution shall treat the exposure to that another transaction as if it were exposed to underlying assets of that other transaction.

(2) Provision of paragraph (1) of this Article shall be applied as long as the underlying exposures represent exposures to underlying assets of a transaction.

(3) When identifying exposures to an underlying asset of a transaction, a credit institution shall distinguish between the transaction in which all investors are equally treated (such as collective investment undertakings - CIU) and other transactions (such as securitisations), which may involve tranching where exposures rank differently in seniority.

(4) For the transactions that rank *pari passu*, the calculation of exposure to an underlying asset shall exclusively depend on the pro-rata contribution of exposure to a single investor in overall exposures to all investors.

(5) For the transactions that rank differently in seniority, losses are distributed first to a certain tranche depending on their seniority and, in case of more than one investor into this tranche, the losses amongst those investors shall be allocated on a pro-rata basis.

(6) A credit institution, taking into account that in the case of worst-case scenario subordinated tranches may disappear very quickly, shall treat all tranches in a securitisation equally, reductions from subordinated tranches and recognise the maximum loss to be suffered by all investors in a certain tranche in case of a total loss on an underlying asset.

(7) The exposure of a credit institution to an underlying asset of a transaction shall be the lower of the following:

- 1) the exposure value of a credit institution's exposure arising from an underlying asset; and
- 2) the total exposure value of the credit institution's exposures to the underlying asset of the transaction.

(8) For the exposure of a credit institution to a transaction, the exposure value of the resulting exposure to an underlying asset shall be determined as follows:

- 1) where the exposures of all investors in this transaction rank *pari passu*, the exposure value of the resulting exposure to an underlying asset is the pro rata ratio for the credit institution's exposure to the transaction multiplied by the exposure value of the exposure arising from the underlying asset;
- 2) where the exposures do not rank *pari passu*, the exposure value of the resulting exposure to an underlying asset is the pro rata ratio for the credit institution's exposure to the transaction multiplied by the lower of:
  - the exposure value of a credit institution's exposure arising from an underlying asset; and
  - the total exposure value of the credit institution's exposure to the transaction together with all other exposures to this transaction that rank *pari passu* with that credit institution's exposure.

(9) The pro rata ratio for a credit institution's exposure to a transaction referred to in paragraph (8) of this Article shall be the exposure value of the credit institution's exposure divided by the total exposure value of the credit institution's exposure

together with all other exposures to this transaction that rank pari passu with that credit institution's exposure.

### **Determining the impact of underlying exposures on overall exposures to transactions**

#### **Article 9**

(1) For each credit risk exposure for which the debtor is identified, a credit institution shall include the exposure value of its exposure to the relevant underlying asset when calculating the overall exposure to this debtor as a single person or to the group of connected persons to which this debtor belongs.

(2) A credit institution shall identify all debtors of an underlying asset of a transaction in which it invests, unless it would create unjustifiable costs for the credit institution or where other circumstances prevent in practice the credit institution from identifying those debtors.

(3) In the case of paragraph (2) of this Article, a credit institution shall assess the materiality of the total value of the exposures to the transaction and depending on such materiality, assign the exposures to the transaction to a separate or unknown client.

(4) If a credit institution has not identified the debtor of an underlying credit risk exposure, or where a credit institution is unable to confirm that an underlying exposure is not a credit risk exposure, the credit institution shall assign this exposure as follows:

- 1) where the exposure value does not exceed 0.25% of the credit institution's Tier 1 capital, it shall assign this exposure to the transaction as a separate client;
- 2) where the exposure value is equal to or exceeds 0.25% of the credit institution's Tier 1 capital and the credit institution can ensure, by means of the transaction's characteristics i.e., based on the investment policy (mandate), that the underlying exposures of the transaction are not connected with any other exposures in its portfolio, including underlying exposures from other transactions, it shall assign this exposure to the transaction as a separate client;
- 3) in cases not covered in items 1) and 2) of this paragraph, it shall assign this exposure to the unknown client.

(5) If a credit institution is not able to distinguish the underlying exposures of a transaction, the credit institution shall assign the total exposure value of its exposures to the transaction as follows:

- 1) where this total exposure value does not exceed 0.25% of the credit institution's Tier 1 capital, it shall assign this total exposure value to the transaction as a separate client;
- 2) in cases not covered in item 1) of this paragraph, exposures shall be assigned to the unknown client.

(6) For the purpose of paragraphs (1) and (4) of this Article, the credit institution shall regularly, and at least on a monthly basis, monitor such transactions for possible changes in the composition and the relative share of the underlying exposures.

## **General rules for the calculation of the indirect exposure value to a client arising from derivative contracts**

### **Article 10**

(1) A credit institution shall, in accordance with the provisions of Articles 11 to 13 of this Decision, calculate the indirect exposure value to a client arising from derivative contracts referred to in Article 148 paragraph (8) of the Decision on Capital Adequacy and credit derivative contracts, where the derivative contracts were not directly entered into with that client, but the underlying debt or equity instrument was issued by that client.

(2) By way of derogation from paragraph (1) of this Article, where the underlying instruments are included in a debt, equity or credit default swap index or a collective investment undertaking, or where the derivative contracts have multiple underlying reference names, a credit institution shall calculate the indirect exposure values to a client arising from the derivative contracts referred to in paragraph (1) of this Article and the contribution of that exposure to the exposure to a client in accordance with the methodology set out in Article 14 of this Decision.

(3) A credit institution shall allocate the indirect exposures referred to in paragraph (1) of this Article to one of the following categories of derivative contracts:

- 1) options on debt and equity instruments;
- 2) credit derivative contracts;
- 3) other derivative contracts referred to in Article 148 paragraph (8) of the Decision on capital adequacy having as underlying asset a debt or equity instrument and which are not included in the categories referred to in items 1) and 2) of this paragraph.

(4) Where the derivative contracts and credit derivative contracts referred to in paragraph (1) are allocated to the trading book after the calculation of indirect exposure value to a client based on those contracts, a credit institution shall include those exposure values in the exposures to that client in the trading book; after aggregation, negative net exposure to a client shall be set at zero.

(5) By way of derogation from paragraphs (1) and (2) of this Decision, where derivative contracts and credit derivative contracts referred to in paragraph (1) of this Article are allocated to the non-trading book, and, after the calculation of the indirect exposure value to a client based on those contracts, the indirect exposures have negative value, a credit institution shall assign those exposure zero before including them into the exposures to that client.

### **Calculation of the indirect exposure value for options on debt and equity instruments**

#### **Article 11**

(1) A credit institution shall, in accordance with paragraphs (2), (3) and (4) of this Article, calculate the indirect exposure value for options referred to in Article 10 paragraph (3) item 1) of this Decision as the sum of the current market value of the option and the amount owed to the counterparty of the option as a result of a potential

default of the issuer of the underlying instrument reduced by the amount owed to the credit institution by that counterparty.

(2) For call options, the indirect exposure value shall be equal to the value of the market value of the option, whereat for a long position in a call option, the indirect exposure value shall be positive while for a short position in a call option, the indirect exposure value shall be negative.

(3) For put options, the indirect exposure value shall be the value of the difference between the market value of the option and its strike price, whereat for a short position in a put option, the indirect exposure value shall be positive while for a long position in a put option, the indirect exposure value shall be negative.

(4) By way of derogation from paragraph (3) of this Article, for put options not having a strike price available at transaction date but available at a later stage, a credit institution shall use the expected modelled strike price used for the calculation of the fair value of the option.

(5) Where the market value of the option is not available on a given date, a credit institution shall take the fair value of the option on that date, and where the fair value of an option is also not available on a given date, a credit institution shall take the most recent of the market value or the fair value, and if neither of those values is available at any date, a credit institution shall take the value at which the option is measured in accordance with the accounting framework.

### **Calculation of the indirect exposure value for credit derivative contracts**

#### **Article 12**

(1) The indirect exposure value to a client arising from a credit derivative contract referred to in Article 10 paragraph (3) item 2) of this Decision shall be calculated as the sum of the current market value of that contract and the amount owed to the counterparty of the credit derivative contract as a result of a potential default of the issuer of the underlying instrument reduced by the amount owed to the credit institution by that counterparty.

(2) Where the market value of the credit derivative is not available on a given date, a credit institution shall take the fair value of the credit derivative on that date, and where the fair value of the credit derivative is also not available on a given date, the credit institution shall take the most recent of the market value or the fair value, and if neither of those values are available at any date, credit institution shall take the value at which the credit derivative contract is measured in accordance with the applicable accounting framework.

### **Calculation of the indirect exposure value for other derivative contracts**

#### **Article 13**

(1) In calculating the indirect exposure value to a client arising from other derivative contracts referred to in Article 10 paragraph (3) item 3) of this Decision, including swaps, futures or forwards, a credit institution shall decompose their multiple transaction legs into individual transaction legs.

(2) For the transaction legs referred to in paragraph (1) of this Article entailing default risk, credit institution shall calculate their indirect exposure value as if they were positions in those legs.

(3) Where a credit institution cannot apply the treatment provided for in paragraphs (1) and (2) of this Article, it shall determine the indirect exposure value toward the issuer of the underlying instruments as the maximum loss that the credit institution would incur from a potential default of the issuer of the underlying instruments to which the derivative contract refers.

### **Calculation of the indirect exposure values arising from derivative contracts with multiple underlying reference names**

#### **Article 14**

(1) In determining the indirect exposure value to a client arising from derivative contracts written on debt, equity or credit default swap indices or CIUs, a credit institution shall look through to all the individual underlying instruments of the index or CIU and calculate their indirect exposure value as the variation in the price of the derivative contract in case of default of any of the underlying reference names included in the index or CIU, and assign each indirect exposure value to an identified client, a separate client or the unknown client, in accordance with Article 9 paragraphs (1) and (4) of this Decision.

(2) Where the credit institution is not able to look through to all the individual underlying instruments of the derivative contract in accordance with paragraph (1) of this Article or where it would be unduly burdensome for the credit institution to do so, the credit institution shall:

- 1) look through to those individual underlying instruments where it is able to do so or where it would be unduly burdensome for credit institution to do so and calculate the indirect exposure value in accordance with paragraph (1) of this Article;
- 2) for those underlying instruments where a credit institution is not able to look through or where it would be duly burdensome for credit institution to do so, calculate the indirect exposure value by looking at the variation of price of the derivative in case of default of all underlying reference names.

(3) The indirect exposure value referred to in paragraph (2) item 2) of this Article shall be assigned either to the derivative transaction to a separate client or unknown client, as laid down in Article 9 paragraph (5) of this Decision.

(4) By way of derogation from paragraphs (1) and (2) of this Article, where the indirect exposure values are assigned to an unknown client in accordance with Article 9 paragraphs (4) and (5) of this Decision and where the indirect exposure values are negative, a credit institution shall set to zero the indirect exposure value before includes it in the exposure to unknown client.

## **Additional exposure constituted by the structure of a transaction**

### **Article 15**

(1) Where the transaction ensures that exposure losses of that transaction may arise only from the default of underlying assets, the structure of a transaction may not create additional exposure.

(2) A credit institution shall have additional exposure if the transaction includes payment obligation for a separate client as an addition to cash flows arising from underlying assets or as a prepayment for these cash flows so that the credit institution which is an investor could suffer additional losses arising from default of that separate client, although default of an underlying asset has not occurred yet.

(3) The structure of a transaction does not constitute an additional exposure if the transaction meets the following conditions:

- 1) the legal and operational structure of the transaction is designed to prevent the manager of the transaction or a third party from redirecting any cash flows which result from the transaction to persons who are not otherwise entitled under the terms of the transaction to receive these cash flows;
- 2) neither the issuer nor any other person can be required, under the transaction, to make a payment to the credit institution in addition to, or as an advance payment of, the cash flows from the underlying assets.

(4) The condition referred to in paragraph (3) item 1) of this Article shall be considered to be met where the transaction referred to in Article 2 item 9) of this Decision is one of the following:

- 1) UCITS with head office in Montenegro or EU Member State; or
- 2) a business undertaking with head office in a third country, that carries out activities similar to those carried out by a UCITS and which is subject to supervision pursuant to regulations of a third country which applies supervisory and regulatory requirements which are at least equivalent to those applied in Montenegro and the EU Member States to UCITS.

## **III MANAGING LARGE EXPOSURES**

### **Capacity to identify and manage large exposures**

#### **Article 16**

(1) A credit institution shall have, in accordance with the Law, sound administrative and accounting procedures and adequate internal control mechanisms in place 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.

(2) A credit institution shall set out an internal framework for the purpose of identifying, managing, controlling and mitigating the risks arising from exposures to shadow banking entities, which includes the following:

- 1) analysis regarding the business of a shadow banking entity to which the credit institution is exposed, as well as the potential risks to the credit institution and the likelihood of contagion stemming from these risks to the credit institution;

- 2) taking into account risks arising from the exposures to shadow banking entities within the credit institution's Internal Capital Adequacy Assessment (ICAAP) and capital planning;
- 3) the establishment of risk tolerance or risk appetite for exposure to shadow banking entities;
- 4) adequate processes for determining interconnectedness between shadow banking entities, and between shadow banking entities and the credit institution, including credit risk mitigation techniques that may arise in case where interconnectedness cannot be determined;
- 5) reporting procedures to the management body of the credit institution regarding the exposures to shadow banking entities;
- 6) action plans in the event of a breach of exposure limits set by the credit institution.

### **Limits to large exposures**

#### **Article 17**

(1) The largest exposure value of a credit institution to a single person or a group of connected persons after taking into account the effect of the credit risk mitigation techniques referred to in Articles 25 to 27 of this Decision, in accordance with the Law, shall not exceed 25% of its Tier 1 capital.

(2) By way of derogation from paragraph (1) of this Article where a person to which a credit institution has an exposure is another credit institution, or where a group of connected persons includes one or more credit institutions, such exposure shall not exceed 25% of Tier 1 capital of the credit institution or the amount of EUR 2,500,000, whichever is higher, provided that the sum of exposure values, after taking into account the effect of the credit risk mitigation techniques referred to in Articles 25 to 27 of this Decision to all connected persons that are not credit institutions does not exceed 25% of Tier 1 capital of the credit institution.

(3) Another credit institution, within the meaning of paragraph (2) of this Article, shall be a credit institution from Montenegro, an EU Member State, and a private or state-owned business undertaking, including subsidiary undertakings of that undertaking authorised by a third country that applies prudential supervisory and regulatory requirements equivalent to those applied in Montenegro and EU Member States, and which would correspond to the definition of a credit institution referred to in the Law or EU regulation if it had head office in Montenegro or an EU Member State.

(4) Where the prescribed limit of EUR 2,500,000 is higher than 25% of Tier 1 capital of the credit institution, the value of the exposure, after having taken into account the effect of credit risk mitigation techniques in accordance with Articles 25 to 27 of this Decision, shall not exceed a reasonable limit in terms of that credit institution's Tier 1 capital, which limit shall be determined by the credit institution in accordance with its policies and procedures in order to address and control concentration risk.

## Setting exposure limits to shadow banking entities

### Article 18

(1) A credit institution shall set an aggregate exposure limit to shadow banking entities relative to its Tier 1 capital applying principal approach referred to in paragraphs (2), (3) and (4) of this Article, and if this is not possible, applying fallback approach referred to in paragraph (5) of this Article.

(2) When setting a limit referred to in paragraph (1) of this Article, a credit institution shall take into account:

- 1) the business model, risk management framework and risk appetite;
- 2) the size of its current exposures to shadow banking entities relative to its total exposures and relative to its total exposure to regulated financial sector entities;
- 3) interconnectedness between shadow banking entities and between the credit institution and shadow banking entities.

(3) A credit institution shall set tighter limits than those specified in accordance with paragraph (1) of this Article on individual exposures to shadow banking entities.

(4) When setting limits referred to in paragraph (3) of this Article, a credit institution shall take into account in particular:

- 1) a status of the shadow banking entity, in particular whether it is subject to any type of prudential requirements;
- 2) the financial situation of the shadow banking entity including but not limited to, its capital position, leverage and liquidity position;
- 3) information available about the portfolio of the shadow banking entity, in particular non-performing loans;
- 4) evidence about the adequacy of the credit analysis performed by the shadow banking entity, if applicable;
- 5) whether the shadow banking entity will be vulnerable to asset price or credit quality volatility;
- 6) concentration of credit intermediation activities relative to other business activities of the shadow banking entity;
- 7) interconnectedness between shadow banking entities and between the credit institution and shadow banking entities.
- 8) any other relevant factors identified by the credit institution.

(5) If a credit institution is not able to apply the principal approach for setting limits to its exposures to shadow banking entities in accordance with paragraphs (2) to (4) of this Article, it shall apply to its exposures to shadow banking entities exposure limit referred to in Article 17 paragraph (1) of this Article by applying the fallback approach as follows:

- 1) if a credit institution cannot meet the requirements regarding effective processes and control mechanisms or oversight by its management body, the sum of all its exposures to shadow banking entities shall not exceed 25% of Tier 1 capital of the credit institution;
- 2) if a credit institution can meet the requirements regarding effective processes and control mechanisms or oversight by their management body, but cannot gather sufficient information to set out appropriate limits, the sum of the exposures to shadow banking entities for which the credit institution is not able

to gather sufficient information shall be equal to the sum referred to in item 1) of this paragraph, and exposure limits as set out paragraphs (2) to (4) of this Article shall be applied to the remaining exposures to shadow banking entities.

### **Exposures in trading book**

#### **Article 19**

(1) A credit institution may exclude exposures in trading book from the calculation of the exposures to a single person or a group of connected persons, provided that the following conditions are met:

- 1) the exposure in the non-trading book to a single person or group of connected persons in question does not exceed the limit laid down in Article 17 of this Decision;
- 2) where 10 days or less have elapsed, the trading-book exposure to the person or group of connected persons in question does not exceed 500% of the credit institution's Tier 1 capital;
- 3) any excesses that have persisted for more than 10 days do not, in aggregate, exceed 600% of the credit institution's Tier 1 capital; and
- 4) for exposures referred to in items 2) and 3) of this Article, the credit institution meets an additional own funds requirement which is calculated in accordance with the provision of Articles 494 and 495 of the Decision on Capital Adequacy.

(4) A credit institution shall notify the Central Bank without delay on all exposures in the trading book which, in accordance with paragraph (1) of this Article, are excluded from the calculation of large exposures.

### **Compliance with the large exposure requirements**

#### **Article 20**

(1) A credit institution which exceeds the exposure limit referred to in Article 17 of this Decision, shall, when reporting to the Central Bank of the breach, in accordance with the Law, without delay, provide, in particular, the following information:

- 1) the amount of the breach in relation to Tier 1 capital;
- 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 (even if not eligible for credit risk mitigation), if any;
- 5) a detailed explanation of the reasons for the breach;
- 6) remedial actions already implemented or planned by the credit institution to remove the breach; and
- 7) expected time needed to return to compliance with the large exposure limits.

(2) The Central Bank may require the credit institution to provide further information and explanations if it is not satisfied that the information referred to in paragraph (1) of this Article is sufficiently detailed to allow for a comprehensive assessment of the specific circumstances of the breach.

(3) For the purposes of its assessment of the period during which the credit institution should resolve the breach, the Central Bank shall at least consider the following elements:

- 1) the credit institution's record of breaches, and whether breaches are repeated and how often;
- 2) the credit institution's promptness of notifying about the breach;
- 3) the reason(s) for the breach, in particular those that led to the impossibility of preventing the occurrence of the breach that the credit institution could not influence;
- 4) the systemic nature, complexity and magnitude of the breach;
- 5) the possible impact on the overall financial situation of the credit institution, in particular whether the credit institution comply with regulatory capital requirements;
- 6) the overall risk concentration in the banking book of the institution across different counterparties;
- 7) the type of client or group of connected persons and its creditworthiness, and the effects of their possible default on the compliance with regulatory capital requirements;
- 8) the measures already implemented to resolve the breach.

### **Reasons for the breach of large exposure limits**

#### **Article 21**

(1) For the purposes of Article 20 paragraph (3) item 1) of this Decision, the Central Bank shall assess whether the breach of the limits referred to in Article 17 of this Decision is a rare event taking into account any previous breaches of the credit institution due to the same cause, triggered by the same event or concerning the same client or group of connected persons.

(2) If a credit institution notifies the Central Bank of a second breach during the last 12 months that concerns the same client or group of connected persons or stems from the same origin as the first breach, that event shall not be deemed a rare one within the meaning of paragraph (1) of this Article, and if, during the last 12 months, a credit institution has already notified the Central Bank of two breaches of the large exposure limits referred to in Article 17 of this Decision that concern different persons or different groups of connected persons, and are due to different causes or have been triggered by different events, any further breach or breaches, though unrelated, shall not be deemed a rare event.

(3) The reasons referred to in Article 20 paragraph (3) item 3) of this Decision shall be, in particular, the following:

- 1) an unexpected and substantial decrease of own funds of the credit institution, including due to the impact of major operational risk events, such as external fraud, natural disaster or pandemic, that are not linked to an inadequate implementation of the credit institution's internal control mechanisms;
- 2) where an exposure to which the large exposure limits referred to in Article 23 of this Decision do not apply, or an exposure to which limits to large exposures to reduced value referred to in Article 24 of this Decision are applied, fully or partially ceases to be eligible for such an exemption due to a decision of a third party that could not have been anticipated or prevented by the credit institution;

- 3) the merger of counterparties or clients (by establishing a new legal person or by acquisitions between counterparties), but only in cases when the credit institution did not have knowledge of or could not have anticipated this merger to prevent a breach.

(4) For the purposes of Article 20 paragraph (3) item 3) of this Decision, the Central Bank shall assess whether the credit institution could have foreseen the breach event, whether it had applied proper and effective risk management measures in accordance with the regulation governing the minimum standards for risk management in credit institutions and the regulation governing the governance arrangements in credit institutions, or whether the credit institution could have been in a position to anticipate the breach using available information.

(5) Where the Central Bank finds that in multiple credit institutions identical or similar breaches have occurred that could be attributed to the same cause, it shall be deemed that the breach was caused by an unforeseeable event.

### **Plan to return to compliance with large exposure limits**

#### **Article 22**

(1) The compliance plan referred to in Article 172 paragraph (8) of the Law should at least encompass the following:

- 1) arrangements to reduce the concerned exposure(s);
- 2) measures to increase the credit institution's own funds, where necessary;
- 3) arrangements to reinforce internal risk management and control processes;
- 4) any necessary amendments to the policy to ensure credit institution's compliance;
- 5) appropriate procedures to ensure the timely implementation of the measures; and
- 6) a detailed timetable to implement the measures, including the intended date of returning to compliance.

(2) The measures proposed by a credit institution should include a description of any foreseeable risks or obstacles to the effective and timely execution of the compliance plan.

(3) The credit institution should inform the Central Bank immediately in case some of the measures foreseen cannot be achieved as planned.

(4) The management bodies of the credit institution shall, pursuant to their powers, oversee and monitor the implementation of the measures to ascertain the return to compliance with limits referred to in Article 17 of this Decision.

### **Exemptions**

#### **Article 23**

(1) The following exposures shall be exempted from the application of the provisions of Article 17 of this Decision:

- 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 Decision on Capital Adequacy governing the calculation of capital requirements for credit risk applying Standardised Approach;
- 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 Decision on Capital Adequacy governing the calculation of capital requirements for credit risk applying Standardised Approach;
  - 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 Decision on Capital Adequacy governing the calculation of capital requirements for credit risk applying Standardised Approach;
  - 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 Decision on Capital Adequacy governing the calculation of capital requirements for credit risk applying Standardised Approach;
  - 5) asset items constituting claims on local self-government units in Montenegro and units of regional governments or local self-government units of EU Member States and other exposures to or guaranteed by those regional governments or local self-government units of Montenegro and EU Member States, where those claims would be assigned a 0% risk weight under the provisions of the Decision on Capital Adequacy governing the calculation of capital requirements for credit risk applying Standardised Approach;
  - 6) exposures to counterparties referred to in Article 150 of the Decision on Capital Adequacy if they would be assigned a 0% risk weight under the provisions of that Decision governing the calculation of capital requirements for credit risk applying Standardised Approach, whereat the exposures that do not meet those criteria shall be treated as exposures to third parties;
  - 7) asset items and other exposures secured by collateral in the form of cash deposits placed with the lending credit institution or with a credit institution which is the parent undertaking or a subsidiary of the lending credit institution;
  - 8) asset items and other exposures secured by collateral in the form of certificates of deposit issued by the lending credit institution or by a credit institution which is the parent undertaking or a subsidiary undertaking of the lending credit institution and lodged with either of them;
  - 9) exposures arising from undrawn credit facilities that are classified as low-risk off-balance sheet items in accordance with Article 148 paragraph (3) of the Decision on Capital Adequacy and provided that an agreement has been concluded with the person or group of connected persons under which the facility may be drawn only if it has been ascertained that it will not cause the limit applicable under Article 17 of this Decision to be exceeded;
  - 10) clearing members' trade exposures and default fund contributions to qualified central counterparties (QCCP);
  - 11) exposures to deposit guarantee schemes arising from the funding of those schemes, if the member credit institution of the scheme has a legal or contractual obligation to fund the scheme;

- 12) clients' trade exposures referred to in Article 392 paragraph (2) or (4) of the Decision on Capital Adequacy;
- 13) interests of resolution entities or their subsidiary undertakings that are not resolution entities in own funds instruments and eligible liabilities issued by any of the following entities:
  - with regard to the resolution entities, other entities belonging to the same resolution group;
  - with regard to the subsidiary undertakings of resolution entities that are not resolution entities, subsidiary undertakings of the corresponding subsidiary undertaking belonging to the same resolution group;
- 14) exposures arising from the minimum value commitment meeting all requirements for the calculation of risk weighted off-balance sheet exposure arising from the CIU as listed in Article 175 paragraph (5) of the Decision on Capital Adequacy.

(2) Cash received under a credit linked note issued by the credit institution and loans and deposits of a counterparty to or with the credit institution which are subject to an on-balance sheet netting agreement recognised under the provisions of the Decision on Capital Adequacy governing the credit risk mitigation techniques shall be deemed to fall under paragraph (1) item 7) of this Article.

### **Exposures to which limits to large exposures to reduced value are applied**

#### **Article 24**

(1) A credit institution may, for the purposes of determining large exposures, reduce by 80% exposure value, including participations or other kinds of holdings, to its parent undertaking including ultimate parent undertaking, to other subsidiary undertakings of that parent undertaking, or to its own subsidiary undertakings, and qualifying holdings, insofar as those undertakings are covered by the supervision on a consolidated basis to which the credit institution itself is subject, in accordance with the law governing the operations of credit institutions, EU regulations or with equivalent standards in force in a third country.

(2) The provision of paragraph (1) of this Article shall be applied if the following conditions are met:

- 1) the nature of the exposure to the counterparty or the relationship between the credit institution and the counterparty is such that eliminates or reduces the risk of the exposure;
- 2) the concentration risk can be addressed by policies and procedures provided for in Article 108 paragraph (2) of the Law.

(3) Exposures to entities to which the conditions referred to in paragraphs (1) and (2) apply, regardless of whether they have been exempted from the application of Article 17 of this Decision shall be treated as exposures to a third party if those conditions have not been met.

(4) The simultaneous application of more than one exemption set out in Article 23 of this Decision and paragraph (1) of this Article to the same exposure shall not be permitted.

## **IV MITIGATION OF EXPOSURES APPLYING CREDIT RISK MITIGATION TECHNIQUES**

### **Credit risk mitigation techniques**

#### **Article 25**

(1) A credit institution 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 provisions of the Decision on Capital Adequacy, provided that the credit risk mitigation technique meets the conditions set out in paragraphs (2) to (5) of this Article.

(2) For the purposes of Articles 23, 24, 26, and 27 of this Decision, guarantees and other sureties shall be credit derivatives recognised in accordance with the provisions of the Decision on Capital Adequacy as credit risk mitigation instruments other than credit linked notes.

(3) Where a credit institution, in accordance with paragraph (4) of this Article, uses funded or unfunded credit protection, this protection shall be subject to compliance with the eligibility requirements and other requirements set out in the Decision on Capital Adequacy governing the credit risk mitigation techniques.

(4) Credit risk mitigation techniques which are available only to credit institutions using the Internal Risk Based Approach (IRB Approach) may not be used to reduce exposure values for the purposes of calculating large exposures.

(5) A credit institution shall analyse, to the extent possible, its exposures to collateral issuers, providers of unfunded credit protection and underlying assets pursuant to Article 3 paragraph (5) of this Decision for possible concentrations and where appropriate take action and report findings to the Central Bank.

### **Calculating the effect of the use of credit risk mitigation techniques**

#### **Article 26**

(1) When calculating the exposure value referred to in Article 17 of this Decision, a credit institution may use the fully adjusted exposure value as calculated in accordance with the provisions of the Decision on Capital Adequacy taking into account the credit risk mitigation techniques, volatility adjustments, and any maturity mismatch (E\*).

(2) With the exception of credit institution using the Financial Collateral Simple Method, for the purposes of the calculation of the exposure value referred to in paragraph (1) of this Article, a credit institution shall use the Financial Collateral Comprehensive Method, regardless of the method used for calculating the capital requirements for credit risk.

(3) By way of derogation from paragraph (1) of this Article, a credit institution which applies methods in accordance with the Decision on Capital Adequacy in the part governing the calculation of credit risk mitigation techniques and in the part governing the internal model method (IMM) for the calculation of capital requirements for

counterparty credit risk, may use those methods for calculating the exposure value of securities financing transactions.

(4) In calculating the exposure value referred to in Article 17 of this Decision, a credit institution 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.

(5) The periodic stress tests referred to in paragraph (4) of this Article shall address risks arising from potential changes in market conditions that could adversely impact the credit institution's adequacy of own funds and risks arising from the realisation of collateral in certain stressed events.

(6) A credit institution shall include the following in their internal acts to address concentration risk:

- 1) policies and procedures to address 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.

(7) Where a credit institution reduces an exposure to a client using a credit risk mitigation technique in accordance with Article 25 paragraph (1) of this Decision, it shall treat the part of the exposure by which the exposure to the client has been reduced as having been incurred for the protection provider rather than for the client.

## **Substitution approach**

### **Article 27**

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

- 1) treat the portion of the exposure which is secured by a guarantee or other surety of a third party as exposure to the protection provider rather than to the client, provided that, in accordance with the Decision on Capital Adequacy governing the calculation of capital requirements for credit risk by applying Standardised Approach, 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 by the market value of recognised collateral as exposure to the collateral giver rather than to the client, provided that in accordance with the provisions of the Decision on Capital Adequacy governing the calculation of capital requirement for credit risk by applying Standardised Approach, 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) A credit institution shall not apply the provision of paragraph (1) item 2) of this Article where, in accordance with Article 275 of the Decision on Capital Adequacy, there is a mismatch between the maturity of the exposure and the maturity of the protection.

(3) For the purposes of calculating the exposure, a credit institution may use both the Financial Collateral Comprehensive Method and the substitution method referred to in paragraph (1) item 2) of this Article only where it may use both the Financial Collateral Comprehensive Method and the Financial Collateral Simple Method for the purposes of Article 114 of the Decision on Capital Adequacy.

(4) Where a credit institution applies the provision of paragraph (1) item 1) of this Article, the credit institution:

- 1) where the guarantee or other surety is denominated in a currency different from that in which the exposure is denominated, shall calculate the amount of the exposure that is deemed to be covered in accordance with Decision on Capital Adequacy governing 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 Decision on Capital Adequacy governing the treatment of maturity mismatch set;
- 3) may recognise partial coverage in accordance with the treatment set out in the Decision on Capital Adequacy on the credit risk mitigation techniques.

(5) For the purposes of paragraph (1) item 2) of this Article, a credit institution may, using the alternative treatment, replace the amount referred to in item 1) of this paragraph with the amount referred to in item 2) of this paragraph, provided that the conditions set out in items 3), 4) and 5) of this paragraph are met:

- 1) the total amount of the credit institution's exposure to a collateral issuer due to tri-party repurchase agreements facilitated by a tri-party agent;
- 2) the full amount of the limits that the credit institution has instructed the tri-party agent referred to in item 1) of this paragraph to apply to the securities issued by the collateral issuer referred to in that item;
- 3) the credit institution has verified that the tri-party agent has in place appropriate safeguards to prevent breaches of the limits referred to in item 2) of this paragraph;
- 4) the sum of the amount of the limit referred to in item 2) of this paragraph and any other exposures of the credit institution to the collateral issuer does not exceed the limit set out in Article 17 of this Decision;
- 5) the Central Bank assesses this treatment eligible in the supervision process of the credit institution.

(6) A credit institution that decides to use alternative treatment referred to in paragraph (5) of this Article regarding tri-party repos in which tri-party agent participates, shall apply the conditions referred to in Annex 3 that makes an integral part of this Decision.

## **V FINAL PROVISIONS**

### **Repealed regulations**

#### **Article 28**

As from the date of commencement of application of this Decision, the Decision on Large Exposures of Credit Institutions (OGM 127/20, 140/21) shall be repealed.

### **Entry into force**

#### **Article 29**

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 1 January 2026.

## **THE COUNCIL OF THE CENTRAL BANK OF MONTENEGRO**

**CHAIRPERSON  
GOVERNOR**

**Irena Radović, m.p.**

Decision number: 0101-5891-16/2025  
Podgorica, 25 July 2025

## 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 10 paragraphs (1) and (2) of the Law, the criteria referred to in this Annex shall apply.

#### I Groups of connected persons based on control

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1. Where a credit institution is able to demonstrate that no single risk exists within the meaning of Article 10 paragraph (1) item 1) of the Law, despite the existence of a control relationship among 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. A credit institution should apply the concept of control referred to in Article 10 of the Law as follows:

- in relation to persons that prepare their consolidated financial statements in conformity with the International Accounting Standards/International Financial Reporting Standards, a credit institution shall treat the control relationship between a parent undertaking and its subsidiary undertakings within the meaning of those accounting standards and group clients accordingly on the basis of their clients' consolidated financial statements;
- in relation to persons to which indent 1) of this paragraph do not apply (e.g., natural persons, central governments, and clients of the credit institution that prepare consolidated financial statements in accordance with the accounting rules of a third country), the credit institution 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.

When conducting this assessment, a credit institution shall deem any of the following criteria to constitute a control relationship:

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

Other possible indicators of control that credit institution 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 natural persons are involved in the management or supervisory board of two or more entities);
- holding more than 50% of the shares of capital of another entity.

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

**4.** A credit institution shall group two or more persons 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 Articles 14 and 15 of this Decision.

## **II. Alternative approach for exposures to central government**

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**1.** In line with the provisions of Article 10 paragraph (2) of the Law, credit institutions 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 (alternative approach).

A credit institution 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 CG 1 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 CG 2 of this Annex);
- each group of connected persons under indent 1 of this paragraph includes also persons controlled by or interconnected with the person who is directly controlled by or directly interconnected with the central government (see scenario CG 3 of this Annex).

**2.** 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 CG 4 of this Annex).

**3.** Provisions of this Chapter shall also apply to local self-government units to which Article 132 paragraph (3) of the Decision on Capital Adequacy applies, and natural or legal persons directly controlled by or interconnected with these local self-government units.

### **III Establishing interconnectedness based on economic dependency**

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1. Interconnectedness among credit institution's persons based on economic dependency, in accordance with Article 10 paragraph (1) item 2) of the Law shall 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 E 1, E 2, E 3 and E 4 of this Annex).

2. Where a credit institution 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 considered 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. A credit institution 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 will experience financial problems if a claim against the entity occurs;
- where a significant part of a person's annual gross receipts or gross expenditures 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 person of the credit institution, and the production/output cannot easily find another client (customer).
- 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 credit institution (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 an undertaking is related to one or more other undertakings because they all have the same shareholder structure without a single controlling shareholder or because they are managed on a unified basis. This management may be pursuant to a contract concluded between the undertakings, or to provisions in the memoranda or articles of association of those undertakings, or if the administrative management or supervisory bodies of the undertaking and of one or more other undertakings consist for the major part of the same persons.

4. A credit institution shall also consider the non-exhaustive list of situations in item 3 of this Chapter when assessing connections among shadow banking entities, in

accordance with this Decision. The credit institution shall give due consideration that relationships between shadow banking entities will most likely consist not of equity ties but rather of a different type of relationship (e.g., sponsorship and the like).

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

6. A credit institution shall form a group of connected persons where two or more of their clients are economically dependent on an entity, even if this entity is not a person of the credit institution.

7. A credit institution 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 fully or partially exempted from the application of the large exposures limit under Articles 14 and 15 of this Decision.

8. A credit institution should consider situations where the funding problems of one person are likely to spread to another on account of a one-way or two-way 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.

9. A credit institution should consider cases where the common source of funding depended on is provided by the credit institution itself, its financial group or its connected persons (see scenarios E5 and E6 of this Annex). Being persons of the same credit institution does not in itself create a requirement to group the persons if the credit institution providing funding can be easily replaced.

10. A credit institution should also assess any contagion or idiosyncratic risk that could emerge from the following situations:

- use of one funding entity (e.g., the same institution or conduit that cannot be easily replaced);
- 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 between the maturity of underlying assets and the frequency of the refinancing needs.

#### **IV Relation between interconnectedness through control and interconnectedness through economic dependency**

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1. A credit institution should first identify which persons are connected via control in accordance with Article 10 paragraph (1) item 1) of the Law and which persons are connected via economic dependency in accordance with Article 10 paragraph (1) item

2) of the Law, 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, a credit institution 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. A credit institution 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 a credit institution's credit granting and surveillance process. The management body and senior management should ensure that adequate processes for the identification of connections among persons are documented and implemented.

3. A credit institution shall identify all control relationships among their clients and document as appropriate. A credit institution shall 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, a credit institution becomes aware that persons have been considered interconnected by another credit institution, it should take into account that information.

4. The efforts that credit institution 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, a credit institution should collect information on all entities forming a chain of contagion. If a credit institution 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 credit institution (see scenario Mm 1 of this Annex), it should use this information when assessing connections.

6. The procedures for identifying connected persons should be subject to periodic review to ensure their appropriateness. A credit institution should also monitor changes to interconnections, particularly in the case of their periodic loan reviews and a substantial increase to a loan is planned.

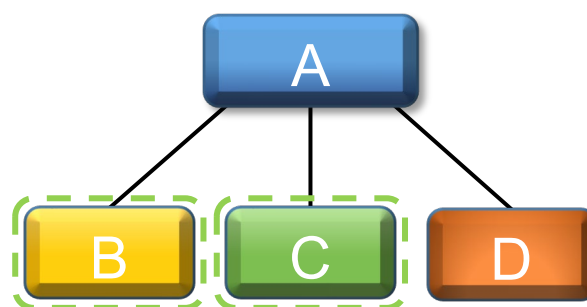
### Examples of interconnectedness in the group of connected persons

The scenarios included in this Annex illustrate the application of the guidelines to groups of connected persons falling under the definition in Article 10 paragraph (1) items 1) and 2) of the Law, from the perspective of the reporting institution.

#### Groups of connected persons based on control

##### Scenario C1: Exceptional case (no single risk exists despite the existence of control)

The credit institution has exposures to all entities shown below (A, B, C and D). The entity A has a control over the entities B, C and D. The entities B, C and D are special purpose entities/ special purpose vehicles (SPEs/SPVs).

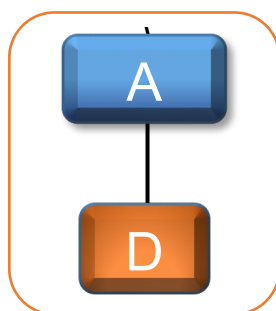


To assess if there is no single risk, despite the existence of a control relationship, the credit institution should assess at least all of the following elements in relation to each of the SPEs/SPVs (entities B, C and D in this scenario):

- 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/SPV (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/SPV or the derecognition of securitised assets under the applicable accounting rules have to be assessed as potential signs of material positive correlation.
- The specific nature of the SPE/SPV, especially its bankruptcy remoteness based on Article 336 item 1) of the Decision on Capital Adequacy – in the sense that effective arrangements exist that ensure that the assets of the SPE/SPV will not be available to the creditors of parent undertaking A in the event of its insolvency – and if the debt securities issued by the SPE/SPV normally reference assets that are third parties' liabilities.
- The structural enhancement in a securitisation, and the delinkage of the obligations of the SPE/SPV from those of parent undertaking A, such as the existence of provisions, in the transactions documentation, ensuring servicing and operational continuity.

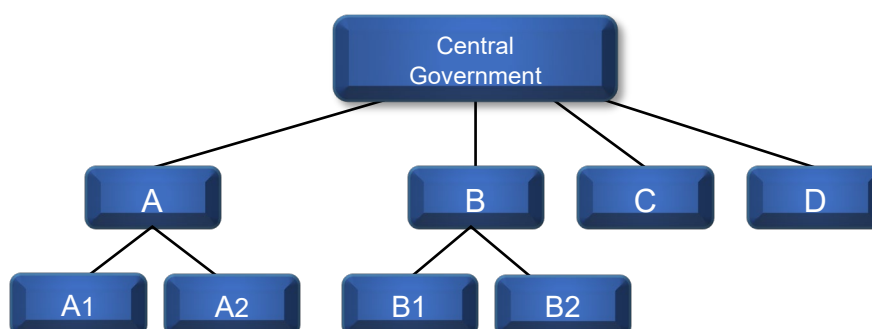
- The compliance with the provisions under Article 270 of the Decision on Capital Adequacy regarding arm's length conditions.

Having assessed all of these elements, the credit institution could conclude that, for example, subsidiary undertakings B and C do not constitute a single risk with parent undertaking A. As a result, the credit institution needs to consider a group of connected persons composed only of persons A and D. The credit institution should document these assessments and their findings in a comprehensive way.



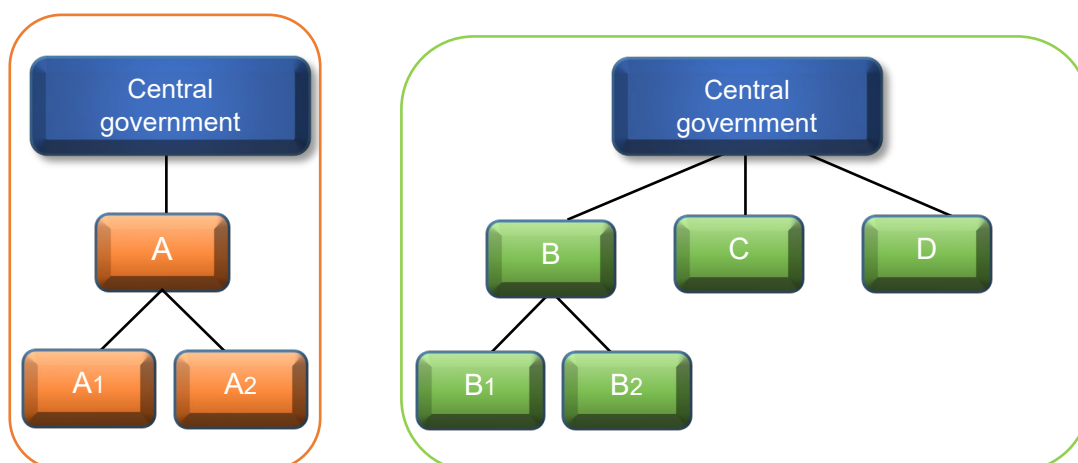
### Alternative approach for exposures to central governments

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 subsidiaries each (A1/A2, B1/B2). The credit institution has exposures to the central government and all of the entities shown.

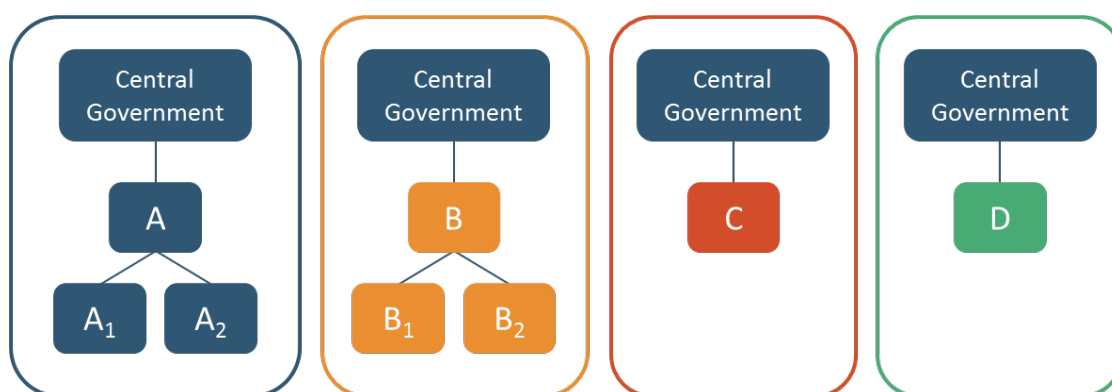


### Scenario CG1: Alternative approach – partial use

A credit institution 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'):

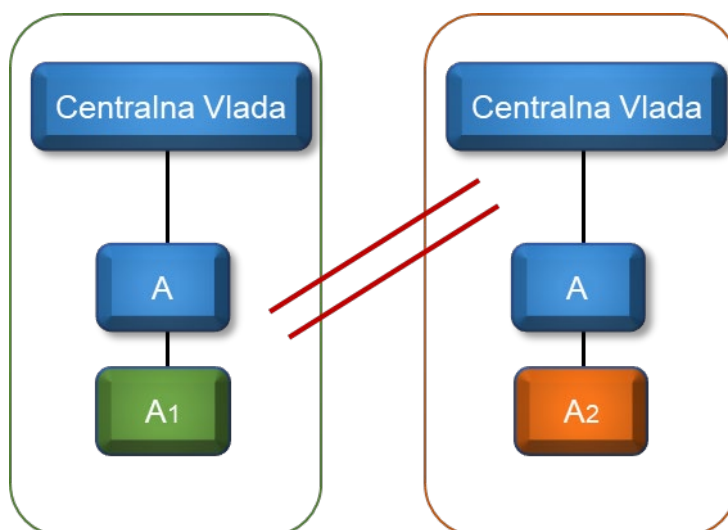


**Scenario CG 2: Alternative approach – used for all directly dependent entities**



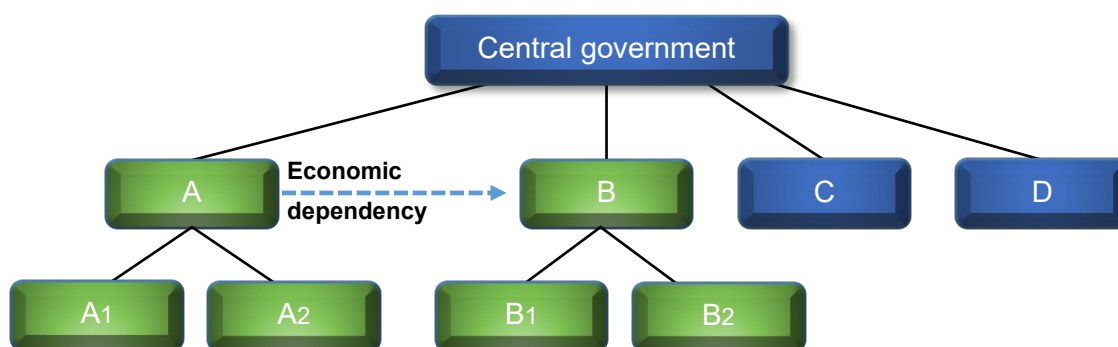
**Scenario CG 3: Alternative approach – applicable on “first/second level”, not below**

In the scenarios CG1 and CG2, 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’):

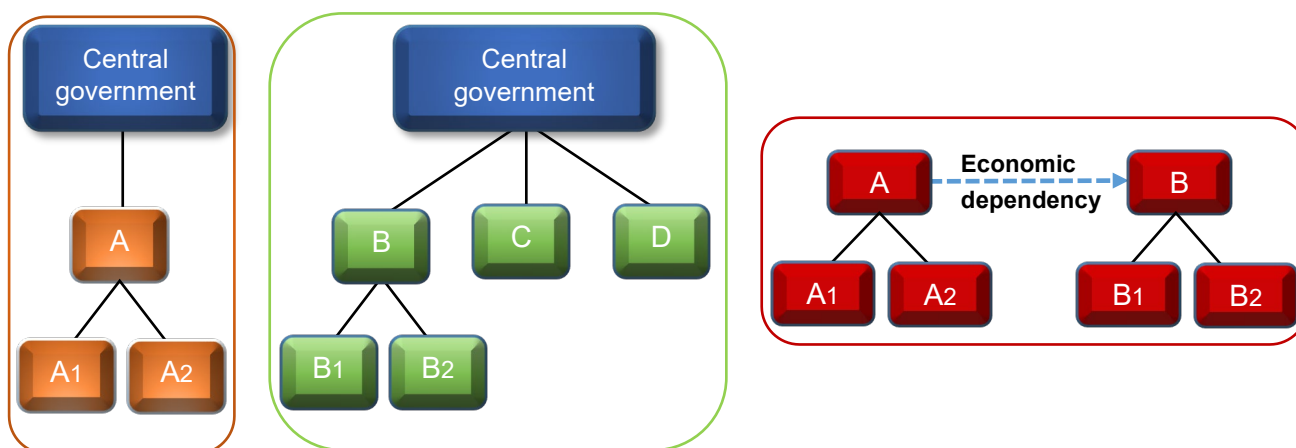


**Scenario CG 4: “Horizontal connections” on the second level**

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



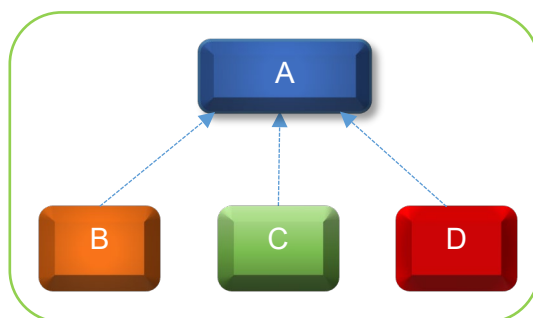
Assuming that the credit institution uses the alternative approach only in part, as described in scenario CG 1 above, the following groups of connected persons need to be considered:



## Establishing interconnectedness based on economic dependency

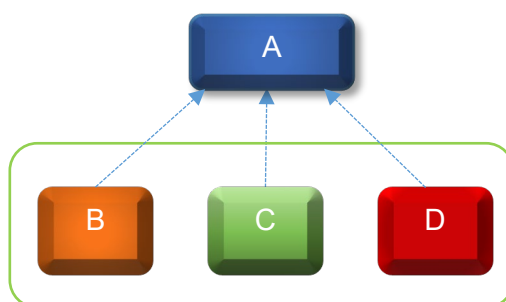
### **Scenario E1: Main case**

The credit institution 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 credit institution is in all cases A. The credit institution 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.



### **Scenario E2: Variation on main case (no direct exposure to source of risk)**

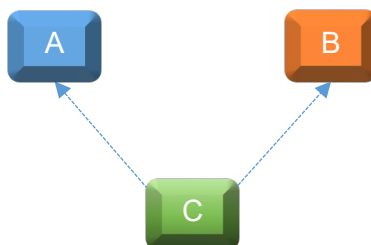
There is a grouping requirement even if the credit institution does not have a direct exposure to A but is aware of the economic dependency of each person (B, C and D) on A. If possible payment difficulties for A are contagious to B, C and D, they will all experience payment difficulties if A gets into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



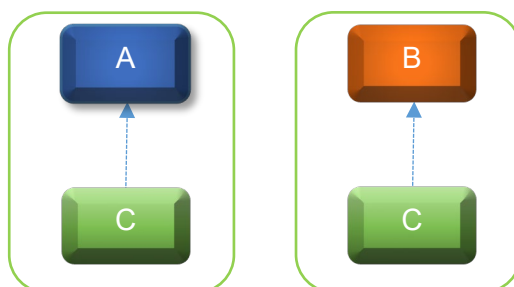
As in scenario E 1, it does not matter that there is no dependency among B, C and D. A causes the grouping requirement, although it is not a client itself and thus is not part of the group of connected persons.

### **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:



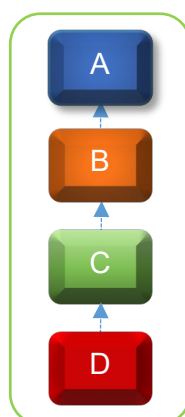
The argument that the exposure to C will be double-counted is not valid because the exposure to C is considered a single risk in two separate groups.

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).

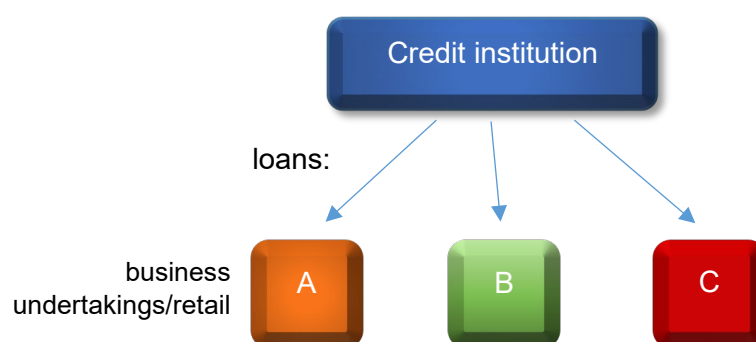
### **Scenario E4: Chain of dependency**

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).



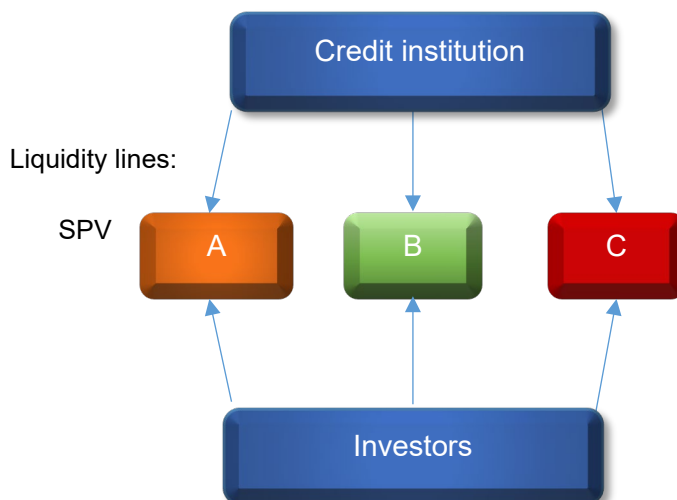
### **Scenario E5: Credit institution as source of funding (no grouping requirements)**

In the following scenario, the credit institution 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.

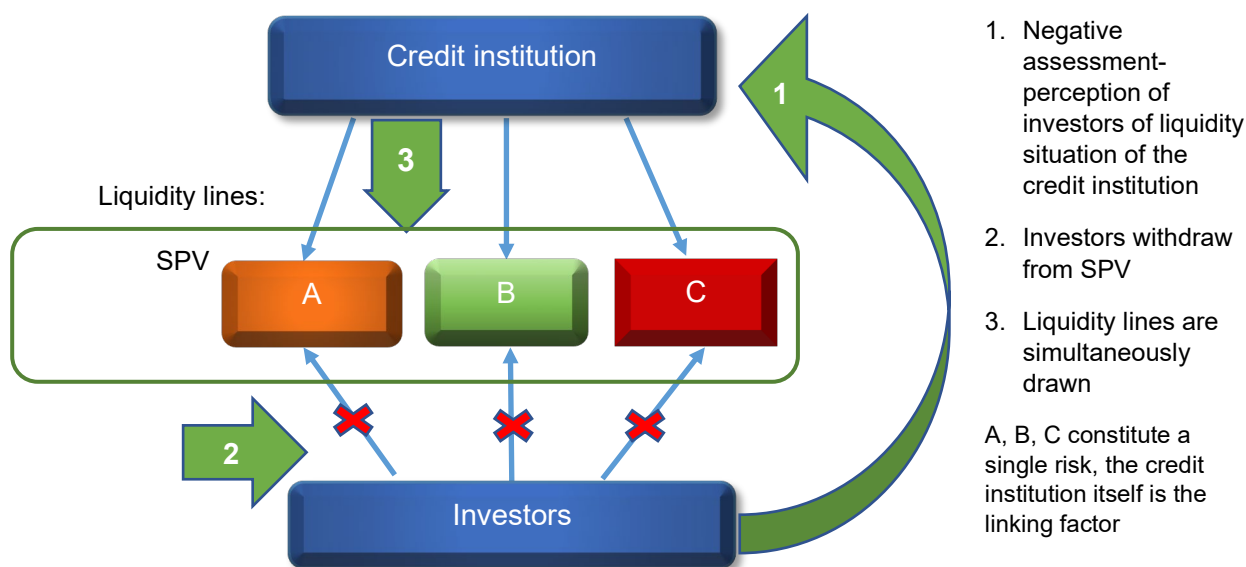


### Scenario E6: Credit institution as source of funding (grouping requirements)

In the following scenario, the credit institution is the liquidity provider of three SPVs or conduits (similar structures):



In such a case, the credit institution itself can constitute the source of risk (the underlying risk factor) and it is also important to take into account risks arising from a common source of significant funding provided by the credit institution itself, its financial group or its connected persons.



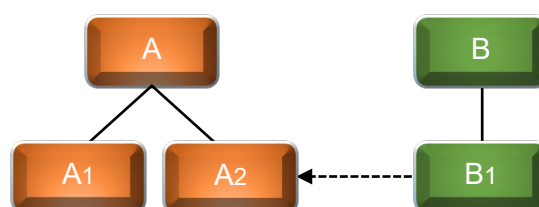
In the scenario above, it does not make a difference whether the liquidity lines are directly to the SPV or to underlying assets within the SPV. What matters is the fact that liquidity lines are likely to be drawn on simultaneously. Diversification and quality of the assets are also not considerations in this scenario, nor is the reliance on investors in

the same sector (e.g., investors in the ABCP market), as the single risk is created by the use of similar structures and the reliance on commitments from one source (i.e., the credit institution as the originator and sponsor of the SPVs).

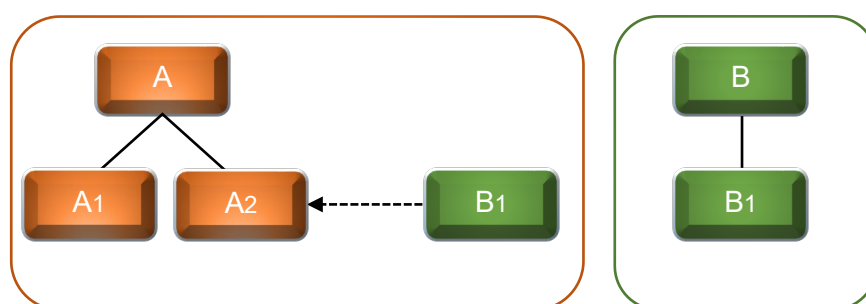
### Relation between interconnectedness through control and interconnectedness through economic dependency

#### **Scenario C/E 1: Combined occurrence of control and economic dependency (one-way dependency)**

In the following scenario, the credit institution 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):



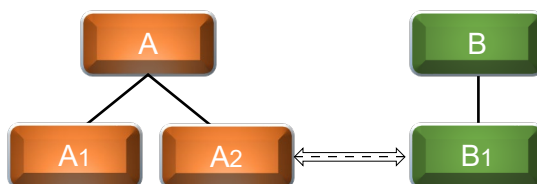
Grouping requirement: In this scenario, the credit institution should come to the conclusion that B1 is in any case to be included in the group of connected persons of A (the group thus consisting of A, A1, A2 and B1) as well as of B (the group thus consisting of B and B1):



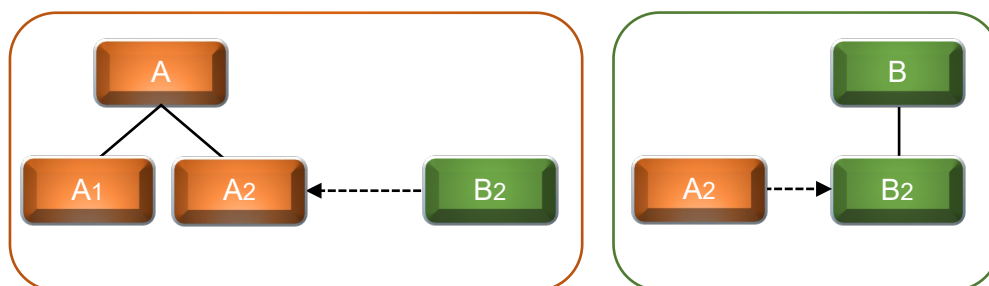
In case of financial problems for A, A2 and ultimately B1 will also experience financial difficulties on account of their legal (A2) and economic (B1) dependency respectively. The forming of three different groups (A + A1 + A2, A1 + B1, B + B1) would not be sufficient to capture the risk stemming from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

**Scenario C/E 2: Combined occurrence of control and economic dependency (two-way dependency)**

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

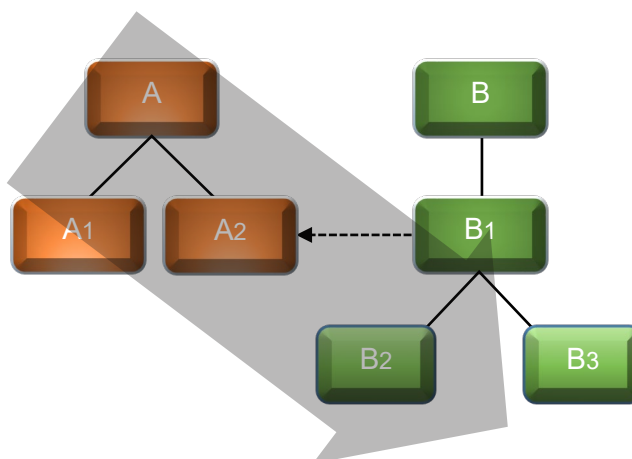


Grouping requirement: A2 would need to be included additionally in group B, and B1 would need to be included additionally in group A:

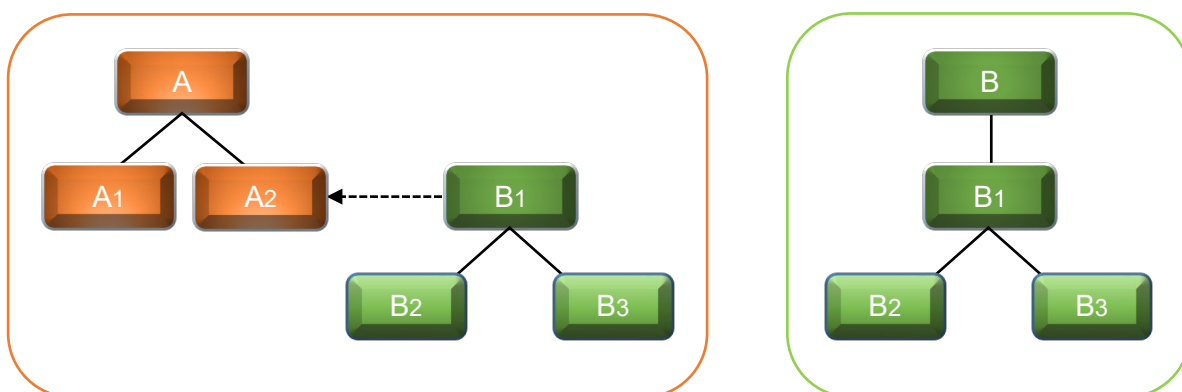


**Scenario C/E 3: Downstream contagion**

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').



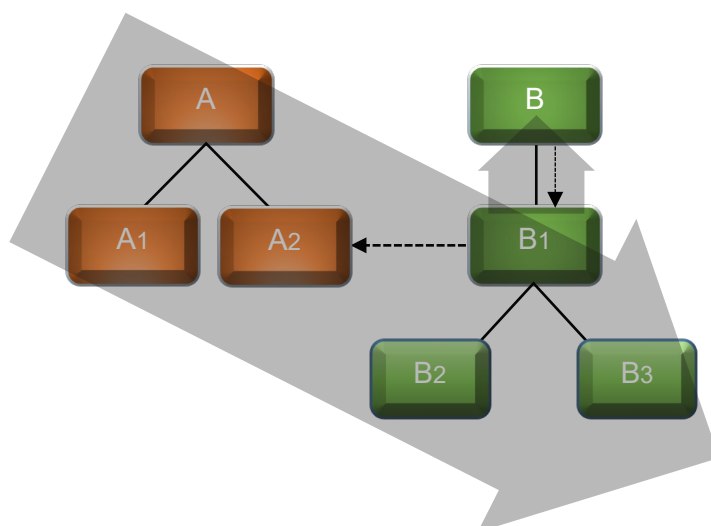
Grouping requirement:



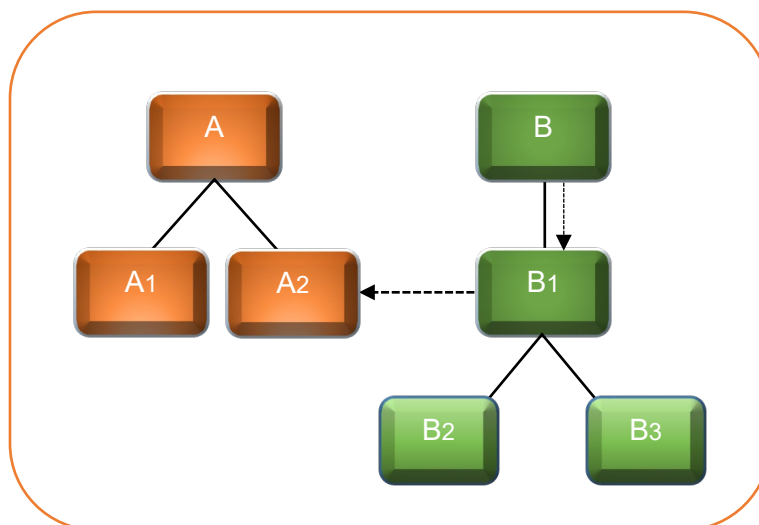
**Scenario C/E 4: Upstream contagion**

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).



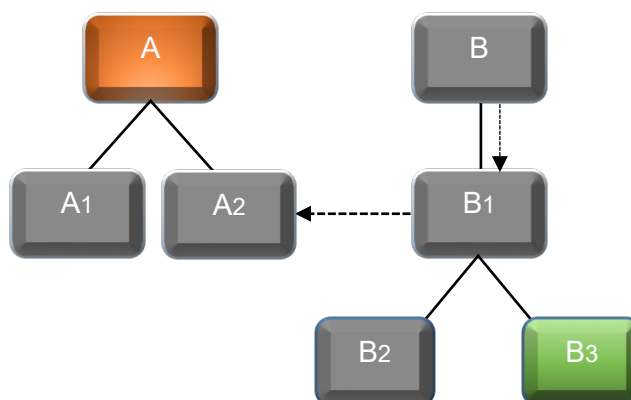
Grouping requirement:



**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 credit institution has exposures only to entity A and entity B3. In such a case, it is recognised that it might not be possible for the credit institution to become aware of the chain of contagion and the group of connected persons might not be correctly formed.



## ANNEX 2

### Criteria for identifying shadow banking entities

1. A credit institution shall identify as a shadow banking entity the following:
  - 1) any entity that offers banking services referred to in Article 4 of the Law or performs banking activities as set out in Article 5 of the Law, which is not licensed nor regulated in accordance with the regulations of Montenegro or any European Union act referred to in item 3 of this Annex;
  - 2) any undertaking for the collective investment in transferable securities registered as the money market funds;
  - 3) any alternative investment fund registered as the money market fund that employs leverage on a substantial basis or is not prohibited from originating loans in the ordinary course of its business or from purchasing third-party lending exposures for its own account on the basis of its rules or instruments of incorporation.
  
2. By way of derogation from item 1 of this Annex, a credit institution may not identify the following entities as shadow banking entities:
  - 1) financial institutions whose exposures are treated in accordance with Article 136 paragraph (6) of the Decision on Capital Adequacy of Credit Institutions;
  - 2) any entity excluded from the scope of any of the following regulations:
    - Directive 2013/36/EU of the European Parliament;
    - Regulation (EU) No 648/2012;
    - Directive 2009/138/EC of the European Parliament;
    - Regulation (EU) No 575/2013;
  - 3) any entity that is excluded from the application of any of the following regulations:
    - Directive 2013/36/EU of the European Parliament;
    - Regulation (EU) No 648/2012;
    - Directive 2009/138/EC of the European Parliament;
    - Regulation (EU) No 575/2013;
  - 4) any entity that is a part of non-financial group whose principal activity is to carry out credit intermediation activities for its parent undertaking or its subsidiary undertakings or other subsidiary undertakings of its parent undertaking;
  - 5) entity where it is included in the supervision on a consolidated basis of a credit institution;
  - 6) any entity established in a third country that meets any of the following criteria:
    - entity is licensed and supervised by a third-country competent authority in accordance with the Basel Principles;
    - regulatory regime of a third country, based on which the entity is authorised and supervised, is equivalent to the regulations of Montenegro and regulation that is applied to those entities in the European Union;
    - entity is included in the supervision of the credit institution on consolidated basis, which is licensed and supervised by the third-country competent

authority that applies banking regulation and supervision based on Basel Principles.

3. For the purposes of item 1 of this Annex, the European Union acts shall be the following:

- 1) Regulation (EU) No 575/2013 of the European Parliament;
- 2) Directive 2013/36/EU of the European Parliament;
- 3) Regulation (EU) No 2019/2033 of the European Parliament;
- 4) Directive (EU) No 2019/2034 of the European Parliament;
- 5) Regulation (EU) No 600/2014 of the European Parliament;
- 6) Directive 2014/65/EU of the European Parliament;
- 7) Regulation (EU) No 648/2012 of the European Parliament;
- 8) Directive (EU) 2015/2366 of the European Parliament;
- 9) Directive 2009/110/EC of the European Parliament;
- 10) Directive 2009/138/EC of the European Parliament;
- 11) Directive (EU) 2016/2341 of the European Parliament;
- 12) Directive 2014/59/EU of the European Parliament;
- 13) Directive 2009/65/EC of the European Parliament;
- 14) Directive 2011/61/EU of the European Parliament;
- 15) Regulation (EU) No 2015/760 of the European Parliament;
- 16) Regulation (EU) No 346/2013 of the European Parliament;
- 17) Regulation (EU) No 345/2013 of the European Parliament.

## ANNEX 3

### Guidelines for the application of the alternative treatment of the credit institution exposures that refer to tri-party repurchase regiments

#### Subject matter, scope and definitions

1. These Guidelines shall prescribe, for the purpose of substitution approach referred to in Article 27 of the Decision on Large Exposures of Credit Institutions - hereinafter: the Decision, the criteria the credit institution should meet if it decides to use alternative treatment regarding tri-party repos facilitated by tri-party agent.
2. These guidelines apply in relation to credit institutions' exposures to collateral issuers due to tri-party repurchase agreements (tri-party repos) facilitated by a tri-party agent.
3. For the purposes of these Guidelines, in addition to the definitions referred to in Article 2 of the Decision, the following definitions shall apply:
  - 1) **collateral management service agreement (service agreement)** means the agreement between a credit institution and a tri-party agent for the management of collateral provided to the institution in the context of the execution of a tri-party transaction.
  - 2) **collateral issuer** means a third party that executes collateral management services, which may include payments and/or delivery of securities, safekeeping and administration services of securities including collateral selection and custodianship for the account of the counterparties to a tri-party transaction.

#### II. Conditions for the application of the alternative treatment

4. A credit institution should rely on a tri-party agent for the use of the alternative treatment only where they have carried out appropriate due diligence to verify that the tri-party agent complies with the conditions specified in these guidelines.
5. For the purposes of these Guidelines, a credit institution should ensure that
  - 1) the use of the alternative treatment is adequately documented in its policies and procedures; and
  - 2) their management body oversees and monitors the implementation of the alternative treatment.

##### **2.1. Minimum elements to be included in the service agreement**

6. For the purposes of verifying that the tri-party agent has put in place appropriate safeguards to prevent breaches of the specified limits and without prejudice to other provisions in these guidelines, a credit institution should ensure that the service agreement sets out at least the following elements:

- 1) a clear description of the services provided by the tri-party agent with regard to collateral management including securities delivery;
- 2) the limits set out by the credit institution and applicable to a portfolio of securities in respect of a given collateral issuer as well as the conditions for their revision and the frequency of revision;
- 3) a statement confirming that the tri-party agent has put in place appropriate safeguards in accordance with item 4 of these guidelines to ensure compliance with the specified limits;
- 4) the tri-party agent's monitoring systems, including the communication by the tri-party agent of any development that may have a material impact on its ability to effectively carry out its functions in line with the service agreement and, where applicable, in compliance with the laws and regulatory requirements;
- 5) the tri-party agent's obligation to submit reports to the credit institution, at least on a weekly basis, on the amount and composition of the collateral received and/or managed by the tri-party agent for the account of the credit institution;
- 6) the tri-party agent's obligation to report immediately to the credit institution when a breach of the specified limits has occurred;
- 7) the right of the credit institution or a legitimate third party (inter alia the statutory auditor, the competent authority or third parties appointed by them) to verify that the tri-party agent has put in place the safeguards in accordance with item 4 of these guidelines;
- 8) the communication channels to be used between the institution and the tri-party agent during the performance of the agreement.

**2.2. The safeguards that the tri-party agent should put in place to ensure compliance with the specified limits should include the following:**

7. The safeguards that the tri-party agent should put in place to ensure compliance with the specified limits should include the following:
  - 1) tri-party collateral management is only performed in accordance with the duly signed service agreement;
  - 2) tri-party agent has set up a control environment which ensures, for each communication on specified limits, that these limits are duly authorised by the credit institution, and are entered and processed accurately, in due time and only once in their collateral management system;
  - 3) tri-party agent has set up a control environment that ensures that collateral is safeguarded, actively monitored and pricing values are duly recorded in a timely manner;
  - 4) tri-party agent has set up a control environment which ensures the detection, in a timely manner, of possible breach(es) of the specified limits;
  - 5) when allocating collateral securities to cover an exposure, the tri-party agent's systems ensure that their market value does not breach any of the specified limits and/or exclusions. In case of an inadequate application of the revised limits specified by the credit institution due to operational issues, the tri-party agent should notify the credit institution in good time;
  - 6) tri-party agent should be contractually required to comply with the specified limits and to ensure that the eligibility profiles of collateral issuers and securities as referred to in section 2.3.1 can be verified on the basis of the

information provided under the service agreement by the credit institution and the collateral provider.

8. A credit institution should obtain, at least annually, an adequate level of assurance in the form of a written declaration that the tri-party agent complies with the safeguards put in place in accordance with the service agreement.

## **2.3. Determination, revision and monitoring of the limits specified by the credit institution to the tri-party agent for the securities issued by the collateral issuer**

### **2.3.1. Determination of the specified limits**

9. A credit institution should determine specific limits for each collateral issuer and, if deemed necessary, exclude certain collateral issuers in order not to breach the large exposure limits set out in Article 17 of the Decision.
10. Limits should be expressed as an absolute amount or percentage value of all securities or a specific type of security in the collateral issuer's portfolio.
11. With a view to determining the specified limits, a credit institution should set up eligibility profiles based on lists of collateral issuers and on types of securities which the tri-party agent could use for the composition of a given collateral issuer's portfolio of securities. For these purposes, credit institution should take into account possible connections between single collateral issuers or between single collateral issuers and clients of the whole portfolio that could lead to a group of connected persons.
12. For the purposes of determining the specified limit applicable to a portfolio of securities by a given collateral issuer, a credit institution should take into account the following:
  - 1) the current exposures to the collateral issuer and its group of connected persons, if available;
  - 2) the exposures to the collateral issuer and its group of connected persons, if available, during the previous calendar year;
  - 3) the scheduled exposures to the collateral issuer and its group of connected persons, if available, for the forthcoming 6 to 12 months;
  - 4) whether the credit institution has managed the securities issued by a collateral issuer via tri-party repos or a combination of tri-party repos and repo transactions entered into directly with a counterparty.
13. In addition to the elements mentioned in items 11 and 12 of these Guidelines, credit institution should set limits by applying a margin of conservatism that would allow the credit institution to comply with the large exposure limits set out in Article 17 of this Decision.

### **2.3.2 Revision of the specified limits and its frequency**

14. A credit institution should ensure that the service agreement includes the circumstances under which the specified limits could be revised and the frequency of their revision.

15. In particular, a credit institution should be in the position to request the revision of the specified limits based on the reports from the tri-party agent referred to in item 6 sub-item 5 of these Guidelines or when they are informed of any breaches of the specified limits by the tri-party agent.
16. In determining the circumstances referred to in item 14 of these Guidelines, credit institution should consider their overall exposures to a collateral issuer and its group of connected persons, if available, and the risk of breaching the large exposure limits set out in Article 17 of this Decision. Credit institution should also take into account the ability, with due regard to their administrative and accounting procedures and internal control mechanisms, to manage in a timely manner any other exposures to a collateral issuer they may have so as to avoid a breach of the large exposure limits.
17. The revision of the specified limits should take the form of a change of the absolute amount of the specified limit or the percentage value of a specific type of securities in the portfolio of a collateral issuer. It may also take the form of the exclusion or inclusion of a type of securities in the portfolio of a collateral issuer.
18. The revision of the specified limits should be possible during the lifetime of the service agreement and should be executed in a timely manner by the tri-party agent once it has been informed thereof

### **2.3.3. Monitoring of the specified limits and its frequency**

19. Where the credit institution makes use of the alternative treatment, they should verify that the systems that the tri-party agent has in place to monitor the collateral composition are adequate with regard to the accurate and timely management of the specified limits.
20. In particular, credit institution should verify that the tri-party agent's monitoring systems allow the tri-party agent to trigger movements within the portfolio of securities of a given collateral issuer to ensure compliance with the specified limits.
21. A credit institution should also verify that the tri-party agent manages the collateral revaluation, variation margining, income payments on the collaterals and possibly any necessary substitution of collateral in accordance with its tri-party obligations under the service agreement.

### **2.4. Ensuring compliance with the large exposure limits referred to in Article 17 of the Decision**

22. A credit institution should ensure that the use of the alternative treatment does not lead to a breach of the large exposure limits set out in Article 17 of the Decision.
23. Where a breach of the specified limits has occurred, the tri-party agent should inform the credit institution immediately of:

- 1) the name of the collateral issuer in relation with which the breach has occurred;
- 2) the international securities identification number (ISIN) or security code of the securities received as collateral;
- 3) the market value of the collateral received;
- 4) the date when the breach occurred;
- 5) the remedial action adopted by the tri-party agent; and
- 6) the timeframe within which the breach has been or is expected to be remedied.

24. The credit institution shall ensure that its management body is notified without undue delay of any breaches of the specified limits on the securities by a collateral issuer and its likely impact on compliance with the large exposure limits of Article 17 of the Decision with respect to the same collateral issuer.

25. Without prejudice to the actions by the tri-party agent to remedy any breach of the specified limits, credit institution should also have in place appropriate action plans to deal with breaches of the specified limits to ensure that the large exposure limit of Article 17 of the Decision to a given collateral issuer is complied with at all times.

## **2.5 Communication with the Central Bank**

### **2.5.1. Notification of the intention to use the alternative treatment**

26. Where a credit institution intends to make use of the alternative treatment with a tri-party agent, it should notify ex-ante the Central Bank. The notification should at least comprise the following elements:

- 1) a confirmation of its intention to use the alternative treatment;
- 2) a description of the main elements of the service agreement;
- 3) the identification of the tri-party agent(s) that it intends to use;
- 4) a declaration approved by the management body of the credit institution that the use of the alternative treatment complies with the requirements of these guidelines.

27. Where a credit institution intends to terminate the agreement concluded with a tri-party agent, it shall, without undue delay, notify the Central Bank thereof.

### **2.5.2. Material concerns**

28. A material concern about the use of the alternative treatment should be based at least on any of the following reasons:

- **with regard to the credit institution:**

- 1) the use of the alternative treatment leads or is likely to lead to a breach of the large exposure limits of Article 17 of this Decision;
- 2) the alternative treatment is not integrated or is only partially integrated in the risk management framework of the credit institution;

- 3) relevant findings from on-site inspections, internal and external audits or other supervisory assessments provide evidence of insufficient internal procedures to manage and/or monitor the use of the alternative treatment in accordance with these guidelines.
- **with regard to the service agreement:**
    - 4) the provisions included in the service agreement do not ensure compliance with the requirements set out in the Law and regulations passed on the basis of the Law, including the provisions of this Decision, and particular:
      - the provisions of the service agreement regarding the revision of the specified limits would make it impossible for an institution to request the timely implementation of changes to prevent a breach of the large exposure limits of Article 17 of this Decision.
      - the credit institution or a legitimate third party do not have the right to audit the services provided by the tri-party agent under the service agreement to verify that the tri-party agent has in place appropriate safeguards to prevent breaches of the limits specified by the credit institution as referred to in Article 27 paragraph (5) item 3) of the Decision;
  - **with regard to the tri-party agent:**
    - 5) the tri-party agent is a regulated entity and its authorisation is subsequently withdrawn by its competent authority;
    - 6) there is evidence that the tri-party agent has not complied with the requirements for the timely introduction of revisions to the specified limits in accordance with the terms of the service agreement, or it has not observed requests from the credit institution to exclude certain types of collateral or collateral issuers; or its monitoring systems do not provide for accurate and timely management of the specified limits.

### **2.5.3. Procedure for dealing with a material concern**

29. A credit institution should not use the alternative treatment until the Central Bank has satisfied itself that the credit institution has satisfactorily addressed any material concerns.
30. If a credit institution is already making use of the alternative treatment and subsequently the Central Bank informs the credit institution that it has concerns about its use, the credit institution should cease to use the alternative treatment and provide evidence to the Central Bank to that effect.
31. The credit institution should only resume the use of the alternative treatment where, within the time frame set by the Central Bank, it has satisfactorily addressed the material concerns and provided evidence that effect.