



Deposit Protection Fund

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1. BASIC INFORMATION ABOUT THE DPF

Deposit Protection Fund (hereinafter: the Fund) was established pursuant to the Law on Deposit Protection (Official Gazette of the Republic of Montenegro, no 40/03 and 65/05).

The main activity of the Fund is the insurance of deposits with banks, achieved through the collection of premiums for the payment of guaranteed deposits to depositors in the event when, in accordance with the law, bank bankruptcy proceedings have been initiated.

The Fund is managed by the Management Board, consisting of 5 members appointed by the Central Bank of Montenegro Council for a period of 4 years. Exceptionally, in the initial appointment of the Management Board, the President and one member are appointed for a period of 6 years.

The authorities of the Management Board and the President of the Management Board are specified by the Law.

The Management Board passes decisions, the By-Laws, and other internal regulations of the Fund, regulates policies and adopts reports of the Fund.

The President of the Management Board represents and acts for the Fund, and is held responsible for the legality of operations of the Fund.

The Fund commenced its operations with the appointment of members of the Management Board in June 2004.

The Central Bank of Montenegro provided resources, through technical and financial assistance, for regular operating of the Fund in 2005 (the acquisition of fixed assets, training of employees, marketing activities, and employees' salaries).

The information system (work stations – PCs and software for the payment of guaranteed deposits) was donated by the DFID.

The Fund had three employees with a university degree as at 31 December 2005.

The registered seat of the Fund is in Podgorica, St. Miljana Vukova bb.

2. CHARACTERISTICS OF THE DEPOSIT PROTECTION SCHEME MONTENEGRO

The deposit protection scheme in Montenegro is mandatory for all banks, covering the insurance of deposits by private individuals and legal entities, regardless of whether they were deposited in the EUR or in other currencies.,

Deposit protection does not cover the following:

- deposits by legal entities engaged in insurance,
- deposits by the Budget of the Republic of Montenegro and local authorities,
- deposits by off-Budget Funds in the meaning of the law governing the Budget of the Republic of Montenegro (hereinafter: the Republic),
- deposits by pension funds,
- deposits by joint investment schemes founded in compliance with the law (privatization funds, investment funds, and the like),
- deposits by banks,
- deposits by persons for whom the bank, on their behalf and for their account, acting under their instructions, performs the operations for which the person that provides the money shall bear the risk,
- deposits by persons holding a bank's shares providing them with more than 5% of votes at the bank's shareholders assembly,
- deposits by a bank's general manager, members of the bank management board and its standing committees, directors, deputy directors and chiefs of departments and other organizational units in the bank, deposits by legal entities in which such persons have 10% or higher share in capital or voting shares, as well as deposits by their spouses and relatives in the straight or lateral lines of kinship, up to the second degree of kinship, and
- deposits by persons responsible for the audit of the bank's financial reports.

Also excluded are deposits for which it has been found through the examination reports prepared by the Central Bank of Montenegro that they belong to a depositor who has contributed to a deterioration in the bank's financial position, as well as deposits by persons against whom legal proceedings have been initiated in order to establish the connection with transactions or actions that represent money laundering or terrorism financing.

The total amount of the protected deposit of a depositor shall be determined as at the day of the initiation of bank bankruptcy proceedings by deducting liabilities of the depositor from the sum of all the protected deposits of such a depositor with that bank, including any interest accrued.

The amount of the guaranteed deposit the Fund shall pay per depositor of a bank undergoing bankruptcy proceedings may not exceed EUR 5,000 and shall be paid in this currency.

The Fund is obligated to start with the payment of guaranteed deposits not later than within 60 days as of the protected event occurrence, about which depositors are informed through public media.

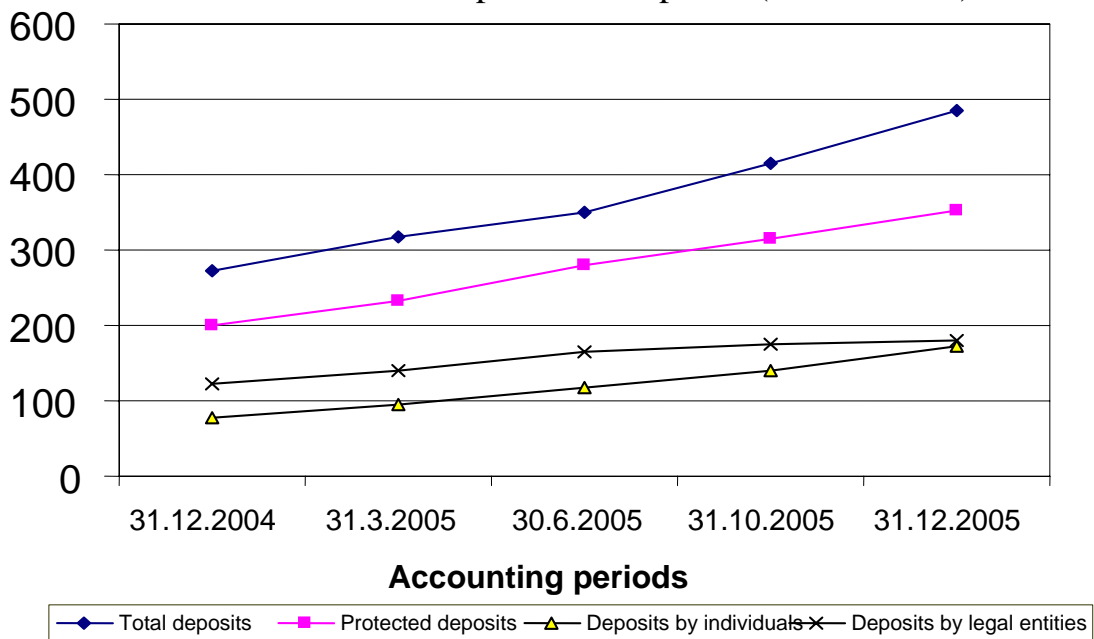
3. DEPOSITS IN 2005

Data on deposits that member banks submitted to the Fund during 2004 and 2005 show the uptrend in total deposits in the Montenegrin banking system.

The rate of growth in total deposits as at 31 December 2005 is 173% in relation to 31 December 2004. At the same time, this increase was accompanied by an increase in deposits in all banks (from 140% to 425%).

Figure1:

Movement of total and protected deposits (EUR million)

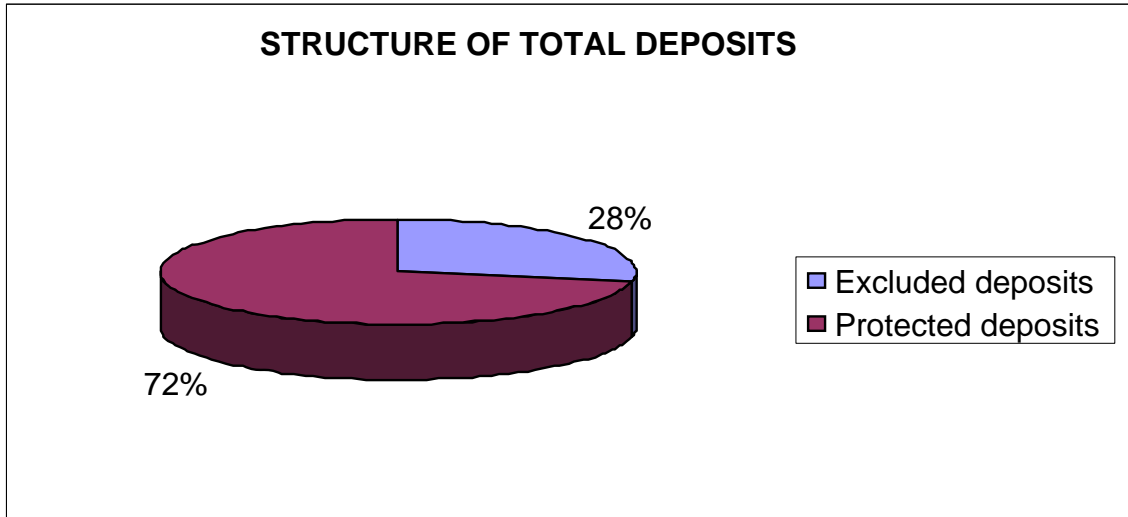


Two banks accounted for 63% of total deposits as at 31 December 2005.

Total deposits of member banks of the Fund as at 31 December 2005 amounted to EUR 472.6 million.

Figure 2 :

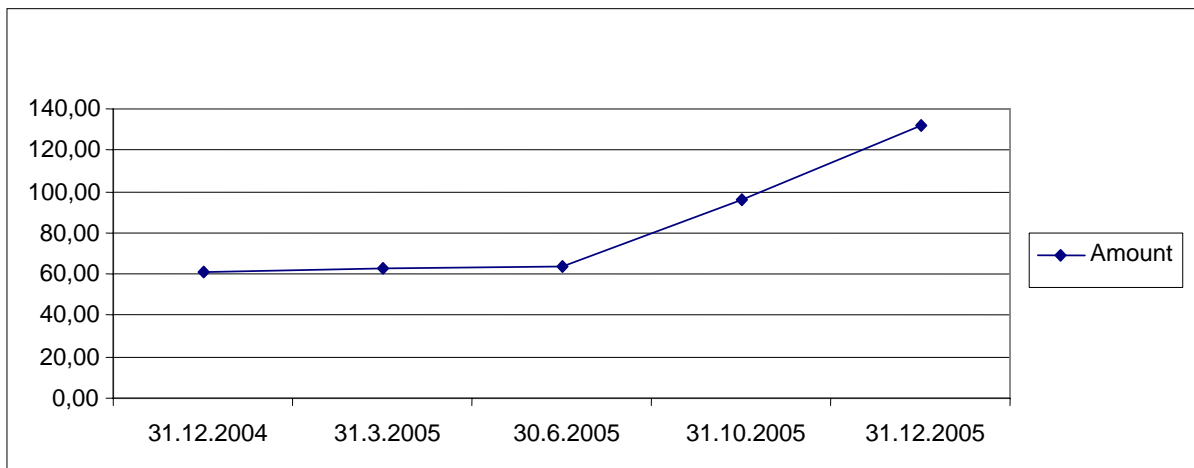
Contribution of protected deposits to total deposits as at 31 December 2005



Protected deposits at as 31 December 2005 amounted to EUR 340.9 million, of which 49% were deposits by private individuals, and 51% deposits by legal entities. This similarity in proportions is the result of a faster growth in deposits by private individuals than that in deposits by legal entities in 2005.

Figure 3 :

Movement trend of excluded deposits



Deposits excluded from the protection amounted to EUR 131.7 million or 27.9% of total deposits with member banks of the Fund.

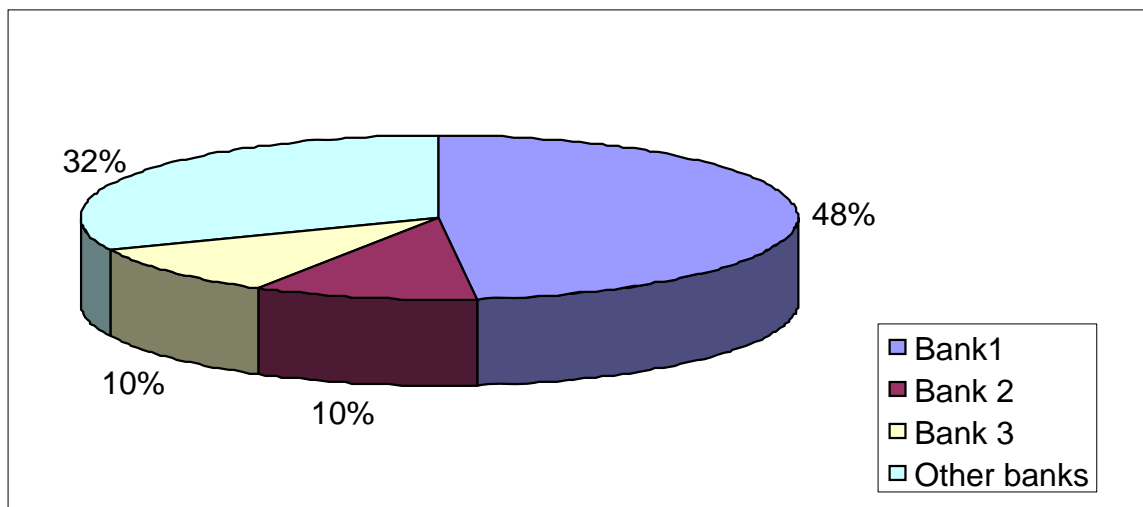
In relation to the balance as at 31 December 2004, excluded deposits rose by 182% (in two banks this growth ranged between 260% and 450%). The uptrend in excluded deposits came from:

1. an increase in deposits by legal entities engaged in insurance (84%,);
2. an increase in deposits by the Budget of the Republic of Montenegro and local authorities (183%);
3. an increase in deposits by banks (14%) and
4. an increase in deposits by the off-Budget funds (1,000%)

Overall exposure of the Fund to all banks is stated through the amount of guaranteed deposits with banks that are members of the Fund which amounted to EUR 55.4 million as at 31 December 2005.

Figure 4:

DPF exposure to banks



The contribution of guaranteed deposits to total deposits and protected deposits amounted to 11.7% and 16.2%, respectively. On the last day of 2005, 273,093 depositors were recorded, having guaranteed deposits in 8 member banks of the Fund.

The growing trend in total deposits was accompanied by an uptrend in protected and guaranteed deposits, but the increase in total deposits was higher than that in guaranteed deposits.

Such movements of deposits point to an increase in deposits per depositor:

1. The average guaranteed deposit by legal entities as at 31 December 2004 amounted to EUR 537, and that on 31 December 2005 EUR 787 or 47% higher.
2. The average guaranteed deposit by private individuals as at 31 December 2004 totalled EUR 87, and on 31 December 2005 it was EUR 178 or 116% higher.

4. INFORMATION ON DEPOSIT PROTECTION PREMIUM

Deposit insurance funds are collected from premiums that banks pay to the Fund under conditions and in the manner specified by the Law.

For the establishment and the functioning of the deposit protection scheme banks are obligated to immediately pay the initial premium and regularly pay the annual premium. Pursuant to the Law, in the event of the initiated bank bankruptcy proceedings and the lack of funds for the payment of guaranteed deposits, the Fund may pass a decision to introduce an extraordinary premium.

The Law prescribes that all banks entered in the Central Registry of the Commercial Court become members of the Fund and have the obligation to pay the initial premium of 0.3% of their total deposits. This premium was paid in the legally prescribed deadline by 8 banks that became members of the Fund.

Two banks that have been ordained rehabilitation measures shall become members of the Fund when the Central Bank assesses that the introduced measures have resulted in their rehabilitation or if it passes a decision on the termination of these measures and the payment of the initial premium.

Newly founded banks shall pay the initial premium to the fixed amount of EUR 10,000 within 60 days as of the day of their registering into the Central Registry of the Commercial Court.

The amount of the annual premium is determined by the Management Board by taking into account the amount of the collected funds and a bank's liquidity. The annual premium is calculated and paid on a quarterly basis. The base for the calculation of the annual premium instalments is the average of total deposits as at the last day of each month in the previous trimester. The Management Board established the annual premium for 2006 to the amount of 0.25% of total deposits by banks.

Eight member banks of the Fund paid in December 2005 the initial premium to the total amount of EUR 1,203,000.

Taking into account that the amendments to the Deposit Protection Law came into force in November 2005, banks did not pay the annual premium.

An extraordinary premium can be introduced only in exceptional situations in order to enable the Fund, due to the initiation of bank bankruptcy and a lack of funds, to pay guaranteed deposits to depositors. This is a one-off restrictive premium, and together with the annual premium it may not exceed more than 1.5% of total deposits of banks.

a) INVESTMENT POLICY

The Deposit Protection Law prescribes the obligation to the Fund to invest its resources in the safest and the most liquid securities.

Pursuant to the Law, the Fund may invest in securities issued or guaranteed by the Republic, securities issued by a bank, a financial institution, or a country with a high credit rating assigned by an internationally recognized agency, and deposits of banks with high ratings assigned by an internationally recognized agency.

The Fund received income of EUR 2,033 from investing the resources from the collected initial premiums.

b) AMENDMENTS TO THE LAW

The Deposit Protection Law, enacted by the Montenegrin Parliament in July 2003 (“Official Gazette of the Republic of Montenegro”, no 40/03), created the normative conditions for the establishment of the Fund, but due to the lack of funds the deposit insurance scheme was not implemented. Since certain deficiencies were identified in the meantime, it was estimated as justifiable to make certain amendments to the original text of the Law.

Deposit protection was assessed by the European Commission as the crucial element for the rounding-off of an internal market and a necessary supplement to the system of supervision of credit institutions, as a connected system of all institutions of a financial market whereby a failure of any of them could jeopardize the financial system stability of one or more member countries.

In the procedure of providing the initial funds, the KfW (the German Development Bank) showed interest to provide a donation for the implementation of the deposit insurance scheme. The Government of the Republic of Montenegro signed the protocol on bilateral cooperation with the Government of the Federal Republic of Germany on 15 April 2005; the item 3.1 thereof foresees the grant to the amount of EUR 3,000,000 for the establishment of the Fund and the implementation of deposit protection.

Amendments to the Law were necessary for the implementation of this donation with a view to its harmonization with EU Directives. The European Union Directives, due to the existing legislative framework and economic situation could not have been entirely implemented, thus viable and acceptable solutions were given in the proposed amendments. The KfW, offered its technical assistance in the preparation of the amendments by providing competent consultants.

With the assistance of foreign experts the Law was analysed in details, and the identified weaknesses were removed. The corrections and amendments were made throughout the entire text of the Law.

One of the most significant amendments to the Law refers to the method of the refund of paid resources for guaranteed deposits. When the Fund, in a case of the “protected event” occurrence, pays depositors guaranteed deposits, the amount of paid funds shall be retrieved from the bankruptcy estate after all depositors have been paid out.

By bolstering depositors` confidence that in a case of bank bankruptcy their deposits would be paid to them in full or partly, the confidence in the banking system is also strengthened, thus creating a basis for a faster growth in deposits. This provides the opportunity to increase the amount of guaranteed deposits to be paid by the Fund in the next few years up to the amount of EUR 20,000 (in accordance with EU Directive 19/94 EC from 1994).

A novelty is that the Fund may issue securities in case it lacks sufficient funds to pay all guaranteed deposits in the occurrence of the protected event.

In addition, the Law was improved in the following:

- Prescribing the investment policy;
- Additions to the DPF authorities:
 - a) Determines the annual premium at different rates, the so-called differentiated premium rate, depending on a bank`s rating;
 - b) Introduces extraordinary premiums in the case of the protected event occurrence;
 - c) Reduces and suspends the collection of the premiums when the level of the Fund`s resources reaches the amount of 3% of the protected deposits.

Another novelty is a greater independence of the Fund in relation to the Central Bank of Montenegro, with the emphasis on the obligation to exchange information that may be of importance for the occurrence of the “protected event” and the payment of guaranteed deposits. The manner of the exchange of information and the cooperation between the Fund and the Central Bank shall be regulated by the Memorandum on Cooperation and Understanding.

The Amended Law on Deposit Protection was enacted by the Montenegrin Parliament on 25 December, and it came into force on 11 November 2005.

c) THE IMPLEMENTATION OF THE AMENDED LAW

After the enactment of the Amended Law on Deposit Protection it was necessary to harmonize the enabling regulations with the consolidated text. The preparation of the new sub-regulations already started in the mid-2005.

After the Central Bank of Montenegro Council's appointment of the Management Board in accordance with the Amended Law, the new sub-regulation were enacted: the By-Law and the internal regulations of the Fund, decisions on the reporting with new forms for monthly and quarterly reporting, and the Decision on the Establishment of the Annual Premium for 2006.

Bearing in mind the provision that the Fund is obligated to pay guaranteed deposits as of 1 January 2006, the preparation of sub-regulations specifying the payment of guaranteed deposits and the Investment Policy of the Fund has also been initiated.

After the enforcement of the Amended Law on Deposit Protection (11 November 2005), a presentation was given for all banks in the banking system with a view to providing full information on the amendments to the Law. Banks were particularly informed about their obligations towards the Fund, as well as about the opportunities that the deposit protection scheme offers to bank depositors.

d) MARKETING ACTIVITIES

Due to the importance of informing and educating the public on the deposit insurance scheme in Montenegro in a timely manner, the Fund dedicated a lot of attention to marketing activities that were implemented in accordance with the marketing policy of the Fund adopted by the Management Board of the Fund.

A marketing agency has been engaged to provide professional assistance in the promotion of the deposit protection scheme.

An info flyer was printed and distributed with daily newspapers in 65,000 copies with a view to informing the Montenegrin public on the deposit protection scheme.

In accordance with the Law, the Fund made a placard and a sticker with the Fund's logo and distributed them to all member banks of the Fund with a view to a simpler and more convenient method of informing bank clients about the deposit insurance scheme.



The Fund also recorded a TV commercial with a view to promoting its sign and the logo.

After the adoption of the Amended Law on Deposit Protection, the Fund organised appearances in the state television station, press conferences and issued press releases in order to inform the public about the scheme.

In order to inform a broader domestic and international public, the Fund hired a professional agency to prepare the Fund's website, available at the address www.fzdcg.org containing all information about the Fund's activities.

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Kontakt **Fond za zaštitu depozita - Republika Crna Gora**
 Adresa: Miljana Vukova bb, 81000 Podgorica, Crna Gora Tel: 081 210 466 E-mail: fzd@cg.yu

e) INTERNATIONAL COOPERATION

In October 2004, the Fund became 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 about deposit insurance in Europe. The EFDI organised four seminars and the annual meeting in 2005, where the achievements in the field of deposit protection in EU countries and countries in transition were presented.

At the annual conference in Sarajevo, the Fund presented its media campaign on the deposit protection scheme in Montenegro.

The KfW and the GBDS organised for the Deutsche Asset Management, a European renowned investment fund, to prepare the presentation for the Fund on investment opportunities.

5. PLANNED ACTIVITIES FOR 2006

The Fund shall continue with the preparation and adoption of enabling regulation, including the adoption of the Investment Policy of the Fund.

Monthly and quarterly analyses of data on deposits and developments in the banking system, regular collection of the annual premium, investment of funds, and the exchange of data with the Central Bank are continuous tasks of employees of the Fund.

Together with a continued training of employees, employment of solicitors, and obtaining funds through donations provided by the German Government, the Fund shall continue creating both human and financial resources to perform the function of deposit protection in Montenegro in full.