Pursuant to Article 17, paragraph 1, point 2 of the Law on the Central Bank of Montenegro ("OG RoM" No. 52/00 and 47/01) and Article 67, paragraph 3 of the Law on Banks ("OG MNE", 17/08), the Council of the Central Bank of Montenegro, on its meeting held on 17 and 18 October 2008, passed the following

DECISION
on minimum standards for interest rate risk management not originating from bank's trading activities

1. General Provisions

Article 1

This Decision shall prescribe in more details the minimum standards for managing interest rate risk not originating from bank's trading activities (hereinafter: interest rate risk from the banking book).

Article 2

Individual terms used in this Decision shall have the following meanings:

1) **"banking book" -** all bank's on-balance and off-balance sheet items not considered as positions in the trading book;
2) **"trading book" –** shall have the meaning as set out in the Central Bank's Decision on Capital Adequacy of Bank;
3) **"significant currency"** – each currency accounting for more than 5% of total on-balance and off-balance sheet assets or total on-balance and off-balance sheet liabilities in the banking book;
4) **"standardized interest rate shock"** – a parallel movement (positive or negative) of interest rates on the referent yield curve by 200 base points for every individual significant currency or in aggregate for other currencies;
5) **"basis point" -** a unit equal to a hundredth part of 1%.

2. Risk management

Article 3

In line with bank strategy and policies, bank is obliged to:

1) assess all important sources of interest rate risk (maturity mismatch, yield curve risk, base risk, option risk);
2) establish a proper system of reporting on exposures to interest rate risk in the banking book, including regular reporting by a person and/or a body responsible for interest rate risk management in the banking book;

3) determine inputs (e.g. interest rates, maturity, period to the next change of interest rates, built-in options, etc.) that properly reflect the influence of changes in interest rates on the interest rate risk in the banking book;
4) measure the exposure to interest rate risk for all on-balance and off-balance sheet items from the banking book which are sensitive to interest rate risk by applying the established methods of risk measurement, at least by applying gap analyses;
5) measure and monitor the change in bank's economic value due to the exposure of the banking book asset items to interest rate risk;
6) perform testing of bank's sensitivity to interest rate risk in the banking book and use the test results in decision-making and revising of policies, procedures and limits referring to interest rate risk.

Article 4

Bank is obliged to prescribe in its documents the manner of establishing interest rates, and in case of using the interest rate index, the types of indices to be used in establishing interest rates and the criteria for the use of certain indices.

The criteria from paragraph 1 of this Article shall refer to the maximum coverage per one index, the maximum maturity per product and other similar factors.

Article 5

Bank shall measure and monitor the impact of interest rate risk on the change of economic value of the banking book by using the standardized interest rate shock for every individual important currency, or in aggregate for other currencies.

Bank shall measure the impact of interest rate shock to the change of economic value of the banking book by using the following procedure:

1) banks shall distribute all banking book items sensitive to interest rate risk into the corresponding time zones in the following table:

Time zone	**The middle of Time zone**	**Estimated modified duration**	**Interest rate shock in basis points (b.p.)**	**Weight**
	1	**2**	**3**	**4=2 x 3**
up to 1 month	0.5 months	0.04 years	200 b.p.	0.08 %
from 1 to 3 months	2 months	0.16 years	200 b.p.	0.32 %
from 3 to 6 months	4.5 months	0.36 years	200 b.p.	0.72 %
from 6 to 12 months	9 months	0.71 years	200 b.p.	1.43 %
from 1 to 2 years	1.5 years	1.38 years	200 b.p.	2.77 %

from 2 to 3 years	2.5 years	2.25 years	200 b.p.	4.49 %
from 3 to 4 years	3.5 years	3.07 years	200 b.p.	6.14 %
from 4 to 5 years	4.5 years	3.85 years	200 b.p.	7.71 %
from 5 to 7 years	6 years	5.08 years	200 b.p.	10.15 %
from 7 to 10 years	8.5 years	6.63 years	200 b.p.	13.26 %
from 10 to 15 years	12.5 years	8.92 years	200 b.p.	17.84 %
from 15 to 20 years	17.5 years	11.21 years	200 b.p.	22.43 %
over 20 years	22.5 years	13,01 years	200 b.p.	26.03 %

2) the allocation of items from paragraph 2, point 1 of this Article into the corresponding time zone shall be performed by:
   - allocating items with fixed interest rate into time zones according to the remaining period of maturity,
   - allocating items with variable interest rate according to the period until the following change in interest rates,
   - allocating items which maturity is unknown or cannot be determined with certainty (demand deposits, items which interest rates are changed on the basis of bank decision, and the like) based on the earlier experience;
3) property and liabilities items (for every individual important currency, or in aggregate for other currencies) shall be summed up as per every time zone from the table under paragraph 2 of this Article and the obtained results shall represent net positions per those zones;
4) the calculated net position by individual time zone shall be multiplied by the corresponding weight from table given in paragraph 2 of this Article (for every individual important currency, or in aggregate for other currencies) and the calculated results shall represent weighted positions per these zones;
5) weighted positions per all time zones shall be summed up and the obtained result shall represents a net long or short position in the banking book (for every individual important currency, or in aggregate for other currencies);
6) net long and net short positions for all currencies in absolute amounts shall be summed up and the obtained result shall represent total risk weighted position of the banking book.

Article 6

If the amount of the total risk weighted position in the banking book calculated according to Article 5 of this Decision is higher than 20% of the bank's own assets, the Central Bank shall order the bank to take appropriate measures (increase the amount of own assets, take measures to diminish the risk, and the like).

Article 7

Reporting on exposure to interest rate risk in the banking book shall be done separately for every individual important currency, and in aggregate for other currencies.

Article 8

Bank shall submit to the Central Bank reports on interest rate risk in the banking book using the forms and within the deadlines prescribed in a special decision of the Central Bank.

3. Final Provision

Article 9

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

THE COUNCIL OF THE CENTRAL BANK OF MONTENEGRO

PRESIDENT OF THE COUNCIL

Ljubiša Krgović

Decision No. 0101-323/11-7
Podgorica, 18 September 2008