

FINANCIAL SECTOR ASSESSMENT PROGRAM  
**MONTENEGRO**

TECHNICAL NOTE  
**DEPOSIT INSURANCE SYSTEM**

JANUARY 2016

This Technical Note was prepared in the context of a joint World Bank-IMF Financial Sector Assessment Program mission in Montenegro during September 2015 led by Alexander Pankov, World Bank and Peter Lohmus, IMF, and overseen by the Finance and Markets Global Practice, World Bank and the Monetary and Capital Markets Department, IMF. The note contains technical analysis and detailed information underpinning the FSAP assessment's findings and recommendations. Further information on the FSAP program can be found at [www.worldbank.org/fsap](http://www.worldbank.org/fsap).



THE WORLD BANK GROUP  
FINANCE & MARKETS GLOBAL PRACTICE

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## GLOSSARY

AMB	Association of Montenegrin Banks
BCBS	Basel Committee
By-Law	By-Law of the Deposit Insurance Fund
CAR	Capital adequacy ratio
DIS	Deposit Insurance System
DPF	Deposit Insurance Fund
BLL	Bank Bankruptcy and Liquidation Law
BRRD	Bank Recovery and Resolution Directive
CBM	Central Bank of Montenegro
CBML	Central Bank of Montenegro Law
CP	Core Principles for Effective Deposit Insurance Systems
EU	European Union
DGSD	Deposit Guarantee Scheme Directive
DPL	Deposit Protection Law
EBA	European Banking Authority
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EFDI	European Forum of Deposit Insurers
FSC	Financial Stability Council
FSCL	Financial Stability Council Law
FSB	Financial Stability Board
IADI	International Association of Deposit Insurers
IMF	International Monetary Fund
MoF	Ministry of Finance
MoU	Memorandum of Understanding
NCP	National Contingency Plan
NPL	Non-performing loans
PA	Public Awareness
PPO	Public Policy Objectives
WB	The World Bank

## EXECUTIVE SUMMARY

1. During September 1 – 15, 2015 an assessment under the IMF/World Bank Financial Sector Assessment Program (FSAP) was conducted for Montenegro. The mission assessed financial sector risks and vulnerabilities, assessed the quality of financial sector supervision, and evaluated financial safety-net arrangements. As part of the FSAP, the deposit insurance system was assessed against the BCBS-IADI Core Principles for Effective Deposit Insurance Systems (CP) from 2009. The revised IADI CP from 2014, which still have to be adopted by the IMF and the World Bank, have been used as a reference in this assessment. The assessment was conducted by a team of experts from the World Bank and IMF<sup>1</sup>.
2. During the assessment, meetings were held with officials from the DPF, the Ministry of Finance (MoF), the Central Bank of Montenegro (CBM), Association of Montenegrin Banks (AMB) and individual banks. The assessor would like to thank the Montenegrin authorities and the staff of the DPF in particular for their help and cooperation during the mission.
3. The assessment has the following main findings: The deposit insurance system in Montenegro is relatively well developed. DPF was established in 2006 and operates under the narrow mandate of a pay-box. It is financed by annual premiums from member banks, supported by a standby credit line with the EBRD and a statutory provision for back-up funding from the government. The current level of funding is sufficient to cover the insured deposits in all small banks. The coverage level is EUR 50,000 per depositor per bank and covers natural and legal persons. With this level, DPF insures 99.26 percent of depositors and 36.38 percent of deposits fully. Since its establishment, DPF has developed much of the infrastructure required to ensure prompt payout of deposits, including payout software to reimburse depositors within fifteen working days after a bank failure and a MoU to support information exchange and coordination with CBM. The deposit insurance system has never been triggered.
4. However, the assessment came up with a number of areas where deficiencies exist in the deposit insurance system and the financial safety-net arrangements and accordingly is proposing a corrective action plan to address these areas. To further enhance the effectiveness of the deposit insurance system, the Deposit Protection Law (DPL) should be amended to enable DPF to finance the transfer of insured deposits to another bank. In addition, DPF should be allowed to use other options for payout, including the ability to make payments electronically to deposit accounts established by depositors in other banks or to use interim or advanced payments in the case of prolonged delays. Furthermore, when transposing EU directives the payout timeframe should be further shortened to seven working days as required by international best practice and risk-based premiums should be introduced.

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<sup>1</sup> The assessment was conducted by Jan Philipp Nolte (World Bank). The FSAP was led by Alexander Pankov (World Bank) and Peter Lohmus (IMF).

5. It is essential for DPF, in close cooperation with CBM and MoF, to test the payout procedures and to strengthen internal contingency planning. There has been no system-wide crisis simulation involving the DPF and focusing on prompt payout of deposits, including the transfer of deposits and the availability of back-up financing arrangements. Furthermore, DPF should be a member of the Financial Stability Council (FSC) to be fully involved in system-wide contingency planning and crisis management. Although DPF has tested depositor data, this testing should take place more frequently and involve more banks. Also, DPF should pre-arrange the use of agent banks for payouts, call-centers, and other contractors. DPF should also have a MoU with the MoF in place which details, among other things, how the DPF would receive back-up financing from the state budget. As the banking market is dominated by banks with foreign parents, DPF should strengthen information exchange and coordination with relevant foreign deposit insurance systems (DIS).

6. The assessment identified further minor shortcomings in other areas such as Public Policy Objectives, Governance, Coverage, Legal Protection, Public Awareness, Reimbursing depositors and Recoveries which seem not to hamper DPF's capabilities at the moment, but would - once tackled - strengthen the overall system and bring it in line with international best practice. The transposition of the DGSD and the BRRD, which are currently underway, offer the opportunity to address many shortcomings identified. After the EU DGSD and the BRRD have been transposed into national law, DPF will have to revise all its internal guidelines and procedures as well as MoUs with other safety-net participants to bring them in line with the new frameworks.

7. The mandate of the DPF could be enhanced to take over other responsibilities which will have to be introduced into national law once Montenegro joins the EU. Following accession, a mandatory bank resolution fund which will be financed by contributions of financial institutions will have to be set up as it is foreseen under the BRRD. As DPF is already tasked with collecting annual premiums from banks for deposit insurance purposes, it would have the needed knowledge and experience to also collect contributions for the future resolution fund and manage the collected funds. However, for the time being contributions from the banking sector should be directed solely to the deposit insurance fund and help it to reach its target level. Furthermore, Montenegro will have to transpose the Investor Compensation Scheme Directive (1997/9/EC). Such a scheme could also be administered by the deposit insurer as it is already done in other EU member states (e.g. UK).

<b>Table 1: Recommended Action Plan to Improve Compliance with the BCBS – IADI Core Principles</b>		
<b>Principle</b>	<b>Recommendations</b>	<b>Time<sup>1</sup></b>
1. Public Policy Objectives	DPF should establish an internal review process on a regular basis (at least every 5 years) which also includes the views of stakeholders (member banks, consumer groups). A formal external review should also take place on a regular basis (to be done by the parliament, an external auditing firm or IADI).	<b>MT</b>
2. Mitigating Moral Hazard	DPF is currently not applying risk weighted premiums and should implement such a premium system (DPF is already in the process of discussing such a system with other stakeholders). Weaknesses in the resolution framework should be addressed through the transposition of BRRD (foreseen for 2017).	<b>NT</b>
3. Mandate	None	
4. Powers	DPF's powers should be enhanced to also include the power to finance the transfer of deposits (P&A) as well as other reimbursement tools and the power to make interim payments.	<b>NT</b>
5. Governance	Board members should serve on staggered terms to keep crucial institutional knowledge within the Board when members leave. The Managing Board should adopt a multi-annum strategic plan. DPF should implement an internal audit function appropriate to its size.  The authorities should consider enlarging the Managing Board (in view of the revised IADI CP) in order to minimize the dominant influence of other safety-net participants.	<b>NT</b>
6. Relationship with Other Safety Net Participants	DPF and MoF should sign a MoU. DPF should become a member of the FSC. All safety-net participants should engage in contingency planning, critically revisit the National Contingency Plan, develop a resolution manual which specifies the roles of all safety-net participants and hold a system-wide crisis simulation exercise.  The MOU between CBM and DPF should be improved to make clear that the CBM will inform the DPF of any applications for amalgamation, merger, bank de-merger, division and any meetings with potential bank founders. There should also be notification to DPF of the approval of both domestic and foreign branches.	<b>I</b>

<b>Table 1: Recommended Action Plan to Improve Compliance with the BCBS – IADI Core Principles</b>		
<b>Principle</b>	<b>Recommendations</b>	<b>Time<sub>1</sub></b>
7. Cross-border Issues	DPF is encouraged to engage in cross-border cooperation with other relevant deposit insurers on information exchange and coordination as it has no arrangements in place.	<b>MT</b>
8. Compulsory Membership	None	
9. Coverage	In the event of a merger of separate banks, the DPL should foresee that the deposits held with these banks before the merger would enjoy separate coverage for a limited period after the merger (e.g. 3 months). The definitions of “deposit” in the DPL and the Banking Law should be made consistent, by defining deposit in the Banking Law and having the Deposit Protection Law cross-reference that definition.	<b>NT</b>
10. Blanket Guarantee	None	
11. Funding	DPF should explore ways to enter into repo-agreements and engage with MoF to specify the conditions for pre-arranged supplementary back-up funding from the budget or state guarantees. The DPF should apply risk-based contributions (DPF is currently working on such a premium system). DPF should abolish the possibility of investing its funds into commercial banks’ securities. DPF’s income should remain exempt from taxes, as is the case for other public funds.	<b>NT</b>
12. Public Awareness	Based on the results of the next public awareness survey, DPF should critically assess its current PA program. A long term strategy to be adopted by the Managing Board should identify milestones (the level of public awareness to be achieved) and allocate budget for future PA activity needs. DPF should amend its guidelines to ensure that in a payout of deposits it would also provide information about the possibility of interim payments (after this power has been given to DPF) and procedures whereby uninsured depositors can make claims with the bank bankruptcy administrator.	<b>NT</b>
13. Legal Protection	The DPF should further define the legal protection granted by the law in an internal guideline (e.g. that legal fees are covered by the DPF in advance). Furthermore, the law should also include those working at the direction of the DPF.	<b>NT</b>
14. Parties at fault	None	

<b>Table 1: Recommended Action Plan to Improve Compliance with the BCBS – IADI Core Principles</b>		
<b>Principle</b>	<b>Recommendations</b>	<b>Time<sup>1</sup></b>
15. Early Detection and Timely Intervention and Resolution	DPF should become a member of the FSC and engage with the safety-net in crisis preparedness and management exercises.	<b>I</b>
16. Effective Resolution Processes	Deficiencies in the resolution framework for problem banks should be addressed through the development of draft legislation for an enhanced resolution framework in line with BRRD (foreseen for 2017).	<b>NT</b>
17. Reimbursing Depositors	<p>DPF should have a credible plan to shorten the payout timeframe to 7 business days. The DPF should have the power to use other reimbursement methods that may include payments or the transfer of deposits through closed bank P&amp;A-transactions and make interim payments. Although the DPF has tested depositor data in the past, this testing should be made mandatory, take place on a more frequent basis and involve more banks. In conjunction with this, DPF should pre-arrange the use of agent banks for payouts, call-centers and other contractors.</p> <p>Insured deposits should not be unavailable under a moratorium as this would contradict the deposit insurance arrangements and could possibly lead to contagion. The bank bankruptcy administrator should be obliged to provide the DPF with the necessary data within 5 – 7 days for the calculation of the reimbursement amounts as the payout timeframe has been reduced. To be able to prepare for closing activities, DPF should be given early warning of potential failures through its membership in the FSC.</p>	<b>NT</b>
18. Recoveries	Consideration should be given to the possibility of making DPF a member of the bankruptcy board. Costs incurred by DPF from the reimbursement procedures should also be recognized in bankruptcy procedures. Clear rules should be in place that prevent other financial safety-net participants from buying assets from a failed bank.	<b>NT</b>

1 I-Immediate” is within one year; “NT-near-term” is 1–3 years; “MT-medium-term” is 3–5 years.



## I. THE BANKING SECTOR AND THE DEPOSIT INSURANCE SYSTEM IN MONTENEGRO

1. As in most countries in the Western Balkans, the financial sector of Montenegro is dominated by banks with foreign parents. There are currently 14 banks operating in Montenegro, up from 11 in 2013. About 80 percent of the total banking sector capital includes foreign owners, mainly from Austria, Hungary, and Slovenia. Banks' assets are concentrated in lending products (60 percent) with most of the lending in the trade sector and households (mostly mortgages), each representing about 38 percent of total loans. Loans to non-residents represent 18 percent of the total. Liabilities are concentrated in deposits (75% of the total), which are closely split between demand (46 percent) and time (53 percent) deposits. Foreign deposits represent about 20 percent of the total deposits.
2. The Montenegrin economy has yet to recover from the collapse of the lending boom. The crisis triggered a prolonged period of balance sheet deleveraging, which has translated into a near uninterrupted credit contraction. Banks are still vulnerable due to high non-performing loans (NPLs), low profitability, weak capital and high private sector indebtedness. Progress in the intervening years to address the debt overhang, reduce NPLs, and restructure/recover assets has been limited partly owing to a weak, depressed market for real estate, banks' unwillingness to take further losses, and gaps remaining in the debt resolution framework.
3. Policy measures were adopted to reduce credit growth with limited results. By late 2007, the CBM introduced stricter rules for asset classification and provisioning (which were relaxed again during the crisis), and increased CAR by two percentage points to 10 percent. Early in 2008, temporary bank-specific ceilings on credit growth in the 30-60 percent range were introduced. Furthermore, the reserve requirement base was broadened to include public sector deposits and the required reserve rates on certain deposits were increased. To reverse an outflow of deposits in late 2008, the government guaranteed all bank private deposits through a temporary Law on Measures for the Protection of the Banking System. This anti-crisis law also allowed for liquidity support from the CBM and the Government, with one large domestically owned bank receiving a sizeable loan from the Government. The anti-crisis law lapsed at end-2009, and at the same time the coverage of the insured deposits was increased by four-fold to EUR 20,000 (now EUR 50,000).

### *The financial safety-net in Montenegro*

4. The financial safety-net in Montenegro consists of the CBM, the MoF, the Insurance Supervision Agency (ISA), the Securities and Exchange Commission (SEC) and the DPF. There is no designated resolution authority in Montenegro. CBM and its Bank Supervision Department, which has the responsibility for bank resolution and bank bankruptcy, is currently the de facto resolution authority.

5. The FSC was established by law in 2010. The FSC has a mandate for exchange of relevant information, identification of risks to the financial system and coordination functions. The Council also has the responsibility to determine the contingency plan for financial crisis management (the “National Contingency Plan”) and to organize stress testing and financial crisis simulation exercises.

*The Deposit Protection Fund (DPF)*

6. The DPF is an independent legal entity established in 2003 and entrusted with specific powers under the Deposit Protection Law (DPL). It started its operations on January 1 2006. The legal framework was last amended in August 2015<sup>2</sup>. It is the sole deposit insurer in Montenegro. The DPF protects deposits of natural persons and legal entities with member institutions and reimburses depositors for the insured deposit amount of EUR 50,000. With this level, DPF insures 99.26 percent of depositors and 36.38 percent of deposits fully. Deposits in Montenegro are small compared to the level of coverage. The average amount of insured deposits amounts to EUR 1,284. In the event of a member institution failure deposits are reimbursed within 15 business days after the scheme has been triggered. All banks licensed to take deposits by the CBM (and, in theory, foreign branches whose deposits are not covered by their home country DIS) are compulsory members of the DPF. All 14 banks are currently insured by DPF.

7. The DPF is governed by a three member Managing Board. Members of the Managing Board are appointed by the CBM, provided that one member is nominated by the MoF and one member is nominated by the Association of Montenegrin Banks. The Chairman of the Managing Board is designated in a decision on the appointment of the CBM. The Board appoints the Director General of the DPF who is a full-time employee and responsible for the day-to-day management of the deposit insurer.

8. The DPF has the following (minimum) powers: (i) assessing and collecting premiums; (ii) reimbursing insured depositors; (iii) obtaining directly from banks depositor records for testing purposes; (iv) sharing information within the financial safety-net; (v) compelling member banks to comply with their membership obligations via the CBM; (vi) setting operating budgets, policies and practices; and (vii) entering into contracts. The DPF comprises of 7 (full-time) employees and appears to be adequately staffed for its narrow mandate. The deposit insurer controls its own resources to fund its activities and fulfill its mandate.

9. The DPF is maintaining a deposit insurance fund which is ex-ante funded by its member institutions. The sources of the fund are: (i) initial (entry) premiums from banks; (ii) annual premiums from banks; (iii) investment returns; (iv) recoveries from the estate of failed banks after the subrogation of depositor claims; and (v) other sources such as loans, donations, foreign assistance, etc. The DPF is exempt from paying state or local taxes and fees for its deposit guarantee operations, which includes the income of the

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<sup>2</sup> Law amending the Deposit Protection Law from August 18, 2015.

DPF<sup>3</sup>. Currently, member institutions contribute an annual premium equal to 0.5 percent of total deposits of total depositors for the preceding year.

10. Montenegro is not a Member State of the EU. Montenegro received EU candidate status in December 2010 and, pursuant to Montenegro's 2015-2016 EU Accession Program it is obligated to transpose the EU *acquis communautaire* by the date of EU accession, but no later than by December 31, 2018. Therefore, the deposit insurance framework is based on EU legislation (directives) and is broadly adequate. Montenegro has already transposed the main parts of two EU Directives on Deposit Guarantee Schemes (DGSD) into national law. The latest EU directive on deposit insurance is from 2014 and still has to be transposed into national law. DPF has started to draft amendments of the law, which are not expected to come into force before 2018.

*Box 1: The EU Directive on Deposit Guarantee Schemes*

Montenegro's legislation is partially aligned with the Directive 94/19/EC on deposit-guarantee schemes, as amended by the Directive 2009/14/EC. The latest Directive on deposit guarantee schemes (2014/49/EU) foresees further changes to the framework for deposit insurers within the EU.

The DGSD foresees an EU-wide, harmonized coverage level of EUR 100,000 per depositor and bank. The DIS protects all deposits held by individuals and enterprises whatever their size. However, deposits of financial institutions and public authorities will not be covered. The repayment deadlines will be gradually reduced from 20 working days to 7 working days (from January 1, 2024 at the latest). National DIS will also act as a "single point of contact" and manage, on behalf of the home DIS, the claims of depositors of local branches of banks opened in other EU Member States with funding provided by the home DIS for the reimbursement.

Other measures stipulated in the Directive ensure that the faster payout will be achieved in practice. DIS will be informed at an early stage by supervisory authorities if a bank failure becomes likely. The DIS will enjoy prompt access to information on deposits at any time. Member institutions will be required to tag eligible deposits, provide single customer views, and maintain up to date records. Moreover, the new Directive improves depositor information to ensure that depositors are aware of the key aspects of deposit protection. For example, depositors will countersign a standardized information sheet containing all relevant information about the coverage of the deposit by the responsible DIS.

The Directive prescribes, in principle, a target level for *ex ante* funds of DIS of 0.8 percent of their insured deposits to be reached within 10 years. If this is insufficient, EU DISs may borrow from each other up to a certain limit (on a voluntary basis) or – as a last resort – use additional funding sources, such as loans from public or private third parties (alternative funding arrangements). The Directive stipulates that the contributions to DGS will be based on the amount of insured deposits and the degree of risk incurred by the respective member (risk-based premiums). The European Banking Authority (EBA) has issued guidelines to specify methods for calculating the contributions to DIS.

This Directive has not yet been transposed into Montenegrin law. Therefore, the current DPL is not in line with the following provisions, among others: The current level of insurance is with EUR 50,000 below the EUR 100,000 prescribed and no reduction of the payout timeframe is foreseen. In this context, Montenegrin authorities stated that they aim to further align the national legislation with the DGSD. The DPF is currently in the process of drafting amendments. However, authorities emphasized that full compliance in the area of coverage should be only achieved by the date of accession to the EU given the small average size of deposits.

<sup>3</sup> A recent change in the DPL foresees that the DPF should pay taxes, but does not seem to change the general tax exemption granted for public funds under the Corporate Profit Tax Law.

11. In parallel, the authorities have not started to transpose the EU's Bank Recovery and Resolution Directive (BRRD) which will bring relevant amendments to the Central Bank of Montenegro Law (CBML), the Bank Bankruptcy and Liquidation Law (BBLL), and (probably) the DPL. The transposition is expected to be finished in the course of 2017 and come into force by end of 2017. Important policy decisions to be made include the institutional setup of a resolution authority and the expansion of resolution tools. At this point, it is unclear if and how the DPF mandates and powers might be enhanced through the implementation (e.g. some EU Member States have decided to let their DIS manage the resolution fund).

## II. MAIN FINDINGS

### Public Policy Objectives of DPF (Core Principle 1)

12. The DPL stipulates the following public policy objectives (PPOs) of the DPF: protecting the interest of depositors and contributing to the maintenance of the banking system's stability<sup>4</sup>. The PPOs are disclosed also in the By-Law of the DPF, DPF's annual report, its website and its information material. The design of the DPF can be described as a narrow "pay box" due to its mandate limited to the payout of insured deposits in case of a bank bankruptcy. The revised IADI CPs stipulate that the design of a deposit insurer should be consistent with the system's public policy objectives<sup>5</sup>. DPF's current design is consistent with the PPOs of protecting the interests of depositors and contributing to the maintenance of financial stability. There are no additional PPOs for the DPF which could conflict with its two objectives.

13. Best practice suggests that the deposit insurer is expected to undergo a review of the extent to which it is meeting its PPOs. The revised IADI CPs foresee not only an external but also an internal review conducted on a regular basis by the governing body of the deposit insurer<sup>6</sup>. Such internal reviews of DPF have taken place in the course of the Managing Board's consideration of the implementation of the DPF's activities and the exercise of its functions<sup>7</sup>, for example, when the annual report was discussed. Furthermore, an external review is missing. Under the revised DPL, the government and the parliament will in the future receive the DPF's annual report not only for information (as in the past), but "for consideration"<sup>8</sup>. This new process offers the opportunity for the policy makers to review to which extent the DPF is meeting its PPO.

14. It is recommended that the DPF establish a mandatory and formal internal review process in its By-Law on a regular basis, while a formal external review process could be foreseen in the DPL (to be done by the parliament, an external auditing firm or IADI) which should also consider key stakeholder views (e.g. the views of member institutions).

### Mandate and powers of DPF (Core Principle 3 and 4)

15. The DPL formally and clearly specifies the mandate and powers of DPF which are in line with its PPOs. As mentioned above, the mandate of the DPF can be described

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<sup>4</sup> Art. 1 DPL.

<sup>5</sup> CP 1, EC 2 of the revised IADI CP, November 2014.

<sup>6</sup> CP 1, EC 3 of the revised IADI CP, November 2014.

<sup>7</sup> Art. 8 Nr. 2 By-Law.

<sup>8</sup> Art. 2 of the Law Amending the Deposit Protection Law (No. 47/15).

as a “pay box”<sup>9</sup> due to its narrow mandate of reimbursing depositors only<sup>10</sup>. The DPF’s mandate is aligned with the mandates of other financial safety-net participants as there is no overlap or lack of clarity as to where specific powers are embedded. However, Montenegro’s bank resolution framework should be strengthened, including the set-up of a designated resolution authority and a reform of the overall coordination mechanism within the safety-net<sup>11</sup>.

16. The DPF is set-up as a separate legal entity which is holding the rights and obligation as established under the DPL and further specified by the By-Law of the DPF<sup>12</sup>. The DPF is therefore the holder of rights, obligations and responsibilities in legal transactions. The DPF is represented by its Director General who can act on its behalf. The current powers of DPF enable it to fulfill its mandate in practice. DPF has the powers necessary to effectively reimburse insured deposits after a bank failure. These powers are set out in the DPL<sup>13</sup>. The DPF has the following (minimum) powers<sup>14</sup>: (i) establishing the rate for premium collection; (ii) collecting the premiums; (iii) investing its funds; (iv) calculating and performing the payout of insured deposits; (v) providing secondary legislations provided for under the DPL; (vi) setting operating budgets, policies and practices; (vii) entering into contracts; and (viii) performing other activities in accordance with the DPL. The DPL explicitly foresees that the DPF can issue regulations on (i) the information of depositors about deposit insurance<sup>15</sup>; (ii) the By-Law<sup>16</sup>; (iii) the specification of the type of depositor data and information provided by member institutions<sup>17</sup>; and (iv) the conditions, manner and procedure of the guaranteed deposits payout<sup>18</sup>. Furthermore, DPF can obtain directly from banks depositor data on a monthly basis<sup>19</sup>; engage in contingency planning; share information within the safety-net<sup>20</sup> and

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<sup>9</sup> Mandates can range from narrow “pay box” systems to those with extensive responsibilities, such as preventive action and loss or risk - minimization/ management, with a variety of combinations in between. These can be broadly classified into four categories:

- a. A “pay box” mandate, where the deposit insurer is only responsible for the reimbursement of insured deposits;
- b. A “pay box plus” mandate, where the deposit insurer has additional responsibilities such as certain resolution functions (e.g. financial support);
- c. A “loss minimizer” mandate, where the insurer actively engages in a selection from a range of least-cost resolution strategies; and
- d. A “risk minimizer” mandate, where the insurer has comprehensive risk minimization functions that include risk assessment/management, a full suite of early intervention and resolution powers, and in some cases, prudential oversight responsibilities.

<sup>10</sup> In emergency circumstances, there is a possibility of enacting a legislation that foresees that the DPF could finance the transfer of deposits of systemic banks. Hence, under the *lex specialis* the mandate of the DPF could be described as a “pay box plus”.

<sup>11</sup> See discussions below under “Relationship with other safety-net participants” and under “Failure Resolution”.

<sup>12</sup> Art. 10 DPL.

<sup>13</sup> Art. 11 and Art. 26 - 37 DPL.

<sup>14</sup> Art. 11 DPL.

<sup>15</sup> Art. 9 (6) DPL.

<sup>16</sup> Art. 23 DPL.

<sup>17</sup> Art. 33 (2) DPL.

<sup>18</sup> Art. 36 7 (5) DPL.

<sup>19</sup> Art. 33 DPL.

<sup>20</sup> Art. 46 of the By-Law.

with deposit insurers in other jurisdictions<sup>21</sup>; and compel member institutions to comply with their membership obligations via pecuniary fines (to be requested from and enforced by CBM)<sup>22</sup>. However, DPF's powers are incomplete as it currently cannot finance the transfer of deposits to another bank; it can only payout deposits through an agent bank<sup>23</sup>. Furthermore, it is not foreseen that the DPF can make interim payments, for example, in difficult cases of prolonged delays due to uncertain depositor data.

17. DPF's powers should be enhanced to also include the power to finance the transfer of deposits (P&A) as well as other reimbursement tools and the power to make interim payments.

### **Governance of DPF (Core Principle 5)**

18. DPF has a two-tier system of governance in the form of a three member Managing Board and the Director General. The DPF is governed by a three member Managing Board.<sup>24</sup> Members of the Managing Board are appointed by the CBM, provided that one member is nominated by the MoF and one member is nominated by the Association of Montenegrin Banks and Financial Institutions. The Chairman of the Managing Board is designated in the decision on the appointment of the CBM.

19. Currently the Managing Board consist of the following persons:

- Velibor Milošević, Vice-Governor for banking system supervision, responsible for regulation and supervision of banks and financial institutions, CBM, as the Chairman;
- Bojana Bošković, Director of the Directorate for the Financial System and Improvement of Business Environment, as the representative of the MoF;
- Prof. Dr. Marko Backović, University of Belgrade, as the representative of the Association of Montenegrin Banks.

20. The current composition of the Board raises concerns as other members of the safety-net (the MoF and the CBM) not only constitute a majority, but also serve as Chair of the Board (CBM). According to the revised IADI Core Principles<sup>25</sup> this might lead to potential conflicts of interest. The Board should therefore be enlarged with other independent members (e.g. the Investor Protection Agency or the President's office).

21. Members of the Managing Board have to be persons with a recognized integrity, holding a university degree and being highly knowledgeable in the financial sector<sup>26</sup>. The DPL forbids active bankers to be a member of the Board and foresees a cool-off period of 3 years<sup>27</sup>. Members are subject to fixed terms of 4 years and may not be appointed for

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<sup>21</sup> Art. 47 and 48 of the By-Law.

<sup>22</sup> Art. 40 DPL.

<sup>23</sup> See discussions under "Reimbursing depositors".

<sup>24</sup> Art. 14 DPL.

<sup>25</sup> CP 3 EC 8 revised IADI Core Principles, November 2014.

<sup>26</sup> Art. 15 (1) DPL.

<sup>27</sup> Art. 15 (2) DPL.

more than two consecutive terms<sup>28</sup>. However, the law (and the current practice) does not foresee the staggering of terms which would ensure that critical knowledge is maintained within the Managing Board. The process for the appointment and removal of members is transparent and regulated in law<sup>29</sup>. The Managing Board has adopted internal rules which supplement the legal provisions<sup>30</sup>. The Managing Board meets at least quarterly<sup>31</sup>. The DPL stipulates clear rules on conflict of interest of Board members and its disclosures<sup>32</sup>.

22. The Managing Board (i) appoints the Director General of DPF; (ii) passes the By-Laws of the DPF and passes other secondary legislation provided for by the DPL; (iii) establishes the premium rate; (iv) passes DPF's financial plan; (v) adopts the annual financial reports and considers the annual report as well as the annual audit; (vi) establishes the investment policies and takes investment decisions; and (vii) appoints the auditor<sup>33</sup>. The Board has to approve contracts whose values are exceeding EUR 20,000.

23. The Director General of the DPF is a full-time employee and is responsible for the day-to-day management of the deposit insurer<sup>34</sup>. He is appointed by the Managing Board for a four-year term and may be reappointed<sup>35</sup>. The Director General attends the Managing Board meetings, but has no voting right<sup>36</sup>. His responsibilities according to the DPL and as more fully specified by the By-Law, among others, include: (i) represent and act on behalf of the DPF and be responsible for its operations; (ii) prepare and propose drafts of the secondary legislation, the annual budget, the investment policy as well as the premium rate to the Managing Board; (iii) decide on the investment of the DPF's resources within the limits set by the By-Law; and (iv) decide on the rights, obligations and responsibility of DPF's staff<sup>37</sup>. The Director General may delegate certain tasks and duties within its competencies to another employee of the DPF, but only through a written act<sup>38</sup>.

24. DPF has the capacity and capability to fulfill its narrow mandate. It is operating with 7 full-time employees for which detailed job descriptions exist: (i) one Director General; (ii) one Advisor to the Director General, (iii) one Secretary of the DPF which person is required to hold a law degree<sup>39</sup>; (iv) two Advisors on Deposit Insurance; (v) one IT officer; and (vi) one accountant. DPF's Managing Board has adopted a Code of Ethics for the staff<sup>40</sup>. The DPF has its own annual budget and its own resources to fund its activities<sup>41</sup> which make the DPF operationally independent. 4.40 percent of DPF's budget

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<sup>28</sup> Art. 18 (1) DPL.

<sup>29</sup> Art. 14 (3) and Art. 18 (2) DPL.

<sup>30</sup> Rules on the work of the Managing Board of the Deposit Protection Fund, last amended February 6, 2015.

<sup>31</sup> Art. 9 16 (1) DPL.

<sup>32</sup> Art.17 DPL.

<sup>33</sup> Art. 8 of the By-Law.

<sup>34</sup> Art. 21 DPL.

<sup>35</sup> Art. 21 (2) DPL.

<sup>36</sup> Art. 16 (3) DPL.

<sup>37</sup> Art. 21 (1) DPL.

<sup>38</sup> Art. 18 of the By-Law.

<sup>39</sup> Art. 28 of the By-Law.

<sup>40</sup> Code of Ethics from September 10, 2012.

<sup>41</sup> Art. 25 DPL.



(2014) is spent on training and development of its staff. DPF spends 5.22 percent of its annual budget (2014) on information technology, after it has spent in the previous year over 10 percent of its budget for an upgrade of its IT platform (including a new server, a new server room and an upgrade of the payout software) to facilitate the payout of deposits.

25. The DPF Managing Board decides on activities of the DPF for the next year and allocates funds for the implementation of these activities in the financial plan. DPF also plans to adopt a multi-annum implementation plan once the DGSD is transposed into national law. However, a general strategic plan for DPF, which outlines strategic goals over the next years, is missing at the moment.

26. DPF is accountable to the CBM, to whom it submits the annual report for the DPF's operations for adoption and the annual financial plans and records for information<sup>42</sup>. In addition, all the reports are submitted to the Government and the Parliament of Montenegro for consideration<sup>43</sup>. DPF publishes regularly its annual report and other information via its website. Its By-Law and general acts in the form and decision of rules (e.g. decision on the rate of annual premiums) have to be published in the 'Official Gazette of Montenegro'<sup>44</sup>. It is required by law that the financial statements have to be audited by an external firm<sup>45</sup>. The same audit firm may not audit the DPF's financial statements for more than three consecutive years<sup>46</sup>. However, DPF is not subject to an internal audit which would focus on a regular basis on the policies and controls of the DPF along with its management of key corporate risks (e.g. operational risks, investment risks).

27. The authorities should improve the following parts of the governance framework: (i) enlarge the Managing Board with other independent members; (ii) Board members should serve on staggered terms; (iii) DPF should implement an internal audit function appropriate to the size of the deposit insurer; and (iv) the Managing Board should adopt a multi-annum strategic plan.

### **DPF's Relationship with other safety-net participants (Core Principle 6)**

28. The financial safety-net framework in Montenegro is not providing enough close coordination and information sharing. The DPF is not yet a full member of the safety-net and the information exchange within the safety-net involves some gaps. In Montenegro, the financial safety-net consists of the CBM, the MoF, the Insurance Supervision Agency (ISA), the Securities and Exchange Commission (SEC) and the DPF.

29. The DPL does not provide for the exchange of information between the DPF and other safety-net participants. The DPL foresees that CBM upon request from the DPF can examine the data and information banks have to provide on a monthly basis about

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<sup>42</sup> Art. 20 (1) and (2) DPL.

<sup>43</sup> Art. 20 (3) DPL.

<sup>44</sup> Art. 23 (3) of the By-Law.

<sup>45</sup> Art. 12 (3) DPL.

<sup>46</sup> Art. 37 (2) of the By-Law.

deposits<sup>47</sup>. CBM and DPF have formalized this and further information exchange in a MoU from 2006<sup>48</sup>. The MoU is fully operational and despite its age is fulfilling its purpose. Among other things, it stipulates the immediate sharing of information about the issuance and revocation of a license, the decision on the initiation of bankruptcy proceedings and the results from examination findings when measures have been imposed on a bank<sup>49</sup>. Based on the MoU, the DPF has asked the CBM to perform targeted on-site examinations to verify depositor data in the past<sup>50</sup>. According to the MoU, DPF can also propose to CBM that DPF's employees can join the inspection teams, which request has been granted in the past.

30. There is currently no MoU in place between the DPF and the MoF. A tri-partite MoU between CBM, MoF and DPF from 2009,<sup>51</sup> which dealt with the financial crisis at the time, seems to be inactive. A MoU with the MoF is crucial, as the DPL foresees that DPF can ask the MoF for back-up financing if its funds are not sufficient to perform the reimbursement of insured deposits. DPF has identified that gap and transmitted to the MoF a draft MoU which is currently under consideration at the Ministry. The draft MoU foresees a repurchase (Repo) agreement for T-bills issued by Montenegro, the borrowing from the budget of Montenegro and for a guarantee for borrowing of the DPF from international financial institutions as well as coordinated media activities in the case of a payout of insured deposits.

31. The FSC was established in 2010. The Council is responsible for the monitoring, identification, prevention, and mitigation of potential systemic risks in the financial system in order to ensure financial stability and avoid episodes that may lead to widespread financial distress<sup>52</sup>. The FSC is established under the Financial Stability Council Law (FSCL). By law, members of the council are: (i) the governor of the CBM as its chair; (ii) the Minister of Finance; (iii) the President of the Council of the Insurance Supervision Agency; and (iv) the President of the Securities and Exchange Commission<sup>53</sup>. FSC has a mandate for exchange of relevant information, identification of risks to the financial system and coordination functions. The Council also has the responsibility to determine the contingency plan for financial crisis management (the "National Contingency Plan") and organize stress testing and financial crisis simulation exercises<sup>54</sup>. The FSC meets at least quarterly, though more frequently if needed.

32. The DPF is currently not a member of the FSC, but may participate in its meetings as a guest only upon invitation and with prior approval of the majority of Council members<sup>55</sup>. In the past, DPF has not been invited to any meetings of the FSC nor

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<sup>47</sup> Art. 34 DPL.

<sup>48</sup> Memorandum on Cooperation and Exchange of Information between the Central Bank of Montenegro and the Deposit Protection Fund from August 30 2006.

<sup>49</sup> Art. 1.1. of the MoU between CBM and DPF from August 30, 2006.

<sup>50</sup> Art. 1.2. of the MoU between CBM and DPF from August 30, 2006.

<sup>51</sup> Memorandum of Understanding on Maintenance of Financial Stability from February 20, 2009.

<sup>52</sup> Art. 2 FSCL.

<sup>53</sup> Art. 3 FSCL.

<sup>54</sup> Art. 8 (1) Nr. 5 FSCL.

<sup>55</sup> Art. 4 (6) FSCL.

has it been a participant in a crisis simulation carried out in 2013<sup>56</sup>. But the DPF has been a member of the working group which formulated the National Contingency Plan. Therefore, DPF is currently not fully involved in the information exchange and coordination effort within the safety-net on an ongoing basis.

33. Confidentiality rules apply to all members of the safety-net. Members of the DPF's Managing Board, the Director General, the general staff as well as persons hired by the DPF to perform certain tasks are obliged to keep confidential all data and information which they have obtained while carrying out their duties<sup>57</sup>. The legal provisions are supplemented by further rules in the MoU between CBM and DPF<sup>58</sup>. Rules of confidentiality also apply to the members of the FSC<sup>59</sup> and the CBM staff<sup>60</sup>.

34. The revised IADI CPs from 2014 put an emphasis on effective contingency planning and crisis management policies and procedures of a deposit insurer to ensure that it is able to respond swiftly to the possibility of bank failures and other events<sup>61</sup>. DPF currently has no comprehensive contingency planning process (e.g. risk management policy, business continuity plans) in place which would include conducting regular stress tests of its IT system. DPF should develop its own contingency plan and feed it into the National Contingency Plan (NCP). The contingency plan should be tested on a regular basis in the future with periodic updates.

35. According to international best practice, the deposit insurer should also be a member of any institutional framework for ongoing communication and coordination involving other safety-net participants related to system-wide crisis preparedness and management<sup>62</sup>. The deposit insurer should participate in regular contingency planning and simulation exercises as well as in the development of crisis management communication plans involving all safety-net participants<sup>63</sup>. A working group of the FSC has drawn up a system-wide crisis management contingency plan, the NCP, with the participation of the DPF. Together these plans provide a comprehensive set of policies and procedures for the agencies' response in case of a crisis in the financial sector, however, progress and updates of the plan are not regularly tabled for discussion by the FSC. The authorities participated in a crisis simulation exercise with the World Bank in 2013, but without the participation of the DPF.

36. The DPF should have a MoU in place with the MoF. The current draft is a good basis for further discussions between the parties. The MoU between CBM and DPF from 2006 should be updated in light of the changing regulatory landscape once the BRRD has been transposed into national law. The MOU should be improved to make clear that the CBM will inform the DPF of any applications for amalgamation, merger, bank de-

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<sup>56</sup> The Crisis Simulation Exercise was carried out by the World Bank Vienna Financial Sector Advisory Center (FinSac).

<sup>57</sup> Art. 35 (1) DPL, Art. 45 of the By-Law.

<sup>58</sup> Art. 3 of the MoU between CBM and DPF from August 30, 2006.

<sup>59</sup> Art. 6 FSCL.

<sup>60</sup> Art. 84 CBML.

<sup>61</sup> Principle 6 - Deposit insurer's role in contingency planning and crisis management, IADI Core Principles, November 2014.

<sup>62</sup> Principle 6, EC 3 revised IADI Core Principles, November 2014.

<sup>63</sup> Principle 6, EC 4 and 5 revised IADI Core Principles, November 2014.

merger, division and any meetings with potential bank founders. There should also be notification to DPF of the approval of both domestic and foreign branches.

37. Furthermore, DPF is an important part of the financial safety-net in Montenegro and therefore should become a full member of the FSC. As the FSC is, among other things, tasked with the management of financial crises and the approval of the NCP, it is important that DPF is included in such work on a constant basis. Otherwise DPF cannot efficiently fulfill its mandate which would weaken the financial safety-net as a whole. All safety-net participants should engage in contingency planning, critically revisit the NCP, develop a resolution manual which specifies the roles of all safety-net participants and hold a system-wide crisis simulation.

### **Cross-border issues (Core Principle 7)**

38. Cross-border issues are of high importance for DPF as the banking system in Montenegro is dominated by foreign owned banks. There are 14 banks operating in Montenegro, of which 9 are subsidiaries of foreign banks or have foreign owners. Currently, there are no branches of foreign banks active in Montenegro<sup>64</sup>. The high number of foreign-owned banks which form a material presence makes formal information sharing and coordination arrangements between DPF and relevant foreign deposit insurers necessary. The By-Law of the DPF authorizes DPF to establish cooperation with foreign DISs in other countries<sup>65</sup>. Furthermore, the By-Law foresees that the DPF may exchange data and information on the basis of bilateral or multilateral agreements<sup>66</sup>. However, DPF has (in the absence of foreign branches) not joined any multilateral MoUs or initiated bilateral ones. DPF would (in theory) also insure deposits with branches of Montenegrin banks abroad<sup>67</sup>.

39. CBM is exchanging information and cooperating concerning subsidiaries of foreign banks with home supervisors through a number of bilateral MoUs. DPF expects to receive information on particular problem banks which might have an impact on the Montenegro market via its links to/MoU with CBM. However, CMB does not have MoUs in place with all important authorities (e.g. Austria). CBM should be aware that branches of foreign banks where the home coverage is higher than Montenegro's coverage level (e.g. from the EU, including neighboring Croatia) might be a destabilizing factor in times of stress.

DPF is encouraged to strengthen the cross-border cooperation with other relevant deposit insurers as the absence of arrangements is unsatisfactory. The authorities should work closely together to be certain that critical information is accurate and shared on a timely basis. DPF should sign MoUs with foreign DIS to cover information exchange and coordination concerning foreign owners of subsidiaries in Montenegro as problems might

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<sup>64</sup> Subsidiaries of foreign banks come, among others, from Austria; Croatia; France; Hungary; Serbia; and Slovenia.

<sup>65</sup> Art. 47 By-Law of the DPF.

<sup>66</sup> Art. 48 By-Law of DPF.

<sup>67</sup> No such branches exist at the moment (September 2015).

spill over from the parent to the subsidiary or could have a negative impact on depositors of that subsidiary.

### **Compulsory membership (Core Principle 8)**

40. Currently, all banks licensed to take deposits by the CBM are compulsory members of the DPF<sup>68</sup>. The number of banks insured by DPF is 14 (5 domestic banks; 9 foreign-owned subsidiaries). This would (in theory) also include foreign branches whose deposits are not covered by their home country DIS. Furthermore, DPF would also cover deposits with branches of Montenegrin banks in foreign countries, if these existed<sup>69</sup>. Foreign branches do not have to be a member of the DPF, if their deposits are protected by the deposit insurance scheme of their home country<sup>70</sup>. The micro credit institutions have licenses to grant loans, but not to receive deposits from the public<sup>71</sup>. Credit unions (which are not operating at the moment) would be not eligible for membership in the DPF, but are allowed to only accept deposits from their union members, but not from the public. However, the authorities should consider changing the scope of coverage of the DPF to also include these institutions once the sector is developing. Bank branches of other countries would be covered by their respective home country DIS - if this is foreseen by their national legislation – and therefore be excused from membership in DPF.

41. DPF has no membership requirements or conditions of its own. Membership is granted automatically with the licensing authorization from CBM and after the institution has paid the initial premium of currently EUR 50,000<sup>72</sup>. The conditions, the process and the timeframe for attaining membership in DPF are clearly stated in the DPL. The DPL does not foresee any powers for DPF to terminate membership of a bank in the scheme. Membership can only end in the cases where the banking license is withdrawn<sup>73</sup>. CBM is obliged via law to immediately inform the DPF on the issuing and revocation of a banking license<sup>74</sup>. In practice, DPF has always been informed about the issuance of new licenses within the foreseen timeframe.

### **Coverage (Core Principle 9)**

42. The current coverage level is limited to EUR 50,000 per depositor per bank and does include interest. This is half of the mandatory deposit coverage level for the EU of EUR 100,000 foreseen by the DGSD. With its current level, DPF insures 99.26 percent of depositors and 36.38 percent of deposits (both as of end of 2014) fully. Deposits in Montenegro are small compared to the level of coverage. The average amount of an insured deposit amounts to not more than EUR 1,284. While this would justify a lower coverage level, Montenegro has to take into account higher levels in neighboring

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<sup>68</sup> Art. 3 (2) DPL.

<sup>69</sup> Art. 6 (1) DPL.

<sup>70</sup> Art. 3 (3) and (4) DPL.

<sup>71</sup> Art. 146 Banking Law.

<sup>72</sup> Art. 8 (2) DPL.

<sup>73</sup> Art. 8 (3) DPL.

<sup>74</sup> Art. 8 (4) DPL.

countries as in times of stress depositors might move deposits to these banks<sup>75</sup>. It must also consider the need for the upcoming full harmonization with the EU coverage level.

43. The coverage level can be found in line with international best practice regarding coverage. However, as the coverage level is relatively high it is important that safety-net participants maintain an effective supervisory and regulatory system and other measures to mitigate moral hazard. The planned introduction of risk-based contributions for the DPF and the future transposition of the EU BRRD are especially welcomed in this aspect. However, the introduction of risk-based premiums should not negatively impact the ability of the DPF to replenish itself and must therefore be designed in such a way as to be income neutral. As Montenegro is not yet a member of the EU it can still deviate from the EU coverage level and should not yet seek full compliance with the DGSD in this aspect. Depending on the future growth of deposits, it might have to wait to further raise the coverage level until the date of accession to the EU.

44. The DPL<sup>76</sup> defines clearly and publicly what is an insured deposit. However this definition is not consistent with how the term “deposit” is defined in the Banking Law<sup>77</sup>. These two definitions should be made consistent, perhaps by defining deposit in the Banking Law and having the Deposit Protection Law cross-reference that definition. The DPL foresees that those deposits are excluded from protection have received higher interest rates on deposits than those paid to depositors of the same bank<sup>78</sup>. In practice, this deposits would to be frozen and the case brought to court for decision. The DPF should work on clear criteria when it would consider bringing this instance to court (e.g. definition of what is a higher interest rate) and ensure that it payout capabilities are adjusted to identify these deposits. Consideration should be given if it would be more appropriate to determine not to pay a higher rate of interest than to other depositors but the exclusion of the entire deposit seems unreasonable.

45. Depositors have sufficient information available via the DPF webpage and the DPL and DPF brochures to determine the level and scope of coverage. Deposits in Euro and in foreign currency<sup>79</sup> are insured and the reimbursement is done in Euro using the official exchange rate of CBM at the date the DPF is triggered<sup>80</sup>. All natural persons as well as legal persons are covered in general, which is in line with the PPOs of DPF. However, certain persons or institutions are excluded from deposit protection, in line with the EU directives. For example, members of the bank’s management or owners of the bank as well as their spouses and children, but also financially sophisticated depositors like pension, investment and insurance funds and banks, are not covered by the DPL<sup>81</sup>. In addition, depositors for whom the supervision reports of the CBM establish that they have contributed to deterioration of the financial position of the bank or are convicted of

<sup>75</sup> Serbia: EUR 50,000; Croatia: EUR 100,000; Slovenia: EUR 100,000; Bosnia and Herzegovina: EUR 25,000.

<sup>76</sup> Art. 2 Nr. 4 DPL: “Deposit is any credit balance which results from funds left in an account or from temporary situations deriving from normal banking transactions and which a bank must repay under the legal or contractual conditions, including any debt evidenced by a certificate issued by the bank.”

<sup>77</sup> Art. 3 Nr. 4 Banking Law.

<sup>78</sup> Art. 6 DPL.

<sup>79</sup> Art. 3 (1) DPL.

<sup>80</sup> Art. 5 (4) DPL.

<sup>81</sup> Art. 6 (2) DPL.

constituting money laundering or terrorism financing involving their deposits have no right to be reimbursed<sup>82</sup>.

46. The DPL does not apply co-insurance, but applies set-off with due claims (“matured liabilities”)<sup>83</sup>. The current coverage level includes accrued interest and applies in level and scope to all member banks. There is no discrimination in coverage on the grounds of residency status or nationality of depositors. The level of coverage has been reviewed in the past and has been last raised in 2012 to the current level. The Managing Board considers the coverage level on a quarterly basis when it considers reports on the deposits and depositors with member institutions as well when it determines annually the rate for the premium calculation<sup>84</sup>.

47. In the event of a prior merger of separate banks, it is not foreseen in the DPL that the deposits held with these banks before the merger would enjoy separate coverage for a limited period after the merger (e.g. 3 months). Such a provision should be introduced to ensure that depositors in merged banks have time to adjust and bring their deposits under the coverage limit.

### **Funding (Core Principle 10 and 11)**

48. DPF is maintaining a deposit insurance fund which is ex-ante funded by its member banks. The sources of the fund are<sup>85</sup>: (i) initial (entry) premiums from banks; (ii) regular annual premiums from banks; (iii) investment returns; (iv) recoveries from the estate of failed banks after the subrogation of depositor claims; (v) fines paid by member institutions and/or its management or members of its board based on an order of the CBM imposing measures under the Banking Law<sup>86</sup>; and (vi) donations<sup>87</sup>. DPF is exempted from paying state or local taxes and fees for its deposit guarantee operations, which includes the income of the fund<sup>88</sup>.

49. Currently, member institutions contribute an annual premium equal to 0.5 percent of total deposits and are primarily responsible for funding the deposit insurance system<sup>89</sup>. The DPL, through a recent change, foresees a maximum premium rate of 0.8 percent<sup>90</sup>. The annual premium is calculated and has to be paid in four installments on a quarterly basis based on the average amount of total deposits with a member institution as at the

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<sup>82</sup> Art. 6 (3) DPL.

<sup>83</sup> Art. 5 (1) DPL.

<sup>84</sup> Art. 8 Nr. 3 of the By-Law.

<sup>85</sup> Art. 24 (1) DPL.

<sup>86</sup> Art. 118 (1) Nr. 3 and (2) Nr. 1 Banking Law.

<sup>87</sup> Such as the EUR 2,500,000 donation given by the Government of the Federal Republic of Germany via KfW as a support to the DPF.

<sup>88</sup> Art. 12 (2) DPL. A recent change in the DPL foresees that the DPF should pay taxes, but does not seem to change the general tax exemption granted for public funds under the Corporate Profit Tax Law.

<sup>89</sup> Art. 8 (1) DPL, Art. 1 of the Decision on the regular Premium Rate and the Manner of the Regular Premium Calculation in 2014 from November 22, 2013. Art. 28 (3) DPL foresees that 0.5 % of total deposits is also the maximum rate allowed.

<sup>90</sup> Art. 28 (3) DPL.

last day of each month for the previous quarter<sup>91</sup>. Under the DPL and for the purpose of premium collection, DPF's Managing Board issued instructions on the type of data and information to be provided by member institutions on a monthly basis<sup>92</sup>. DPF can request CBM to make an on-site inspection to verify the reported information<sup>93</sup>. Furthermore, DPF can enforce the obligation to pay premiums through the CBM.

50. The Managing Board decides on the regular premium rate and the manner of the calculation for the following year, as a rule, at the end of November of the current year<sup>94</sup>. The DPF currently has a target level ratio of 10 percent of insured deposits<sup>95</sup> which would amount to EUR 112 million based on figures as of end of July 2015<sup>96</sup>. As of the end of July 2015, the DPF amounted to EUR 64 million or 5.7 percent of insured deposits. As the DPF collects annual premiums of around the size of EUR 10 million, it might reach its target level within the next 6 years (provided there is no payout). When the DPF's resources reach the target level, the Managing Board may decide, subject to the assessment of the amount of insured deposits, the DPF's resources and the overall situation in the banking sector, to reduce the regular premium collection or temporarily discontinue the regular collection<sup>97</sup>.

51. In general, the target size of a deposit insurance fund should be sufficient to participate in the resolution and payout of a number of small bank failures or several medium sized bank failures, depending on size and composition of the banking sector. Based on the current level of deposits, DPF's target level amounts to EUR 112 million. With this amount, DPF could currently reimburse all insured deposits at the 6 smallest banks simultaneously, if they fail at the same time. On a bank-by-bank basis, the funds would be sufficient to cover the insured deposits up to the 12th largest bank. Leaving only two banks which deposits could not be fully covered by the DPF. The target level seems therefore to be appropriate for Montenegro.

52. Emergency funding arrangements exist and are formalized in law. If the DPF's resources collected from premiums and other revenues are insufficient, additional funds may be provided from the following sources<sup>98</sup>: (i) extraordinary premiums from member institutions, provided that the total amount of both regular and extraordinary premiums does not exceed 1 percent of total deposits in the banks as at the last day in a month preceding the protected event date<sup>99</sup>; (ii) borrowing from the government budget; (iii) taking loans from foreign banks and financial institutions; and (iv) issuing securities. There are no pre-arranged back-up lines in place with the Government. DPF has arranged for a contingent line of credit with EBRD in the amount of EUR 30 million which would be available within 15 business days. DPF has not pre-arranged any repo agreements with commercial banks or the MoF for providing liquidity in the case of need

<sup>91</sup> Art. 28 (1) and (2) DPL.

<sup>92</sup> "Decision on bank monthly reports to be submitted to the Deposit Insurance Fund" from 21 December 2012.

<sup>93</sup> Art. 34 DPL.

<sup>94</sup> Art. 28 (4) DPL.

<sup>95</sup> Art. 30 DPL.

<sup>96</sup> Data provided by the Deposit Protection Fund.

<sup>97</sup> Art. 30 DPL.

<sup>98</sup> Art. 24 (20) DPL.

<sup>99</sup> Art. 31 DPL.



and to prevent a fire sale of T-bills, but proposes such a possibility in the draft MoU with the MoF.

53. DPF's Managing Board is responsible for the investment policy of the deposit insurance fund and the investment decisions in accordance with the policy<sup>100</sup>. The DPL establishes broad investment guidelines, according to which the funds shall be invested in: (i) government securities; (ii) securities issued by a foreign bank, a financial institution and/or a country holding a high rating assigned by an internationally recognized rating agency; and (iii) deposits in central banks and foreign banks holding high ratings assigned by an internationally recognized rating agency<sup>101</sup>. The DPF has an account with CBM and does not keep funds with commercial banks. As the amount of deposits kept in foreign currency is relatively small, no special investment policies (e.g. hedges of the currency risk) have been implemented in this regard.

54. The Managing Board has issued an Investment Policy<sup>102</sup>. The investment policy of the DPF is based on achieving the following objectives: (i) safety; (ii) liquidity; (iii) transparency; (iv) and income from investments. The primary objective of all investment decisions is security, in order to protect the capital in the fund<sup>103</sup>. The policy also includes an investment exposure limit of 20 percent of the total portfolio per investment. The DPF has appointed the CBM as its asset manager and concluded an agreement in this regard<sup>104</sup>. The CBM invests the funds in T-bills or keeps them in cash with central banks of Germany, Luxembourg, and The Netherlands. The Director General reports quarterly to the Board on the financial status of the deposit insurance fund and the development of the investment portfolio.

55. DPF is currently not applying a differential premium based system. The DPL already allows the Managing Board to set different premium rates for individual banks, depending on their rating and risk profile<sup>105</sup>. Such a system will have to be introduced once the DGSD, which provides for introduction of risk-based contributions and which is supplemented by EBA guidelines, is transposed into national law. The DPL and the MoU with the CBM already foresee that CBM will have to share all available data on the bank's rating and operating risk<sup>106</sup>. However, the introduction of risk-based premiums should not negatively impact the ability of the DPF to replenish itself and must therefore be designed in such a way as to be income neutral. DPF has already set-up a working group with the MoF and CBM to discuss a new contribution model.

56. Currently, there is no blanket guarantee for deposits in place in Montenegro<sup>107</sup>.

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<sup>100</sup> Art. 19 (1) Nr. 8 DPL.

<sup>101</sup> Art. 26 DPL.

<sup>102</sup> Investment Policy of the Deposit Protection Fund.

<sup>103</sup> Art. 5 of the Investment Policy of the Deposit Protection Fund.

<sup>104</sup> Agreement on Asset Manager No. 0104-245/1 signed May 7, 2012.

<sup>105</sup> Art. 29 DPL.

<sup>106</sup> Art. 29 (2) DPL.

<sup>107</sup> From October 2008 until the end of 2009, the Law on Measures for the Protection of the Banking Sector foresaw, in addition to other measures, a government guarantee for all deposits and for the full amount (regardless of the official coverage level).

57. The DPF and the authorities should push forward the on-going work of introducing risk-based contributions in line with the EU DGSD and EBA guidelines. Furthermore, DPF should no longer be allowed to invest in securities issued by (commercial) banks. The terms and conditions under which the DPF can borrow from the government (or ask for a government guarantee) should be formalized and DPF should explore ways to enter into repo-agreements. DPF's income should remain exempted from taxes, as is the case for other public funds.

### **Public Awareness (Core Principle 12)**

58. DPF is responsible and promotes public awareness on an ongoing basis using a variety of communication channels and tools. These include the website of DPF, brochures and TV and radio spots. The DPL stipulates that member institutions shall provide to its present and potential depositors written information on the deposit insurance scheme, which shall be easily available on the bank's premises and on the bank's website<sup>108</sup>. The information has to contain information on: (i) the right for compensation of the insured amount; (ii) the coverage level and the calculation of the insured amount; (iii) the circumstances under which DPF reimburses insured deposits ('protected event'); and (iv) the procedures under which the insured deposits are paid out<sup>109</sup>. Member institutions are not allowed to use the fact of membership in DPF for advertising for any of its banking products<sup>110</sup>, but rather are only allowed to inform in a neutral way about the membership in the DPF<sup>111</sup>.

59. The DPF has developed guidelines on how the deposit insurer and its member institutions should provide information on deposit insurance<sup>112</sup>. The DPF will provide depositors and the public with information on deposit insurance through easily accessible means, including electronic media, print media, its website and through direct communication with depositors and the public (phone, fax, mail and email). To raise awareness the DPF has developed information material which consists of (i) a brochure containing basic information about the deposit protection scheme; (ii) a poster with the DPF's logo; and (iii) a label with DPF's logo. The DPF is already allocating more than 30 percent of its annual budget for public awareness activities.

60. Member institutions are obliged to use the DPF's information material (brochures and posters) and display them in all premises where it does business with depositors<sup>113</sup>. The label with the logo of the DPF has to be on display at the front door of the bank and the counters designated for customer business. Furthermore, member institutions are obliged to hand over to every new depositor, when signing the contract, the DPF brochure and provide basic information on deposit insurance<sup>114</sup>. To ensure that

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<sup>108</sup> Art. 9 (1) DPL.

<sup>109</sup> Art. 9 (2) DPL.

<sup>110</sup> Art. 9 (5) DPL.

<sup>111</sup> Art. 14 "Guide to informing depositors and potential depositors about the deposit protection scheme".

<sup>112</sup> "Guide to informing depositors and potential depositors about the deposit protection scheme" from 12 March 2012.

<sup>113</sup> Art. 6 "Guide to informing depositors and potential depositors about the deposit protection scheme" from 12 March 2012.

<sup>114</sup> Art. 8 (1) "Guide to informing depositors and potential depositors about the deposit protection scheme" from 12 March 2012.

information is given in a correct manner, banks are further obliged to train their staff. DPF is delivering the information material to its member institutions and has offered seminars for bank staff in the past. The information brochure has also been distributed in combination with the four biggest newspapers which have a national circulation.

61. Twice in the past the DPF's Managing Board has adopted a communication strategy but always in connection with important changes in the overall framework (e.g. major amendments of the DPL in 2009)<sup>115</sup>. The policies identified certain target groups, main topics, communication channels and activities. However, a general, long term communication strategy is currently missing. Such a strategy should include specific milestones (e.g. to increase levels of awareness above a certain percentage) to be achieved and identify special budget needs for certain (future) activities. DPF can easily built on its earlier strategies to formulate a new one.

62. DPF's Guide to informing depositors also includes the requirement that the DPF conduct a survey to measure public awareness at least once in every three years<sup>116</sup>. The last survey was carried out in 2012<sup>117</sup>. Respondents were partially aware of the existence of DPF, but more than half had never heard of the DPF. Those respondents who knew of the existence of DPF had only a satisfactory level on the scope and limitations of DPF. While the results were not satisfactory the survey did note a positive trend of increase compared with the previous survey in 2008. The next PA survey is scheduled for the end of 2015.

63. In the event of a bank failure, the DPF will immediately release in electronic media, on its website and in at least two printed media distributed in Montenegro the information about the occurrence of the protected event (withdrawal of the banking license which triggers the deposit insurance), DPF's obligation to reimburse the insured deposits and the calculation method to determine the insured amount as well as the amount of guaranteed deposits<sup>118</sup>. Through the same communication channels, DPF will inform the insured depositors about the selection of one or more paying agent banks through which the uninsured deposits will be paid out on behalf of the deposit insurer<sup>119</sup>. The Guidelines prescribe that this information includes the name of the agent bank, the start date for the pay out, the branches where the payout will be done and the opening hours of these locations. However, the Guidelines do not foresee providing information about bankruptcy proceedings where depositors who lose the uninsured portion of their deposits can make claims.

64. The MoU with the CBM includes provisions for joint media appearances and a coordination of press releases in the case of a bank failure<sup>120</sup>. While there is currently no MoU with the MoF, a draft MoU foresees a coordination of media activities during a

<sup>115</sup> Strategy 2005 – 2006 and 2009 – 2010.

<sup>116</sup> Art. 5 (3) "Guide to informing depositors and potential depositors about the deposit protection scheme" from 12 March 2012.

<sup>117</sup> Public Opinion Poll, prepared by Megatrend Co Podgorica, December 2012.

<sup>118</sup> Art. 36 (4) DPL, Art. 13 (2) "Guide to informing depositors and potential depositors about the deposit protection scheme" from 12 March 2012.

<sup>119</sup> Art. 36 (6) DPL, Art. 13 (3) "Guide to informing depositors and potential depositors about the deposit protection scheme" from 12 March 2012.

<sup>120</sup> Art. 1.6 of the MoU between CBM and DPF from August 30, 2006.

payout of deposits. Similar provisions can be found in the NCP. The DPF's participation in the FSC would enable better contingency planning for joint public communications in a crisis situation.

65. Based on the results of the next public awareness survey, DPF should critically assess its current PA program. A long term strategy to be adopted by the Managing Board should identify milestones (level of public awareness to be achieved) and allocate budget for future PA activity needs. DPF should amend its Guide<sup>121</sup> to ensure that in a payout of deposits it would also inform about the possibility of interim payments (after this power has been given to DPF) and procedures whereby uninsured depositors can make claims to the bank bankruptcy administrator.

### **Legal protection (Core Principle 13)**

66. The DPL provides for legal protection for the Managing Board, the Director General and employees of the DPF in the implementation of their legally prescribed powers, unless it is proved that the activity in question has been performed in bad faith or as an act of gross negligence<sup>122</sup>. It is understood that this coverage would also protect former members of the Board or former staff in case they are sued after they have left the DPF<sup>123</sup>. The DPL further foresees that the DPF bears the costs of protecting the staff and others in litigation disputing the performance of duties in accordance with the DPL and its regulations<sup>124</sup>. The legal protection does not prevent legitimate challenges by depositors, claimants or banks and would therefore be in line with the CPs.

67. Members of the Managing Board and the Director General are bound under the DPL to disclose to the Managing Board any private interest which impairs the DPF's interests<sup>125</sup>. In addition, the members of the Managing Board, the Director General and the staff of DPF are obliged to act in accordance with the By-law and the Code of Ethics of the DPF which include detailed rules and codes of conduct to which Board members and staff are accountable.

68. The DPF should further specify the legal protection granted by the law in an internal guideline (e.g., that legal fees are covered by the DPF in advance). Furthermore, the law should also include those working at the direction of the DPF.

### **Dealing with parties at fault in a bank failure (Core Principle 14)**

69. In Montenegro, the DPF is not an authority responsible for carrying out investigations and criminal proceedings against persons who contributed to the failure of a bank. Investigations are carried out by the relevant authorities, the prosecution office, based on national laws. The failure of a bank as such is not an offence. But it may be caused by unlawful actions by parties at fault. Depending on the type of action, laws and

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<sup>121</sup> "Guide to informing depositors and potential depositors about the deposit protection scheme" from 12 March 2012.

<sup>122</sup> Art. 22 (1) DPL.

<sup>123</sup> Authorities might consider a clarification in the DPL to this extent.

<sup>124</sup> Art. 22 (2) DPL.

<sup>125</sup> Art. 17 DPL.

regulations provide the following types of punishment of persons managing a bank: criminal liability (e.g., imprisonment, restriction of liberty) and civil liability (e.g., compensation and court invalidation of civil actions).

### **Early detection and timely intervention (Core Principle 15) and Effective resolution processes (Core Principle 16)**

70. The DPF with its narrow mandate as a pay-box is not directly involved in the early detection or timely intervention in troubled banks. These responsibilities are with the CBM and its Banking Supervision Department. The DPF is currently not efficiently integrated into the early detection and intervention framework within the financial system safety-net as there is no MoU between the DPF and the MoF and DPF is not a member of the FSC<sup>126</sup>.

71. The CBM has a number of enforcement tools to require banks to effect corrective action. The Banking Law grants powers to the CBM to take (or require a bank to take) corrective actions and impose sanctions when banks do not comply with regulations for example if in its assessment the bank's financial viability could be threatened. These measures include requiring a bank to scale down or cease certain operations, establish adequate reserves for losses, sell assets, restrict or cease dividends, increase capital, and remove executive directors or board members, among others<sup>127</sup>. In practice measures to raise capital have been successfully imposed on several occasions over the last five years. CBM can also impose interim administration and require banks to undertake contingency planning, including for purposes of restoring capital and liquidity. The early detection and timely intervention framework will be further strengthened with the transposition of the EU BRRD into national law<sup>128</sup>.

72. CBM has extensive powers under the Banking Law to resolve a failing bank through interim administration<sup>129</sup>. Although in practice the CBM has not used these powers under the current law (in place since 2010), it has the authority under an adequate range of circumstances to appoint an interim administrator with the power to manage the affairs and restructure a bank. Upon appointment of the interim administrator the terms of office of board members and the duties of the executive directors are terminated and the administrator assumes the powers of the shareholders' General Meeting, the board and the executive directors. The Administrator has wide powers to restructure and resolve the bank, including to sell assets and to transfer assets and liabilities to another bank without the consent of depositors, creditors or shareholders. Under the Banking Law the CBM directs and supports the interim administration and has procedures in place for doing so. The outcome of interim administration for a failing bank is either the resolution via recapitalization or the transfer of some or all of the bank's assets and liabilities to another bank, or its bankruptcy.

73. There are no resolution provisions in the current law that enable the continued operation of a systemically important bank. In emergency circumstances, there is a

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<sup>126</sup> See discussion under "Relationship with other safety-net participants and contingency planning".

<sup>127</sup> Art. 116 Banking Law.

<sup>128</sup> The transposition of the BRRD into Montenegrin law is expected by the end of 2017.

<sup>129</sup> Art. 120 – 128 Banking Law.

possibility of enacting a legislation that would enable the providing of additional resolution powers to the government, including to nationalize a failing bank and to create a bridge bank. Such legislation could be submitted to parliament if and when the CBM council determines that current circumstances constitute a financial crisis and that existing primary and secondary legislation is insufficient to deal with the crisis. This legislation would enable, inter alia, the raising of the deposit coverage level from EUR 50,000 to EUR 100,000 and would allow DPF to use funds to support the transfer of deposits in a P&A transaction.

74. In general, the DPF should be able to use its funds to finance a P&A transaction. Such a transaction may well prove less costly than a payout of insured deposits in the context of bankruptcy, and would prove less disruptive to depositors and other bank clients as they maintain access to their deposits. The objective of a least cost resolution should be explicit in law. Policies for the conditions and limits under which DPF's funds could be used to support an extraordinary public sector financed resolution should be developed. DPF's funds should be used for this purpose only when the resolution results in a viable, solvent and restructured bank and insured depositors continue to have access to their deposits. The amount of its assistance should be restricted to the costs DPF would otherwise have incurred in a payout of insured deposits in a liquidation net of recoveries. The DPF should be informed and involved in the resolution decision-making process. Safeguards should be put in place to provide protections (via compensation) to the DPF against incurring costs in excess of that which it would have realized in bankruptcy.

75. The transposition and implementation of the BRRD into national law is critical to address the gaps in the resolution and crisis management toolkit to deal with problem banks. The new framework will include the designation of the resolution authority for banks and adequate resolution and recovery planning as well as the introduction of new resolution powers. Therefore, the conditions for a comprehensive resolution framework as well as cooperation and collaboration within the financial safety-net – as required under this CP – are still to be determined and implemented. The transposition into national law is in progress and is expected to come in force by the end of 2017.

### **Reimbursing depositors (Core Principle 17)**

76. Currently, DPF is required to start with the payout of insured deposits not later than 15 working days after the obligations of the deposit insurer are triggered<sup>130</sup>. This period may be extended for an additional ten working days upon request of a bank bankruptcy administrator and by decision of DPF's Managing Board<sup>131</sup>. The triggering event ("protected event") is the day the CBM passes a decision on commencing bankruptcy proceedings against a bank<sup>132</sup>. The initiation of bankruptcy proceedings is subject to challenge in an administrative court, but this is not seen as a significant constraint on the implementation of bankruptcy proceedings. A revoked license cannot be

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<sup>130</sup> Art. 36 (2) DPL.

<sup>131</sup> Art. 36 (3) DPL.

<sup>132</sup> Art. 4 (1) DPL.

restored. The withdrawal of the license should therefore be kept as one of the triggers, even when the DGSD is fully transposed<sup>133</sup>.

77. While the recent shortening of the payout timeframe is welcomed, the DPF should further reduce the payout delay. The DGSD foresees a timeframe of only 7 working days from 2024 onwards. The revised IADI CPs ask for a credible plan of the deposit insurer to meet a target of 7 working days<sup>134</sup>. With the transposition of DGSD into national law, the DPF should also implement a timeframe to shorten the payout to 7 working days.

78. The Banking Law foresees a general moratorium under interim administration<sup>135</sup>. The moratorium applies to incurrence of new liabilities and payment of liabilities by the bank with the possible exception only of the payment of insured deposits<sup>136</sup>. These actions are not only likely to impede the efficient resolution of the bank, but could lead to potential contagion to other financial institutions, and generally might undermine financial stability if insured deposits are blocked. If they are not exempted from the moratorium, as is permitted under the law, insured deposits should not be blocked longer than the payout timeframe of DPF under the DPL (currently, 15 working days). It is quite unlikely that a bank will leave the moratorium and return to business as usual as it has lost the confidence of its depositors, other clients and the wider market. Other country experiences show that a moratorium in almost every case leads to the bankruptcy of the bank and a payout of insured deposits.

79. The CBM is obliged to immediately inform DPF about its decision on commencing bankruptcy proceedings<sup>137</sup>. The bankruptcy administrator shall provide the DPF in electronic format with the information on a depositor's total claims and matured liabilities with the failed bank within 10 days<sup>138</sup>. Since the payout timeframe was recently shortened to 15 days, the deadline for the administrator should also be shortened to 5 – 7 days to give DPF enough time to verify the submitted data. The DPF has prepared a draft MoU to be signed with the administrator which details the cooperation and coordination with him during the payout. The CBM is obliged, within the scope of its authority, to initiate full cooperation with the trustee in a bankruptcy in the payment of insured deposits<sup>139</sup>.

80. In general, DPF is limited by law to the reimbursement method of using agent banks<sup>140</sup>. The DPF would decide on the selection of one or more banks for the payout<sup>141</sup>. The DPF will inform depositors of the failed bank (and the wider public) in at least two countrywide print media and on its webpage about the conditions and manner of the reimbursement process<sup>142</sup>. On the basis of the depositor data received through the

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<sup>133</sup> The DGSD foresees as triggers only the decision of the supervisor or a judicial authority that the institution is not able to repay deposits or deposits are unavailable.

<sup>134</sup> CP 15 EC 1 revised IADI Core Principles, November 2014.

<sup>135</sup> Art. 125 (3) Banking Law.

<sup>136</sup> Art. 125 (6) Banking Law.

<sup>137</sup> Art. 4 (2) DPL.

<sup>138</sup> Art. 37 (1) DPL.

<sup>139</sup> Art. 2.3 of the MoU between CBM and DPF from August 30, 2006.

<sup>140</sup> Art. 36 (5) DPL.

<sup>141</sup> Art. 7 of the "Decision on detailed conditions, manner and procedure of the guaranteed deposit payout".

<sup>142</sup> Art. 36 (6) DPL.

bankruptcy administrator, the DPF calculates the amount of insured deposits per depositor (including interest accrued) and passes this information to the agent bank where depositors can receive their insured amount. The DPF's payout software enables the DPF to control the payout process via an agent bank in real time. DPF has published a decision about the payout process<sup>143</sup>. However, the DPL does not allow the DPF the possibility of making interim payments, which would be useful in payout cases with prolonged delay due to, for example, technical problems.

81. DPF is working with its own payout manual and payout software (the same as has been used in Croatia by the DIS and been tested in several payouts) that would support the payout. DPF applies set-off with due claims and includes any accrued interest at the date of the protected event<sup>144</sup>. A unique identifier number for natural and legal persons which is available for every depositor supports the quick identification of depositors and calculation of insured amounts. The set-off of claims would provide no obstacle in the payout of insured deposits as DPF's software is able to handle this issue<sup>145</sup>. DPF itself calculates the insured amount and is not relying on a calculation done by the member institution. Currently, DPF is testing the depositor records of one member institution a year. However, this testing is now being performed on a voluntary basis and a clear mandatory requirement for this process is missing from the law. CBM can assign DPF staff upon request of the deposit insurer to bank inspection teams, and DPF has in fact requested such an assignment which has been granted<sup>146</sup>.

82. DPF has adequate resources and trained personnel dedicated to the reimbursement function for a small payout. It could also rely on external service providers (e.g. a call center), but has not secured such support upfront. Due to its limited manpower, such prearranged support can become crucial even in a medium sized payout or when several small banks fail at the same time. A post-mortem of bank payouts is not foreseen by DPF's internal procedures.

83. In line with the DGSD and international best practice, DPF should plan to reduce its payout timeframe to 7 working days. In this context, the authorities should critically assess the ability of the deposit insurer to apply set-off under a stricter payout timeframe. The DPL should give the DPF more reimbursement methods in addition to its current use of agent banks. There could be bank failures where other reimbursement tools such as direct payments to depositors or the transfer of insured deposits through a closed bank P&A transaction might be more efficient than using an agent bank.

84. As a matter of contingency planning, DPF should have signed agreements in place with a small number of potential payout agent banks. This would minimize the time needed to prepare for the reimbursement of insured deposits. To ensure it is prepared for the demands of a larger payout, the DPF should have other outsourcing procedures (e.g.

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<sup>143</sup> "Decision on detailed conditions, manner and procedure of the guaranteed deposit payout" from 2012.

<sup>144</sup> Art. 5 (1) DPL.

<sup>145</sup> Authorities should critically re-assess if they can handle set-off when they further reduce the payout timeframe to 7 working days.

<sup>146</sup> Art. 2.2 of the MoU between CBM and DPF from August 30, 2006.



call center, IT experts, observers of the payout process) in place. DPF should also be allowed to make interim payments.

85. To be able to prepare for closing activities, DPF should be given early warning of potential failures through its membership in the FSC. Insured deposits should not be unavailable under a moratorium as this would contradict the deposit insurance arrangements and could possibly lead to contagion. The bank bankruptcy administrator should be obliged to provide the DPF with the necessary data within 5 – 7 days for the calculation of the reimbursement amounts as the payout timeframe has been reduced. A post-mortem of bank payouts should be required by DPF's internal procedures.

### **Recoveries (Core Principle 18)**

86. After the withdrawal of the banking license by CBM<sup>147</sup> and after CBM has appointed a Bankruptcy Administrator, DPF can claim the rights of insured depositors of the failed bank in regard to their insured deposits, regardless of the amount and the date on which the deposit insurer makes payments on the guaranteed amount to any depositor<sup>148</sup>. Through subrogation after the payout, DPF shares in the recoveries of the estate of the failed bank<sup>149</sup>. The BBL stipulates a clear creditor hierarchy in bank bankruptcies: (i) secured claims; (ii) debts to the central bank and the costs of the bank bankruptcy, (iii) claims for which the DPF is subrogated; (iv) deposits of eligible depositors (natural and legal persons) above the coverage level; (v) claims of other depositors; (vi) claims of other creditors; etc.<sup>150</sup>. Costs of DPF from the reimbursement process are not recognized as a claim.

87. The BBL grants the CBM a strong position in bank bankruptcies as it appoints and exercises control over the activities of the bankruptcy administrator (via the bankruptcy board). CBM has the right to appoint the administrator from a list it maintains<sup>151</sup>. Furthermore the CBM appoints a five member Bankruptcy Board<sup>152</sup>, which is a body of the central bank, to supervise the administrator, comparable to a Creditors Committee. This Board can include central bank staff but also others, potentially a representative of the DPF.

88. The Bankruptcy Administrator is bound by law to cooperate with the DPF and must submit to the DPF depositor data and, if required by the DPF, documents needed for the calculation and payout of insured deposits<sup>153</sup>. The initiation of bankruptcy proceedings can be challenged in administrative courts, but the courts cannot reverse the decision, nor prevent the opening of formal bankruptcy proceedings, thereby delaying the recovery process<sup>154</sup>. Overall, the bankruptcy process and the administrator's work are

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<sup>147</sup> Art. 129 Banking Law.

<sup>148</sup> Art. 38 DP (2) L.

<sup>149</sup> Art. 38 DPL (1).

<sup>150</sup> Art. 48 BBL.

<sup>151</sup> Art. 26 LBB.

<sup>152</sup> Art. 17 BBL.

<sup>153</sup> Art. 13 Nr. 3a BBL.

<sup>154</sup> Court decisions are limited to assessing a damages remedy only.

guided by commercial and economic considerations and in the interest of creditors to maximize recoveries<sup>155</sup>.

89. It should also be considered to make DPF a mandatory member of the Bankruptcy Board as the deposit insurer will be always one of the biggest creditors in a bank bankruptcy due to subrogation and has therefore a particular interest in how the bankruptcy is managed. Costs incurred by the DPF from the reimbursement procedures should also be recognized as a claim in the bankruptcy. Clear rules which explicitly prohibit financial safety-net participants, and those working on behalf of the deposit insurer, to buy assets from a failed bank are currently missing. Such rules should be introduced.

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<sup>155</sup> Art. 45 BBLL.

## ANNEX 1. DEPOSIT INSURANCE SYSTEM ASSESSMENT TABLE

<p><b>Core Principle 1: Public policy objectives. The first step in adopting a deposit insurance system or reforming an existing system is to specify appropriate public policy objectives that it is expected to achieve. These objectives should be formally specified and well integrated into the design of the deposit insurance system. The principal objectives for deposit insurance systems are to contribute to the stability of the financial system and protect depositors.</b></p>	
<b>Description</b>	<p>DPF's public policy objectives (protecting the interests of depositors and contributing to the banking system's stability) are formally specified, and publically disclosed via the DPL and publications of the DPF. The PPOs are well integrated into the design features of the deposit insurance system as a narrow pay-box. DPF is missing a (formal) internal as well as an external review process of how it meets its PPOs.</p>
<b>Comments</b>	<p>DPF should establish an internal review process on a regular basis (at least every 5 years) which also includes the views of stakeholders (member banks, consumer groups). A formal external review should also take place on a regular basis (to be done by the parliament, an external auditing firm or IADI).</p>
<p><b>Core Principle 2: Mitigating moral hazard. Moral hazard should be mitigated by ensuring that the deposit insurance system contains appropriate design features and through other elements of the financial system safety net.</b></p>	
<b>Description</b>	<p>The design of the deposit insurance system recognizes the existence of moral hazard and mitigates it as much as possible, in line with public policy objectives. However, the bank resolution framework can be further strengthened with the transposition of the EU BRRD. This is of particular importance given that the coverage limit is relatively high, covering fully 99.26 percent of insured depositor accounts.</p>
<b>Comments</b>	<p>DPF is currently not applying risk weighted premiums and should implement such a premium system (DPF is already in the process of discussing such a system with other stakeholders). Weaknesses in the resolution framework should be addressed through the transposition of BRRD (foreseen for 2017).</p>

<b>Core Principle 3: Mandate. It is critical that the mandate selected for a deposit insurer is clearly and formally specified and that there is consistency between the stated public policy objectives and the powers and responsibilities given to the deposit insurer.</b>	
<b>Description</b>	The DPF's mandate as a pay box is clearly specified in the DPL and consistent with the public policy objectives and the DPF's powers and responsibilities.
<b>Comments</b>	None
<b>Core Principle 4: Powers. A deposit insurer should have all powers necessary to fulfil its mandate and these should be formally specified. All deposit insurers require the power to finance reimbursements, enter into contracts, set internal operating budgets and procedures, and access timely and accurate information to ensure that they can meet their obligations to depositors promptly.</b>	
<b>Description</b>	The DPL provides the DPF with most of the powers necessary to fulfil its mandate and the DPF Managing Board is making use of these powers effectively. However, DPF is limited to making a payout of insured deposits via an agent bank. It cannot finance the transfer of deposits from a failed bank to a third bank or make interim payments.
<b>Comments</b>	DPF's powers should be enhanced to also include the power to finance the transfer of deposits (a P&A) as well as other reimbursement tools and the power to make interim payments.
<b>Core Principle 5: Governance. The deposit insurer should be operationally independent, transparent, accountable and insulated from undue political and industry influence.</b>	
<b>Description</b>	<p>The governance structure of the DPF demonstrates operational independence, transparency, accountability and integrity. However, an internal audit function is missing. The DPF Board has also not adopted a general strategic plan; plans in the past were related to special circumstances (e.g. the introduction of a revised deposit insurance law).</p> <p>The revised IADI CP foresee that a Managing Board should not be dominated by other members of the safety-net, nor should a member of the safety-net serve as Chair. Two of DPF's Board members come from the safety-net (CBM and MoF) and the representative of the CBM serves as the Chair.</p>
<b>Comments</b>	Board members should serve on staggered terms to keep crucial institutional knowledge within the Board when members leave. The

	<p>Managing Board should adopt a multi-annum strategic plan. DPF should implement an internal audit function appropriate to its size.</p> <p>The authorities should consider enlarging the Managing Board (in view of the revised IADI CP) in order to minimize the dominant influence of other safety-net participants.</p>
<p><b>Core Principle 6: Relationships with other safety-net participants. A framework should be in place for the close coordination and information sharing, on a routine basis as well as in relation to particular banks, among the deposit insurer and other financial system safety-net participants. Such information should be accurate and timely (subject to confidentiality when required). Information-sharing and coordination arrangements should be formalized.</b></p>	
<p><b>Description</b></p>	<p>A MoU exists between the CBM and the DPF which supports the deposit insurer in fulfilling its current mandate. However, DPF has no MoU with the MoF (a tri-partite MoU between DPF, CBM and MoF seems to be inactive). DPF is not a member of the Financial Stability Council (FSC) and may only participate as a guest in its meetings when invited. The last crisis simulation which tested the National Contingency Plan was performed without the participation of the DPF.</p>
<p><b>Comments</b></p>	<p>DPF and MoF should sign a MoU. DPF should become a member of the FSC. All safety-net participants should engage in contingency planning, critically revisit the National Contingency Plan, develop a resolution manual which specifies the roles of all safety-net participants and hold a system-wide crisis simulation exercise.</p> <p>The MOU between CBM and DPF should be improved to make clear that the CBM will inform the DPF of any applications for amalgamation, merger, bank de-merger, division and any meetings with potential bank founders. There should also be notification to DPF of the approval of both domestic and foreign branches.</p>
<p><b>Core Principle 7: Cross-Border Issues. Provided confidentiality is ensured, all relevant information should be exchanged between deposit insurers in different jurisdictions and possibly between deposit insurers and other foreign safety-net participants when appropriate. In circumstances where more than one deposit insurer will be responsible for coverage, it is important to determine which deposit insurer or insurers will be responsible for the reimbursement process. The deposit insurance already provided by the home country system should be recognized in the determination of levies and premiums.</b></p>	
<p><b>Description</b></p>	<p>Cross-border issues are of high importance for DPF as the banking system in Montenegro is primarily foreign owned and the current</p>

	arrangements need improvement. DPF has not signed any MoUs with foreign deposit insurers and relies fully on information received from CBM.
<b>Comments</b>	DPF is encouraged to engage in cross-border cooperation with other relevant deposit insurers on information exchange and coordination as it has no arrangements in place.
<b>Core Principle 8: Compulsory membership. Membership in the deposit insurance system should be compulsory for all financial institutions accepting deposits from those deemed most in need of protection (e.g. retail and small business depositors) to avoid adverse selection.</b>	
<b>Description</b>	Membership in the DPF is compulsory for all banks taking deposits and licensed by the CBM and for foreign branches without deposit insurance. DPF is informed in time by CBM about the issuing of new licenses.
<b>Comments</b>	None
<b>Core Principle 9: Coverage. Policymakers should define clearly in law, prudential regulations or by-laws what is an insurable deposit. The level of coverage should be limited but credible and be capable of being quickly determined. It should cover adequately the large majority of depositors to meet the public policy objectives of the system and be internally consistent with other deposit insurance system design features.</b>	
<b>Description</b>	Insured (guaranteed) deposits are clearly defined in law and reflect the public policy objectives. Coverage is limited to EUR 50,000 per depositor per bank which is relatively high (e.g., covering 99.26 percent of insured depositors fully). Thus it is important that safety-net participants maintain an effective supervisory and regulatory system and other measures to mitigate moral hazard.
<b>Comments</b>	In the event of a merger of separate banks, the DPL should foresee that the deposits held with these banks before the merger would enjoy separate coverage for a limited period after the merger (e.g. 3 months). The definitions of “deposit” in the DPL and the Banking Law should be made consistent, by defining deposit in the Banking Law and having the Deposit Protection Law cross-reference that definition.

<p><b>Core Principle 10: Transitioning from a blanket guarantee to a limited coverage deposit insurance system. When a country decides to transition from a blanket guarantee to a limited coverage deposit insurance system, or to change a given blanket guarantee, the transition should be as rapid as a country’s circumstances permit. Blanket guarantees can have a number of adverse effects if retained too long, notably moral hazard. Policymakers should pay particular attention to public attitudes and expectations during the transition period.</b></p>	
<b>Description</b>	The Core Principle is not applicable as there is currently no blanket guarantee in Montenegro.
<b>Comments</b>	None
<p><b>Core Principle 11: Funding. A deposit insurance system should have available all funding mechanisms necessary to ensure the prompt reimbursement of depositor’s claims including a means of obtaining supplementary back-up funding for liquidity purposes when required. Primary responsibility for paying the cost of deposit insurance should be borne by banks since they and their clients directly benefit from having an effective deposit insurance system. For deposit insurance systems (whether ex-ante, ex-post or hybrid) utilizing risk-adjusted differential premium systems, the criteria used in the risk-adjusted differential premium system should be transparent to all participants. As well, all necessary resources should be in place to administer the risk-adjusted differential premium system appropriately.</b></p>	
<b>Description</b>	The DPF is well funded through member banks’ premiums and has a variety of funding mechanisms available, including access to supplementary back-up funding from the state budget and a contingent credit-line with EBRD, to ensure the prompt reimbursement of depositors claims. Currently, the DPF is not applying risk-based contributions.
<b>Comments</b>	DPF should explore ways to enter into repo-agreements and engage with MoF to specify the conditions for pre-arranged supplementary back-up funding from the budget or state guarantees. The DPF should apply risk-based contributions (DPF is currently working on such a premium system). DPF should abolish the possibility of investing its funds into commercial banks’ securities. DPF’s income should remain exempt from taxes, as is the case for other public funds.
<p><b>Core Principle 12: Public Awareness. In order for a deposit insurance system to be effective it is essential that the public be informed on an ongoing basis about the benefits and limitations of the deposit insurance system.</b></p>	
<b>Description</b>	The DPF undertakes a range of good practices to promote public awareness about deposit insurance on an ongoing basis. Depositors

	are also informed through member institutions which use information material prepared by the deposit insurer.
<b>Comments</b>	Based on the results of the next public awareness survey, DPF should critically assess its current PA program. A long term strategy to be adopted by the Managing Board should identify milestones (the level of public awareness to be achieved) and allocate budget for future PA activity needs. DPF should amend its guidelines to ensure that in a payout of deposits it would also provide information about the possibility of interim payments (after this power has been given to DPF) and procedures whereby uninsured depositors can make claims with the bank bankruptcy administrator.
<b>Core Principle 13: Legal Protection. The deposit insurer and individuals working for the deposit insurer should be protected against lawsuits for their decisions and actions taken in “good faith” while discharging their mandates. However, individuals must be required to follow appropriate conflict-of-interest rules and codes of conduct to ensure they remain accountable. Legal protection should be defined in legislation and administrative procedures, and under appropriate circumstances, cover legal costs for those indemnified.</b>	
<b>Description</b>	The DPL provides for legal protection for the Managing Board, the Director General and employees of the DPF in the implementation of their legally prescribed powers. DPF believes the protection would extend to former employees. Appropriate conflict of interest rules exists for the Managing Board and staff.
<b>Comments</b>	The DPF should further define the legal protection granted by the law in an internal guideline (e.g. that legal fees are covered by the DPF in advance). Furthermore, the law should also include those working at the direction of the DPF.
<b>Core Principle 14: Dealing with parties at fault in a failure. A deposit insurer, or other relevant authority, should be provided with the power to seek legal redress against those parties at fault in a bank failure.</b>	
<b>Description</b>	The relevant authorities (e.g. the Prosecution Office) and the administrator (in a bank bankruptcy) are provided with appropriate powers to seek legal redress against those parties deemed to be at fault in a bank failure.
<b>Comments</b>	None



<p><b>Core Principle 15: Early detection and timely intervention and resolution. The deposit insurer should be part of a framework within the financial system safety net that provides for the early detection and timely intervention and resolution of troubled banks. The determination and recognition of when a bank is or is expected to be in serious financial difficulty should be made early and on the basis of well-defined criteria by safety-net participants with the operational independence and power to act.</b></p>	
<b>Description</b>	The deposit insurer is not part of an early detection framework within the financial safety-net as DPF is not a member of the FSC. The CBM has a number of enforcement tools to require banks to effect corrective action.
<b>Comments</b>	The DPF should become a member of the FSC and engage with the safety-net in crisis preparedness and management exercises.
<p><b>Core Principle 16: Effective resolution processes. Effective failure-resolution processes should: facilitate the ability of the deposit insurer to meet its obligations including reimbursement of depositors promptly and accurately and on an equitable basis; minimise resolution costs and disruption of markets; maximise recoveries on assets; and, reinforce discipline through legal actions in cases of negligence or other wrongdoings. In addition, the deposit insurer or other relevant financial system safety-net participant should have the authority to establish a flexible mechanism to help preserve critical banking functions by facilitating the acquisition by an appropriate body of the assets and the assumption of the liabilities of a failed bank (e.g. providing depositors with continuous access to their funds and maintaining clearing and settlement activities).</b></p>	
<b>Description</b>	CBM has extensive powers under the Banking Law to resolve a failing bank through interim administration. The Interim Administrator has wide powers to restructure and resolve the bank, including to sell assets and to transfer assets and liabilities to another bank. There are no resolution provisions in the current law that enable the continued operation of a systemically important bank.
<b>Comments</b>	Deficiencies in the resolution framework for problem banks should be addressed through the development of draft legislation for an enhanced resolution framework in line with BRRD (foreseen for 2017).

<p><b>Core Principle 17: Reimbursing depositors. The deposit insurance system should give depositors prompt access to their insured funds. Therefore, the deposit insurer should be notified or informed sufficiently in advance of the conditions under which a reimbursement may be required and be provided with access to depositor information in advance. Depositors should have a legal right to reimbursement up to the coverage limit and should know when and under what conditions the deposit insurer will start the payment process, the time frame over which payments will take place, whether any advance or interim payments will be made as well as the applicable coverage limits.</b></p>	
<p><b>Description</b></p>	<p>Currently, DPF is obliged to reimburse depositors within 15 business days. DPF has recently updated its payout software for the payment of insured deposits and is testing member banks' depositor data. The DPF can verify data on-site together with CBM. DPF is limited to repay deposits via the use of agent banks. The Banking Law foresees the imposition by CBM of a general moratorium on payments of liabilities by a bank of up to 180 days with the only possible exception of the payment of insured deposits.</p>
<p><b>Comments</b></p>	<p>DPF should have a credible plan to shorten the payout timeframe to 7 business days. The DPF should have the power to use other reimbursement methods that may include payments or the transfer of deposits through closed bank P&amp;A transactions and make interim payments. Although the DPF has tested depositor data in the past, this testing should be made mandatory, take place on a more frequent basis and involve more banks. In conjunction with this, DPF should pre-arrange the use of agent banks for payouts, call-centers and other contractors.</p> <p>Insured deposits should not be unavailable under a moratorium as this would contradict the deposit insurance arrangements and could possibly lead to contagion. The bank bankruptcy administrator should be obliged to provide the DPF with the necessary data within 5 – 7 days for the calculation of the reimbursement amounts as the payout timeframe has been reduced. To be able to prepare for closing activities, DPF should be given early warning of potential failures through its membership in the FSC.</p>

<p><b>Core Principle 18: Recoveries. The deposit insurer should share in the proceeds of recoveries from the estate of the failed bank. The management of the assets of the failed bank and the recovery process (by the deposit insurer or other party carrying out this role) should be guided by commercial considerations and their economic merits.</b></p>	
<p><b>Description</b></p>	<p>The DPF does not play a role in the bankruptcy procedure, which is supervised by CBM. The DPF shares in the proceeds of recoveries from failed banks. Asset management practices emphasize maximizing economic returns in the interest of creditors. Insured deposits enjoy depositor preference.</p>
<p><b>Comments</b></p>	<p>Consideration should be given to the possibility of making DPF a member of the bankruptcy board. Costs incurred by DPF from the reimbursement procedures should also be recognized in bankruptcy procedures. Clear rules should be in place that prevent other financial safety-net participants from buying assets from a failed bank.</p>