Erste Bank AD Podgorica

METHODOLOGY FOR DETERMINING CHANGES IN INTERESTS RATES ON THE BANK'S LOANS AND PRODUCTS ON WHICH AGREED INTEREST IS CALCULATED

1. THE AIM OF THE METHODOLOGY

The Methodology documents the practice applied by the Bank in determining the need for change in the agreed interest rates that the Bank calculates within its operations with clients on loans and other products of the Bank on which interest is calculated (hereinafter active interest rates).

The aim of this methodology is:

- to determine the criteria for the change in the active interest rates (elements affecting the change in active interest rates);
- to achieve competitiveness of loans and other products of the Bank.

2. TYPES OF INTEREST RATES

Since interest rates have variable character, the Bank is authorized to agree fixed and variable interest rates with the clients.

2.1. **Fixed** interest rate is a rate which is not variable during the entire loan period **(F)**.

2.2. **Variable interest rate** is the one whose level is subject to changes during the loan period and it may be:

- ***Administrative interest rate*** **(K_1)** - interest rate whose level is subject to changes based on the Bank's acts;
- ***Market-indexed interest rate*** **(K_2)** - interest rate whose level is subject to changes based on the market index, margin and/or other costs.
- Variable based on **decisions of external relevant authorities, or institutions (E) –** e.g. EBRD, Montenegro, EU**.**

If the interest rate is agreed as variable, then such rate, as referred to in this Methodology (unless expressly stated otherwise), shall be considered as administrative interest rate.

The above stated shall not refer to special programmes in cooperation with other state/inter-state/private institutions and/or bodies (e.g. EBRD, Montenegro, EU), since in such cases the change in the interest rates for such loans and products is also influenced, among other, by decisions of institutions and bodies in cooperation with whom the loans were approved.

3. CHANGES IN INTEREST RATES

Changes in interest rates represent re-determining of the interest rate level in accordance with the agreed variability terms.
The period of change in interest rate shall be the period between two consecutive determinations of the interest rate level.

3.1. ADMINISTRATIVE INTEREST RATE

In case of administrative interest rate the interest rate level is changed in accordance with the decisions of the Bank's relevant bodies.

3.1.1. Change in the administrative interest rate

The Bank shall be authorised to change interest rate the clients must pay to the Bank based on the existing transactions agreed with the Bank and products approved by the Bank in case of change in the interest rate index (as defined below).

3.1.2. Interest rate index

KI – Interest rate index is calculated by applying the following formula:

$KI = IxRE+RI_{portfolio}$

Where:

I – price of the source of the Bank's funds calculated based on:

- the level of short-term reference interest rates (EURIBOR, CHF LIBOR, USD LIBOR),
- weighted bank interest rate, for citizens' deposits in the Republic of Montenegro published by the Central Bank of Montenegro,
- market risk premium quotation for the Republic of Montenegro

RE – regulatory and legal costs calculated based on:

- application of enforcement norms (decision of the Central Bank of Montenegro and other legal provisions and regulations that are binding for the Bank and affect the Bank's operations),
- the level of short-term reference interest rates (EURIBOR, CHF LIBOR, USD LIBOR),
- costs of the Bank's source of funding.

$RI_{portfolio}$ – risk premiums determined by the Bank based on the costs of risk developments through expected loss, i.e. the amount for which it is expected that it will not be collected on specific exposure, whereby risk development is assessed in the aggregate report at the banking sector level in accordance with all affirmative regulations. If the Bank's portfolio involves more risk than the risk average aggregated at the banking sector level, the Bank shall not charge additional risk premium.

3.1.3. Changes in the client's risk

During the period of loan utilisation, the Bank shall be authorised to change interest rates at the level of individual client/loan in case of change in the client/loan risk premium resulting from the change in internal client/loan risk group. The change in the risk premium is thereby calculated as the difference in the previous and the current standard risk cost for individual risk group based on internal risk assessment.

3.1.4. Conditions under which interest rates may be changed during loan utilisation period, i.e. loan repayment period

Interest rate adjustment may be performed for all loans that are used or that are being repaid as on the date of the concerned change in elements.

If there is change in the Interest Rate Index by over 0.12 percentage points, the Bank shall be authorised to change the interest rate by maximum up to the change in the Interest Rate Index plus maximum 0.25 percentage points.

Dates on which and based on which the changes in the factors are considered are 31st March, 30th June, 30th September and 31st December.

In case of interest rate adjustment the new interest rates shall apply within 3 months from the date when the change in elements was determined the latest.

If the Bank does not perform interest rate level adjustment in the previous quarters for any reason whatsoever, it retains the right to increase the change in the interest rate in one of the following quarters by the level of the adjustment which was not performed.

For the avoidance of any doubt, the provision on interest rate level adjustment in this Article as referred to in this Methodology shall mean that the Bank:

- may, at its sole internal discretionary assessment, increase or reduce the amount of the interest rate if the interest rate index has changed by minimum 0.12 percentage points in the period from the last change in the interest rate taking into consideration the change in the interest rate index for which the interest rate was not previously changed. Maximum change in the interest rate may be by the value of the change in interest rate index plus 0.25 percentage points.
  The Bank shall monitor changes in the index value per quarters and if the index values change by more than 0.12 percentage points, the Bank may correct the interest rate by the amount of the change plus maximum 0.25 percentage points. If the Bank does not correct the interest rate up to the full amount of the change in the interest rate index for any reason whatsoever such value shall be transferred to the following quarters. Any change in the interest rate level shall affect the index by increasing or reducing the index value by the effected change.
- may increase or reduce the interest rate amount if the average value of the cumulative change in the interest rate index corrected for the already performed interest rates adjustments per types of loans compared to the initial calculation period (March 2013) is changed by more than 1.00 percentage point, if such change in increase of interest rates on the existing loans, according to the Bank's assessment, would not result in significant increase in the Bank's credit risk.
  The Bank shall monitor changes in the value of the index per quarters and if the average cumulative index value, measured from March 2013, changes by more than 1.00 percentage points, the Bank shall correct the interest rate level. The Bank may choose not to increase the interest rate if such change would compromise regular loan repayment, creditworthiness of clients and/or compromise market operations of the Bank.

Based on its sole discretionary assessment, the Bank shall make the decision on the level of change in the interest rate, i.e. it shall decide independently whether it will and at what point it will make use of the maximum possibility to change the interest rate level.

Independent of the level of change in the interest rate index, the Bank shall be authorised to reduce the interest rate level at any moment.

3.2. MARKET-INDEXED INTEREST RATE

In case of market-indexed interest rates, unless otherwise agreed or determined, the frequency of changes in the interest rate level shall be determined in accordance with the time period of the market index and according to the agreed date for changing of the interest rate.

3.2.1. Formula for determining market-indexed interest rate

Formula for determining market-indexed interest rate is:

$$K_2 = aX_t\% \pm m\%$$

where:

K_2 market-indexed interest rate presented in %
A percentage value of market index (unless otherwise determined in a special agreement with the client it shall be deemed that the value is 100%)
X_t% market index (EURIBOR, LIBOR, and other), where t denotes time period
m% total interest margin

As referred to in this Methodology, the total interest margin (m) shall denote total costs of risk, regulation, sources and interest margin of the Bank.

Change in the interest rate level results from the change in the value of all described components and all elements are variable in accordance with the rules and conditions prescribed in Article 3.3 of this Methodology.

Market-indexed interest rate may have specified **caps and floors**, whereby they determine the maximum, i.e. minimum interest rates during the contractual relation: **f ≤ I ≤ c**

f bottom interest rate level (floor)

c top interest rate level (cap)

If individual agreement with a client includes agreement on the interest rate floor and/or cap, the interest rate level paid by the client shall vary in accordance with the market-indexed interest rate (K_2), taking into consideration the limits agreed as floor and/or cap.

3.2.2. Date of market index determination and change in the interest rate due to change in the market index value (Xt%)

In case of market-indexed interest rates, unless otherwise agreed or determined, frequency of changes in the interest rate level shall be in accordance with the time period of the market index and according to the agreed date for change in the interest rate.

Market indexes shall be changed in accordance with the changes in the money market or other market where prices are quoted in the manner prescribed in the General Terms.

Market indexes reference for the General Terms are:

CURRENCY	MARKET INDEX*	MARKET INDEX TIME PERIOD**
EUR	EURIBOR	1 month, 3 months, 6 months, 12 months
	LIBOR	1 month, 3 months, 6 months, 12 months
CHF, USD, GBP	LIBOR	1 month, 3 months, 6 months, 12 months

*The Bank may determine other market indexes and market index time periods in its decisions.

**If market index is EURIBOR, and the monitored time period for the market index is 3 months, the loan agreement shall define the interest rate related to the change in three-month EURIBOR

3.2.3. DETERMINING THE MARKET INDEX LEVEL

EURIBOR, LIBOR,
For loans with interest rate related to EURIBOR, LIBOR market indexes, the applicable market index is the one from the calendar period when the loan was approved in accordance with Article 3.2.2, published on Reuters on the day of change in the interest rate, unless otherwise determined in the agreement or for a specific product. In case of loans approved in tranches for new approved tranches the applicable interest rate shall be the one specified in the concerned loan agreement.

Other market indexes
For other market indexes, updating is done in accordance with the instructions and procedures applicable for the concerned indexes and/or types of products.

Market index value
Market index value shall be applicable until the end of the current period of the change in the interest rate when new value is determined for the following period.

Termination of market index
If certain market index ceases to exist, the parties shall agree a new market index in writing. If not, they shall transfer to administrative interest rate.

Date of market index determination
For market-indexed interest rates the Bank shall apply two methods for re-determining of the market index, and thereby also the interest rate:

- **at the beginning of the calendar periods:**

value of market index is changed at the beginning of the calendar period:

- in case of quarterly change in interest rate – market index value is determined at the beginning of the calendar quarter (1st March, 1st June, 1st September and 1st December) in accordance with the previously stated method for determining market index values for the current periods of change in the interest rate
- in case of semi-annual change in interest rate – market index value is determined at the beginning of the calendar six-month period (1st June and 1st December) in accordance with the previously stated method for determining market index values for the current period of change in the interest rate

- **on the agreed date or the date determined in another manner**

value of market index is changed on the agreed date, or the date determined in another manner:

- in case of quarterly change in interest rate – market index value is determined on the agreed date for the following three-month period of change (NR from 15th December to 15th March or NR 30th September to 31st December)
- in case of semi-annual change in interest rate - market index value is determined on the agreed date for the following six-month period of change (NR from 26th February to 26th August or NR 31st December to 30st June)
- other frequency according to the time period of the market index or the agreement.

3.2.4. CHANGE IN THE TOTAL INTEREST MARGIN AND OTHER COSTS

The Bank shall be authorised, during the time period of business relation, to change the total interest margin and include the risk costs and premiums at any point, if the value of the following elements changes by over 0.12 percentage points compared to the previous three-month period

- market risk premium quotation for the Republic of Montenegro,
- application of enforcement norms (decision of the Central Bank of Montenegro and other legal provisions and regulations binding the Bank and affecting the Bank's operations),
- risk premium determined by the Bank taking into consideration the costs of risk developments through expected loss, i.e. the amount for which it is expected that it will not be collected on specific exposure, whereby risk development is assessed in the aggregate report at the banking sector level in accordance with all affirmative regulations. If the Bank's portfolio involves more risk than the risk average aggregated at the banking sector level, the Bank shall not charge additional risk premium.

The Bank shall be authorised to change the total interest margin by maximum up to the amount of the change plus 0.25 percentage points and it shall notify the client in case there is change in the total interest margin level in the manner prescribed in the General Terms, at least 15 days prior to the change.

3.3. FINAL PROVISIONS

The Bank shall be authorised, once in six months, to review the presumptions and elements taken into consideration when calculating the change in the value of administrative interest rate interest indexes and the total interest margin. In case when the Bank changes the presumptions and elements taken into consideration when calculating interest indexes and the total interest margin, the rules applicable for changes of the General Terms shall apply (Articles 7.4, 7.5 and 7.6 of the General Terms).

This Methodology is an integral part of the General Terms of Business of Erste Bank AD Podgorica.