

## CONTENT

<b>Introduction .....</b>	<b>2</b>
<b>1. MAIN INFORMATION ABOUT THE DEPOSIT PROTECTION FUND.....</b>	<b>3</b>
1.1. Members of the Deposit Protection Fund .....	3
<b>2. MOVEMENT AND STRUCTURE OF INDIVIDUAL DEPOSIT CATEGORIES</b>	<b>5</b>
2.1. Movement of total deposits .....	5
2.2. Movement of excluded deposits .....	5
2.3. Movement of protected deposits .....	6
2.4. Movement of guaranteed deposits.....	7
<b>3. ACTIVITIES OF THE FUND IN 2008.....</b>	<b>8</b>
3.1. Work tasks implemented in 2008.....	8
3.2. Accounting operations and investment activities in 2008.....	9
3.3. Normative and legal affairs.....	9
3.4. Reports for 2007.....	9
3.5. Marketing activities.....	10
3.6. Operational report of MB .....	10
3.7. International cooperation .....	11
<b>4. MAIN GOALS AND TASKS OF THE FUND IN 2009.....</b>	<b>13</b>
<b>5. IMPORTANT EVENTS AFTER THE REPORTING PERIOD.....</b>	<b>14</b>

## INTRODUCTION

The crisis of financial markets starting in 2007 as a mortgage market segment in 2007 in the USA, due to narrow connection among financial markets, was transferred to Europe comprising all segments of financial sector. In addition to that, the monetary authorities of developed countries tried to improve the liquidity by additional funds, especially that of the financial sector, the condition was not stabilised, and the crisis extended to other industries, outgrowing from financial to the Global economic crisis.

In Montenegro the crisis was not sensed in the banking sector until the middle of the third quarter 2008. Although it is in accordance with the preventive measures of the Central Bank of Montenegro (hereinafter: the Central Bank) the credit growth was reduced, the deposits still grew. When the crisis overtook the European financial markets to a large extent information on bankruptcy of large banks causes the reaction of deponents in Montenegro. The withdrawal of deposits started from September, and in the last quarter 2008 the level of deposits was lower than at the beginning of 2008. Although the withdrawal of deposits was primarily under the psychological influence of events in other countries, and not due to real uncertainty of the banking system, the panic reaction of deponents impacted the liquidity of banks.

Analogously to measures and mechanisms agreed at the level of the EU states, the Ministry of Finance and the Central Bank determined the measures and instruments for the protection of the banking sector in Montenegro and maintenance of its stability and security, primarily with a view of protecting the households and their property.

By adopting the Law on Measures for the Protection of the Banking System in October 2008, in addition to other measures, the government guaranteed the payout of deposits to the full amount. As an emergency measure, the law is of limited duration and its implementation was determined until the end of 2009. In the meantime, the Deposit Protection Fund, in line with the European directives, will work on the preparation of the new deposit protection law according to which valid regulations will be compliant with the European directives.

In addition to that, due to sudden deposit withdrawal, banks had certain problems in their liquidity maintenance, at end- 2008 the banking sector in Montenegro was maintained, showing high level of security.

## **1. MAIN INFORMATION ABOUT THE DEPOSIT PROTECTION FUND**

The Fund is the legal person established by the Deposit Protection Law („Official Gazette of RM”, no 40/03 and 65/05).

The main activity of the Fund is:

- Collection of premiums that member banks shall pay for deposit protection;
- Investment of funds and,
- Payment of guaranteed deposits in case of opening the bankruptcy in the bank.
- 

In performing its main activity, the Fund is exempt from paying taxes and fees.

The Fund shall not have the authority to intervene or undertake measures aiming at improving the condition in a bank, but operates on the «pay box» principle, or, in case of introducing the bankruptcy in the bank, the Fund shall execute the payment of guaranteed deposits.

The Fund is managed by the Managing Board which consists of five members. The term of office of the member of the Managing Board lasts 4 years.

The members of the Managing Board are:

Predrag Markovic, president

Ljiljana Sekulic, member

Idriz Cetkovic, member

Marko Backovic, member

Predrag Stanojevic, member from September 2008 insted of Mr.Knezevic

The President of the Managing Board, who, among three members is employed in the Fund, represents and acts for the Fund, manages its operations and is responsible for the legality of the operations of the Fund.

The head-office of the Fund is in Podgorica, Miljana Vukova Street.

### **1.1. Members of the Deposit Protection Fund**

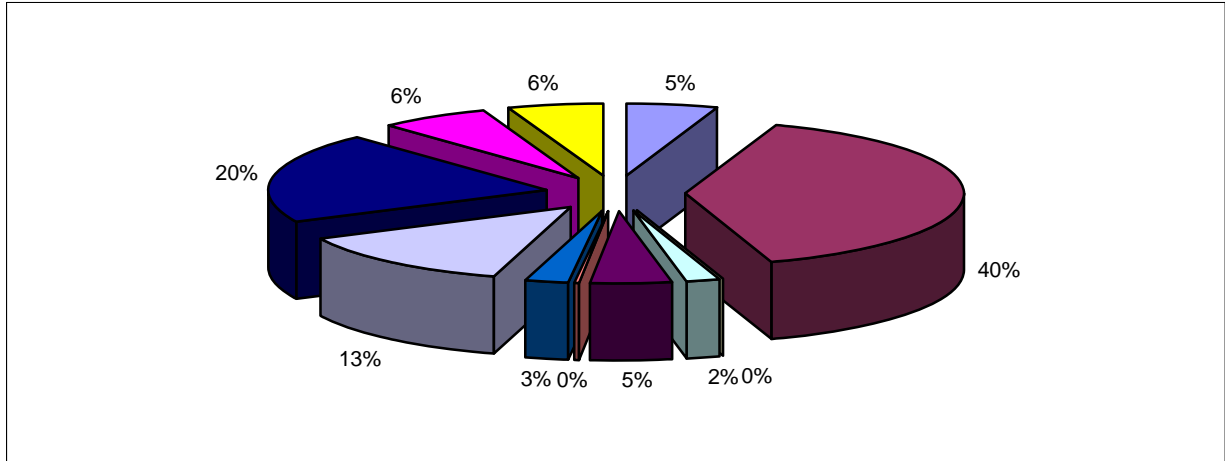
In 2008, 11 banks operated in the banking sector of Montenegro and all of them are members of the Deposit Protection Fund (the list of banks is annexed).

At the whole banking system, the total deposit portfolio amounted to EUR 2,099,372 as at 31 December 2007, it was reduced by 7% and amounted to EUR 1,951,883,000 as at 31 December 2008.

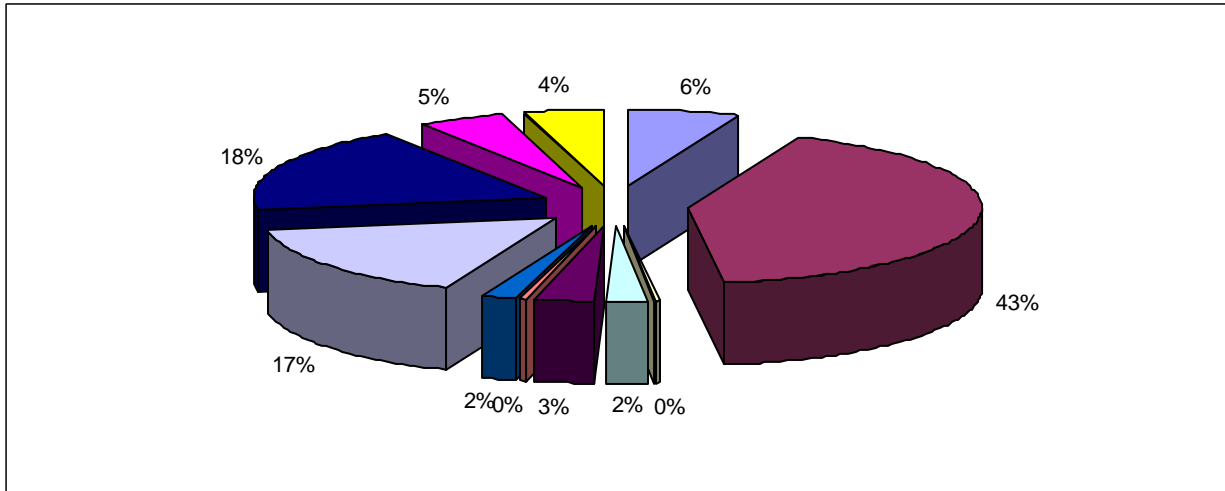
Of 11 banks, at the end of 2008 the two banks for more than half deposit portfolio of the banking sector, while five banks have only around 10% of the deposit portfolio of the banking sector.

The participation of individual banks in the total deposit portfolio at end-2007 and at end- 2008 is shown in Graph 1 and Graph 2.

**Graph 1-Share of banks in total deposits (EUR 2.099.372.000) as at 31 December 2007**



**Graph 2 share of banks in total deposits (EUR 1.951.882.000) as at 31 December 2008**



In addition to that, the amount of total deposits was reduced on the level of the banking sector; during the reporting period there was a mild change in percentages of participation of banks in total deposits: at end-2008 three largest banks increased their shares in total deposits from 73% to 78%. The largest bank increased its share from 40% to 43%, and the difference in percentages of share between the second and the third bank was also reduced: at the beginning of the reporting period the second bank had 20% of total deposits and the third one 13, so that at the year-end the second bank had 18% and the third 17% of share in total deposits.

## 2. MOVEMENT AND STRUCTURE OF INDIVIDUAL DEPOSIT CATEGORIES

### 2.1. Movement of total deposits

During 2008, total deposits oscillated. At the first quarter-end they were 2% higher compared to end- 2007, at the second quarter-end they were 6.3% higher compared to the first quarter-end. At the third quarter-end total deposits increased by 2% in relation to the end of the second quarter, so that in the fourth quarter they declined significantly (even 16%) compared to the third quarter-end.

At the beginning of 2008 total deposits in the banking sector amounted about EUR 2.10 million. During 2008 the highest level of total deposits was reached at the third quarter-end and amounted to EUR 2.33 million, so at the year-end total deposits were EUR 1.95 million.

*Table ( EUR 000 )*

MOVEMENT OF TOTAL DEPOSITS IN 2008 (EUR 000)					
	31.12.07	31.03.2008	30.06.2008	30.09.2008	31.12.2008
<b>TOTAL</b>	<b>2.099.372</b>	<b>2.141.060</b>	<b>2.275.961</b>	<b>2.327.313</b>	<b>1.951.822</b>

\*Source: data from monthly reports of banks

By comparing the data on the amount of total deposits as at 31 December 2007 with data as at 31 December 2008, total deposits at end- 2008 were 7% less.

### Movement of excluded deposits

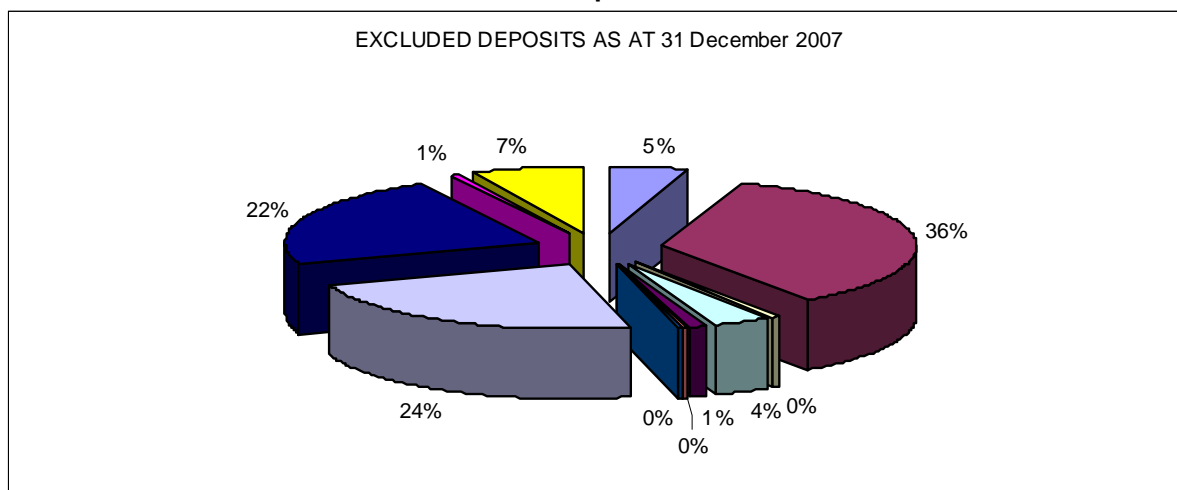
*Table 2 (in EUR 000 )*

MOVEMENT OF EXCLUDED DEPOSITS IN 2008 (in EUR 000)					
	31.12.07	31.03.2008	30.06.2008	30.09.2008	31.12.2008
<b>TOTAL</b>	<b>292.373</b>	<b>299.387</b>	<b>307.091</b>	<b>329.775</b>	<b>379.474</b>

\* Source: data from monthly reports that banks submit to the Fund

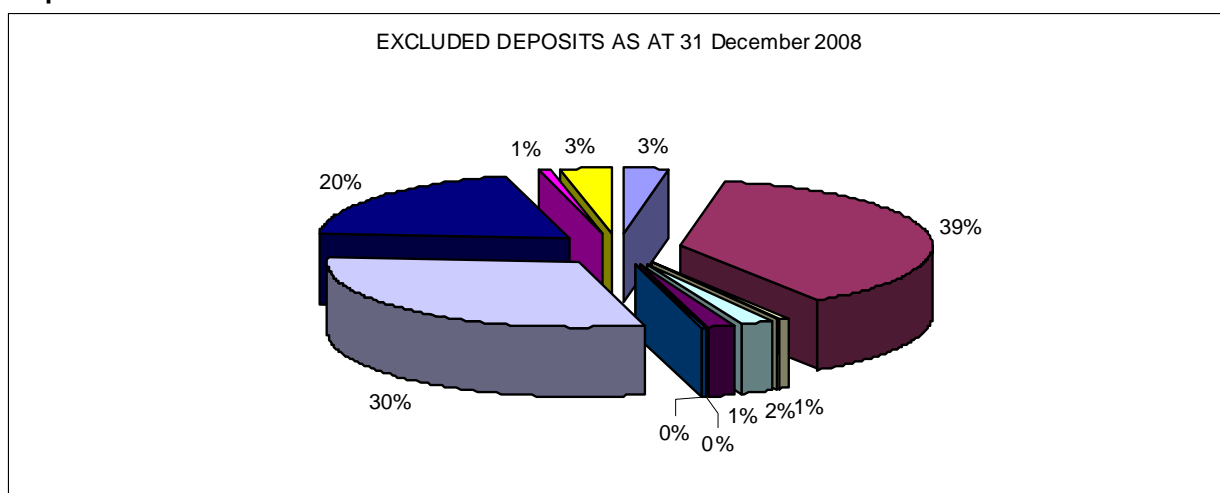
Data on excluded deposits on the last day of each quarter in 2008 are given in Table 2. It is interesting that excluded deposits grew constantly and at-end 2008 they were 29.7% higher compared to 31 December 2007.

**Graph 3**



The three largest banks have 82% of share in excluded deposits at the beginning of the period, while their share at the end of the period was 89%.

**Graph 4**



**Table 3 ( EUR 000 )**

	31.12.07	31.03.2008	30.06.2008	30.09.2008	31.12.2008
<b>EXCLUDED DEPOSITS</b>	<b>292.373</b>	<b>299.387</b>	<b>307.091</b>	<b>329.775</b>	<b>379.474</b>
<b>TOTAL DEPOSITS</b>	<b>2.099.372</b>	<b>2.141.060</b>	<b>2.275.961</b>	<b>2.327.313</b>	<b>1.951.822</b>
<b>SHARE OF EXCLUDED IN TOTAL DEPOSITS</b>	<b>13,93%</b>	<b>13,98%</b>	<b>13,49%</b>	<b>14,17%</b>	<b>19,44%</b>

The share of excluded in total deposits increased from 13.93 % at end- 2007, to 19.44 % at-end 2008. On one side, there was the increase in the share of excluded deposits due to their absolute growth (December 2008 / December 2007) by 90 million (29.7%), and, on the other hand, the decline of total deposits by 7% conditioned that excluded deposits had higher share in total deposits.

## 2.2. Movement of protected deposits

**Table 4**

(in EUR 000)

	PROTECTED DEPOSITS IN 2008				
	31.12.07	31.03.2008	30.06.2008	30.09.2008	31.12.2008
<b>TOTAL</b>	<b>1.806.999</b>	<b>1.841.673</b>	<b>1.968.870</b>	<b>1.997.539</b>	<b>1.572.346</b>

\*\* Source: data from quarterly reports that banks submit to the Fund

Protected deposits mainly followed movements in total deposits and showed almost the same trend. They grew in the first (2%), second (6.9%) and the third quarter (1.4%), but in the fourth quarter there was the decline of 12.3% compared to the third quarter-end. At end- 2008, protected deposits were 13% less than their condition at the beginning of the year.

## 2.4. Movement of guaranteed deposits

**Table 5**

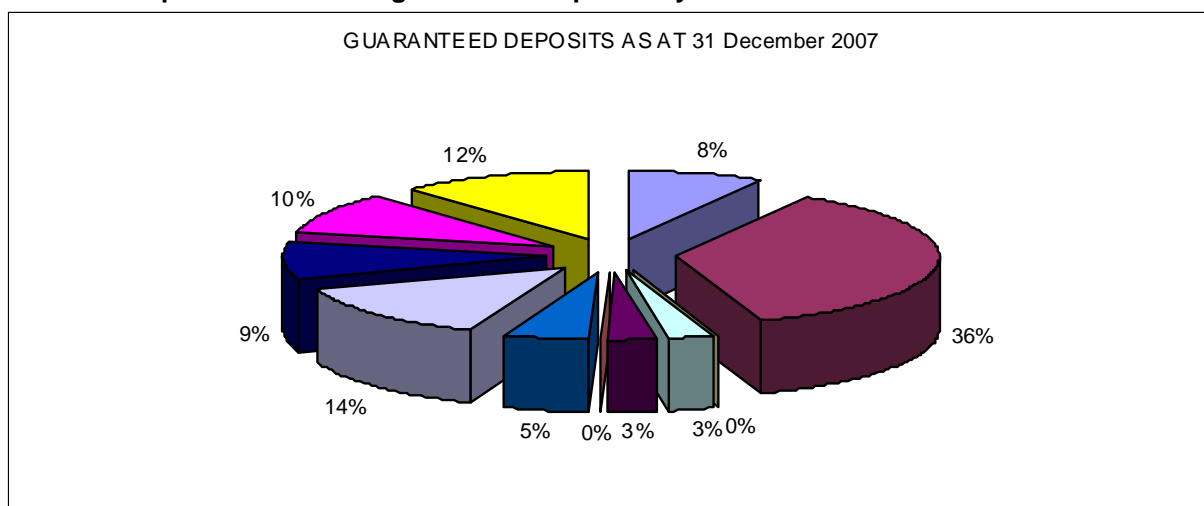
(in EUR 000)

	31.12.07	31.03.2008	30.06.2008	30.09.2008	31.12.2008
<b>GUARANTEED D.</b>	186.456	194.947	212.910	225.938	176.890
<b>TOTAL DEPOSITS</b>	2.099.372	2.141.060	2.275.961	2.327.313	1.951.822
<b>SHARE OF GUARANTEED IN TOTAL DEPOSITS</b>	8,88%	9,11%	9,35%	9,71%	9,06%

\*\* Source: data from quarterly reports that banks submit to the Fund

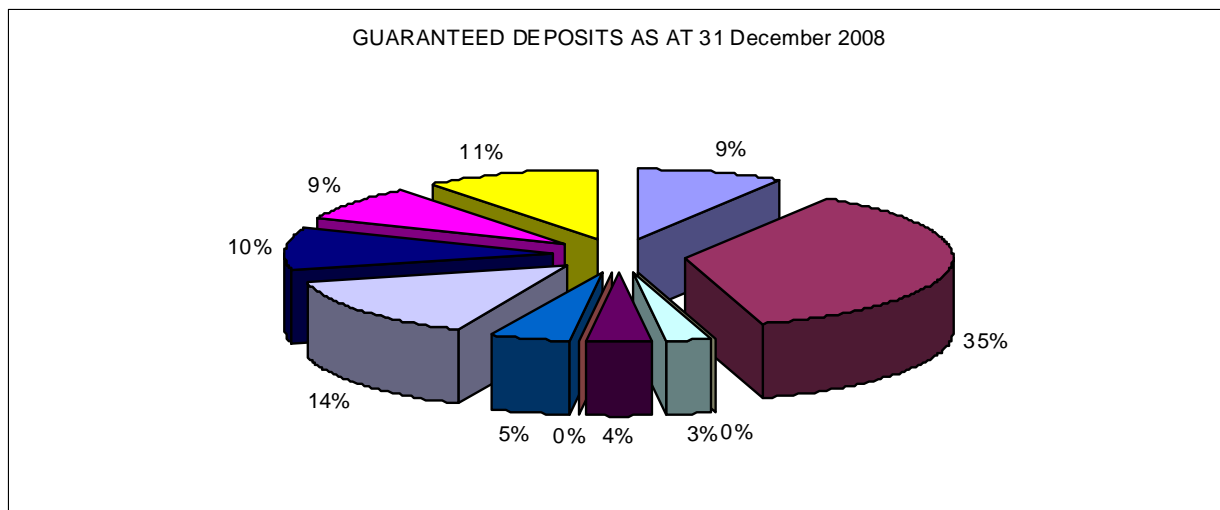
Guaranteed deposits increased in the first and second quarter of 2008, so that at the third quarter-end they reached the highest level up to this time (EUR 225.9 million). Under the influence of the Global financial crisis and the withdrawal of deposits from banks in the system, there was the significant decline of guaranteed deposits in the last quarter (21.7%). At end- 2008 guaranteed deposits were by EUR 10 million or 5.41% less than their amount at the beginning of the period. In addition to their significant decline, the share of guaranteed in total deposits at end-2008 was insignificantly higher than their share at the beginning of the period.

**Graph 3- Structure of guaranteed deposits by banks as at 31 December 2007**



At the beginning of the period guaranteed deposits with three largest banks in the system make 60%, and, at the end of the period 59% of all guaranteed deposits.

**Graph 4 Structure of guaranteed deposits by banks as at 31 December 2008**



The decline of guaranteed deposits to the absolute amount did not condition any significant change in the structure of banks share in the total amount of guaranteed deposits, but it is visible that the structure of total and guaranteed deposits differ significantly (78% of the share in total deposits, which have three largest banks in the system, correspond to 59% of the share in guaranteed deposits at the end of the period). This is primarily because other banks have large number of deponents with small deposits which belong to the category of guaranteed deposits up to EUR 5 000, as well as larger amount of excluded deposits with largest banks.

### 3. ACTIVITIES OF THE FUND IN 2008

#### 3.1. Work tasks implemented in 2008

By the Operational Plan for 2008 the tasks of the Fund were determined. During the implementation of the part of planned activities, the Fund was assisted by the consultant house GBDS from Berlin, as a part of technical assistance selected by the donor- KfW.

Together with the GBDS consultants some work was done on sublegal regulation, which prescribes the procedures for acting in case the protected event arises.

In 2008 the Fund, after the implementation of the procedure for the selection of the asset manager selected the Central Bank, with which the Asset Management Contract was concluded for a three-year period.

The analysis of deposit movements is permanent task of the Fund, and in the last quarter the data were additionally exchanged with the Central Bank and the Ministry of Finance with a view to following-up the influence of the Global Financial Crisis on the banking sector in Montenegro.



### 3.2. Accounting operations and investment activities in 2008

Performing of the part of accounting operations on the basis of the contract was conferred to the specialized agency. The contract defines that the Fund shall prepare all necessary documentation for the accounting of changes arisen from operations, and the Agency performs booking in the bookkeeping software of the Fund and prepares financial reports for the business year. On the basis of the accounting data information and overviews with a view to following-up the implementation of the Financial Plan of the Fund were prepared, about which the Managing Board was regularly informed.

The Fund invested the part of free assets in time and overnight deposits, and the part of them, in accordance with the investment policy, was invested in government securities.

In accordance with the Deposit Protection Law the audit house „Deloitte“ performed the audit of the annual account and financial statements of the Fund for 2008.

### 3.3. Normative and legal affairs

- The Managing Board of the Fund determined the rate of the annual premium to the amount of 0.25% by the **Decision on the Amount of the Annual Premium for 2008**. Prior to passing of this decision, the Managing Board considered analysis of deposit movements and the condition in the banking system and assessed the rate; the calculation of the annual premium should be maintained at the same level as in the previous year.
- With a view to more precise and quality following-up of deposit movements, which in the last quarter 2008 started to decline under the influence of the Global Financial Crisis, as well as better overview of the basis for the strategy of increasing the level of deposit protection, the **Decision on Amendment of the Decision on the Quarterly Report that Banks Submit to the Fund** was adopted, which prescribes the obligation of banks to deliver more detailed data on protected and guaranteed deposits.
- **Decision on Conditions, Manner and Procedure of Guaranteed Deposit Payout** defines all necessary activities for the acting of the Fund, after introducing the bankruptcy proceedings in the procedure of guaranteed deposit payout.

### 3.4. Reports for 2007

In accordance with the Article 19 of the Deposit Protection Law, the MB President proposed and the Managing Board of the Fund considered and adopted three reports:

- **Operational Report for 2007** was prepared with the active participation of all members of the Managing Board of the Fund and suggestions of the GBDS consultants.

- **Financial reports of the Fund for 2007** were prepared in accordance with the IAS, adopted by the Managing Board and submitted to the Central Bank and the Government of Montenegro.
- **Report of an Independent External Auditor for 2007** was considered and adopted by the Managing Board of the Fund. The report was prepared by the audit house „Deloitte“. The opinion of an independent internationally recognized external auditor is that : «financial reports reflect real condition of the operations of the Fund and they are prepared according to the laws of RM and IAS».

### **3.5. Marketing activities**

Within the three-year Project Plan with the GBDS, the first survey on questioning the public opinion on deposit protection in Montenegro was conducted in August 2008. The conducting of this survey was conferred to the agency CEED (Center for Entrepreneurship and Economic Development) from Podgorica, which prepared the Report on public knowledge about the deposit protection in Montenegro and the Fund.

This survey was conducted in the period August /September 2008. The survey showed that the public in Montenegro knows very little about the deposit protection system. Only 22.9% of examinees had some knowledge about deposit protection, while only 12.1% recognized the sign and the logo of the Fund.

With a view to promoting the deposit protection system, at end-2008 pocket calendars with the logo of the Fund were printed and they were distributed to the public over three dailies in Montenegro.

In the daily »Vijesti« the interview with the President of the Managing Board was published in which current activities of the Fund were presented to the public, with the special accent on the readiness of the Fund to implement appropriate measures if the protected event arises. The President of the Managing Board appeared in the broadcast »Business and Exchange« on TV »Vijesti« where the topic was the Global financial crisis and deposit protection in Montenegro.

### **3.6. Operational report of the Managing Board**

In addition to performing affairs related to the managing of the Fund and participation in its sessions, the members of the Managing Board actively assisted employees in performing the most complex tasks, including work with consultants when needed. In addition to already mentioned, the Managing Board passed other sublegal and internal acts:

- Decision on the Criteria for the Selection of the Asset Manager;
- Decision on the Selection of the Asset Manager of the Fund;
- Decision on the Procedure and Criteria for the Selection of the Payout Bank;

- Decision on the Selection of Auditor of Financial Reports for 2008, 2009, 2010 and 2011;
- Regulation on Seals and Stamps;
- Technical Instructions for the Execution of Guaranteed Deposit Payout;

Through the special item of the agenda, the Managing Board at each session considered data on total, protected and guaranteed deposits, by banks and at the level of the banking sector and initiated the extension of analysis. Members of the Managing Board were regularly informed about the premium payment in each quarter of 2008.

Financial reports with the report of an auditor and the Operational report of the Fund were adopted by the Managing Board and submitted to the Central Bank of Montenegro and the Ministry of Finance.

### **3.7. International cooperation**

From October 2004 the Fund is a member of the European Forum of Deposit Insurers – EFDI, which represents the association of the European funds on a voluntary basis, and enables the exchange of ideas and experiences about the deposit insurance in Europe.

In 2008, the EFDI organized several seminars, work meetings as well as regular annual assembly. The representatives of the Fund attended the seminar in Warsaw, on the topic « Deposit Protection Schemes waiting the financial market integration», organized by the Polish Fund with the EFDI. In addition to participants from the European deposit protection systems, significant contributions to its work was given by experts from other international financial institutions: the World Bank, the IMF, the European Commission, as well as the representatives from the American Federal Reserves. Special attention was paid to the division of responsibilities and tasks among the deposit protection systems and investor protection systems on the markets facing the integration of financial markets.

The investor protection system was especially interesting as its establishment was announced in Montenegro, so that presentations about this topic served the representatives of the Fund to expand their knowledge related to modern financial markets. During this seminar, a range of meetings were held with the representatives of the funds from Croatia, Slovakia, Bulgaria and Macedonia who transmitted the part of their knowledge about the work of the investor protection scheme.

The Fund participated in the regular annual assembly of the EFDI which was organized in September in Dublin. This was the first joint conference of the International Association of Deposit Insurers – IADI and the EFDI in which the forms and modalities of cooperation were agreed as well as exchange of information between these two associations of deposit protection funds. The issue of the influence of the Global financial crisis and the position of the deposit protection system were particularly emphasized. It is interesting to mention that different

opinions of the American and European representatives about the impact of the Global financial crisis were heard at this seminar. Experiences with the representatives of the funds from Bosnia and Herzegovina, USA, Russia, Albania and Ireland were exchanged at the conference.

The annual assembly of IADI – held in November in Washington organized by the American fund for deposit insurance – FDIC (Federal Deposit Insurance Company). At this meeting special accent was put on the role of the fund in crisis situations, especially in light of changes on the global financial market. Informing of the public was presented as one of key factors for returning the lost confidence in the banking system. During the conference, the representatives of the Fund, in addition to others, made contacts with the British Deposit Protection Fund. Due to large occupation in the organization of the conference and problems in the American banking system, the previously planned meeting with the main people of the FIDIC could not be organized.

Within the task- strengthening the capacity of the Fund, envisaged by the project plan with the consultant house GBDS, the Fund visited the European Deposit Protection System twice. On the basis of the detailed structural analysis of the system, and similarity of legal and economic ambience, it was decided to visit the Hungarian and the Bulgarian deposit protection funds.

The visit to the Hungarian Fund was organized in March 2008. The National Deposit Insurance Fund of Hungary existed since March 1993 and has had several cases of deponents payout so far.

The manner of determining the premiums in Hungary was presented to the representatives of the Montenegrin Fund, as well as different alternative methods of determining the premiums. In addition to that, the procedures of deponents payout were presented, as well as the division of tasks and responsibilities in that process with the special emphasis on the practical experiences in cases of payouts. As particularly interesting topic was payout of deposits over cash-machines which is applied in Hungary. The method by which the level of deposit protection in Hungary is determined was presented. The future cooperation was agreed, as well as direct communication channels between two funds. This visit was of great assistance to the representatives of the Montenegrin Fund for making the draft of acts related to the payout procedure, which started in April 2008.

In June 2008 the representatives of the Fund visited the Bulgarian Deposit Insurance Fund, which exists from 1998 and it also had some experience with the deponents payout.

Except for introducing with the experiences of deposit payout and payout procedures of the systems for determining the premiums, Bulgarian colleagues held the presentations about their investment, PR activities as well as their legal framework and the organizational scheme. Due to the activities of the Fund on drafting the regulations for the procedure of deposit payout, special attention was paid to the manner of functioning of exchange of information and cooperation among institutions included in the deposit protection system.

In addition to two aforementioned visits, within the Project plan, being implemented in accordance with the contract with the KfW, the representatives of the Fund participated in two workshops in Berlin organized by the GBDS consultants:

- In February 2008, except for work on regular tasks from the Project plan, special attention was paid to legal issues– international harmonization of the Montenegrin legal acts – Deposit Protection Law and the Law on the Bankruptcy and Liquidation of Banks. Key issues were defined, which shall be resolved by sublegal acts on the payout procedure, on which the Fund will work in the upcoming period.
- In September 2008, the following draft documents were revised: Decision on Conditions, Manner and Procedure of Guaranteed Deposits Payout; Decision on the Procedure and Criteria for the Selection of the Payout Bank; Memorandum on Cooperation with the Bankruptcy Administrator in Guranteed Deposits Payout and Technical Instructions for Guaranteed Deposits Payout.

Also, large significance was dedicated to planning and organizing of future activities related to promotion of deposit protection– Survey on questioning of public opinion and meetings with banks and the Association of Banks. The strategy and sequence of activities on the promotion of deposit protection in the upcoming period was determined.

#### **4. MAIN GOALS AND TASKS OF THE FUND IN 2009**

The permanent goal of the Fund is monitoring situation at banks, collection of premium and investment funds.

Changing the deadline for submission of reports that banks submit to the Fund (instead of quarterly - monthly), the Fund will be able to have timely data on movement and balance of deposits in banks.

In addition to ensure possibly the missing funds in the event of bankruptcy of a bank, the Fund will consider the implementation of "stand by" arrangement with the EBRD.

The improvement of institutional capacities of the Fund with a view to timely intervening at the moment of arising the „protected event“ is permanent task of the Fund. In communicating with the banks, the Fund will test the software and work on a permanent capacity for its employees may use.

The Fund shall follow the latest developments in the region and the EU in the area of the deposit protection scheme and shall assist the Ministry of Finance in the preparation of the proposal for the improvement of the Deposit Protection Law and its compliance with the EU directive.

After implementation of marketing activities, the Fund will, in late 2009 together with GBDS's consultants implement the second part of the survey " Public awarnes regarding deposit protection."

## **5. IMPORTANT EVENTS AFTER THE EXPIRATION OF THE REPORTING PERIOD**

After passing the Law on Measures for the Protection of the Banking System, with a view to its more efficient and more precise impementation, with the Ministry of Finance, the Fund prepared the **Memorandum on Cooperation in Guaranteed Deposit Payout** which defines the responsibility of each of the aforementioned institutions in arising of the «protected event». This Memorandum was signed on 14 January 2009.

Tripartite Agreement on the Financial Stability Maintenance, which defines forms and modalities of cooperation among three institutions– Ministry of Finance, the Central Bank and the Fund was signed in February 2009.