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**Deposit Protection Fund**

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**ANNUAL REPORT  
2007.**



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## 1. INTRODUCTION

The Deposit Protection Fund (hereinafter: the Fund) was established pursuant to the Deposit Protection Law (Official Gazette of the Republic of Montenegro, no 40/03 and 65/05). With respect to the performance of its main activity, the Fund is exempt from taxation and any other duties. The Fund commenced its operations on 1 January 2006. Natural and legal persons holding accounts with commercial banks in Montenegro are included in the deposit insurance scheme.

The Fund is governed by the Management Board consisting of the President and four members.

On 4 January 2007, the Fund, together with the Montenegrin Ministry of Finance and the Central Bank of Montenegro, signed the Agreement with KfW on donation to be provided by the German Government to Montenegro aimed at increasing financial capacity of the Deposit Protection Fund and technical assistance for capacity building in the following three years. Having fulfilled the criteria set out in the Agreement, the Fund received EUR 2.5 million grant on 23 July 2007 for the capitalisation of its assets and an additional EUR 0.5 million of technical assistance funds.

As at 31 December 2007 there were 11 banks operating in the Montenegrin banking system (Atlas Mont Bank AD Podgorica; Crnogorska Komercijalna Bank AD Podgorica; First Financial Bank AD Podgorica; Hipotekarna banka AD Podgorica; Hypo Alpe Adria bank AD Podgorica; Invest banka Montenegro AD Podgorica; Komercijalna banka AD Budva; NLB Montenegro banka AD Podgorica; Prva banka Crne Gore AD Nikšić; Opportunity bank AD Podgorica and Podgorička banka Societe Generale Group AD Podgorica. All banks are members of the Fund.

Member banks of the Fund increased in relation to 2007:

- First Financial Bank AD commenced its operations after being licensed by the Central Bank of Montenegro on 12 October 2007, registering at the Commercial Court and thus fulfilling
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conditions for becoming a member of the Fund. During the reporting period, the bank was involved only in wholesale banking;

- In October 2007 the Central Bank informed the Fund that two banks, Hipotekarna banka AD-Podgorica and Invest banka Montenegro AD-Podgorica, were no longer under the measures imposed against them by the Central Bank, so they also fulfilled the necessary conditions and became members of the Fund.
- The aforesaid changes affected the Fund's operations resulting in increased revenues from premiums in the fourth quarter, yet larger potential exposure of the Fund to the amount of guaranteed deposits in the member banks.

Employees of the Fund performed the following activities in 2007:

- monitoring of the movement of all deposits;
- collection of the premiums;
- monitoring investments of the Fund's assets;
- preparation of the required reports for 2006 (Annual Report for 2006, the Financial reports of the Fund for 2006 and the Independent Auditor's Report for 2006, and reporting to KfW in accordance with the obligations set out in the Donation Agreement);
- preparation of the Financial plan and the Annual Programme of the Fund for 2008;
- rounding off of the normative regulations of the Fund by adopting new documents (Rules on the performance and organisation of financial and accounting operations with the Chart of Accounts; the Rules on Professional Secret; The Rulebook on clerical and archival operations; Decision on the annual premium for 2008);
- marketing presentation of the deposit protection scheme in the media and via promotional material and the establishment of cooperation with other corresponding Funds and international institutions.

## 2. ANALYSES

### 2.1. Analysis of deposit trends

All deposits showed dynamic growth in the period 2005 – 2007, as shown in Table 1.

*Table 1- Movement of banking deposits in the period 31 December 2005 - 31 December 2007*

Period	Total deposits		Excluded deposits		Protected deposits		Guaranteed deposits	
	000 EUR	Index	000 EUR	Index	000 EUR	Index	000 EUR	Index
31.12.05.	472.560	100	131.738	100	260.994	100	52.787	100
31.12.06.	1.032.465	218	180.820	137	712.698	273	112.506	213
31.12.07.	2.099.373	444	292.374	222	1.605.143	615	186.455	353

The comparison of data as at 31 December 2005 and those at 31 December 2007 shows that all deposits increased over the period: total deposits by 4.4 times, excluded deposits by 2.2 times, protected deposits by 6.6 times and guaranteed deposits by 3.5 times. The uptrend in deposits continued in 2007 as well, as presented in Table 2.

*Table 2 - Movement of banking deposits in 2007*

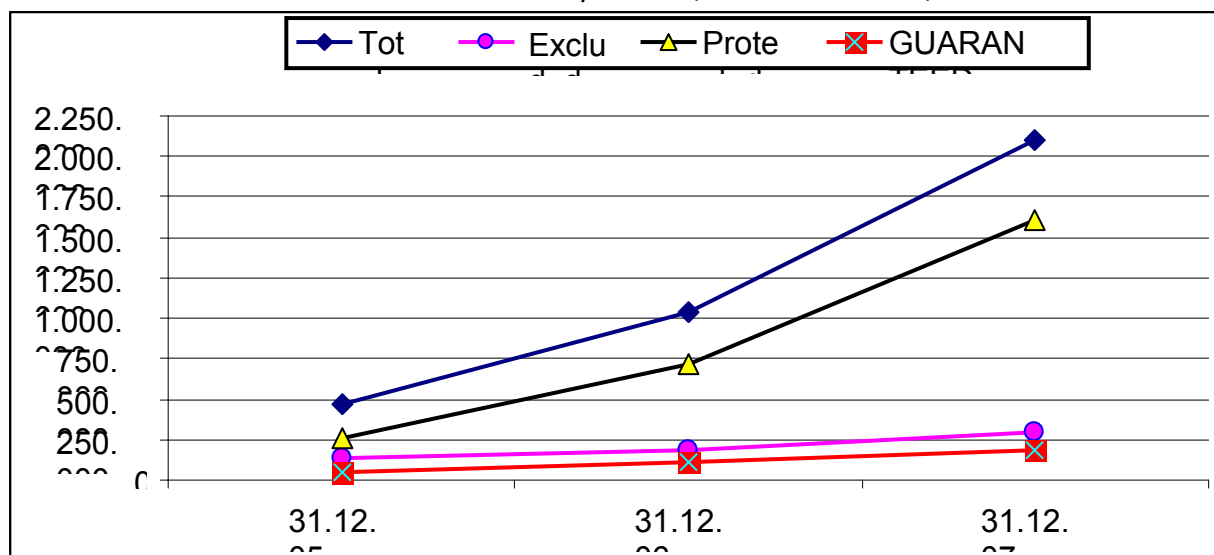
Period	Total deposits		Excluded deposits		Protected deposits		Guaranteed deposits	
	000 EUR	Index	000 EUR	Index	000 EUR	Index	000 EUR	Index
01.01.07.	1.032.465	100	180.820	100	712.698	100	112.506	100
31.03.07.	1.259.450	122	228.947	127	887.107	124	136.589	121
30.06.07.	1.550.470	150	259.365	143	1.123.668	158	148.304	132
30.09.07.	1.785.079	173	236.033	131	1.360.270	191	166.361	148
31.12.07.	2.099.373	203	292.374	162	1.605.143	225	186.455	166

#### 2.1.1. Total deposits

The year-on-year increase in **total** deposits in 2007 amounted to 103%. Banks' lending activity increased substantially over 2006 and 2007, which resulted in

rather large credit expansion, which partly affected an increase in total deposits. Total deposits primarily rose due to large sales of real estates, significant inflows of funds arising from privatisation, and larger volume of tourism services. The movement of all deposits in the period 31 December 2005 – 31 December 2007 are presented in Chart 1.

**Chart 1- Movement of deposits (EUR thousand)]**



### 2.1.2. Excluded deposits

Pursuant to Article 5 of the deposit Protection Law, excluded deposits are those which are automatically excluded from the insurance scheme.

The index of excluded deposits growth (Table 1) is lower than that of other deposit categories. A share of excluded deposits in total deposits showed a continuous downtrend in 2007, and one of the reasons for this decline is that a part of the Government and local authorities' deposits was moved from banks' accounts to the account with the Central Bank of Montenegro in 2006. The percentage share of excluded deposits in total deposits declined from 18% as at 31 December 2006 to 13.9% as at 31 December 2007.

### 2.1.3. Protected deposits

**Protected deposit** of a depositor, within the meaning of Article 6 of the Deposit Protection Law, is determined by adding up all the protected deposits of such a depositor, including any accrued interest on such deposits and reducing the obtained amount by the depositor's liabilities to the bank. The movement of these deposits is presented in Table 4.

*Table 4 - Movement of protected deposits*

Period	31.12.05.		31.12.06.		31.12.07.	
	000 EUR	Index	000 EUR	Index	000 EUR	Index
Protected deposit ≤ 5.000 €	24.882	100	45.966	185	70.436	283
Protected deposit > 5.000 ≤10.000 €	15.735	100	33.820	215	54.393	346
Protected deposit > 10.000 ≤20.000 €	22.993	100	51.296	223	89.801	391
Protected deposit > 20.000 ≤100.000 €	64.322	100	156.938	244	289.570	450
Protected deposit > 100.000 €	133.062	100	424.678	319	1.100.943	827
<b>Total - Protected deposits</b>	<b>260.994</b>	<b>100</b>	<b>712.698</b>	<b>273</b>	<b>1.605.143</b>	<b>615</b>

The year-on-year increase in protected deposits in 2007 amounted to 125%. The category of protected deposits over EUR 100,000 accounted for 68.6% of protected deposits as at 31 December 2007, showing the highest growth index in relation to all other deposit categories (Table 4).

### 2.1.4. Guaranteed deposits

**Guaranteed deposit** is a part of the protected deposit by a depositor held with a bank, the payment of which is made by the Fund in case of an occurrence of the protected event and up to the amount of EUR 5,000.

*Table 5 - Movement of guaranteed deposits*

Period:	31. 12. 05.		31. 12. 06.		31. 12. 07.	
Type of deposits	000 EUR	Index	000 EUR	Index	000 EUR	Index
Guaranteed deposits	52.787	100	112.506	213	186.455	353

The year-on-year growth index of guaranteed deposits amounted to 166 as at 31 December 2007, whereas in comparison with end-2005 it was 353. In the structure of guaranteed deposits, those of the corporate sector and natural persons accounted for 17.5% and 82.5%, respectively.

*Table 6 - Movement of average guaranteed deposit*

Period:	31. 12. 05.		31. 12. 06.		31. 12. 07.	
Type of deposits	EUR	Index	EUR	Index	EUR	Index
Average guaranteed deposit	212	100	373	176	473	223
Average guaranteed deposit by natural persons	172	100	333	194	426	248
Average guaranteed deposit by legal persons	360	100	834	232	993	276

**An average guaranteed deposit** as at 31 December 2007 amounted to EUR 473, which is 26.8% more than at year-end 2006.

**An average guaranteed deposit by legal persons** amounted to EUR 993 at end-2007, which is the year-on-year increase of 19.1%.

**An average guaranteed deposit of private individuals** amounted to EUR 426 as at 31 December 2007, which is 27.9% more than the average at end-2006.



## 2.1.5. Depositors

A depositor is a natural or legal person holding a deposit with a bank in accordance with the law and signed agreement. During 2007, the number of depositors, both legal and natural persons, increased. The number of depositors increases partly due to the fact that a legal or a natural person may hold deposits with more than one bank.

*Table 7- Movement of total depositors*

Period	31.12.05.		31.12.06.		31.12.07.	
	Number	Index	Number	Index	Number	Index
Total number of depositors	398.879	100	475.998	119	631.882	158
No. of depositors holding Excluded deposits	1.786	100	1.235	69	1.376	77
No. of depositors holding Protected deposits	397.093	100	474.736	120	630.506	159

The number of depositors showed the year-on-year increase in 2007 of 33.1% (natural persons by 31.9% and legal persons by 45.4%), and a 58.4% increase in relation to end-2005.

*Table 7a - Movement of depositors holding protected and guaranteed deposits*

Period	31.12.05.		31.12.06.		31.12.07.	
	Number	Index	Number	Index	Number	Index
No. of depositors holding protected deposits	248.500	100	302.005	122	394.306	159
Depositors- natural persons	229.803	100	278.286	121	361.432	157
Depositors-legal persons	18.697	100	23.719	127	32.874	176

The number of depositors holding protected deposits is equal to the number of depositors holding guaranteed deposits. The number of depositors holding protected deposits recorded the year-on-year increase in 2007 of 30.6%, of which the number of natural person depositors rose by 29.9% and that of legal person depositors increased by 38.6%.

## 2.2. Fund's revenues and expenditures in 2007

### 2.2.1. Revenues

Total revenues of the fund in 2007 amounted to EUR 3,434,181, which is 29% more than planned.

#### 2.2.1.1. Revenues from the initial premium

The Fund's revenues from the initial premium amounted to EUR 119,590, being EUR 69,590 or 139% higher than planned. In the fourth quarter of 2007, three banks became members of the Fund. Two of them, Hipotekarna banka AD Podgorica and Invest banka Montenegro were under the measures imposed against them by the Central Bank of Montenegro until October 2007, after when they fulfilled conditions for the Fund membership and paid the initial premium to the amount of 0.3% of their total deposits. Hipotekarna banka paid EUR 99,273 and Invest banka Montenegro paid EUR 10,317 of the initial premium.

The newly established bank, First Financial Bank, paid the initial premium of EUR 10,000 in line with the law after being licensed by the Central Bank and registered at the Commercial Court.

#### 2.2.1.2. Revenues from the annual premium

Banks are obliged to pay the annual premium in quarterly instalments in line with the **Decision on the Establishment of the Annual Premium for 2007 which was passed by the Management Board of the Fund** (the established annual rate was 0.25%, the same as in the previous year).

**Table 10-** Collected annual premium in 2007, EUR

Date	2007-01-20	2007-04-20	2007-07-20	2007-09-20	Ukupno
Amount	577.334	727.214	907.932	1.092.222	3.304.701

The total amount of the annual premium collected was EUR 3,304,701, which is EUR 704,355 or 27% more than planned. Namely, the projected quarterly increase in deposits in banks during 2007 was 12%, but the actual quarterly increase was 19.5%, on average.

### 2.2.1.3. Revenues from invested funds

The total return on investments amounted to EUR 214,868, being EUR 63,592 or 46.6% higher than planned due to the larger available funds than originally planned. In addition, investments were made at the yield rate higher than planned (planned rate was 2.5% and the received rate ranged between 3.5% and 4.48%).

Most of the funds raised from collected premiums in 2007 the Fund invested through the Central Bank of Montenegro and received revenues to the amount of EUR 171,855.37.

The return on donation received from the German Government to the amount of EUR 2.5 million transferred to the account with the Deutsche Bundesbank on 23 July 2007 amounted to EUR 43,012.27 and the entire amount was reinvested.

The average interest rate on time deposits held with the Central Bank amounted to 4.18%; 3.74% on overnight deposits; and 3.81% on donated funds placed as time deposits with the Deutsche Bundesbank. The financial plan of the Fund projected the yield rate of 2.5% in 2007.

Although the Fund has the statutory right to invest up to 20% of its portfolio in securities, the Fund invested EUR 103,854.70 or 1.5% of its portfolio in securities in 2007 (in frozen foreign

currency deposit bonds) issued and guaranteed by the Republic of Montenegro due to the poor offer on the securities market. The maturity dates of these securities are 1 July 2008/9/10 and their nominal value is EUR 128,683.

**Table 11-** *Frozen foreign currency deposit bonds owned by the Fund*

Value/Maturity date	2008	2009	2010	Ukupno
Purchase value	38.650,38	52.045,74	13.158,58	103.854,70
Nominal value	43.528,00	65.357,00	19.798,00	128.638,00

### 2.2.2. Expenditures

The Fund`s expenditures amounted to EUR 210,809 in 2007, being 3.3% lower than intuiially planned. These expenditures include operating expenses, gross salaries opf employees, reimbursements to the Management Board members and ophther expenses.

The Fund used only revenues from invested funds for financing activities envisaged in the Annual Programme and the Financial Plan.

The Fund spent its funds rationally and in line with the Annual Programme and the Financial Plan, thus not exceeding the envisaged funds.

### 3. REPORTS

During the reporting period, the Management Board considered and adopted the following three reports:

- **Deposit Protection Fund Annual Report for 2006**, prepared by the Fund and submitted to the Central Bank of Montenegro and the Montenegrin Government in line with Article 18 of the Deposit Protection Law.
- **Deposit Protection Fund financial reports for 2006** were prepared in line with the IAS. The bookkeeping unit was organized within the Fund, and a part of the bookkeeping and accounting operation were performed by the bookkeeping agency with which the Fund concluded a contract. Based on the bookkeeping information, employees of the Fund prepared information and overviews aimed at monitoring the implementation of the Fund's financial plan and reporting to the Management Board thereof. In addition to the aforesaid, all administrative activities were regularly performed.
- **Independent External Auditor's Report for 2006** was considered and adopted by the Management Board of the Fund. The report was prepared by the auditing house Deloitte. The independent, internationally recognized external auditor presented the opinion that: "the financial reports truly reflect the financial situation of the Fund and were prepared pursuant to the laws of the Republic of Montenegro and the IAS".

The Management Board of the Fund selected the **External Auditor** for 2007 and entrusted the auditing house Deloitte with the auditing of the annual financial statement and reports of the Fund for 2007, same as in the previous two years.

## 4. ACTIVITIES OF THE FUND

### 4.1. Normative activities

With a view to rounding off the regulatory framework, the Fund prepared three draft rulebooks that were adopted by the Management Board in 2007: **Rules on the performance and organisation of financial and accounting operations with the Chart of Accounts; the Rules on Professional Secret; and the Rulebook on clerical and archival operations.** The Management Board of the Fund passed the **Decision on the annual premium for 2008.** This decision determined the annual premium rate of 0.25% of total deposits held with the member banks. The rate remains the same as in 2007 because the conditions for its change specified in Article 27 of the Deposit Protection Law have not been fulfilled.

The Management Board adopted the **Annual Programme for 2008** which defines the tasks and activities that should be carried out by the Fund in 2008 in order to meet the Programme requirements. The Management Board adopted the **Financial Plan of the Fund for 2008** which defines the required funds necessary for the implementation of the Annual Programme for 2008.

The Fund also worked on the preparation of the **Procedures for the payment of guaranteed deposits** and the establishment of the procedure for selecting the agent bank. The GBDS consultants communicated their experiences which will enable the drafting of the **Decision on the payment of guaranteed deposits** and **Decision on the selection of the agent bank** in the first half of 2008.

#### **4.2. Activities on the promotion of deposit protection scheme**

Due to the importance of timely communication and education of citizens on the deposit protection system in Montenegro, the Fund paid a lot of attention to promotional activities.

The Fund provided the required advertising material for the new three member banks (First Financial Bank, Hipotekarna Banka and Invest banka Montenegro) in order for the banks to meet the requirements set out in Article 10 of the Deposit Protection Law.

In addition, the Fund prepared and distributed new advertising material to the existing and the newly established branches of the member banks.

Besides the aforesaid, the President of the Management Board of the Fund gave an interview to daily newspapers ("Vijesti") and communicated two pieces of information on deposit insurance ("Pobjeda" and "Vijesti") presenting the progress made by the Fund with regard to the deposit protection scheme in Montenegro.

#### **4.3. International cooperation**

The Deposit Protection Fund, as a member of the European Forum of Deposit Insurers (EFDI) which represents the association of European funds on a voluntary basis and enables the exchange of ideas and experiences in deposit insurance in Europe, performed the following activities in 2007:

- The participation in the Constituent Assembly of the EFDI held in Brussels on 22 June. Before the Assembly, discussions were held on amending the EFDI Statute. At the same day, the EFDI was officially registered (in accordance with the Belgian Legislation) with the seat in Brussels.

- The attendance at the conference in Rome held on 25-26 October, the topic being "Stability of banks and savings insurance" organized by the Italian Deposit Insurance Fund. Comparative experiences of various deposit insurance funds (Italian, German, Austrian, Dutch, Hungarian...) were presented at the conference, as well as the considerations on the subject presented by representatives of the Banca d'Italia, Deutsche Bundesbank, International Monetary Fund, World Bank and European Commission. Besides the official part of the conference, bilateral meetings with representatives of the corresponding funds in the Western Balkan countries provided the opportunity for exchanging experiences in deposit insurance and were very useful considering the similar economic and financial environment in these countries.
- The attendance at the Annual Meeting of European Forum of Deposit Insurers held on 26-27 November in Istanbul, with the topic being "Current Issues related to the Deposit Insurance System". Experience of members of this forum presented at the meeting covered the issues of designing and implementing deposit insurance schemes, the impact of deposit insurance on the strengthening of the banking system, the importance of banking supervision for the insurance system and future cooperation between the EFDI and FDIC (Federal Deposit Insurance Corporation). Also presented was the US sub-prime crises and its potential implications on the European and broader banking market and deposit insurance schemes.
- Since its establishment, the Deposit Protection Fund has been actively cooperating with the IADI (International Association of Deposit Insurers). IADI has been continuously informing the Fund on all important events and activities and has been sending useful material and information regarding deposit insurance in the world. Thus, the Fund was invited to the annual conference of the IADI in Kuala Lumpur on 28-30 October on the topic



“Higher degree of public awareness of deposit insurance”. Deposit insurance funds` ways of communication with depositors were presented at the conference, and especially the depositors` awareness as the measure for preventing potential disorder arising from bank bankruptcy. Besides the aforesaid, the conference was dedicated to the analysis of and information about the impact of the latest financial market crisis generated by the US second mortgage. The Fund also established numerous contacts with representatives of Asian and American deposit insurance institutions.

## **5. DONATION AGREEMENT WITH THE GERMAN GOVERNMENT**

During 2004 and 2005, a protocol was signed between the Montenegrin and German Governments which, inter alia, as a part of the financial support to Montenegro, on the grant of EUR 3,000,000 to be provided to the Deposit Insurance Project in Montenegro.

A part of the funds of EUR 2,500,000 was to be given for financial capacity building of the Fund, and the remaining EUR 500,000 for financing a consultant to provide technical assistance to the Fund in the period of three years following the signing of the agreement.

The KfW Donation Agreement was signed on 4 January 2007. It specifies several conditions that the Fund had to fulfil before the donated funds are given to the Fund. After signing the Agreement, the Fund undertook activities on fulfilling conditions for withdrawing donation funds. The implementation of the envisaged measures and activities specified in the Agreement was initiated immediately, with communication and reporting manners on the project harmonized. Donation funds of EUR 2,500,000 were transferred to the Fund`s account held with the Deutsche Bundesbank on 23 July 2007.

After the closing of the tender for the selection of a consultant and the evaluation of the received tenders, KfW, as agreed by

the Fund, awarded the service contract to the consulting house GBDS (Global Banking Development Solutions) from Berlin in September 2007 on technical support to be provided in the following three years.

Of the granted EUR 500,000 for the envisaged three-year technical assistance, EUR 40,000 was withdrawn in 2007.

All activities in 2007 in cooperation with the consultants were carried out as planned. These involved: the determining of divergence of the existing laws regulating deposit protection from the relevant EU directives and drafting the proposals for their harmonization; the preparation of Draft Procedures for the payment of guaranteed deposits; the preparation of a Draft decision on the manner of selection of the agent bank; the preparation of the procedure for the selection of the asset manager; the analysis of banking contracts with regard to their content and compliance with provisions under Article 10 of the Deposit Protection Law; the preparation of the lacking rules of procedure of the Fund; the preparation of the first semi-annual report for KfW (in line with the Donation Agreement).

The GBDS consultants paid 6 working visits to Podgorica. Individual meetings were organised with members of the Management Board and the technical service of the Fund so as to review the dynamics of the planned activities. The Fund regularly reports to KfW in the implementation of the envisaged activities.

## **6. MANAGEMENT BOARD ACTIVITIES**

The Management Board meetings were held in full composition in 2007. Its work was primarily focused on institutional capacity building of the Fund through the preparation and adoption of new legal acts necessary for the functioning of the deposit protection scheme.

Members of the Management Board contributed to the establishment of the required standards in deposit insurance through active involvement in the drafting of new regulations.

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In addition, members of the Board actively cooperated with the GBDS consultants in the preparation of documents, exchange of opinions in order to explore the best practices and experiences of the EU member states in deposit insurance that would contribute to institutional capacity strengthening of the Fund.

At its meetings held in 2007, the Management Board considered and adopted the following documents:

- Deposit Protection Fund Annual Report for 2006
- Deposit Protection Fund financial reports for 2006
- Analysis of deposit movements in 2006
- Analysis of the Fund's exposure, together with the Decision on the annual premium for 2008;
- Annual Programme for 2008;
- Financial Plan of the Fund for 2008, with the information on financial plan realization in 2007;
- Rules on Professional Secret;
- Rules on the performance and organisation of financial and accounting operations with the Chart of Accounts;
- Rulebook on clerical and archival operations

In addition to the aforesaid, the Management Board performed regular (quarterly) analyses of deposit trends in 2007, considered information on the collection of the initial and annual premiums and information on the Fund's resources and their investing.