Deposit Protection Fund

DEPOSIT PROTECTION FUND
ANNUAL REPORT
2010

Podgorica, May 2011

CONTENTS

INTRODUCTION

The past year 2010 was marked by a significant change in economic developments. After the financial crisis marked the last quarter of 2008 and the entire 2009, the Montenegrin economy exited recession at the end of the third quarter of 2010. As per the Central Bank of Montenegro`s assessment, the situation in the banking sector significantly improved in 2010 Looking at the continued uptrend in household savings in the current year, it is safe to say that the confidence crisis is over.

Changes in the financial sector legislation that were adopted by the Montenegrin Parliament in July 2010 additionally strengthened monetary authority institutions and the Deposit Protection Fund and gave a strong boost to the banking system stability. Thus, the adopted legislation includes the following: the Central Bank of Montenegro Law, the Amendments to the Banking Law, the Amendments to the Bank Bankruptcy and Liquidation Law, the Financial Stability Council Law and the Deposit Protection Law.

Activities of the Deposit Protection Fund (hereinafter: the DPF) were aimed at further implementation of international standards in deposit insurance.

The new Deposit Protection Law is harmonized with the Directive 10/14/EC amending the Directive 84/19/EC that was adopted in March 2010. The most significant changes in the law involve an increase of coverage from the former 5,000 € to 50,000 € and the shortening of the payout deadline from 90 to 20 business days.

In addition, the new law prescribes that the guaranteed deposit shall be determined for 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 date (earlier this was reduced by total depositor`s liabilities to the bank).

The aforesaid led to the quarter-on-previous-quarter 147 percent increase in guaranteed deposits in the fourth quarter of 2010.

Such a high level of guaranteed deposits required higher reserves of the DPF for potential guaranteed deposit payouts.

In order to avoid the banks` paying a higher regular premium, which would certainly reflect on their business, the DPF concluded a loan agreement with the European Bank for Reconstruction and Development (EBRD) in the amount of 30,000,000 €, which additionally strengthened safety and soundness of the overall banking system.

Other changes in the Deposit Protection Law involve the changes of corporate governance in the manner so as to separate the governance and management functions, introducing new bank reporting forms, and a more efficient procedure of guaranteed deposit payout.

1. BASIC INFORMATION ABOUT DEPOSIT PROTECTION

1.1. Deposit Protection Fund

The Deposit Protection Law adopted in 2003 provided for the establishment of the Deposit Protection Fund (hereinafter: the Fund) and the regulation of the deposit insurance scheme and the Fund`s performance. The Amended Deposit Protection Law as of 2005 provided the harmonization with the Directive 19/94/EC, whereas the new Deposit Protection Law passed in July 2010 (hereinafter: the Law) (OGM 44/10) is for the most part harmonized with the amended deposit insurance principles in the EU and the world introduced after the emergence of the global financial and economic crisis.

Under the Law, the Fund is authorized to:

- pay guaranteed deposits in case of initiation of bankruptcy proceedings against a bank,
- collect premiums from banks, and
- invest its funds.

The Fund is governed by the three-member Managing Board.

Members of the Managing Board are appointed by the Central Bank, provided that one member is nominated by the Ministry of Finance and one member is nominated by the Association of Montenegrin Banks and Financial Institutions. The Chairman of the Managing Board is designated in a decision on the appointment of the Managing Board members. The Chairman of the Board is the Vice-governor of the Central Bank of Montenegro, Mr. Velibor Milošević, and the other members are: the Dean of the Faculty of Economics in Belgrade, Professor Marko Backović, as the representative of the Association of Banks, and Ms. Bojana Bošković, the Assistant Minister of Finance, as the representative of the Ministry of Finance.

The Managing Board appoints the Director General, as per the job vacancy announcement, to a four-year term and he/she may be reappointed. The Director General is an employee of the Fund, represents and acts on behalf of the Fund, manages its operations and is responsible for the legality of its operations.

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

1.2. Members of the Deposit Protection Fund

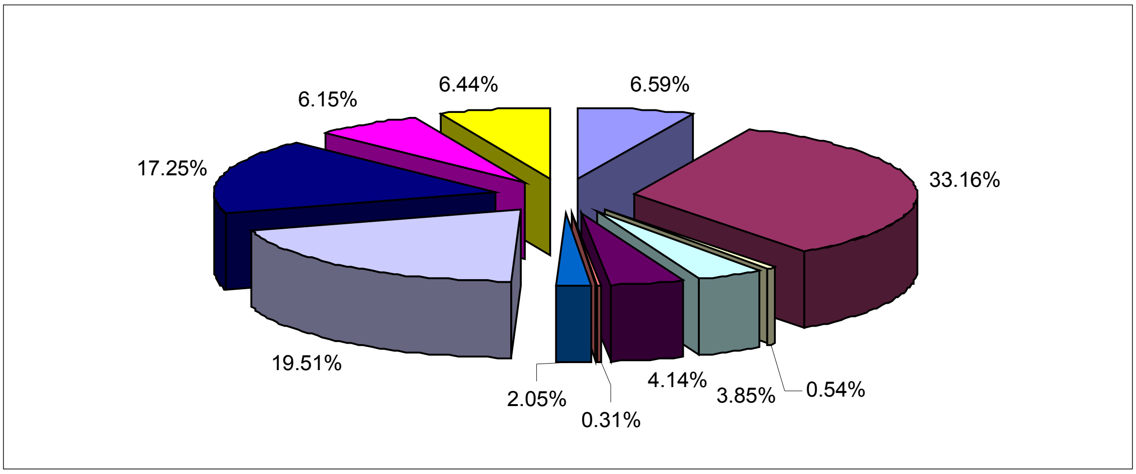
Eleven banks operated in the Montenegrin banking system in 2010. All of them are members of the Fund.

Total deposit portfolio of the banks as at 31 December 2009 amounted to 1.830.361.000 €, whereas the balance as at 31 December 2010 totalled 1.791.297.000 €, which is the year-on-year decline of 2.14%. Considering the deposit portfolio trends in 2008 and 2009, we can conclude that bank run was stopped and that the situation has completely stabilized after almost two years.

At end-2010, three banks accounted for 66.65%, five banks 28.46%, and three banks accounted for 4.89% of total deposit portfolio of the banking sector. This shows that there has been reallocation of deposits among the banks, that is, their percentage share in total deposits has changed. It should also be underlined that the amount of total deposits also declines in 2010, observed on the year-on-year level.

Shares of individual banks in total deposit portfolio in both 2009 and 2010 are shown in Graphs 1 and 2.

Graph 1 Shares of individual banks in total deposits (1.830.361.000 €) as at 31 December 2009



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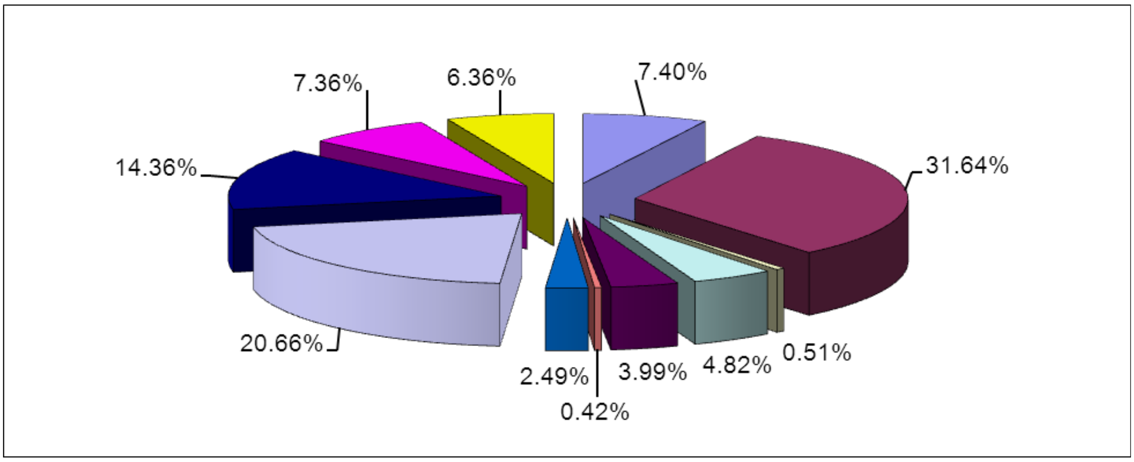
Source: Bank reports submitted to the Fund

Graph 2 Shares of individual banks in total deposits (1.791.297.000 €) as at 31 December 2010



*Source: Bank reports submitted to the Fund

Comparing 2009 and 2010, it can be concluded that the largest bank in the system decreased its share in total deposits from 33.16% to 31.64%, the second largest banks increased it percentage share from 19.21% to 29.66%, while the third largest bank reduced its share in total deposits from 17.25% to 14.36%. The share increase of 1% recorded three banks, whereas all other banks remained with shares at almost the same levels as at end-2009.

2. LEVEL AND STRUCTURE OF INDIVIDUAL DEPOSIT CATEGORIES

2.1. Total deposits

Total deposits fluctuated over 2010.

- At end-Q1 they were 3.19% lower than at end-2009.
- At end-Q2 they rose by 2.32% compared to the previous quarter.
- At end-Q3 they declined by 1.31% in comparison with Q2, yet remaining in Q4 at the same level as in Q3.

At the beginning of 2010, total deposits in the banking sector amounted to 1.830 million €, but at the year-end they totalled 1.791 million €.

Table 1 - Total deposits in 2010

BALANCE OF TOTAL DEPOSITS IN 2010 (in 000 €)					
	31.12.2009.	31.03.2010.	30.06.2010.	30.09.2010.	31.12.2010.
TOTAL	1.830.361	1.771.907	1.813.018	1.789.095	1.791.297

*Source: Bank reports submitted to the Fund

Total deposits as at 31 December 2010 were 2.14% lower than at 31 December 2009.

2.2. Deposits of entities not entitled to the guaranteed deposit payout

Deposits of entities not entitled to the guaranteed deposit payout in line with Article 6 paragraph 2 points 1-12 of the Law are presented in Table 2. Data by quarters indicate a downtrend of these deposits in 2010, resulting in 28.8% less deposits at end-2010 compared to end-2009. The number of depositors not entitled to the guaranteed deposit payout amounted to 1,706.

Table 2 – Deposits by entities not entitled to guaranteed deposit payout

BALANCE OF DEPOSITS BY ENTITES NOT ENTITLED TO GUARANTEED DEPOSIT PAYOUT IN 2010 (in 000 €)					
	31.12.2009.	31.03.2010.	30.06.2010.	30.09.2010.	31.12.2010.
TOTAL	435.642	418.738	380.553	320.422	310.241

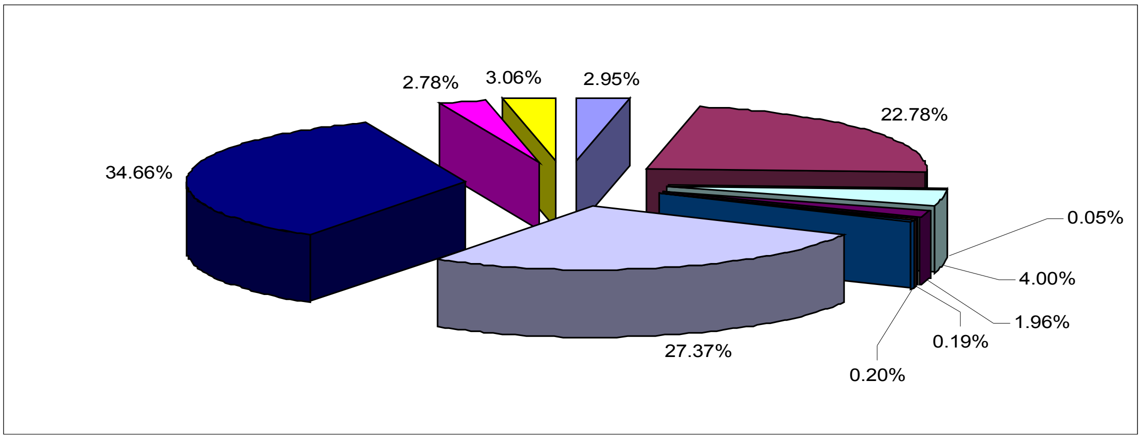
*Source: Bank reports submitted to the Fund

The year-on-year decline in deposits by entities not entitled to the guaranteed deposit payout was due to a decline in the following categories of deposits:

- deposits by the mandatory health, pension and social insurance funds of 45%;
- deposits by pension funds of 57 %, deposits by investment funds of 55%;
- deposits by banks, credit unions, micro-credit financial institutions, and entities performing credit-guarantee activities of 70%;
- deposits by state bodies and organisations, municipalities and local self-governments by 7%.

The year-on-year uptrend recorded only deposits by legal persons involved in insurance activity, by 46%.

Graph 3 – Deposits by entities not entitled to guaranteed deposit payout as at 31 December 2009, by the bank



*Source: Bank reports submitted to the Fund

It should be noted that the movement of this category of deposits by entites not entitled to the guaranteed deposit payout has no direct impact on the deposit protection scheme

Graph 4 – Deposits by entities entitled to guaranteed deposit payout as at 31 December 2010, by the bank

3.10% 3.60% 4.70%

19.94%

41.58%

0.14%

5.05%

0.36% 3.58%

17.36% 0.60%

*Source: Bank reports submitted to the Fund

2.3. Deposits by entities entitled to the guaranteed deposit payout

Deposits by entities entitled to the guaranteed deposit payout recorded a 2.26% decline in Q1 2010 compared to Q4 2009. In Q2 of the reporting year, the quarter-on-quarter increase in these deposits was 5%, continuing this uptrend in Q3 of 2%. Deposits increase in Q4 was minor in comparison with the previous quarter. As the consequence of such a deposit trend over the year, deposits by entities entitled to the guaranteed deposit payout grew by 6% at end-2010 in relation to end-2009.

Table 3

DEPOSITS BY LEGAL AND NATURAL PERSONS ENTITLED TO GUARANTEED DEPOSIT PAYOUT					
	DPOSITS in 000 €				
	TOTAL	**Natural persons**	**Legal persons**		
	1	**2**	**3**	**2/1**	**3/1**
31.12.2009.	**1.394.719**	833.551	561.167	0.60	0.40
31.03.2010.	**1.363.169**	840.020	523.149	0.62	0.38
30.06.2010.	**1.432.466**	856.463	576.003	0.60	0.40
30.09.2010.	**1.468.672**	904.547	564.125	0.62	0.38
31.12.2010	**1.481.055**	944.478	536.577	0.64	0.36
31.12.10. / 31.12.09.	**1.06**	**1.13**	**0.96**		
31.12.10. – 31.12.09.	86.337	110.927	(24.590)		

*Source: Bank reports submitted to the Fund

The increase of deposits by entities entitled to the guaranteed deposit payout was due to an increase in deposits by natural persons of 13%. At the same time, deposits by legal persons declined by 4%. The result of such a trend in the reporting period was the change in the structure of deposits by persons entitled to the guaranteed deposit payout. The percentage of guaranteed deposits by natural persons rose from 60% as at 31 December 2009 to 64% as at 31 December 2010, while deposits by legal person fell from 40% to 36%. This leads to a conclusion that the aggregate growth in these deposits was owing to an increase in deposits by natural persons.

Table 3.1

NUMBER OF DEPOSITORS ENTITLED TO GUARANTEED DEPOSIT PAYOUT					
	TOTAL	**Natural persons**	**Legal persons**		
	1	**2**	**3**	2/1	3/1
31.12.2009.	**808.702**	752.061	56.641	0,93	0,07
31.03.2010.	**755.051**	702.921	52.130	0,93	0,07
30.06.2010.	**771.519**	719.075	52.444	0,93	0,07
30.09.2010.	**743.649**	692.545	51.104	0,93	0,07
31.12.2010	**754.615**	703.685	50.930	0,93	0,07
31.12.10. / 31.12.09.	**0,93**	**0,94**	**0,90**		
31.12.10. – 31.12.09.	(54.087)	(48.376)	(5.711)		

*Source: Bank reports submitted to the Fund

The total number of depositors entitled to the guaranteed deposit payout reduced in 2010 by 6.6%, whereby the number of depositors-natural persons declined by 6.4% and depositors-legal persons fell by 10%.

2.4. Guaranteed deposits

The new Law envisages a gradual increase of covered deposits per a depositor from 5,000 € to 50,000 €, starting from an increase to 20,000 € in 2010 and 2011 to 35,000 € in 2012, reaching the specified coverage of 50,000 € as of 1 January 2013.

The coverage increase (from 5,000 € to 20,000 €) and a different guaranteed deposit calculation method (deduction of only due liabilities instead of the previous total liabilities of a depositor to a bank) resulted in a remarkable increase in guaranteed deposits at end-Q4 2010 in comparison with the previous quarter from the respective 207.640.000 € to 513.476.000 €, i.e. by 147%. Such an increase in guaranteed deposits resulted in a greater exposure of the Fund to banks.

Table 4 – Guaranteed and total deposits by quarters

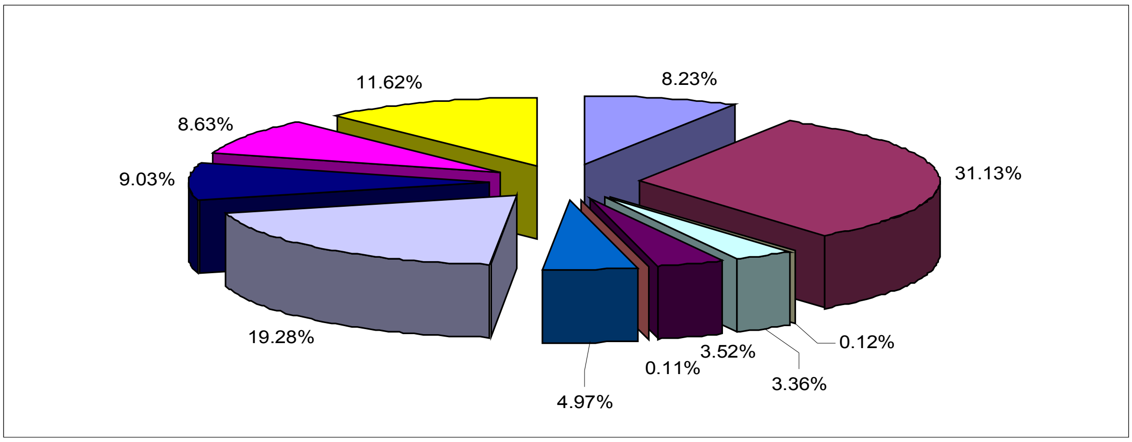
GUARANTEED AND TOTAL DEPOSITS BY QUARTERS (in 000 €)					
	31.12.2009.	**31.03.2010.**	**30.06.2010.**	**30.09.2010.**	**30.12.2010.**
GUARANTEED DEPOSITS	**196.232**	**191.949**	**200.658**	**207.640**	**513.476**
TOTAL DEPOSITS	**1.830361**	**1.771.907**	**1.813.018**	**1.789.095**	**1.791.297**
SHARE OF GD IN TD**	**10,72%**	**10,83%**	**11,07%**	**11,61%**	**28,67%**

*Source: Bank reports submitted to the Fund

** Guaranteed deposits GD; Total deposits TD

Data at the end of the first three quarters in the tabular representation refer to the deposit coverage of 5,000 €, and the coverage as at 31 December amounted to 20,000 €. Guaranteed deposits were 162% higher at end-2010 than the year before.

Graph 5 – Guaranteed deposits by banks as at 31 December 2009



*Source: Bank reports submitted to the Fund

Although there was an enormous increase in total guaranteed deposits over the reporting year, the structure of deposits by the bank did not significantly change at end-2010 in comparison with end-2009. Three banks in the system still hold the highest share of total guaranteed deposits, 64.88%, which represents an insignificant increase as of end-2009 when this share was 62.03%.

Graph 6 - Guaranteed deposits by banks as at 31 December 2010

9,12% 7,01% 7,26%

8,62%

37,11%

18,65%

4,26% 0,20% 3,88% 0,13%

3,78%

*Source: Bank reports submitted to the Fund

The bank with the highest amount of guaranteed deposits increased its share in total guaranteed deposits from 31.13% to 37.11% because the number of depositors – natural persons in this banks rose in Q4 by 50% *with the increase in the level of guaranteed deposits, a number of depositors that used to be classified under the category of non-guaranteed deposits from 5,000 € to 20,000 € are now classified under the guaranteed deposits category). As for the second largest bank by the size of guaranteed deposits, its share in total guaranteed deposits slightly declined from 19.28% to 18.65%, whereas the third largest bank showed a decline in total guaranteed deposits from 11.62% to 7.01% due to the outflow of depositors – natural persons under the category of deposits up to 20,000 €.

The percentage share of guaranteed deposits in total deposits significantly differed by the bank, ranging from 7.04% to 48.99% at end-2010. At the end of the reporting year, three banks holding 66.65% of total deposits had 64.37% of total guaranteed deposits.

Such a total to guaranteed deposits ratio is the result of presence and/or absence of depositors holding deposits above the coverage level, as well as the higher amount of deposits by depositors not entitled to the guaranteed deposit payout, in absolute terms.

Table 4.1

GUARANTEED DEPOSITS (natural and legal persons) in 000 €					
	TOTAL	**Natural persons**	**Legal persons**		
	1	**2**	**3**	**2/1**	**3/1**
31.12.2009.	**196.232**	167.257	28.975	0.85	0.15
31.03.2010.	**191.949**	163.714	28.235	0.85	0.15
30.06.2010.	**200.657**	170.571	30.086	0.85	0.15
30.09.2010.	**207.640**	175.977	31.663	0.85	0.15
31.12.2010.	**513.476**	434.979	78.497	0,85	0,15
31.12.10. / 31.12.09.	**2,61**	**2,60**	**2,71**		
31.12.10. – 31.12.09.	317.244	267.722	49.522		

*Source: Bank reports submitted to the Fund

While the amount of the guaranteed deposits by natural persons rose by 160%, the same deposits by legal persons grew by 171%. This growth is solely due to an increase in the level of guaranteed deposit and the different calculation method whereby the guaranteed deposit is calculated by reducing matured liabilities (earlier total liabilities) of depositor from aggregate deposits held by the depositor with a bank.

Table 4.2 – Number of depositors holding guaranteed deposits

	NUMBER OF DEPOSITORS HOLDING GUARANTEED DEPOSITS				
	TOTAL	**Natural persons**	**Legal persons**		
	1	**2**	**3**	**2/1**	**3/1**
31.12.2009.	**544.366**	500.096	44.270	91,87 %	8,13 %
31.03.2010.	**511.007**	469.094	41.913	91,80 %	8,20 %
30.06.2010.	**537.123**	494.439	42.684	92,05 %	7,95 %
30.09.2010.	**551.228**	507.526	43.702	92,07 %	7,92 %
31.12.2010	**684.848**	637.109	47.739	93,03 %	6,97 %
31.12.10. / 31.12.09.	**1,26**	**1,27**	**1,08**		
31.12.10. – 31.12.09.	140.482	137.013	3.469		

*Source: Bank reports submitted to the Fund

The total number of depositors holding the guaranteed deposits rose on the year-on-year level by 26%, whereby the number of depositors – natural persons and depositors – legal persons increase by 27% and 8%, respectively.

Table 4.3 Total number of depositors and depositors holding guaranteed deposits

TOTAL NUMBER OF DEPOSITORS ENTITLED TO GUARANTEED DEPOSIT PAYOUT (AFTER DEDUCTING MATURED LIABILITIES)				NUMBER OF DEPOSITORS HOLDING A DEPOSIT LOWER OR EQUAL TO THE AMOUNT OF GUARANTEED DEPOSIT OF 20,000 €					
	TOTAL	Natural persons	Legal persons	TOTAL	Natural persons	Legal persons	in %		
	1	2	3	4	5	6	7	8	9
-							= 4/1	= 5/2	= 6/3
31.12.09	**544.366**	500.096	44.270	**522.522**	481.668	40.854	95,99 %	96,32 %	92,28 %
31.03.10	**511.007**	469.094	41.913	**502.962**	462.522	40.440	98,43 %	98,60 %	96,49 %
30.06.10	**537.123**	494.439	42.684	**528.775**	487.626	41.149	98,45 %	98,62 %	96,40 %
30.09.10	**551.228**	507.526	43.702	**542.480**	500.396	42.084	98,41 %	98,60 %	96,30 %
31.12.10	**684.848**	637.109	47.739	**674.447**	628.661	45.786	98,48 %	98,67 %	95,91 %

*Source: Bank reports submitted to the Fund

The number of depositors holding the guaranteed deposit lower or equal to 20,000 € at the banking system level amounted to 674,447 at end-2010, which is 98.48% of total number of depositors entitled to the guaranteed deposit payout (98.67% of natural persons and 95.90% of legal persons). These data indicate that the coverage change from 5,000 € to 20,000 € covered almost 99% of the total number of depositors (96% at end-2010).

An average amount of a deposit by a person entitled to the guaranteed deposit payout amounted to 750€ as at 31 December 2010, which is 107% more than the average guaranteed deposit at 31 December 2009 (360 €).

An average deposit by a person entitled to the guaranteed deposit payout – a legal person - amounted to 1,644 € as at 31 December 2010, which is 151% more than as at 31 December 2009 (655 €).

An average deposit by a person entitled to the guaranteed deposit payout – a natural person - amounted to 683 € as at 31 December 2010, which is 104% more than as at 31 December 2009 (334 €).

3. EXPOSURE OF THE FUND TO BANKS

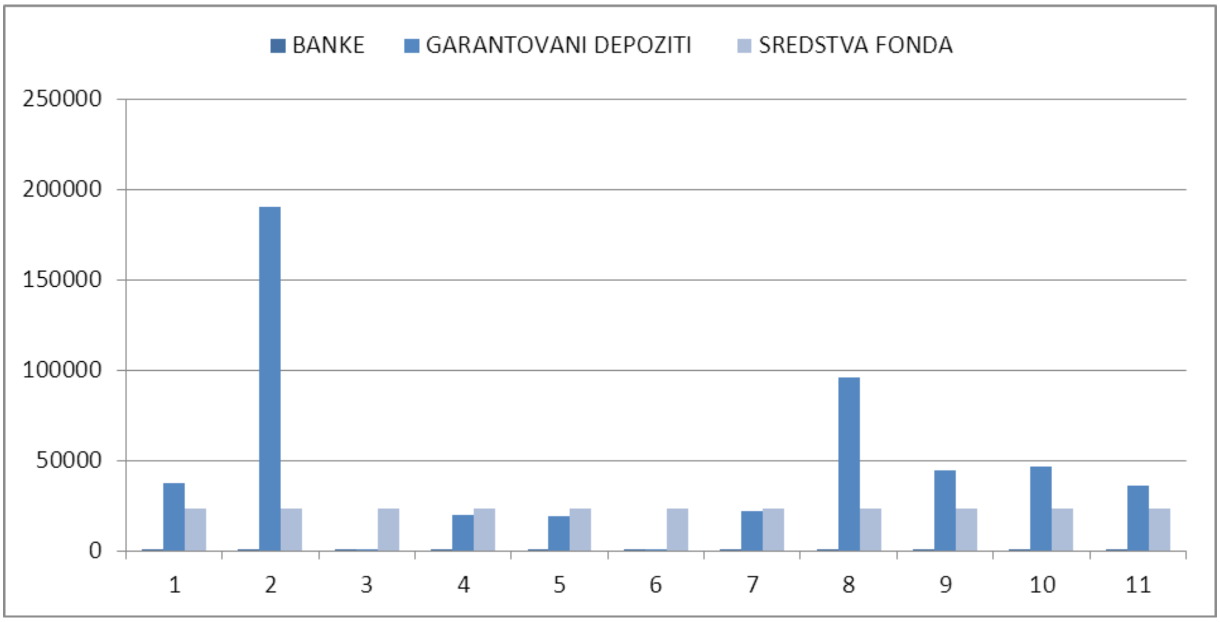
Exposure of the Fund to banks is represented as the ratio of the Fund`s assets to total Fund`s liabilities in case of a bank bankruptcy.

The Fund`s resources amounted to 23.591.802 € as at 31 December 2010, whereas the guaranteed deposits amounted to 513.476.136 €.

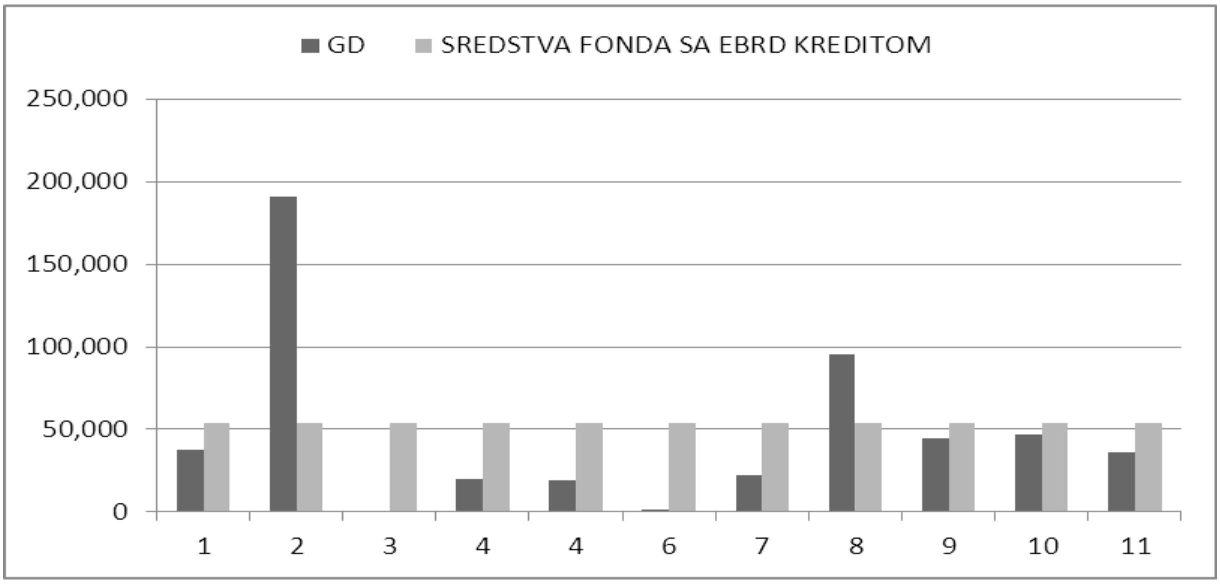
The coverage of guaranteed deposits by the Fund`s assets amounted to 4.59% as at 31 December 2010 (for the guaranteed deposit of 20,000 €), while this coverage a year ago amounted to 9.10% (for the guaranteed deposit of 5,000 €).

Exposure of the Fund to individual banks (ratio of the Fund`s assets to guaranteed deposits in a bank) as at 31 December 2010 is presented in Graph 7 below.

Graph 7 – Exposure of the Fund to individual banks (without the EBRD resources)



Graph 8 - Exposure of the Fund to individual banks (with the EBRD resources)



*Source: Bank reports submitted to the Fund and the Fund`s records

In case of introduction of bankruptcy proceedings in any of 9 nine banks of total 11 banks operating in Montenegro, the Fund`s assets (23.5 million € at the end of the reporting year) and funds provided from the EBRD credit (30 million €) would be sufficient for the payout of guaranteed deposits of all depositors in an individual banks (as shown in Table 5).

In case of bankruptcy proceedings against one of the two largest banks, the Fund would lack 137 million €, that is, 42 million €. The Fund would provide the shortfall amount for additional sources in one of the manner prescribed in the Law (charging the extraordinary premium; borrowing from the Budget of Montenegro; taking loans from foreign banks and financial institutions; and issuing securities).

At end-2010, guaranteed deposits in all 11 banks in the system amounted to 513.476.136 €, while the Fund`s resources totalled 23.591.802 €, indicating the guaranteed deposits coverage of 4.59% (Table 5). At end-2009, when the level of guaranteed deposit was 5,000 €, the coverage ratio was 9.71%. On the basis of the aforesaid, it could be assumed that the coverage ratio declined. However, taking into account that the level of guaranteed deposit rose by four times, it is obvious that the coverage ratio increased. With the funds put by the EBRD at the Fund`s disposal, the degree of security is extremely high.

Table 5 – Coverage ratio for guaranteed deposits in the system

Guaranteed deposits as at 31 December 2010	Fund`s resources as at 31 December 2010	% of coverage of guaranteed deposits
1	2	2/1
513.476.136	20.926.623[1]	4,07 %
513.476.136	23.591.802[2]	4,59 %
513.476.136	53.591.802[3]	10,44 %

*Source: Bank reports submitted to the Fund and the Fund`s records

[1] The Fund`s resources (from the premium collection)
[2] The Fund`s resources increased by the donated funds from KfW in the amount of 2.665.179 €
[3] The Fund`s resources increased by the donated funds from KfW in the amount of 2.665.179 € and funds provided under the Loan Agreement with the EBRD in the amount of 30.000.000 €

4. ACTIVITIES OF THE FUND IN 2010

4.1. General remarks

The working program for 2010 set out the Fund's tasks. In the first half of the year, the a consultancy firm GBDS from Berlin assisted the Fund in the implementation of planned activities, as a part of technical assistance selected and financed by the German development bank KfW.

GBDS organized a workshop in Frankfurt am Main at end-June 2010 where progress in the implementation of planned activities in the past three years as per the Project Plan was analyzed, in accordance with the Donation Agreement and the Project.

It was concluded that the Agreement on financial and technical assistance with the KfW was had been executed in full, thus concluding the project with the consultancy firm GBDS. KfW particularly underlined the importance and their satisfaction as regards the drafting of the new Deposit Protection Law and its harmonization with the newly passed amendments to the EU directive on deposit guarantee schemes and other international standards. A great contribution in the drafting of the Law was given by the GBDS consultants and the experts from the IMF, EBRD and the World Bank.

Together with the Ministry of Finance, the Fund carried out activities on the preparation of necessary documentation for the signing of the Loan Agreement with the European Bank for Reconstruction and Development (EBRD) in the amount of 30 million €. This is the arrangement providing for the funds to be used only if necessary. To wit, the coverage increase from 5,000 € to 20,000 €, changed calculation method and the shortening of the payout deadline significantly increased the Fund's exposure in case of a protected event (bankruptcy of a bank in the system). In order to reduce the Fund's exposure while avoiding any further burdening of banks with additional responsibilities, both the Ministry of Finance and the Fund assessed that it would be purposeful to conclude such an agreement that was subsequently signed on 8 November 2010.

The analysis of deposits movement is an ongoing task of the Fund. With a view to obtaining as accurate data possible, these were exchanged with the Central Bank and then, on the basis of the analysis of deposits trends, scenarios and exposure analyses were prepared with the consultants in order to assess the dynamics of increase of the guaranteed deposit.

4.2. Investment activities and accounting in 2010

In 2010, the Fund invested its funds in line with its Investment Policy, the Asset Management Agreement with the Central Bank, and the financial situation in the world markets (attached hereto is the Asset Manager Report for 2010).

In accordance with its Investment Policy, the Fund invested free funds in time and overnight deposits and a part was invested in government securities.

In line with the prescribed obligation, the Fund hired the audit firm “Deloitte” to audit its 2010 annual accounts and financial statements.

The Fund independently performs financial and accounting operations and prepares annual financial reports. On the basis of bookkeeping data, information and overviews were prepared with a view to monitoring the implementation of the Financial Plan of the Fund that was the subject of regular reporting to the Management Board.

4.3. Normative-legal activities

After the enactment of the new La, the main activities of the Fund were directed towards the harmonization of the existing internal acts with the Law.

The Managing Board of the Fund passed the following normative acts in 2010:

- Bylaws of the Deposit Protection Fund (harmonized with the new Law),
- Decision on the regular premium calculation rate and the method of the regular premium calculation in 2011 (on the basis of analysis of deposits movement and exposure of the Fund to banks after the increase in the deposit coverage from 5,000 € to 20,000 € and the analysis of the situation in the banking sector in 2010, the Managing Board decided that the regular premium rate in 2011 shall be 0.33% of total deposits in banks),
- Decision on the conditions, manner and procedure of the guaranteed deposit payout,
- Decision on monthly bank reports submitted to the Deposit Protection Fund (prescribing the obligation for banks to use new forms for monthly reporting on deposit trends, thus creating conditions for the Fund's follow-up on the movement of all deposits),
- Rules of Procedure of the Managing Board of the Deposit Protection Fund,
- Rules on the organisation and job scheme in the Deposit Protection Fund,
- Code of Conduct of the Deposit Protection Fund.

During the current year, the Managing Board considered and adopted the following:

- 2009 Annual Operating Report of the Fund (prepared with an active participation of all members of the Managing Board and suggestions of the GBDS consultants);
- 2009 Financial Statements of the Fund (prepared in line with the IAS, adopted by the Managing Board and submitted to the Central Bank and the Government of Montenegro);
- External Auditor’s Report for 2009 (considered and adopted by the Managing Board. the Report was prepared by the audit firm “Deloitte”, stating the opinion that “the financial statements give a true and fair view of the financial position of the Fund, in accordance with the laws of Montenegro and the IAS”);
- Financial Plan of the Fund for 2011;
- Work Programme of the Deposit Protection Fund for 2011.

In addition to the aforesaid reports, the Managing Board considered monthly and quarterly reports on deposit movements in the banking system, as well as reports on the Fund's balances, fulfilment of planned activities and investments.

The Fund has also prepared the following internal acts:

- Investment Policy of the Deposit Protection Fund (in line with the Law);
- Rules of procedure on informing bank clients on deposit protection;
- Procedures for the guaranteed deposits payout (harmonized with the new Law); and

- Instructions for the Fund employees for the guaranteed deposits payout.

4.4. Work of the Managing Board

At the beginning of the reporting year, the Managing Board comprised of:

- Predrag Marković, MB Chairman;
- Ljiljana Sekulić, MB member;
- Idriz Ćetković, MB member;
- Professor Marko Backović, MB member; and
- Predrag Stanojević, MB member.

The Council of the Central Bank of Montenegro appointed the Managing Board in September 2010 to comprise of:

- Zdenka Rakočević, MB Chairman;
- Bojana Bošković, MB member and
- Professor Milivoje Radović, MB member.

After the Chairman of the Managing Board, Ms. Zdenka Rakočević, and an MB member, Professor Milivoje Radović delivered their resignations that were accepted by the Council of the Central Bank, Mr.Velibor Milošević was appointed the MB Chairman and Professor Marko Backović was appointed an MB member.

In 2010, the Managing Board held eleven meetings. In addition to their duties related to governing the Fund, the MB members were actively assisting the Fund employees in performing the most complex tasks.

4.5. Marketing activities

During the drafting of the new Law, the Fund paid particular attention to establishing its marketing policy. The main objective was to inform the public in timely and proper manner about the changes in the deposit protection scheme that resulted form the adoption of the new Law.

To wit, the marketing campaign was supposed to be directed towards achieving two main objectives: the promotion of changes in the deposit protection scheme (the coverage increase, shortening of the payout deadline, and the guaranteed deposit calculation methodology) that are positive from the depositors` aspect, and increasing depositors` confidence in the stability of the Montenegrin banking system.

In cooperation with the National Research Institute from Podgorica, the Fund presented the novelties and advantages of the new Law through advertisements – TV broadcasting videos (in the following media: RTVCG, TV IN, TV ATLAS, TV MBC, TV TEUTA, RTV MOJKOVAC, RADIO SKALA and RADIO ADRIATIC in the period 16 August - 16 October 2010 and 1 January – 28 February 2011.

At end-2010, the Fund`s promotion material was delivered to banks and other financial institutions with which the Fund cooperates, and which offers information to depositors about deposit insurance in line with the applicable Law.

The Fund`s website was also regularly updated, in accordance with the new changes and adopted secondary legislation, with a view to timely inform both the professional and general public about the changes in the deposit protection scheme.

Fliers were prepared to be printed and publicly distributed in Q4 2011, in parallel with the broadcasting of a new TV video to timely inform the public about the coverage increase from 20,000 € to 35,000 € as of 1 January 2012.

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`s representatives attended organized meetings and participated in working activities of the Forum. When attending conferences, the Fund`s representative used the opportunities to make contacts and exchange experiences that were subsequently used in the drafting of the new Law and secondary legislation.

The Fund`s representative attended the regular annual meeting of the EFDI that was held on 29 September 2010 in Rome and the joint conference of the EFDI and the IADI (International Association of Deposit Insurers) that was held in the period 30 September – 1 October 2010 also in Rome, with the topic being "The contribution of deposit insurance system to financial stability strengthening".

The conference was attended by representatives of almost all deposit insurance funds from Europe, as well as numerous funds from America, Asia, Africa and Japan. The following topics were discussed at the panels: reforms of financial services in the EU, Preconditions and approaches that strengthen financial stability, Legislative initiatives and institutional arrangements that promote financial stability and cross-border crisis cooperation, and Conditions necessary for efficient deposit insurance system in the existing circumstances.

The Fund followed up all important activities of the EFDI and the IADI, gave its contribution in the organisation of surveys and drafting documents for publishing.

5. AIMS AND TASKS OF THE FUND IN 2011

The ongoing objective of the Fund is the monitoring of deposit balances in banks, the premium collection, and the investment of collected funds.

The adoption of the Deposit Protection Law in July 2010 created the legal obligation for the Fund to prepare and put forward to adoption by the Managing Board the secondary legislation harmonized with the new Law. In addition, the increased coverage as of the beginning of 2012 (to 35,000 €) implies an active promotional campaign in the media that should point to the importance of the deposit insurance and the security of the citizens` deposits in banks.

The building of the institutional capacity of the Fund aimed at timely intervention at the moment of the "protected event" occurrence is an ongoing task of the Fund. In communication with the banks, the Fund will test the software for the guaranteed deposits payout and work on permanent training of employees for its use.

6. FINANCIAL STATEMENTS OF THE FUND FOR 2010

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INDEPENDENT AUDITORS' REPORT

To the Management Board of the Deposit Protection Fund, Podgorica

We have audited the accompanying financial statements (pages 2 to 21) of the Deposit Protection Fund, Podgorica (hereinafter the "Fund"), which comprise of the statement of financial position as of December 31, 2010, and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management of the Fund is responsible for preparation and fair presentation of these financial statements in accordance with the accounting regulations prevailing in Montenegro, and for such internal controls as management determines are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing and the Law on Accounting and Auditing of Montenegro. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a solid basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Deposit Protection Fund, Podgorica, as of December 31, 2010 in accordance with the accounting regulations prevailing in Montenegro.

Deloitte d.o.o., Podgorica
Podgorica, Montenegro
May 20, 2011

Žarko Mionić, Certified Auditor
(License No. 062 issued on March 10, 2011)

OVERALL RESULT					
	Current year 2010	**Previous year 2009**	**current/ previous year (%)**	**Plan 2010**	**2010/ Plan 2010 (%)**
1	**2**	**3**	**4** =2/3	**5**	**6** =2/5
Operating income	4.915.069	5.102.511	96.33	4.739.638	103.83
Income from deposit protection premiums	4.528.105	4.627.036	97.86	4.379.210	103.40
Interest income	252.216	314.662	80.15	220.000	113.61
Other operating income	134.748	160.813	83.79	132.710	101.54
Operating expenses	385.522	369.348	104.38	405.975	94.96
Cost of material, fuel and energy	3.305	25.297	13.06	6.000	55.08
Cost of salaries, fringe benefits and other personal expenses	148.194	144.086	102.85	155.865	95.08
Depreciation	6.913	8.688	79.57	12.000	57.61
Other operating expenses	227.110	191.277	118.73	232.110	97.85
Net profit	4.529.547	4.733.163	0,96	4.349.234	104.66

Operating income were 3.67% lower in 2010 than a year ago, but they were 3.83% higher than planned for the reporting year.

Income from deposit protection premiums recorded the year-on-year decline in 2010 of 2.14%. End-month balance of total deposits, which make the premium calculation base, was lower than in 2009, thus the calculated and collected premium in 2010 was lower than the year before. However, income from premium collection was 3.40% higher than planned for the reporting year because the envisaged deposit outflow was lower than that recorded.

Interest income was 19.85% lower than in 2009 due to the continued downtrend of interest rates in 2010. Nevertheless, this income was 13.61% higher than planned for 2010 (the plan envisaged lower average rates of return than those received).

Other operating income was 16.21% lower than in 2009, yet 1.54% higher than planned.

Operating expenses were higher than in 2009 by 4.38 %, yet 5.04% lower than planned for the reporting year.

Cost of material, fuel and energy was 86.94% lower on the year-on-year level and 44.92% lower than envisaged in the 2010 plan.

Cost of salaries, fringe benefits and other personal expenses rose by 2.85% in 2010 due to the changed personal income tax, but it was 4.91% lower than planned.

Depreciation costs recorded the year-on-year decline of 20.43% and they were also 42.39% lower than planned.

Other operating expenses were 18.73% higher in 2010 than in the previous year, but they were 2.15% lower than planned.

Net profit in 2010 was 4.30% lower than in 2009, yet 4.15% higher than planned for the reporting year.

2. **REPORT ON FINANCIAL POSITION**			
ASSETS	**31.12.2010.**	**31.12.2009.**	**current/ previous year**
Fixed assets	**13.757**	**20.670**	**0.67**
Intangible investments	399	1.008	0.40
Equipment	13.358	19.662	0.68
Current assets	**23.591.803**	**19.057.060**	**1.24**
Other financial assets	2.326.828	3.461.435	0.67
Accrued income	25.327	39.352	0.64
Cash and cash equivalents	21.239.648	15.556.273	1.37
Total assets	**23.605.560**	**19.077.730**	**1.24**
LIABILITIES		.	
Capital	**21.066.304**	**16.536.757**	**1.27**
Undistributed profit	21.066.304	16.536757	1.27
Short-term liabilities	**2.539.256**	**2.540.973**	**1.00**
Contingent donations	2.500.000	2.500.000	1.00
Short-term liabilities from operations	869	548	1.59
Deferred income	38.387	40.425	0.95
Total liabilities	**23.605.560**	**19.077.730**	**1.24**

At end-2010, total assets and liabilities of the Fund were 4.527.830 € or 23.73% higher than at end-2009.

3. **REPORT ON CHANGES IN CAPITAL**			
	UNDISTRIBUTED PROFIT	TOTAL	**current/ previous year**
Balance as at 1 January 2009	11.803.594	11.803.594	
Net profit for the year	4.733.163	4.733.163	
Other total result	-	-	1.40
Balance as at 31 December 2009	16.536.757	16.536.757	
Balance as at 1 January 2010	16.536.757	16.536.757	
Net profit for the year	4.529.547	4.529.547	0.96
Other total result	-	-	
Balance as at 31 December 2010	21.066.304	21.066.304	**1.27**

The Deposit Protection Fund disclosed net profit in 2010 of 4.529.547 €, so the total capital of the Fund amounted to 21.066.304 € at the year-end.

4. CASH FLOW STATEMENT			
Operating activities	2010	2009	**current/ previous year**
Inflow from paid premiums by commercial banks	4.529.948	4.627.036	0.98
Outflow for payments to suppliers and employees	-247.421	-215.433	1.15
Inflow of funds from operating activities	4.282.527	4.411.603	0.97
Investment activities			
Inflow from interest	131.862	215.470	0.61
Inflow from charged fee		1.500	
Inflow from investments in financial assets at fair value presented in P&L account	1.268.986	70.544	17.99
Outflow for investments in financial assets at fair value presented in P&L account	-	3.380.838	
Outflow for equipment purchase	-	-2.526	
Inflow/(outflow) of cash from investment activities	1.399.326	3.095.850	0.45
Net increase in cash and cash equivalents	5.683.375	1.315.753	4.32
Cash and cash equivalents at the beginning of the year	15.556.273	14.240.520	1.09
Cash and cash equivalents at the end of the year	21.239.648	15.556.273	1.37

The cash flow statement provides for the monitoring of cash flows (inflow and outflow). The inflows in 2010 came mainly from premiums and interest on invested funds, while the outflows went to suppliers, employees and the purchase of T-bills issued by the Ministry of Finance of the Government of Montenegro.

5. INTEREST INCOME (in €)	**2010**	**2009**	**current/ previous year**	**Plan 2010**	**2010/ Plan 2010**
Revenues from interest on investments:					
Fund`s cash from regular premium	56.025	92.875	0.60	88.663	0.63
Donated cash from KfW Bank	8.926	16.426	0.54	15.000	0.60
Revenues from default interest and penalties for untimely payment of regular premium	67.240	101.400	0.66		
Revenues from interest on T-bills	117.688	91.976	1.28	116.000	1.01
Revenues from interest on matured frozen foreign currency deposit bonds	2.337	11..985	0.19	2.337	1.00
	251.376	**314.662**	**0.80**	**222.000**	**1.13**

<u>Interest income</u> was 19.85% lower in 2010 than the year before. This was primarily due to a decline in interest rates on invested funds in 2010. However, the recorded interest income was 13.23% higher than envisaged in the 2010 plan.

Revenues from interest on invested resources of the Fund obtained from the regular premium collection were 40% lower than in 2009 because the average interest earned on time deposits amounted to 0.69% in 2009, declining to 0.29% in the first half of 2010 and amounting to 0.39% in the second half of the year. Revenues from interest on the invested funds were 37% lower than planned because the Fund`s Financial Plan for 2010 envisaged an average interest income of 1.2%, but the average interest on funds invested via the Central Bank was much lower than planned, resulting in lower interest accordingly.

At the same time, revenues from interest on donated funds from KfW Bank were 56% lower than in 2009 and 40% lower than planned for 2010, which is also the result of the lower average interest than that planned.

Revenues from default interest and penalties for untimely payment of the regular premium were 34% lower on the year-on-year level. These revenues came from the penalties that the Central Bank charged to banks during bank inspections in the amount of 67.240 €.

Revenues from interest on funds invested in T-bills were 28% higher in 2010 than the year before, primarily because a higher amount of funds was invested in this type of securities (the Law prescribes that 20% of the Fund`s resources may be invested in T-bills). Revenues from these investments were 1.46% higher than planned for 2010.

6. OTHER OPERATING INCOME (in €)	2010	2009	current/ previous year	Plan 2010	2010/ Plan 2010
Revenues from financing consultancy services of monitoring and control of the Project of financing the initial capitalization of the Fund	132.710	145.440	0.91	132.710	1,00
Cancellation of deferred income	2.038	2.556	0.80		
Revenues from the reduction of frozen foreign currency deposit bonds to the market fair value		11.047			
Other revenues		1.770			
	134.748	160.813	0.84	132.710	1.00

Other operating income was 16.21% lower in 2010 than in the previous year. This income came from donations for financing consultancy services of monitoring and control of the Project of financing the initial capitalization of the Fund in the amount of 132.710 € and the cancellation of deferred income in the amount of 2.038 €. Revenues from donations for financing consultancy services are envisaged under the Financing and Project Agreement signed with KfW and they are divided in three years. As per the Agreement, this amount was paid by KfW in 2010 after the submission of the final report on the project approved by the Fund. Other operating income was 13.18% lower than planned for 2010.

7. COST OF MATERIAL, FUEL AND ENERGY (in €)			current/ previous year
	2010	**2009**	
Cost of material	1.111	22.645	0.05
Cost of fuel and energy	1.977	2.652	
Cost of water supply	217	-	
	3.305	**25.297**	**0.13**

The cost of material, fuel and energy were 87% and 45% lower than in 2009 and as planned for 2010, respectively.

8. COST OF SALARIES, FRINGE BENEFITS AND OTHER PERSONAL EXPENSES (in u €)			current/ previous year	Plan 2010	2010/ Plan 2010
	2010	2009			
Cost of net salaries and fringe benefits	72.085	66.446	1.08	73.500	0.98
Cost of personal income tax and fringe benefits	9.483	12.373	0.77	9.500	1.00
Cost of contributions on salaries and fringe benefits at the expense of employees	26.262	16.377	1.60	26.700	0.98
Cost of contributions on salaries and fringe benefits at the expense of employer	13.110	13.569	0.97	13.300	0.99
Cost of fringe benefits to members of the Managing Board	13.860	16.850	0.82	17.265	0.80
Cost of fringe benefits for job contracts	883	1.342	0.66	6.000	0.15
Cost of daily allowances for business travels	3.200	5.577	0.57	6.000	0.53
Cost of accommodation for business travels	3.472	3.182	1.09	6.500	0.53
Cost of transportation for business travel	2.693	4.316	0.62	5.500	0.49
Cost of meal allowances	1.595	1.389	1.15	1.600	1.00
Cost of contribution to medical treatment of employees	1.360	307	4.43	2.000	0.68
Other personal expenses	191	2.358	0.08	6.000	0.03
	148.194	**144.086**	1.03	**173.865**	0.85

8. 1. OTHER OPERATING EXPENSES (in €)	2010	2009	current/ previous year	plan 2010	2010/ plan 2010
Cost of consultancy services	132.710	145.440	0.91	132.710	1.00
Cost of postal services	7.724	6.977	1.11	7.000	1.10
Entertainment costs	3.666	4.874	0.75	4.500	0,81
Costs of advertising and promotional material and office supplies and membership fees	57.167			49.900	1.15
Maintenance costs	1.918	3.096	0.62	4.000	0.48
Cost of payment system services	1.162	1.253	0.93	1.500	0.77
Costs of bookkeeping services	-	1.351			
Cost of professional services	16.556	21.435	0.77	16.500	1.00
Other operating expenses	6.207	6.851	0.91	16.000	0,38
	227.110	**191.277**	**1.19**	**232.110**	**0.98**

The costs of advertising and promotional material were higher than planned, by 15%. These costs also covered a part of costs planned for these purposes in 2011, meaning that 27,000 € were prepaid to the media in December 2010 for the campaign that was carried out in the first two months of 2011.

Other operating expenses were 18.73% higher on the year-on-year level and 2.17% lower than planned for the reporting year.

9. INTANGIBLE INVESTMENTS AND EQUIPMENT	Equipment and furniture	Intangible investments
Purchase costs		
Balance as at 1 January 2009	46.247	14.359
Increments	2.526	-
Balance as at 31 December 2009	48.773	14.359
Balance as at 1 January 2010	48.773	14.359
Increments	-	-
Balance as at 31 December 2010	48.773	14.359
Aggregate depreciation		
Balance as at 1 January 2009	22.601	11.173
Depreciation	6.51	2.178
Balance as at 31 December 2009	29.111	13.351
Balance as at 1 January 2009	29.111	13.351
Depreciation	6.304	609
Balance as at 31 December 2010	35.415	13.96
Present value (as at 31 December 2010)	13.358	399
Present value (as at 31 December 2009)	19.662	1.008

10. OTHER FINANCIAL ASSETS (in €)	31.12.2010.	31.12.2009.
Financial assets at fair value presented in P&L account – frozen foreign currency deposit bonds	-	27.406
Short-term financial investments – T-bills	2.326.828	3.434.029
	2.326.828	**3.461.435**

	Number of bonds	Bond maturity	31.12.2010.	31.12.2009.
2010 bonds	29.744	1 July 2010.	-	29.744
	29.744			

11. ACCRUED INCOME	31.12.2010.	31.12.2009.
Accrued income from interest on invested funds		
Funds held with the Central Bank	895	566
Time deposits from KfW donations	24.432	38.786
Calculated interest on T-bills	25.327	39.352

12. CASH AND CASH EQUIVALENTS	31.12.2010.	31.12.2009.
Gyro account	81.485	43.557
Petty cash	692	194
	82.177	43.751
Allocated cash	164.384	155.787
Cash equivalents – interest bearing deposits	20.993.087	15.356.735
	21.239.684	15.556.273

12.1.STRUCTURE OF DEPOSITS	31.12.2010.	31.12.2009.
Short-term deposits		
From own funds	18.493.187	12.856.835
From KfW donations	2.499.900	2.499.900
Short-term overnight deposits	20.993.087	15.356.735

13. CONTINGENT DONATIONS	31.12.2010.	31.12.2009.
Financing of the initial capitalization of the Fund ("PROJECT")	2.500.000	2.500.000
Financing of consultancy services of monitoring and control of the Project	132.71	145.44
Used during the year for financing consultancy services	132.71	145.44
	2.500.000	2.500.000

13.1. CONSULTANCY SERVICES	As at 31 December	
	2010	2009
Balance as at 1 January	367.240	221.800
Paid during the year	132.710	145.440
Balance as at 31 December	499.950	367.240

14. DEFERRED EXPENSES (in €)	As at 31 December	
	2010	2009
Deferred donations of the Central Bank of Montenegro	32.753	32.753
Deferred donations for purchased equipment	6.634	8.672
Balance as at 31 December	38.387	40.425

14.1. DEFERRED INCOME EQUIPMENT (in €)	As at 31 December	
	2010	2009
Balance as at beginning of the year	8.672	11.228
Depreciation of donated equipment	2.038	2.556
Balance as at 31 December	6.634	8.672

15. FINANCIAL INSTRUMENTS (in €)	As at 31 December	
15.1. FINANCIAL ASSETS	2010	2009
Loans and receivables (including cash and cash equivalents	21.100.591	15.439.838
Depreciation of donated equipment at fair value presented in P&L account	2.326.826	3.461.435
Balance as at 31 December	23.427.419	18.901.273
15.2. FINANCIAL LIABILITIES		
Depreciation	2.500.869	2.500.548

15.3. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES	As at 31 December 2010		As at 31 December 2009	
Financial assets	Book value	Fair value	Book value	Fair value
Loans and receivables	189.711	189.711	195.139	195.139
Financial assets at fair value presented in P&L account	2.326.828	2.326.828	3.461.435	3.461.435
Contingent donations	2.500.869	2.500.869	2.500.548	2.500.548

16. NON-MONETARY TRANSACTIONS	31.12.2010.	31.12.2009.
Revenues from financing consultancy services of the Project control	132.710	145.440
Costs of consultancy services	132.710	145.440