Deposit Protection Fund

DEPOSIT PROTECTION FUND

ANNUAL ACTIVITY REPORT

2016

Podgorica, May 2017

LIST OF ABBREVIATIONS:

ISA .... *Insurance Supervision Agency*

CBCG .... *Central Bank of Montenegro*

EBRD .... *European Bank for Reconstruction and Development*

EFDI .... *European Forum of Deposit Insurers*

EC .... *European Commission*

EU .... *European Union*

Fund .... *Deposit Protection Fund*

FSAP .... *Financial Sector Assessment Program*

IADI……………………................ *International Association of Deposit Insurers*

IADI CP…………………................ *IADI Core Principles*

SEC……………………...................... *Securities and Exchange Commission*

MF.......................... .... *Ministry of Finance*

IMF....................... .... *International Monetary Fund*

WB .... *World Bank*

MB .... *Managing Board*

Law .... *Deposit Protection Law*

Directive 94/19/EC ....*Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes*

Directive 2014/49/EC………..*Directive 2014/49/EC of the European Parliament and of the Council of 16 April 2014 on deposit-guarantee schemes*

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INTRODUCTORY NOTES

Over the past two years, there have been major changes and innovations in the regulatory framework governing the financial system and the EU deposit insurance scheme, which significantly influenced the Fund`s activities. European regulations had introduced new deposit insurance standards which the member states were obliged to transpose to their national legislation by the end of 2016. Deposit insurance funds were assigned special responsibilities in managing banking crises and contributing to the preservation of financial stability. Given the ongoing Montenegro's EU accession negotiations which imply the country`s obligation to align its legislation with the EU acquis, the Fund has been continuously following the amendments to EU legislation in the field of deposit insurance.

The overall deposit insurance scheme in Europe has been amended in accordance with Directive 2014/49/EC. The previous Directive 1994/19/EC (as amended under Directive 2009/14/EC) provided that deposit insurance schemes were to be financed in one of the following manners: via ex ante or ex post financing model. A large number of countries used the ex post model of financing, which meant that funds for intervention were not collected in advance but provided at the moment when a bank experienced troubles, that is, when bankruptcy was introduced in the bank. Such a method of raising funds for intervention was more likely to lead to problems in the entire banking system, especially during a financial crisis, so the adopted Directive 2014/49/EC prescribes that all deposit insurance systems should move to the ex ante system of calculation and collection of deposit insurance premiums.

In addition, besides mandatory deposit insurance, some of the EU member states have introduced a voluntary deposit insurance system covering the total amount of deposits, regardless of the guaranteed amount (mandatory insurance up to 100,000 euros).

In order to provide adequate funds for the protection of deposits, Directive 2014/49/EC prescribes the introduction of a **risk-based contribution**. On the basis of the Guidelines on methods for calculating contributions to deposit guarantee schemes issued by the EBA, the obligation of calculating and collecting this contribution was to be introduced as of 1 June 2016. Most EU member states have used the possibility of extending this deadline and introduced the risk-based contribution at the end of 2016.

In addition to the DGS Directive (Directive 2014/49/EC), the **Bank Recovery and Resolution Directive** (Directive 2014/59/EC) came into force and it specifies a new way of regulating interventions of the relevant authorities in the process of bank resolution and a possible involvement of deposit insurance funds in this process.

1. BASIC INFORMATION ON DEPOSIT INSURANCE

1.1. Deposit Protection Fund

The Deposit Protection Fund was established under the Deposit Protection Law (Official Gazette of the Republic of Montenegro 40/2003) and it started operating on 18 November 2004 when it was registered in the Statistical Office of Montenegro`s registry. A new Deposit Protection Law (OGM 44/10, 40/11, 47/15) was further aligned with the Directive 2014/49/EC (as amended by Directive 2009/14/EC). In exercising its competences, the Fund: establishes the rate for premium calculation; 2) collects the premiums; 3) invests its funds; 4) calculates and performs the payout of the guaranteed deposits; 5) passes secondary legislation provided for under this law, and 6) performs other activities in accordance with the law.

The main activity of the Fund is the insurance of bank deposits and it is obliged to compensate guaranteed deposits to depositors in case of the occurrence of a protected event (bank bankruptcy), up to the amount prescribed by the law. Commercial banks licensed by the Central Bank of Montenegro are obliged to pay the premiums in the manner established by the law. The deposit insurance scheme comprises deposits with banks as at or before the protected event occurrence date. A protected event occurs on the day of passing a decision on initiating bankruptcy proceedings against a bank. The Fund compensates guaranteed deposits in the amount of 50,000 euros per depositor and per bank as of 1 January 2013, regardless of the number and amounts held by a depositor in a bank subject to bankruptcy proceedings.

The Fund`s bodies are the Managing Board and the Director General. The Fund has seven employees.

The Fund`s Mission

The Fund's mission is to ensure the safety of deposits held in banks and to provide for an efficient and expedient payout of guaranteed deposits in case of bankruptcy initiated in any of the banks in Montenegro.

The Fund`s Vision

A stable financial system based on the confidence, safety, and protection of depositors.

The Fund`s objectives

Improved confidence of depositors in the Montenegrin banking system the protection of depositors against loss in case of a bank failure.

The Fund attains the aforesaid objectives with clearly defined obligations towards depositors, the promotion of public confidence in the system, and the providing of finds for the protection of insured deposits.

Governance and Management of the Fund

The Fund is governed by the three-member Managing Board (MB) appointed by the CBCG Council, whereby one member is nominated by the Ministry Finance and one member is nominated by the Association of Montenegrin Banks and Financial Institutions. Pursuant to the Law, the MB holds meetings at least on quarterly basis.

In addition to the powers specified in the Law, the Fund`s By-Law specifies that the MB shall adopt internal general acts, consider the implementation of activities, discuss quarterly reports on the movement of deposits, consider annual and semi-annual reports on investment of funds, decide on the acquisition of immovable property, determine the way of cooperation with government authorities, organizations, and other institutions in Montenegro, define the manner of cooperation with international financial institutions, organizations and deposit insurance schemes, decide on the transfer of certain powers to the Director General of the Fund, and perform other tasks stipulated by the Law and the By-Law.

Pursuant to the Rules of Procedure of the Fund, the MB informs the public about its work, decisions, conclusions and positions, as well as significant issues discussed via press releases, website of the Fund, press conferences, interviews, and in other suitable ways.

Members of the Managing Board of the Fund in the reporting year were:

- Darko Bulatović, Chairman, (Director of the CBCG Supervision Department);
- Bojana Bošković, a member (Deputy Minister for Financial System and Improvement of Business Environment, Ministry of Finance);
- Prof. dr Marko Backović, a member (a professor at the Faculty of Economics, University of Belgrade).

During the reporting period, the MB held eight meetings.

The Director General of the Fund is elected as per the job vacancy announcement and appointed by the MB to a four-year term of office and he/she may be reappointed. The Director General represents and acts on behalf of the Fund, manages the Fund and is responsible for the legality of the Fund's operations. Pursuant to the Law, the Director General proposes the Fund's By-law and secondary legislation, the premium calculation rate, the financial plan of the Fund, annual financial statements with the auditor's report and opinion, the annual operating report of the Fund, and the investment policy of the Fund, implements decisions of the Managing Board, decides on the investment of the Fund's resources up to the amount specified under the By-law of the Fund, issues separate decisions to depositors not entitled to the guaranteed deposit payout, decides on the rights, obligations and responsibilities of the Fund employees, takes care of the utilisation of funds for covering operating costs of the Fund, and performs other tasks and duties in line with the law and the By-law of the Fund.

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

Web address: www.fzdcg.org and e-mail: fzd@t-com.me.

1.2. Harmonization of the legislative and institutional framework with the EU acquis in the field of deposit insurance system

With the adoption of the 2015-2018 Economic Reform Program (ERP), in accordance with new requirements of the European Commission in the economic dialogue with the EU candidate countries, the Government has focused its economic policy commitments to structural reforms aimed at achieving a sustainable economic growth. One of the priority tasks in the upcoming period should be the implementation of solutions identified in this strategic document.

In late 2015, the FSAP mission that assessed the entire financial and banking systems paid particular attention to the Fund as one of the important participants in the financial safety net. The assessment also covered the compliance of the law with the “Core Principles for Effective Deposit Insurance Systems” (issued by the IADI and used by the WB and the IMF as the basis for compliance assessment). On the basis of these assessments and overall evaluation of the financial, banking, and deposit insurance systems, the FSAP mission issued relevant recommendations.

The FSAP mission regarding the deposit insurance scheme mainly involve the following: inclusion of the Fund as a standing member of the Financial Stability Council, introduction of the risk-based premium, periodic simulation exercises to test real data in individual banks; introducing the “risk minimizer” mandate – least-cost method; enabling the Fund to transfer funds in the amount of guaranteed deposits or to include other options for the payout when establishing the bridge bank; internal audit of the Fund`s public objectives; signing of the MoU on cross-border cooperation with foreign/home deposit insurance schemes; introduction of the moratorium on deposits up to three months in case of bank merger (to ensure that depositors in merged banks have time to adjust and bring their deposits under the coverage limit of 50,000 euros); and enabling the Fund to be a member of the bankruptcy board in a bank in bankruptcy.

Of great importance is the continuation of work on the preservation of financial stability, and this is a joint task of the CBCG and other participants of the Montenegrin financial system. Therefore, cooperation and coordination of all involved institutions is of particular importance for the preservation of financial stability. A clear division of responsibilities of each of the institutions, in order for each of them to take actions within their authority, contributes to the strengthening of stability of Montenegro's overall financial system. In order to achieve the common goal and comply with the FSAP recommendations, the Financial Stability Council included the Fund in its work.

In the process of harmonising with EU regulations, the Fund has been introducing relevant standards to align with the Directive 2014/49/EC. One of the most important changes in the system of deposit insurance is the mandatory introduction of the system of differential premiums, i.e. the calculation of premiums based on the degree of risk incurred by banks; this requirement has been binding on the EU Member States as of June 2016. With a view to ensuring a uniform conformity with the Directive 2014/49/EC, the EBA issued the "Guidelines on methods for calculating contributions to deposit guarantee schemes".

The Fund started developing a methodology for the introduction of the differential premium in the insurance of deposits in the banking sector of Montenegro in order to align with the new EU standards and best practices. A new deposit protection law will prescribe that the Fund is to apply the differential premiums for deposit insurance based on pre-defined criteria for risk assessment in banks.

A recommendation of the 2015 FSAP mission is that the introduction of the risk-based premium should take account of its neutrality (to maintain the existing level of premiums) and to reach the targeted level of 10% of guaranteed deposits by 2024.

Essential baseline documents were prepared - Analysis of the movement of deposits in the period from 2005 to end-2016 and the Forecast of deposits trending until 2024. Based on these documents, the Fund adopted the Strategic Plan for the period up to 2021 which, in addition to the forecasts of movements in deposits, premiums, costs and interest rates, includes activities that the Fund should implement over that period.

In addition to preparations for introducing the risk-based premiums, the Fund also developed the Media outreach strategy - the communication strategy. This Strategy is directly linked to the timeframe for drafting a new law, as well as introducing risk-based premiums. It includes activities directed to the expert public (CBCG, banks, MF, financial institutions) and the rest of the public, legal and natural persons - depositors. This approach has enabled us to reach agreement with the WB on expert and technical assistance in establishing risk-based premiums. Thus, through the assistance program, the WB allowed the Fund to make use of best examples from experiences and practices of the EU countries and commissioned a German rating institute GBB Rating (Gesellschaft für Bonitätsbeurteilung mbH) as the consulting house to help introduce a methodology for risk-based premiums within the prescribed deadline.

1.3. Members of the Deposit Protection Fund

In the Montenegrin financial system, which includes banks, microcredit financial institutions, insurance companies, leasing companies, and other financial institutions, the prevailing role has the banking sector. With one new bank established during the reporting year, there were fifteen operating banks in total, of which ten are with the majority equity held by non-residents. Of these ten, eight banks are in total (or almost total) ownership of non-residents - larger banking groups from Austria (two banks), France, Hungary, Slovenia, Serbia, Turkey, and Azerbaijan. Thus, foreign capital accounted for 79% of the banking sector`s capital.

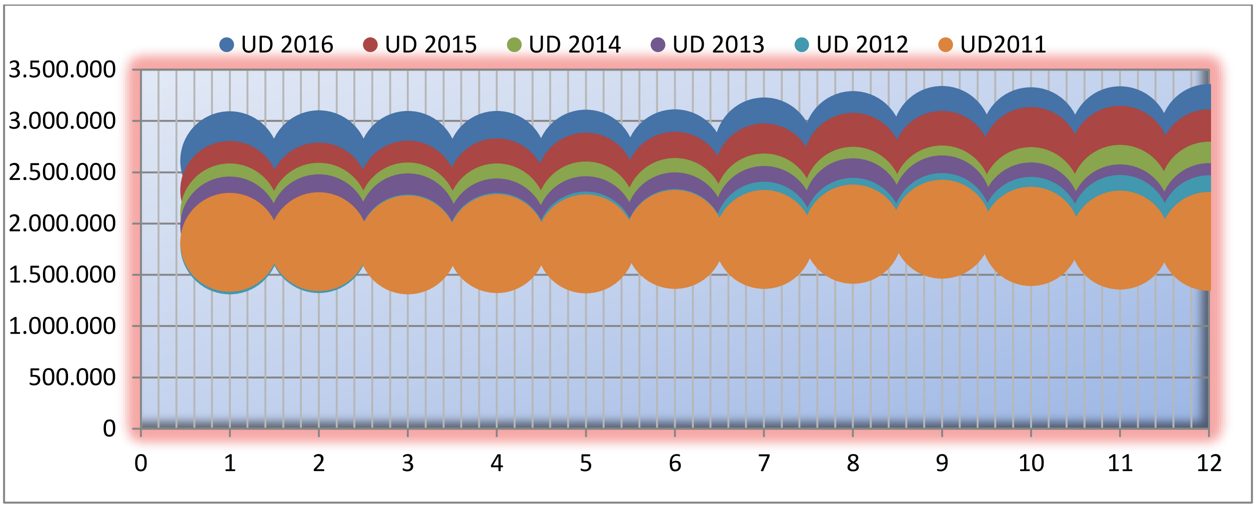
All banks are members of the Fund. In other words, depositors` deposits in all banks are protected by the Montenegrin deposit protection system in accordance with the Law.

Of the total amount of deposits deposited with banks, 37.54% are corporate deposits, while household deposits account for 53.09% of total deposits at the end of the reporting year, with both sectors increasing their funds deposited in banks, whereby household deposits rose by 8.38% and corporate deposits increased by 8.74% year-on-year.

As at 31 December 2016, deposits not covered by the deposit insurance system made up 9.37% of total deposits.

Figure 1 shows the trending of total deposits in the period from 2011 to 2016.

Figure 1 Movement of total deposits, 2011 – 2016 (in euro thousand)



**Source: Monthly reports of banks*

2. LEVEL AND STRUCTURE OF INDIVIDUAL DEPOSIT CATEGORIES

2.1. Total deposits

Total bank deposits amounted to 2,876,267,350 € as at 31 December 2016 whereas at end-2015 they totalled 2,629,783,608 €, which is the year-on-year increase of 9.37% (year-on-year growth in 2015 was 13.49%).

However, in Q1 2016, total deposits declined 0.12% quarter-on-quarter but they picked up pace and rose as follows: 0.62% in Q2, 8.64% in Q3, and 0.60% in Q4.

Table 1 Balance of total deposits by quarters in 2016 (000 €)

	31/12/2015	31/03/2016	30/06/2016	30/09/2016	31/12/2016
TOTAL	2,629,784	2,615,454	2,631,618	2,859,063	2,876,267

**Source: Monthly reports of banks*

The biggest depositors in banks were households and corporate sectors and their deposits recorded growths in 2016.

The share of household deposits amounted to 1.52 billion euros or 53.09% of total deposits as at 31 December 2016, making this sector the most significant depositor in the Montenegrin banking system. The number of household depositors amounted to 774,290 or 91.76% of the total number of depositors.

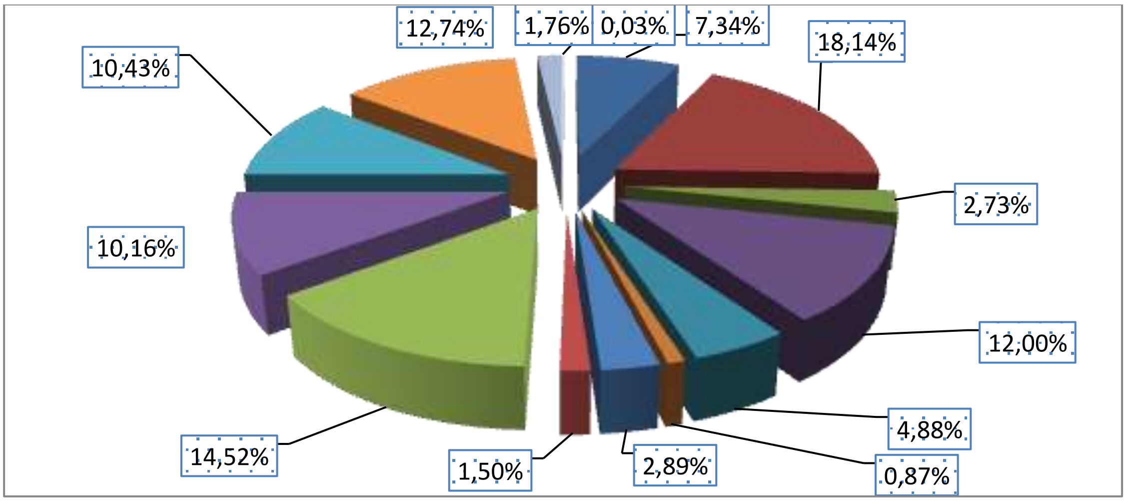
The corporate sector accounted for 37.54% or 1.08 billion euros of total deposits in banks. The number of corporate depositors amounted 67,109, which is 7.95% of total depositors at end-2016.

The total number of depositors was 843,806 and this represents the year-on-year decrease of 0.95% (851,887) that is a result of the "clearing of accounts", that is, deletion of inactive accounts with balances in euro cents.

The trend of reducing the banking sector concentration continued in 2016. From the once highly concentrated market and the dominant role of the three largest banks, today the situation has changed visibly, and the banking market is closer to being a competitive market (at the end of 2008, two banks with the highest deposit amounts made up 60.33% and at the end of 2016 they accounted for 29.44% of the deposit portfolio of the banking sector).

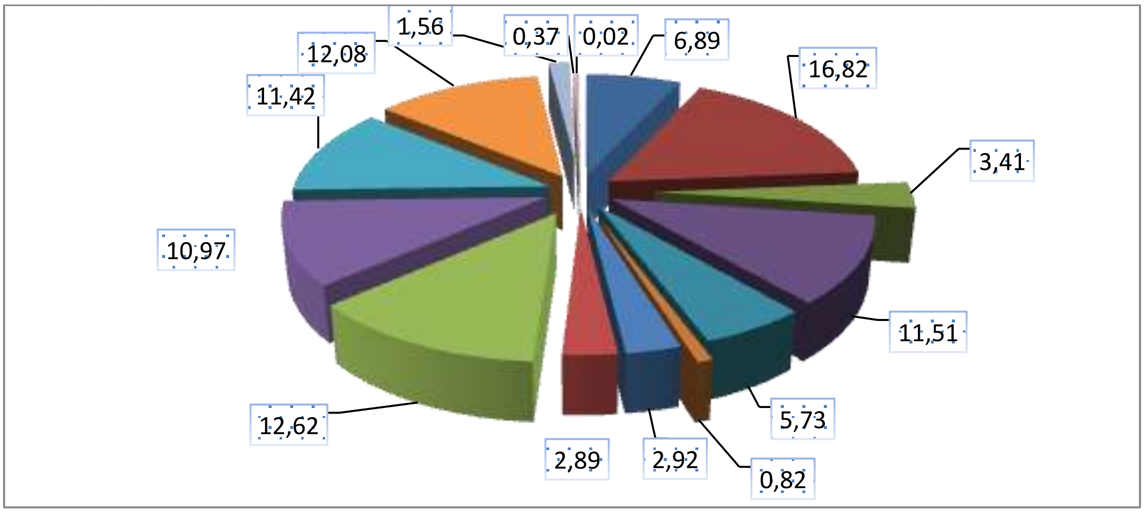
The shares of individual banks in total deposit portfolios in 2015 and 2016 are presented in Figures 2 and 3, respectively.

Figure 2 Share of banks in total deposits (2,629,784,000 €) as at 31/12/2015



**Source: Monthly reports of banks*

Figure 3 Share of banks in total deposits (2,876,267,000 €) as at 31/12/2016



**Source: Monthly reports of banks*

At end-2015, the largest bank in terms of total deposits held 18.14% of total deposits, whereas on year later this share shrank to 16.82%. The second largest bank reduced its share in total deposits from 14.52% to 12.62%, while the third largest bank recorded a slight decline in total deposits from 12.74% to 12.08%.

Individual shares of other banks in total deposits in the banking system remained at the same levels as at end-2015.

2.2. Deposits by persons not entitled to the guaranteed deposit payout

Deposits by persons who are not entitled to the guaranteed deposit payout in line with Article 6 paragraph 2 points 1 to 12 and paragraph 3 points 1 and 2 of the Law are presented in Table 2 (data as at end-quarters).

Deposits by persons not entitled to the guaranteed deposit payout amounted to 269,410,608 euros as at 31 December 2016, as compared to 234,531,068 euros a year ago, which is an increase of 14.87%.

Quarterly data point to great fluctuations of these deposits during the reporting year with decline being recorded in Q1 and Q2 (-6.76% and -2.75%, respectively), and growth in Q3 and Q4 (15.24% and 9.93%, respectively), which resulted in the year-on-year increase of 14.87% at end-2016. The number of depositors not entitled to the guaranteed deposit payout amounted to 2,407 at end-2016, which is 1.47% more than in the previous year (2,372).

Table 2 Deposits by persons not entitled to the guaranteed deposit payout, by quarters in 2016 (in 000 €)

	31/12/2015	**31/03/2016**	**30/06/2016**	**30/09/2016**	**31/12/2016**
Deposits by persons not entitled to payout	234,531	218,672	212,653	245,067	269,411
TOTAL DEPOSITS	2,629,784	2,615,454	2,631,618	2,859,063	2,876,267
% share in total deposits	**8.92**	**8.36**	**8.08**	**8.57**	**9.37**

**Source: Monthly reports of banks*

As at 31 December 2016, this category of deposits accounted for 9.37% of total deposits and their share slightly changed in comparison with end-2015 when it was 8.92%.

Deposits by state bodies and organisations accounted for the main share of depositors that are not entitled to the guaranteed deposit payout (44.66%). The share of deposits by financial institutions made up 4.06%, whereas deposits by legal persons engaged in insurance business accounted for 7.09%, and deposits by legal persons with either direct or indirect participation in capital or voting rights in the relevant bank of 5% or more made up 28.58%.

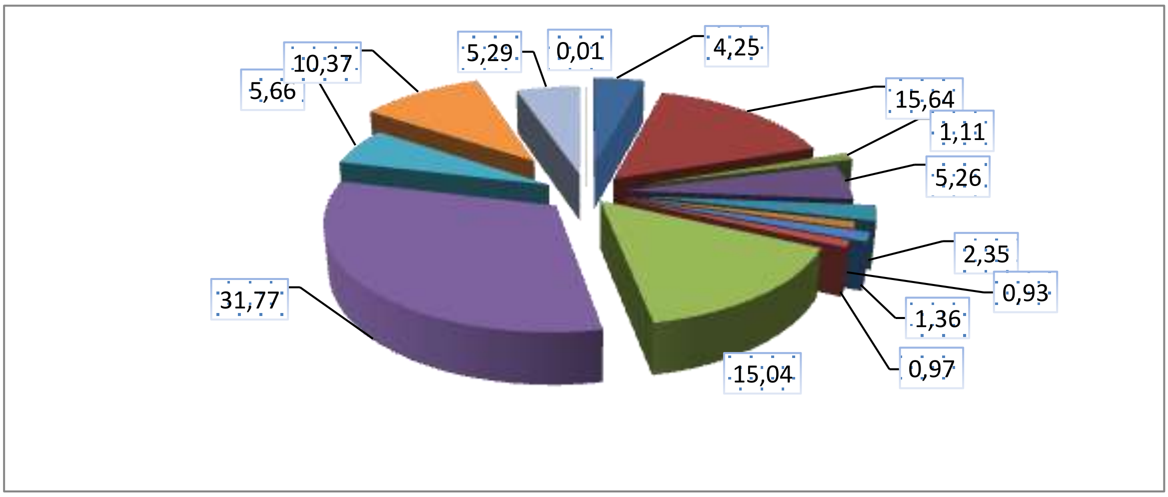
The year-on-year percentage increase of deposits by persons not entitled to the guaranteed deposit payout (of 14.87%) is the result of the following changes:

- an increase of 18.82% or 4 million euros in deposits by persons who are members of bank governance bodies and/or standing bodies of the bank management, persons responsible for daily bank operations, managers of organizational units in bank, legal persons holding, whether directly or indirectly, at least 5% share in the bank capital or voting rights, as well as their spouses and children;

- an increase of 112.83% or 40 million euros in deposits by legal persons holding, whether directly or indirectly, at least 5% share in the bank capital or voting rights;
- an increase of 177.78% or 3.8 million euros in deposits by health care, pension, and social insurance;
- a decrease of 38.68% or 12 million euros in deposits by legal persons engaged in insurance business.

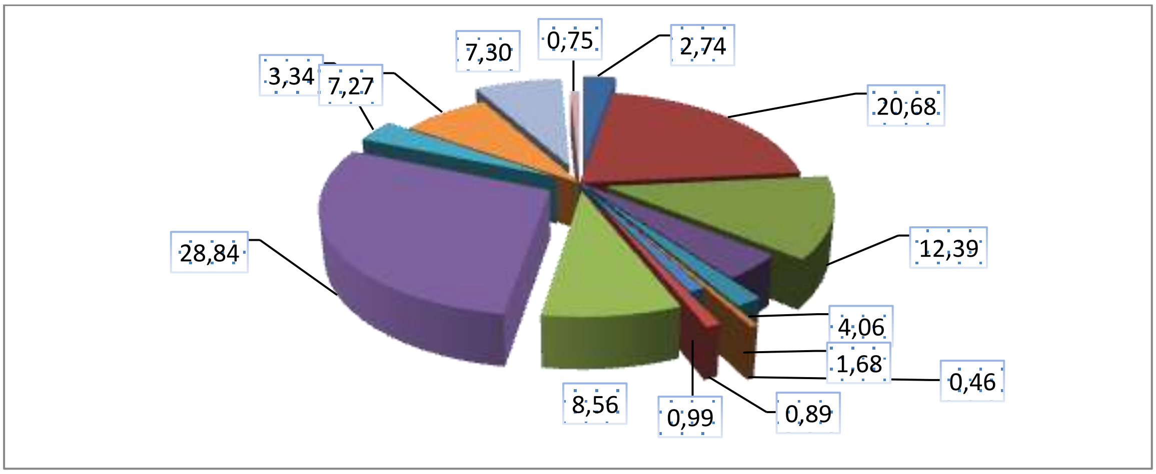
Other categories of deposits by persons not entitled to the guaranteed deposit payout experienced no significant changes at the end of the reporting year as compared to the previous year.

Figure 4 Deposits by persons not entitled to the guaranteed deposit payout, by banks, as at 31 December 2015



**Source: Monthly reports of banks*

Figure 5 Deposits by persons not entitled to the guaranteed deposit payout, by banks, as at 31 December 2016



**Source: Monthly reports of banks*

The movement of deposits by persons not entitled to the guaranteed deposit payout has no direct impact on the deposit protection scheme but it is necessary to track their trending from the aspect of the ratio of total deposits to guaranteed deposits for the purpose of determining the methodology for the calculation of the regular premium rate.

2.3. Deposits by persons entitled to the guaranteed deposit payout

All depositors whose deposits are not excluded within the meaning of Article 6 paragraph 2 points 1-12 and paragraph 3 points 1 and 2 of the Law are entitled to the guaranteed deposit payout (Table 3).

Deposits by persons entitled to the guaranteed deposit payout, that is, total deposits by natural and legal persons included in the deposit protection scheme as at 31/12/2016 amounted to 2,606,856,741 euros, as compared to 2,395,252,540 euros at 31/12/2015. This is the year-on-year increase of 8.83%.

Deposits by persons entitled to the guaranteed deposit payout slightly rose in Q1 2016. In Q2 these deposits also slightly increased quarter-on-quarter by 0.93%, continuing in the same fashion and increasing 8.06% in Q3. The quarter-on-quarter increase in Q4 2015 was minor, 0.27%.

Table 3 Deposits by persons entitled to guaranteed deposit payout (in 000 €)

	TOTAL	**Natural persons**	**Legal persons**	**NP in % (2/1)**	**LP in % (3/1)**
	1	**2**	**3**	**4**	**5**
31/12/2015	2,395,253	1,402,304	992,949	58.55	41.45
31/03/2016	2,396,782	1,412,364	984,418	58.93	41.07
30/06/2016	2,419,768	1,413,808	1,005,961	58.43	41.57
30/09/2016	2,613,996	1,450,107	1,163,889	55.47	44.53
31/12/2016	2,606,856	1,527,118	1,079,738	58.58	41.42
31/12/2016 - 31/12/2015	8.83%	8.90%	8.74%		
31/12/2016 – 31/12/2015	211,604	124,814	86,790		

**Source: Monthly reports of banks*

Deposits by natural persons accounted for the main share in the structure of deposits by persons entitled to the guaranteed deposit payout. Household deposits made up 58.58% and corporate deposits accounted for 41.42%.

The structure of these deposits did not significantly change in comparison with 2015. Both categories of deposits recorded growth in the reporting period (household deposits increased by 8.90% and corporate deposits rose 8.74%), so an increase of this category of deposits amounted to 8.83%.

Table 3.1 Number of depositors entitled to guaranteed deposit payout

	TOTAL	Natural persons	Legal persons	NP in % (2/1)	LP in % (3/1)
	1	2	3	4	5
31/12/2015	849,515	781,718	67,797	92.02	7.98
31/03/2016	841,735	773,462	68,273	91.89	8.11
30/06/2016	854,908	785,301	69,607	91.86	8.14
30/09/2016	821,193	751,206	69,987	91.48	8.52
31/12/2016	**841,393**	**774,284**	**67,109**	**92.02**	**7.98**
31/12/2016 - 31/12/2015	-0.96%	-0.95%	-1.01%		
31/12/2016 – 31/12/2015	-8,122	-7,428	-688		

**Source: Monthly reports of banks*

The number of depositors entitled to the guaranteed deposit payout decreased year-on year to from 849,515 in 2015 to 841,393 in 2016 or 0.96%, whereby the number of natural persons declined by 0.95% (this decline is a result of the "clearing of accounts" – deletion of inactive accounts with balances in euro cents) and the number of legal person fell by 1.01%.

The total number of depositors that were both entitled to the guaranteed deposit payout and whose deposits were higher than their due liabilities (the number of depositors holding guaranteed deposits) slightly decreased year-on-year (by 0.99%) due to the aforementioned "clearing of accounts".

Of 841,393 depositors entitled to the guaranteed deposit payout as at 31/12/2016, 61,256 had liabilities towards banks higher than their deposits with banks (these depositors would not be repaid guaranteed deposits as they would be set off against their due liabilities). Column 1 in Table 3.2 shows the number of depositors whose deposits exceeded their liabilities to banks, that is, the number of depositors who would be entitled to the guaranteed deposit payout by the Fund in case of hypothetical bankruptcy of all banks (780,137 depositors).

Table 3.2 Number of depositors whose deposits [1] exceed their due liabilities to banks

	TOTAL	Natural persons	Legal persons	NP in % (2/1)	LP in % (3/1)
	1	2	3	4	5
31/12/2015	745,359	681,749	63,610	91.47	8.53
31/03/2016	736,712	672,880	63,832	91.34	8.66
30/06/2016	752,421	687,017	65,404	91.31	8.69
30/09/2016	764,706	698,260	66,446	91.31	8.69
31/12/2016	**780,137**	**716,144**	**63,993**	**91.80**	**8.20**
31/12/2016 - 31/12/2015	4.67%	5.05%	0.60%		
31/12/2016 – 31/12/2015	34,778	34,395	383		

[1] Guaranteed deposit is established for every individual depositor by reducing matured liabilities of a depositor with a bank, including any accrued interest, from aggregate deposits held by the depositor with that bank as at the protected event (hence the difference in the number of depositors in Table 3.2 and Table 3.1 because a certain number of depositors have due liabilities that exceed their deposits).

Source: Monthly reports of banks

2.4. Guaranteed deposits

Guaranteed deposits amounted to 1,260,657,104 euros as at 31/12/2016, whereas they totalled 1,150,627,021 euros the year before, thus showing the year-on-year increase in the reporting year of 9.56%.

The enactment of the new Deposit Protection Law in 2010 and its alignment with the Directive 2009/14/EC provided for an increase of the level of insured deposit from 5,000 € to 50,000 € and the reducing of the repayment period from 90 to 20 working days. In Q4 2010 and in 2011, the guaranteed deposit amounted to 20,000 €, in 2012 it was 35,000 €, and as of 1 January 2013 the coverage rose to 50,000 €.

Amendments to the Law passed in 2015 reduced the repayment period to 15 working days (Directive 2009/14/EC prescribed the reduction of the repayment period from 20 to 15 working days as of 2019, then further reduction to 10 and then 7 working days as of 2021 and 2024, respectively).

Quarterly growth of guaranteed deposits was rather uneven in 2016. In Q1 they slightly decreased (0.92%) in comparison with Q4 2015. The quarter-on-quarter growth in Q2 was 1.09%, and this trend continued both in Q3 and Q4 when guaranteed deposits increased 7.49% and 1.77%, respectively.

As at 31/12/2015, guaranteed deposits made up 43.75% of total deposits and at the end of the reporting year this share was 43.83%. Their respective shares in protected deposits amounted to 48.03% and 48.45%.

Table 4 Share of guaranteed deposits in total deposits in 2016 (in 000 €)

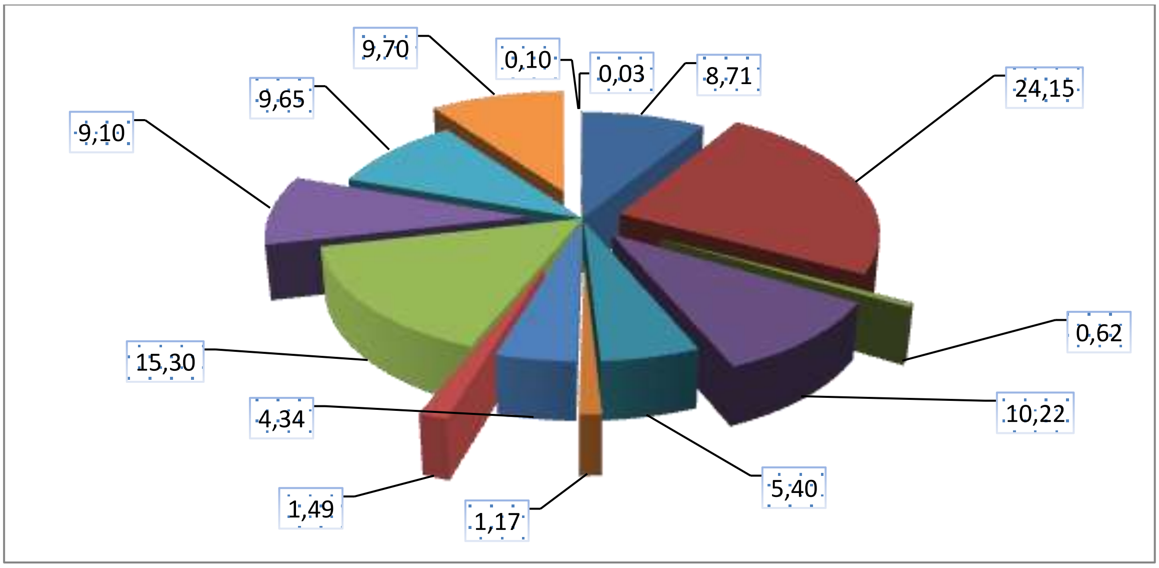
	31/12/2015	31/03/2016	30/06/2016	30/09/2016	31/12/2016
GUARANTEED DEPOSITS	1,150,627	1,140,053	1,152,501	1,238,773	1,260,657
TOTAL DEPOSITS	2,629,784	2,615,454	2,631,618	2,859,063	2,876,267
SHARE OF GD* in TD**	43.75%	43.59%	43.79%	43.33%	43.83%

*Source: Monthly reports of banks; *Guaranteed deposits GD; **Total deposits TD*

On 31 December 2016, guaranteed deposits were 110.5 million euros higher than the year before.

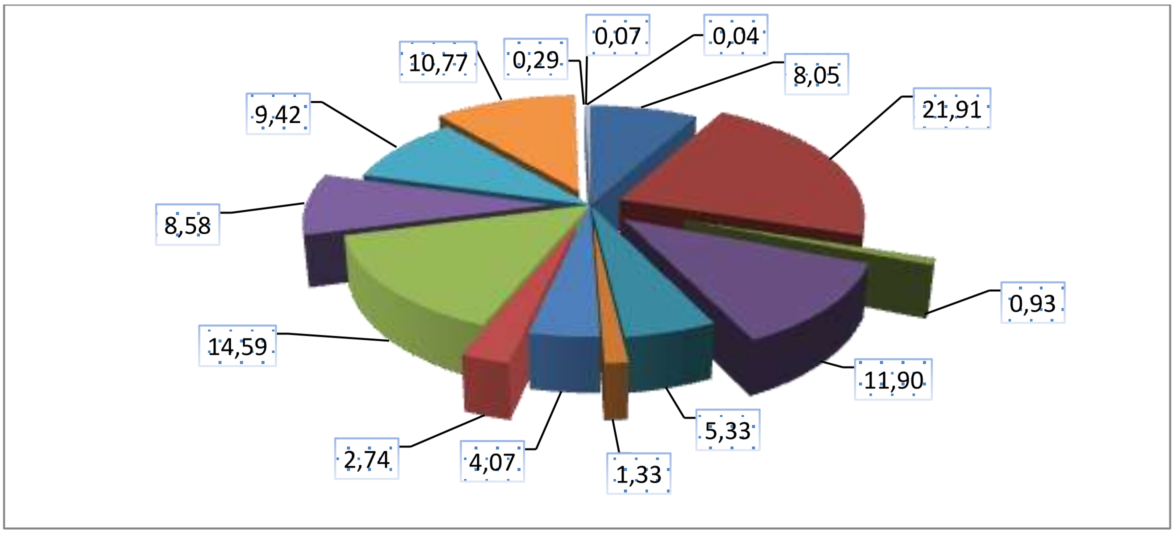
Regardless of their increase during the reporting year, the structure of guaranteed deposits did not significantly change compared to end-2015.

Figure 6* Guaranteed deposits by banks as at *31/12/2015



**Source: Monthly reports of banks*

Figure 7* Guaranteed deposits by banks as at *31/12/2016



**Source: Monthly reports of banks*

Two banks held 36.50% of total guaranteed deposits, which is the year-on-year decline (from 39.45% at end-2015).

The bank with the highest amount of guaranteed deposits reduced its share in total guaranteed deposits from 24.15% to 21.91%. The second bank in terms of size of guaranteed deposits also declined its share in total guaranteed deposits, from 15.30% to 14.59%, whereas the third bank retained a similar share of 11.90%.

At the end of the reporting year, two banks that held 29.44% of total deposits held 36.50% of guaranteed deposits, which is less than a year before when they had 32.64% of total deposits and 39.45% of guaranteed deposits, which indicates a positive trend in deposit diversification and/or risk dispersion.

Table 4.1 Guaranteed deposits (natural and legal persons) in 000 €

	TOTAL	Natural persons	Legal persons	NP in % (2/1)	LP in % (3/1)

	1	2	3	4	5
31/12/2015	1,150,627	972,077	178,550	84.48	15.52
31/03/2016	1,140,053	967,557	172,496	84.87	15.13
30/06/2016	1,152,501	969,020	183,481	84.08	15.92
30/09/2016	1,238,773	1,027,405	211,368	82.94	17.06
31/12/2016	1,260,657	1,063,289	197,368	84.34	15.66
31/12/2016 / 31/12/2015	9.56%	9.38%	10.54%		
31/12/2016 – 31/12/2015	110,030	91,212	18,818		

**Source: Monthly reports of banks*

As at 31 December 2016, guaranteed deposits were 9.56% higher year-on-year (deposits by natural persons by 9.38% and deposits by legal persons by 10.54%).

Table 4.2 Total number of depositors whose deposits exceed their liabilities to bank and who are entitled to the guaranteed deposit payout; and the number of depositors whose guaranteed deposit is below or equals 50,000 €

TOTAL NUMBER OF DEPOSITORS ENTITLED TO THE GUARANTEED DEPOSIT PAYOUT *(AFTER DEDUCTING DUE LIABILITIES)*				**NUMBER OF DEPOSITORS HOLDING A DEPOSIT LOWER OR EQUAL TO THE AMOUNT OF GUARANTEED DEPOSIT OF 50,000€**					
	TOTAL	**Natural persons**	**Legal persons**	**TOTAL**	**Natural persons**	**Legal persons**	**Coverage %**	**Coverage %**	**Coverage %**
	1	**2**	**3**	**4**	**5**	**6**	**7 (= 4/1)**	**8 (= 5/2)**	**9 (= 6/3)**
31/12/15	745,359	681,749	63,610	738,779	676,768	62,011	99.12	99.27	97.49
31/03/16	736,712	672,880	63,832	730,200	667,885	62,315	99.12	99.26	97.62
30/06/16	752,421	687,017	65,404	745,937	682,108	63,829	99.14	99.29	97.59
30/09/16	764,706	698,260	66,446	757,763	693,207	64,556	99.09	99.28	97.16
31/12/16	780,137	716,144	63,993	773,042	710,885	62,157	99.09	99.27	97.13

**Source: Monthly reports of banks*

The number of depositors holding the guaranteed deposit ≤ 50,000 euros at end-2016 amounted to 773,042. They accounted for 71.85% of total guaranteed deposits (710,885 natural persons or 99.27% of the total number of private depositors entitled to payout; and 62,157 legal persons – 97.13% of the total number of legal persons entitled to payout), which made up 99.12% of the total number of depositors entitled to the guaranteed deposit payout. They accounted for 99.09% of the total number of depositors entitled to guaranteed deposit payout.

The number of depositors holding guaranteed deposits >50,000 euros amounted to 7,095, of which 5,259 were natural persons (or 0.72% of the total number of entitled depositors) and 1,837 were legal persons (2.85%) which accounted for 0.90% of the total number of entitled depositors whose deposits exceed their liabilities, which together made up 28.15% of total guaranteed deposits (Table 4.3).

Table 4.3 Guaranteed deposits (natural and legal persons)

Balance as at: 31/12/2016	Amount (000 €)	No. of depositors	Due liabilities (000 €)	Balance (000 €)	No. of depositors holding GD	Coverage %
Deposits	**A**	**B**	**C**	**D**	**E**	
Deposits by persons entitled to the guaranteed deposit payout	2,606,856	841,393	95,731	2,465,189	780,137	
Deposits by natural persons entitled to the guaranteed deposit payout	1,519,152	774,284	32,218	1,514,308	716,144	
Deposits by natural persons ≤50.000 €	803,646	768,947	32,009	800,339	710,885	99,27
Deposits by natural persons >50.000 ≤100.000 €	231,212	3,541	247	230,839	3,495	
Deposits by natural persons >100.000 €	484,293	1,796	872	483,130	1,764	
GUARANTEED DEPOSITS BY NATURAL PERSONS				1,063,289	716,144	
Deposits by legal persons entitled to the guaranteed deposit payout	1,087,704	67,109	66,513	950,881	63,993	
Deposits by legal persons ≤50.000 €	108,127	65,164	52,261	105,568	62,157	97.49
Deposits by legal persons >50.000 ≤100.000 €	54,309	768	1,669	53,548	747	
Deposits by legal persons >100.000 €	925,268	1,177	12,553	791,765	1,089	
GUARANTEED DEPOSITS BY LEGAL PERSONS				197,368	63,993	
GUARANTEED DEPOSITS				1,260,657	780,137	99.30

**Source: Monthly reports of banks*

Total deposits of depositors entitled to guaranteed deposit payout (protected deposits), after the deduction of their due liabilities, amounted to 2,465,189,172 euros as at 31/12/2016, of which protected deposits by natural persons amounted to 1,514,308,062 euros or 61.43%, while protected deposits by legal persons totalled 950,881,102 euros or 38.57%.

Total guaranteed deposits amounted to 1,063,288,615 euros or 43.13% of total protected deposits (84.35% of total guaranteed deposits).

The total number of entitled private depositors holding deposits ≤50,000€ amounted to 710,885 and their deposits amounted to 800,338,615€ or 75.27% of total guaranteed deposits of natural persons (52.85% of total protected deposits by natural persons).

The number of entitled private depositors whose deposits exceed 50,000€ amounted to 5,259 and in case of a bank failure they would be repaid 262,950,000€ or 24.73% of total guaranteed deposits by natural persons amounted (17.36% of total protected deposits of natural persons).

Total deposits by legal persons entitled to the guaranteed deposit payout after the deduction of their liabilities amounted to 950,881,102€ as at 31/12/2016 and they accounted for 38.57% of total protected deposits.

The number of legal depositors holding deposits ≤50,000€ amounted to 62,157 and their guaranteed deposits totalled 105,568,489€ or 53.48% of total guaranteed deposits of legal persons (11.10% of total protected deposits of legal persons).

The number of entitled legal depositors with deposit exceeding 50,000€ amounted to 1,836 and in case of a bank failure they would be repaid 91,800,000€ or 46.51% of total guaranteed deposits of legal persons (9.65% of total protected deposits of legal persons).

Total guaranteed deposits of legal persons amounted to 197,368,489€ or 15.65% of total guaranteed deposits (8.01% of total protected deposits).

As the deposit insurance system is basically designed to protect small and unsophisticated depositors (depositors who do not have or have very limited knowledge of management of financial resources), such a high coverage of depositors (99.09%) that would be fully compensated is an indication that the amount of 50,000€ is a well-designed coverage and that is in line with the economic power of depositors.

Pursuant to Directive 2014/49/EC the mandatory coverage of guaranteed deposits in the EU Member States is 100,000 euros. However, taking into account the presented data, we consider that the coverage percentage in our system is very high and the amount of the guaranteed deposit should remain at the level of 50,000 euros until Montenegro`s EU accession date.

Average amount of guaranteed deposit[2]			
	31/12/2015	**31/12/2016**	**Increase**
Legal persons	2,806	3,084	9.91%
Natural persons	1,425	1,485	4.21%
TOTAL	1,543	1,615	4.67%

3. EXPOSURE OF THE FUND TO BANKS

Total exposure of the Fund to banks is represented with the coverage ratio, i.e. the Fund`s assets to liabilities ratio in case of a hypothetical bankruptcy of all banks (the Fund`s assets/total guaranteed deposits).

As at 31 December 2016, the Fund’s assets amounted to 80,947,151€ and the guaranteed deposits totalled 1,260,657,103€.

The coverage ratio is the internationally recognized ratio for the measurement and indication of the degree of coverage of guaranteed deposits. The coverage of guaranteed deposits with the Fund’s assets at the aggregate level amounted to 6.42% (for the guaranteed deposit ≤ 50.000 €) as at end-2016, whereas it stood at 5.89% in 2015.

The Fund’s exposure to individual banks (the Fund’s assets to the guaranteed deposits in individual banks – the coverage of guaranteed deposits by the bank) as at 31 December 2016 is presented in Table 5 and Figure 8 below.

[2] The indicator of the average amount of guaranteed deposit (at aggregate and individual levels both for natural and legal persons) is much lower than the actual amount and this is because the banks also maintain accounts with balances below one euro and their holders are also treated as depositors.

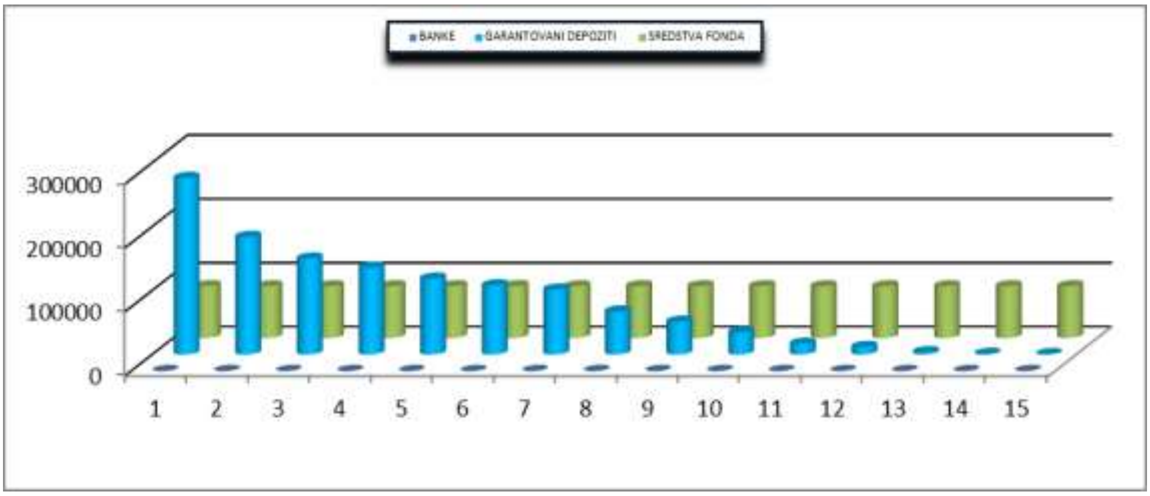
Table 5 Coverage of guaranteed deposits with the Fund's assets (000 €)

BANKS	GUARANTEED DEPOSITS	FUND`S ASSETS	Coverage (%)	FUND`S ASSETS WITH EBRD FUNDS	Coverage[3] (%)	Lacking funds 1	Lacking funds 2
1	**2**	**3**	**4**	**5**	**6**	**7**	**8**
1	276.218	80.947	29.31	110,947	40.17	**195,271**	**165,271**
2	183,952	80,947	44.00	110,947	60.31	**103,005**	**73,005**
3	149,983	80,947	53.97	110,947	73.97	**69,036**	**39,036**
4	135,794	80,947	59.61	110,947	81.70	**54,847**	**24,847**
5	118,700	80,947	68.19	110,947	93.47	**37,753**	**7,753**
6	108,161	80,947	74.84	110,947	102.58	**27,214**	-
7	101,488	80,947	79.76	110,947	109.32	**20,541**	-
8	67,180	80,947	120.49	110,947	165.15		
9	51,251	80,947	157.94	110,947	216.48		
10	34,533	80,947	234.40	110,947	321.28		
11	16,710	80,947	484.42	110,947	663.96		
12	11,704	80,947	691.62	110,947	947.94	-	
13	3,623	80,947	2.234.25	110,947	3.062.30		
14	891	80,947	9.084.96	110,947	12.451.96		
15	470	80,947	17.222.77	110,947	23.605.74		
TOTAL	**1,260,658**	**80,947**	**6.42**	**110,947**	**8.80**		

**Source: Monthly reports of banks and the Fund`s bookkeeping*

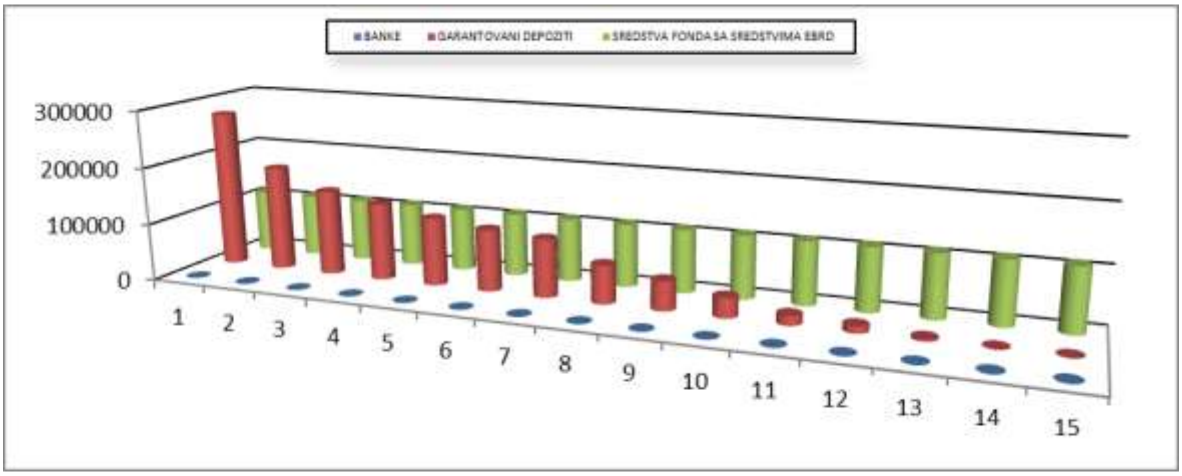
Figure 8 The Fund's exposure to individual banks (without the EBRD funds)

3 Calculated resources of the Fund with the donation and credit of 30.0 million € from the EBRD.



**Source: Monthly reports of banks and bookkeeping of the Fund*

Figure 8.1 The Fund's exposure to individual banks (with the EBRD funds)



**Source: Monthly reports of banks and bookkeeping of the Fund*

In case of introduction of bankruptcy in any of the 10 banks, the Fund`s assets and funds provided from the Stand-by arrangement with the EBRD (this arrangement is valid until November 2017) would be sufficient for the compensation of all depositors in any of the 10 banks (as represented in Table 5, column "lacking funds 2").

In case of bankruptcy in one of five banks, the lacking funds in the biggest bank would total 165.3 million €, the second biggest bank would have a 73.0 million € shortfall, the third bank would need 39.5 million €, while the remaining two would need 24.8 million € and 7.7 million € (Table 5).

The Fund would compensate for the shortfall from additional sources in one of the manner prescribed in the Law (charging the extraordinary premium; borrowing from the Budget of Montenegro; borrowing from foreign banks and financial institutions; and issuing securities; or a combination of two or more of the listed sources).

The aimed coverage ratio is 10% of the guaranteed deposits. When the Fund's resources (without donations) reach the level of 10% of the guaranteed deposits, the MB may pass a decision on reducing the regular premium rate and/or temporary discontinuation of the regular premium collection.

In 2010, the Fund signed the Loan Agreement with the EBRD regulating the withdrawal of 30 million € over seven years for the purpose of guaranteed deposits payout. With these funds, the EBRD provides the coverage ratio of 8.80% through the stand-by arrangement (to be used solely in case of a bank bankruptcy) (Table 6).

Table 6 Coverage ratio for guaranteed deposits in the system

Guaranteed deposits as at 31/12/2016	**Fund's resources as at 31/12/2016**	**% of coverage of guaranteed deposits**
1	**2**	**2/1**
1,260,657,103	80,947, 151[4]	6.42%
1,260,657,103	110,947, 151[5]	8.80%

**Source: Monthly reports of banks and bookkeeping of the Fund*

4. ACTIVITIES OF THE FUND IN 2016

4.1. General remarks

Activities of the Fund in the reporting period were carried out in accordance with planned obligations set out in the Fund's Work programme for 2016 and the Fund`s 2016-2021 Strategic Plan.

The Strategic Plan provides the basic guidelines for a long-term development in line with the changes that have occurred and also with possible future actions to be taken with a view to achieving the set objectives. At the same time, the Strategic Plan has become the operational plan, while the strategies specified therein provide guidelines and establish individual priorities during the long-term development. Also, this plan provides a framework program for the adoption of the budget of the Fund in the forthcoming period, including capital investments.

The signing of the MoU on cooperation with the Ministry of Finance in the process of payout of guaranteed deposits additionally strengthened the network of financial stability. This memorandum defines joint activities of the two institutions aimed at a more expedient, efficient, and transparent compensation of guaranteed deposits in case of bankruptcy of any of the banks.

The Fund also prepared and implemented the Integrity Plan which represents a set of measures of a legal and factual nature that prevent and eliminate potential and actual risks that could affect the lawful, efficient, economic, effective, and professional functioning of the Fund and favour the occurrence and development of corruption and other abuses.

[4] The Fund's resources (from the premium, donations, and the Fund's operating income).

[5] The Fund`s resources increased by funds provided via the EBRD loan (30 million €).

In line with the Communication Strategy of the Fund for the period from 2016 to 2021 and following the highest transparency standards, the public was timely informed about the activities, objectives, and results of the Fund via press releases, web presentations, and appearances in the media.

The promotion of positive sides of the deposit protection system was achieved through the implementation of the campaigns carried out in the period from 15 December 2014 to 15 January 2015 and from 15 December 2016 to 15 January 2017. Throughout the reporting year, the Fund informed the public about its role in preserving the stability of the banking and financial system through press releases, participation in educational information programs, lectures in secondary schools on the week of saving, press and radio interviews, and thus significantly contributed to the trust of depositors in the banking system.

The activities of the Fund related to regular operations, obligations arising from its participation in the EU accession negotiations process that results in amended laws and regulations, as well as the submission of follow-up reports regarding the recommendations of the 2015 FSAP mission.

4.2. Investment activities and accounting in 2016

The Fund invested its assets in 2016 in accordance with its By-Law and Investment Policy, the Asset Management Agreement with the CBCG (dated 4 May 2012), and the financial situation in the domestic and international market.

Through its asset manager (the CBGB) and in line with the Investment Policy, the Fund invested its available assets in time and overnight deposits. The Fund independently invested a part of deposits (20% of total assets) in debt securities issued by the CBCG on behalf of the MF of Montenegro.

Considering the restrictions prescribed by the Law, the Fund's By-Law and Investment Policy, the Fund may invest in:

1) securities issued or guaranteed by Montenegro;
2) securities issued by a foreign bank, a financial institution and/or a country holding a high rating assigned by an internationally recognized rating agency;
3) deposits in central banks and foreign banks holding high ratings assigned by an internationally recognized rating agency,

and following the principles of safety, liquidity, and transparency it achieved the results presented below.

a) Investment in government bonds

In accordance with the Investment Policy and within the 20% of available funds, in November 2016, the Fund invested 2.2 million € in long-term debt securities – **Government bonds** GB1-2016 series issued by Montenegro, at the flat interest rate of 4.0% per annum. The interest payment in the amount of 88,000 € is made once a year, and the maturity date for the principal and annual interest is 15 November 2020. The revenue to be earned in 2016 is 11,090 €.

b) Investment in Treasury bills

In accordance with the Deposit Protection Law and the Fund`s Investment Policy, the Fund independently invested a part of the available 20% of funds in short-term discounted securities – **Treasury bills** issued by Montenegro and sold at auctions by the CBCG on behalf of the Ministry of Finance.

Offered and accepted rates of return on 182-day T-bills by the Fund in H1 and H2 2016 ranged between 0.30% and 2.20% and 1.80% and 2.30%, respectively (Table 7).

The Fund earned a total of 213,092 euros from interest on T-bills, whereas the cost of auction participation fees amounted to 29,730 euros.

Table 7: Investment in T-bills in 2016

Auction no.	Date	No. of days	Accepted rate %	Invested amount	Return	Auction charges 0.1%
1	16.02.2016.	56	1,60	1.995.035	4.965	2,000
2	22.02.2016.	182	0,50	2.842.814	7.186	2.850
			0,65	3.986.899	13.101	4.000
3	01.03.2016.	182	2,00	2.069.079	20.921	2.090
			2,20	3.194.470	35.530	3.230
4	12.04.2016.	182	2,20	2.076.900	23.100	2.100
5	12.07.2016.	182	1,80	1.218.908	10.300	1.230
6	22.08.2016.	182	2,00	6.781.432	49.354	6.850
7	30.08.2016.	182	2,30	5.318.162	41.792	5.380
	Return on invested funds in 2016				**206.249**	
	Return on purchases in 2015				**6.843**	
	T O T A L R E T U R N				**213.092**	**29.730**

**Source: Bookkeeping of the Fund*

c) Investments in foreign markets

When it comes to investing the Fund`s resources on the foreign market during the reporting year, the Fund`s asset manager, the CBCG, invested the funds in 3-mnth and 6-month time deposits with renowned commercial banks holding a high credit rating. However, it turned out that as of 2015, these investments have yielded negative return, which significantly diminished the financial result of the Fund. This is a consequence of the major changes in the international market and declining interest rates induced by deteriorated rating of the previously risk-free economies and such a negative trend continues.

In the reporting period, the Fund`s deposits earned the average weighted interest rate in H1 and H2 of -0.10413% and -0.22616%, respectively.

The reporting period was characterized by low interest rates on the financial market, which resulted in very unfavourable results when it comes to interest income (as of November 2015, the CBCG has been investing funds of the Deposit Protection Fund at negative interest rates). As a consequence, the Fund achieved a negative result from investments in the amount of 84,773 euros.

In line with the statutory obligation, the Fund hired the tender winning audit firm "BDO" d.o.o. Podgorica.

The Fund independently performs its financial and accounting operations and prepares financial statements for every business year. On the basis of bookkeeping data, information and overviews were prepared with a view to monitoring the implementation of the Fund’s Financial Plan, which were subject to regular reporting to the MB.

4.3. Normative and legal activities

The MB of the Fund held eight meetings in 2016 and adopted the following normative acts:

- Decision on the adoption of the Annual financial statements of the Deposit Protection Fund for 2015 (the financial statements were compiled in line with the IAS);
- Decision on adopting the Financial Plan of the Fund for 2017;
- Decision on the regular premium calculation rate and the method of the regular premium calculation in 2017 (the MB decided that the regular premium rate in 2017 shall be 0.50% of total deposits in banks (same as in 2016);
- Decision on signing the MoU with the Ministry of Finance of Montenegro governing the cooperation in the procedure of guaranteed deposits payout;
- Decision on sigining the MoU by the Balkan deposit insurance systems;
- Decision on the appointment of the auditor for the audit of the Fund`s 2016 financial statements;
- Rules on public procurement through direct agreement;
- Rules on job systematisation in the Fund;
- Rules on coefficients for job complexity for the Director General and employees of the Fund;
- Strategic planof the Fund for the period 2016-2021;
- Communication Strategy of the Fund for the period 2016-2018;
- Fund`s Integrity Plan;

During the current year, the MB considered and adopted the following:

- Proposal of the Annual Activity Report of the Fund for 2015 (submitted to the CBCG Council for adoption);
- I External audit report for 2015 was considered by the Fund. The report was prepared by the audit firm “Deloitte” d.o.o. Podgorica. The opinion of the independent external auditor is that “the financial statements fairly and accurately present the position of the Fund and they have been prepared in accordance with the laws of Montenegro and the IAS”);
- Financial plan of the Deposit Protection Fund for 2017.

In addition to the aforesaid reports, the MB also considered monthly and quarterly reports on deposit trending in the banking system, the balance of the Fund's assets, the fulfilment of planned activities, and investments by the Fund

4.4. Activities on testing the payout of guaranteed deposits

In order to ensure the implementation of the FSAP mission recommendations and with a view to creating an efficient and operational system for the payment of guaranteed deposits, the Fund conducted the testing of banks in the H2 2016 through a simulation exercise dealing with the payout of guaranteed deposits in the occurrence of the so-called "protected event" – a bank bankruptcy.

With the aim of assessing the adequacy of the existing regulations governing the compensation of guaranteed deposits and assessment of the Fund's capacity to perform its basic function, which is a quick and efficient payout of guaranteed deposits, in cooperation with the Association of Montenegrin Banks, the Fund prepared testing for the payment of guaranteed deposits. The first such test was carried out in 2015, and after the upgrade of the software solution for the payment of guaranteed deposits, testing with the two banks was carried out at the end of November 2016.

There is no legal basis for testing the banks but an agreement was reached with Association of Montenegrin Banks to arrange individual testing of banks by the Fund. At the request of the Fund, five banks accepted voluntary testing. These banks provided real time data from the database of depositors, deposits, and liabilities (all data had been first encrypted to protect the integrity of depositors) so that testing in two banks was fully completed during November and December, while necessary data from other banks were taken to complete procedure at the end of the second quarter of 2017.

The aforementioned testing enabled us to check the functioning of the upgraded software, verify the compatibility of data that banks submit to the Fund (which are necessary for conducting the test), as well as to complete the process of calculating and paying the guaranteed deposit.

This was an opportunity for banks to adjust their records to the special requirements of the Fund, as well as to train their staff to use the "Guaranteed deposit compensation application" (part of the guaranteed deposit payment software). The tested banks would, in the assumed situation, have the role of an agent for the payout of guaranteed deposits - the agent bank.

4.5. Human resources and education of employees

During 2016, the Fund`s employees went through continuous training and received both general and specialized knowledge. Participation in seminars and working groups organized by international associations enables the employees to be always informed in a timely fashion about changes in the deposit insurance system and to use best practices of the EU countries.

In February, representatives of the Fund attended the meeting of the working group that drafted amendments to the Statute of the EFDI. The meeting was attended by representatives of non-EU countries (Switzerland, Turkey, Albania, Serbia, Bosnia and Herzegovina, Macedonia) in addition to the Board of Directors of the EFDI and the chair of the working group for drafting the amendments to the Statute, with the aim of defining the status of these countries within the EFDI working bodies.

Based on the recommendations of the FSAP mission and the engagement of the WB, representatives of the Fund participated in working seminars in December in Vienna that dealt with the issues of bank recovery and resolution, the role of the deposit insurance system as a risk minimizer, and novelties in funding deposit insurance system through risk assessment in banks.

Documents and instructions presented at these seminars covered the issues of how to conduct bank recovery and resolution both with and without government budget intervention. In addition, modalities of government intervention were explained in detail, which was very valuable for the Fund given that resources of the Fund can be used for bank resolution in certain cases. Technical assistance was agreed with representatives of the WB to cover the development of a methodology for establishing the risk-based deposit protection premium.

Given that the interest rates on the Fund`s invested funds have been negative since the end of 2015, a way was sought to diminish these negative effects by placing funds whilst observing the principles of security and liquidity. In this regard, a meeting was held with the management of the Deposit Insurance Agency from Bosnia and Herzegovina, which has had positive experience with the placement of funds through its investment manager Deutsche Bank for a long period of time. The meeting was attended by representatives of the CBCG from the investment sector. At this meeting, the way of investing funds from the investment manager Deutsche Bank from Frankfurt was presented and we were invited to attend a seminar on investing funds which Deutsche Bank organizes each year for its clients in Frankfurt, and we were also given specific guidelines for changing the Fund's Investment Policy.

The seminar provided the expected educational points regarding investment as well as guidelines for changing the Investment Policy. Draft amendments to the Investment Policy prepared by the Fund were submitted to the asset manager CBCG for comments and suggestions in order to have more opportunities in the coming period to achieve positive returns on invested funds.

In addition to participating in international seminars organized by international institutions (IBRD, EFDI, WB, etc.), at its internal workshops, which addressed the issues of calculating and payout of guaranteed deposits, the Fund perfected procedures and transferred knowledge regarding the use of software for payment of guaranteed deposits to employees in banks that voluntarily accepted the testing. In this way, the level of training of employees in the Fund and banks improved, as did the overall readiness the Fund in case of the so-called “protected event”.

The Fund had seven employees as at 31 December 2016.

4.6. International cooperation

As a full-fledged member of the European Forum of Deposit Insurers (EFDI), which is an association of European deposit insurance funds on a voluntary basis enabling the exchange of ideas and experiences in deposit insurance in Europe, the Fund attended the EFDI`s annual meeting held in September 2016 in Vilnius, Lithuania whereat the chairman and members of the Board of this association were elected. Also, representatives of the Fund attended the meetings of all working groups (ERC, PR and the working group for drafting amendments to the By-Law). A seminar was also organised to address the issue of protection of investors and present international practice related to the relationship between EU legislation and national legislation, as well as the future of the EU deposit guarantee system.

The representatives of the Fund used the presence of conferences to make contacts and share experiences in drafting secondary legislation and its alignment with the Directive 2014/49/EC.

At the same time, representatives of the Fund actively participated in surveys used as the main guidelines for the harmonization of the deposit insurance system in all EFDI member countries. The EFDI goals are achieved by exchanging data on the situation in the financial and banking sector, participation in research projects, improving the regulatory framework and practice, educating expert bodies, exchanging and educating employees, and the like.

As a full member of the IADI, the Fund took part in the International Conference of the European Regional Committee - ERC held in February 2016 in Turin, Italy. The IADI organized a workshop-seminar within the conference to cover the most important aspects of the IAD Core Principles published by this organization, which are also used by the IMF and the WB in practice, in order to verify the compliance of local legislation with the Core Principles. Representatives of the Fund presented the compliance of the Montenegrin deposit insurance model with the IADI Core Principles and Directive 2014/49/EC.

At the IADI conference in Basel, in addition to presentations explaining the timely detection of problems in a bank and early intervention, solutions were presented on how to introduce risk-based premiums, and ways of recovery, liquidation, and P&A transactions to solve problem banks.

A special interest of non-EU countries is reflected in the work of the Balkan EFDI Forum. Regional meetings were held in Serbia and Macedonia and they were attended by representatives from Albania, Bosnia and Herzegovina, Macedonia, Croatia, and Serbia, with the aim of creating a platform to represent common interests in international organizations, to promote mutual information and professional knowledge, as well as to contribute to the strengthening of financial stability in the region by closer cooperation.

Individual achievements of the Funds in further harmonization with the Core Principles were presented at these meetings, as well as practical examples of resolving failed banks. At this forum, the Fund presented its analysis of the introduction of a risk-based premium.

5. OBJECTIVES AND TASKS OF THE FUND IN 2017

The main objectives of the Fund are defined under the Strategic Plan. The introduction of a risk-based premium and the improvement of the effective system of protection and payout of guaranteed deposits are the two most important tasks of the Fund in 2017. The first task will be accomplished with the help of WB consultants within the deadlines foreseen in the RG-9 work plan, and the second goal will be achieved by continuing to test the payout of guaranteed deposits and educating employees in the Fund and banks.

Amendments to the Law and the introduction of the risk-based premium, in accordance with the Fund's Communication Strategy, must be accompanied by a broad public debate to which the general public and depositors will join in addition to the expert public.

6. FINANCIAL OPERATIONS OF THE DEPOSIT PROTECTION FUND IN 2016

6.1. Statement of Financial Performance (Income Statement)[6]

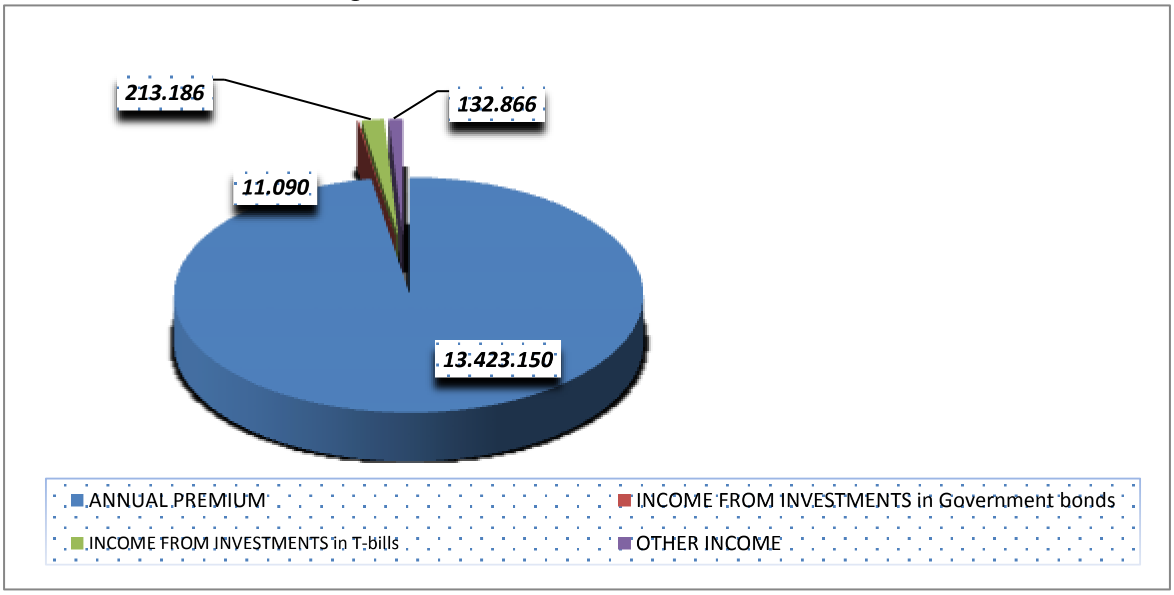
6.1.1. The Fund`s income

The total Fund's income amounted to 13,780,292 € in 2016, exceeding the planed income for the reporting year by 1.68% and being 13.36% higher year-on-year (12,156,755€ in 2015). They involved:

- operating income;
- financial income, and
- other income.

6.1.1.1. Operating income amounted to 13,423,150€ in 2016 and they were 0.17% higher than planned for the reporting year, as well as 11.26% higher than in the previous year when they totalled 12.065.035€.

Figure 9 Structure of total income in 2016



**Source: Bookkeeping of the Fund*

6.1.1.2. The most significant operating income item is **revenues from premium** and they accounted for 97.41% of total income. The 2016 income plan envisaged the annual premium in the amount of 13,350,000€ and 50,000€ from the initial premium collection), yet billed and collected premium amounted to 13,423,150€ or 0.17% more than planned and 10.85% more than in the previous year (12,063,647 €).

[6]Analytical overview of recorded income and expenditure in 2015 and 2016, as well as the plan of income and expenditure for 2016 and 2017 are given in the Annex hereto.

The increase in these revenues is a result of the increased premium base, that is, the premium for 2016 was planned on the basis of total deposits in 2015 of 2.3 billion euros. However, this category of deposits amounted to 2.6 billion euros due to an increase in deposits in Q3 and Q4 and the establishment of one new bank in the reporting year.

6.1.1.3. Financial income amounted to 279,217€ and it was 204.59% higher than in the previous year and 86.14% higher than planned.

- Revenues from the Fund's investments amounted to 224,276€ or 49.52% higher than planned and 305.22% higher year-on-year, accounting for 1.62% of total income.

In the structure of these revenues:

- Investment in Montenegro`s T-bills were 213,186€ and they were 350.37% higher than in 2015 and 42.12% higher than in planned for 2016, which is the result of higher interest rates on these bills as of mid-2016.
- Interest income from Government bonds amounted to 11,090€. The Fund purchased 2.2 million € worth bonds at the flat interest rate of 4% per annum and with the maturity date at 15 November 2020. The first coupon payment is scheduled for 16 November 2017 in the amount of 88,000€.

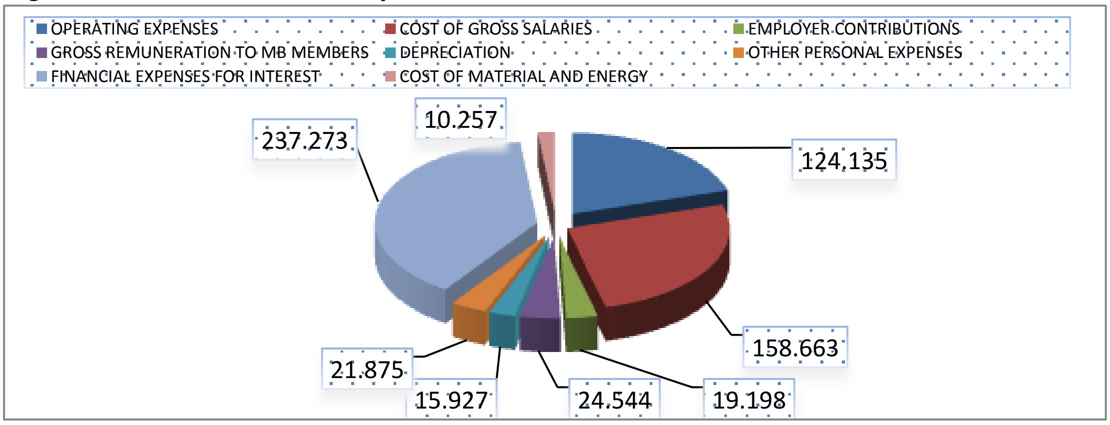
6.1.1.4. Other income totalled 132,866€ and they came from supervisory measures imposed against banks in the amount of 54,941€, and other financial revenues in the amount of 77,925€ that accounted for 0.56% of total income and cover the refund for sick leave and revenues from donated fixed assets, and the like.

6.1.2. The Fund`s expenditure

Total expenditure reached 611,872€**,** being 5.5% lower than planned but 23.18% higher year-on-year. Total expenditure is classified in two main:

-financial expenses and
-operating expenses.

Figure 10 Structure of total expenditure in 2016



** Source: Bookkeeping of the Fund*

6.1.2.1. Financial expenses covered interest payables for the EBRD loan in the amount of 237,273€ and they involved the payment of interest on the EBRD loan (152,500€) and interest arising from time deposits (84,773€). They accounted for 38.78% of total expenditure.

6.1.2.2. Operating expenses amounted to 374,599€ or 9.55% more than in 2015 yet 18.57% less than planned for the reporting year. Operating expenses covered:

- Cost of material and energy of 10,257€ (lease and maintenance of commercial premises, cost of office supply, cost of fuel) that were 10.72% lower year-on-year and 26.74% lower than planned for the reporting year.

- Cost of salaries, wages, remuneration to MB members, service contracts, business travel, and other personal expenses amounted to 224,280€ and they exceeded the same expenses in 2015 by 3.51%, yet they were 10.82% lower than planned for 2016.

6.1.2.3. Depreciation was calculated in the amount of 15,927€ and its was 0.66% higher than in the previous year. These expenses accounted for 2.61% of total expenditure.

6.1.2.4. Other operating expenses totalled 124,135€ or 30.46% less than planned for the reporting year, but they were 26.72% higher than in the previous year.

- Cost of advertising and promotional material had been planned in the amount of 60,000€, and the amount spent was 44,791€ or 74.65% of the plan. These costs were 140.45% higher year-on-year.

- Costs of professional services covered the external audit of financial statements, and education and training and they were 14,370€ or 7.62% and 0.9% less than in the previous year and the 2016 plan, respectively.

- Costs of representation reached 3,610€ or 12.59% and 39.83% less than in 2015 and planned for 2016, respectively.

- Cost of membership fees in the international associations amounted to 17,213€ and it was 44.30% and 32.41% higher than in the previous year and the 2016 plan, respectively. This item rose due to the increase in the IADI membership fee that could not have been envisaged in the plan.

- Cost of postal and payment system services, and other business expenses totalled 20,898€ or 11.40% less than in 2015 and below the plan for the reporting year.

- Cost of fees for T-bills purchase amounted to 29,730€ (introduced under the MF`s decision as of end-2014) and they were 23.27% higher than in the previous year yet 15.06% lower than planned for the reporting year.

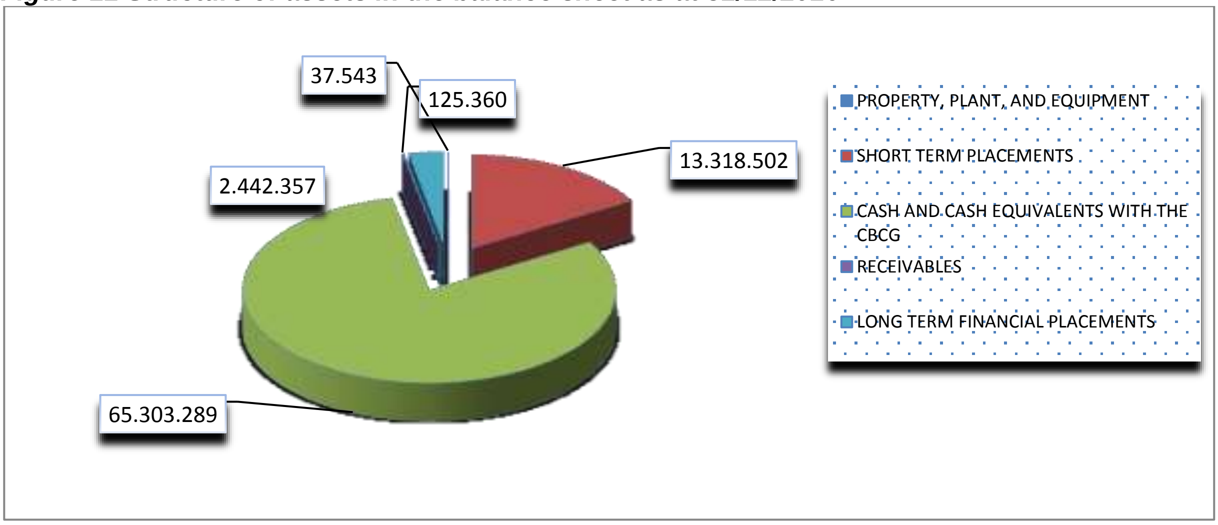
The Fund's business result in 2016 amounted to 13,126,442€, whereas the financial result was 41,944€**.** Total net result amounted to 13,168,420 € or 2.04% more than planned or 12.94% more year-on-year.

6.1.3. **Statement of Financial Position (Balance Sheet)**

Total assets and liabilities of the Fund amounted to 81,227,051€ as at 31 December 2016**.**

The year-on-year increase in assets and liabilities of 13,177,580€ or 13.03% in 2016 was primarily due to retained earnings in 2016 (excess income over expenditure).

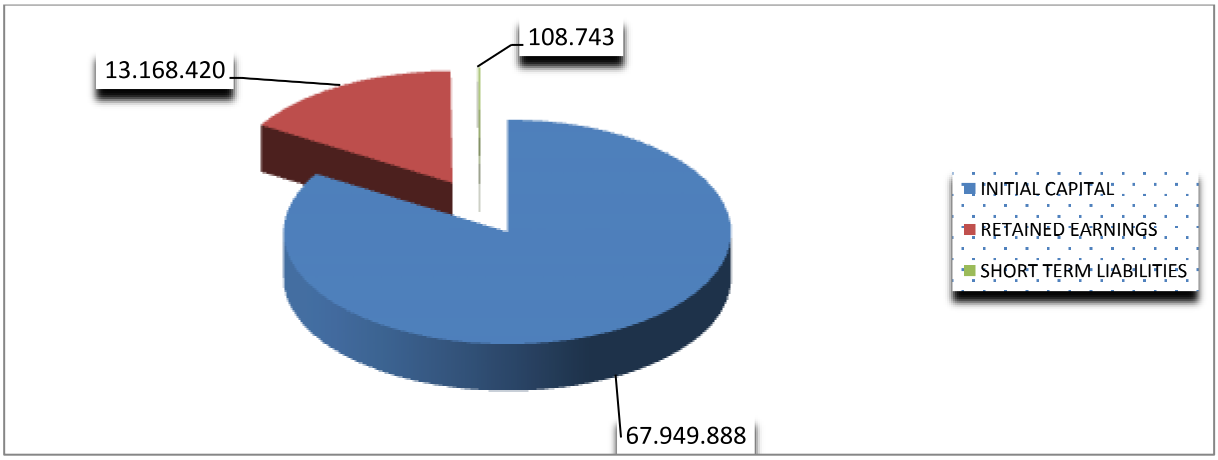
Figure 11 Structure of assets in the balance sheet as at 31/12/2016



** Source: Bookkeeping of the Fund*

In the structure of total assets, equipment accounted for 37,543€ (0.05%), receivables were125,360€ (0.15%), investments in T-bills totalled 13,318,502€ (16.40%), long-term financial placements were 2,442,357€ (3.01%), while 50,318,125€ or 61.95% were funds invested with the CBCG, and 14,985,165€ or 18.45% were funds in the Fund`s giro account and in the Fund`s petty cash.

Figure 12 Structure of liabilities as at 31/12/2016



Source: Bookkeeping of the Fund

In the structure of total liabilities, initial capital made up 83.65%, retained earnings accounted for 16.22%, whereas short-term liabilities[7] made up 0.13%.

6.1.4. **Statement of Changes in Equity**

The capital balance stood at 81,118,308€ as at 31 December 2016, which is 19.38% more than in the previous year.

Investments in T-bills amounted to 13,318,502€ (12,965,857€ in 2015) with the following maturity dates:

13. 01. 2017. with the annual interest rate of 1.80% (1,230,000€);

21. 02. 2017. with the annual interest rate of 2,00% (6,850,000€);

01. 03. 2017. with the annual interest rate of 2.30% (5,380,000€).

7 This amount represents payables to suppliers, interest payables to the EBRD, accrued interest on time deposits.

ANNEX

Income and expenditure in 2015 and 2016 and the plan of income and expenditure for 2016 and 2017

	DESCRIPTION	Executed in 2015	Plan for 2016	Executed in 2016	5/3 (in %)	5/4 (in %)	Plan for 2017
1	2	3	4	5	6	7	8
A.	**TOTAL INCOME**	**12,156,755**	**13,553,000**	**13,780,292**	**113.36**	**101.68**	**14,300,000**
A.1.	**OPERATING INCOME**	**12,063,647**	**13,400,000**	**13,423,150**	**111.27**	**100.17**	**14,000,000**
A.1.1.	REGULAR PREMIUM	12,063,647	13,350,000	13,373,150	110.85	100.17	14,000,000
A.1.2.	INITIAL PREMIUM	0	50,000	50,000	0.00	100.00	0
A.2.	**FINANCIAL INCOME**	**91,671**	**150,000**	**279,217**	**304.59**	**186.14**	**280,000**
A.2.1.	Interest on time deposits	8,013	0	94	1.17		0
A.2.2.	Interest on T-bills and bonds	47,334	150,000	224,182	473.62	149.45	280,000
A.2.3.	Fines and penalties	36,324	0	54,941	151.25		0
A.3.	**Other**	**1,437**	**3,000**	**77,925**	**5.422.76**	**2.597.50**	**20,000**
B.	**TOTAL EXPENDITURE**	**496,745**	**647,500**	**611,872**	**123.18**	**94.50**	**707,000**
B.1.	**OPERATING EXPENSES**	**341,945**	**460,000**	**374,599**	**109.55**	**81.43**	**469,500**
B.1.1.	**COST OF MATERIAL AND ENERGY**	**11,488**	**14,000**	**10,257**	**89.28**	**73.26**	**16,500**
B.1.1.1.	Cost of office supply	1,159	1,500	692	59.71	46.13	1,500
B.1.1.2.	Cost of fuel, water, energy, maintenance	10,329	12,500	9,565	92.60	76.52	15,000
B.1.2.	**SALARIES, FRINGE BENEFITS AND OTHER PERSONAL EXPENSES**	**216,673**	**251,500**	**224,280**	**103.51**	**89.18**	**263,000**
B.1.2.1.	**Gross wages and salaries**	**157,204**	**169,426**	**158,663**	**100.93**	**93.65**	**169,500**
B.1.2.1.1.	Net salaries	101,273	109,146	104,165	102.86	95.44	111,300
B.1.2.1.2.	Taxes	18,082	19,488	16,299	90.14	83.64	17,500
B.1.2.1.3.	Contributions	37,849	40,792	38,199	100.92	93.64	40,700
B.1.2.2.	**EMPLOYER CONTRIBUTIONS**	**19,169**	**20,574**	**19,198**	**100.15**	**93.31**	**20,500**
B.1.2.3.	**REMUNERATION TO MB MEMBERS**	**15,329**	**34,500**	**24,544**	**160.11**	**71.14**	**45,000**
B.1.2.3.1.	Net remuneration to MB members	11,452	25,774	18,820	164.34	73.02	33,618
B.1.2.3.2.	Taxes	1,380	3,106	2,394	173.48	77.08	4,051
B.1.2.3.3.	Contributions	2,497	5,620	3,330	133.36	59.25	7,331
B.1.2.4.	**OTHER PERSONAL EXPENSES**	**24,971**	**27,000**	**21,875**	**87.60**	**81.02**	**28,000**
B.1.2.4.1.	Assistance to employees	1,550	0	0	0.00		0
B..1.2.4.2.	Service contracts	3,693	5,000	4,373	118.41	87.46	3,000
B.1.2.4.3.	Daily allowances	3,976	5,000	4,189	105.36	83.78	7,000
B.1.2.4.4.	Business travel transport	6,928	7,000	7,566	109.21	108.09	8,000
B.1.2.4.5.	Business travel accommodation	8,824	10,000	5,747	65.13	57.47	10,000
B.2.	**DEPRECIATION**	**15,822**	**16,000**	**15,927**	**100.66**	**99.54**	**16,000**
B.3.	**OTHER OPERATING EXPENSES**	**97,962**	**178,500**	**124,135**	**126.72**	**69.54**	**174,000**
B.3.1.	**Cost of advertising and promotion**	**18,628**	**60,000**	**44,791**	**240.45**	**74.65**	**60,000**
B.3.2.	**Cost of professional services**	**15,555**	**14,500**	**14,370**	**92.38**	**99.10**	**19,000**
B.3.2.1.	Audit	5,831	6,000	5,831	100.00	97.18	6,000
B.3.2.2.	Education and training	2,016	6,000	6,039	299.55	100.65	10,000
A.3.2.3.	Surveying	5,236	0	0	0.00		0
B.3.2.4.	Cost of licenses and copyright	2,472	2,500	2,500	101.13	100.00	3,000
B.3.3.	**Membership fees to international associations**	**11,929**	**13,000**	**17,213**	**144.30**	**132.41**	**18,000**
B.3.4.	**Cost of postal services**	**4,545**	**6,000**	**5,085**	**111.88**	**84.75**	**6,000**
B.3.5.	**Cost of representation**	**4,130**	**6,000**	**3,610**	**87.41**	**60.17**	**6,000**
B.3.6.	**Cost of payment system services**	**4,373**	**5,000**	**4,829**	**110.43**	**96.58**	**5,000**
B.3.7.	**T-bill auction fee**	**24,118**	**35,000**	**29,730**	**123.27**	**84.94**	**35,000**
B.3.7.	**Other expenses**	**14,684**	**39,000**	**4,507**	**30.69**	**11.56**	**25,000**
B.3.7.1.	Organisation of regional EFDI conference		15,000	0		0.00	15,000
B.3.7.2.	Legislation drafting working groups	8,570	14,000	0	0.00	0.00	0
B.3.7.3.	Other expenses	6,114	10,000	4,507	73.72	45.07	10,000
C.	**FINANCIAL EXPENSES**	**154,800**	**187,500**	**237,273**	**153.28**	**126.55**	**237,500**
C.1.	EBRD CONTRACTED INTEREST	152,083	152,500	152,500	100.27	100.00	152,500
C2	**Liabilities for time deposit interest**	**2,717**	**35,000**	**84,773**	**3.120.10**	**242.21**	**85,000**
	TOTAL RESULT	**11,660,010**	**12,905,500**	**13,168,420**	**112.94**	**102.04**	**13,593,000**