

## **LAW ON BANKS**

### **I. GENERAL PROVISIONS**

#### **Scope and Purpose of the Law**

##### **Article 1**

This Law governs foundation, management, operations and supervision of banks and financial institutions and it governs the conditions and supervision of operations of parties involved in credit and guarantee operations with the purpose of establishing and maintaining safe and sound banking system that provides protection of interests of depositors and other creditors.

#### **Implementation of Other Laws**

##### **Article 2**

The provisions of the law that governs the legal status of business organizations shall be applied to the banks, unless otherwise specified in this Law.

#### **Terms and Definitions**

##### **Article 3**

Terms and definitions used in this Law shall have following meanings:

- 1) “bank” means a legal person that performs banking operations on the basis of the license or approval issued by competent authority for the performance of such operations;
- 2) “financial institution” means a micro credit financial institution and a credit union;
- 3) “banking operations” mean the operations of accepting cash deposits and approving loans for its own account;
- 4) “credit and guarantee operations” means the operations of issuing guarantees for regular meeting of obligations of loan beneficiaries;
- 5) “deposit” means a sum of money paid to a bank’s account, based on the contract or other legal activity, which results in bank’s obligation for recovery of the amount on demand of depositor or at the maturity of the contracted period, excluding funds that represent additional element of bank’s own funds;
- 6) “branch” means a part of a bank which does not have the status of a legal person and performs all or just some of the activities of that bank;
- 7) “founding capital” means capital which is provided by founders when founding a bank and which may be in money, in things and in rights appraised by the authorized appraiser;
- 8) “qualified participation” is:

- independently or mutually with other related parties, direct or indirect participation in capital or voting rights of a legal person of at least 5%;
  - possibility of making significant influence on management i.e. policy of a legal person based on agreement or contract with other party, or in any other way, regardless of the amount of participation in capital or voting rights in a bank;
- 9) “related parties” means two or more parties that are connected in at least one of the following forms:
- one party controls other party;
  - one party has direct or indirect participation in capital or voting rights of other party of at least 20%;
  - two or more parties are controlled by third party;
  - director, member of board of directors or other managing body of one legal person is at the same time the director, the member of the board of directors or the member of other managing body of other legal person;
  - a family member of a director, a member of a board of directors or a member of other managing body of one legal person is the director, the member of the board of directors or the member of other managing body of other legal person;
  - two or more parties are members of the same family, family members being: a spouse, a person with whom such person lives in a community which is equal to matrimony pursuant to the law, children born in marriage or outside of marriage, adopted children, stepchildren, relatives up to the third degree of blood kinship, in-laws up to the second degree, and persons under the guardianship of such party;
  - there is no relationship between two and/or more parties referred to in bullets 1-6 of this point, but the deterioration or improvement of financial condition of one of those parties may lead to the deterioration or improvement of financial condition of other party or parties;
- 10) “indirect investment” is an investment in the capital or in voting stocks in a legal person, through a third party, where the indirect investor is:
- a party for whose account another party (direct investor) has acquired the voting stocks or participation in the bank’s capital;
  - a party who controls another party (the direct investor);
- 11) “significant influence” means that facts have been known indicating that a certain party:
- may appoint at least one representative in the board of directors or in a similar body of that legal person, either as a result of share ownership, on the basis of mutual consent with the shareholders, authorizations, or in any other way;
  - participates in decision making in that legal person, regardless of whether that party can impose or determine such decisions or exercise influence over that legal person;
- 12) “control” means:
- independently or mutually with other related party, direct or indirect participation in capital or voting rights in legal person of at least 50%;
  - possibility of incurring dominant influence over decision making, business policy and strategy of a legal person, independently or mutually with other parties, without regard to the percentage of participation in capital;
- 13) “bank related parties” are:
- members of bank’s bodies, shareholders, bank employees, as well as members of their immediate family (marital partner and children);

- legal persons in which a party that has a qualified participation in the bank also has a qualified participation;
  - legal persons in which one of the parties in bullets 1 and 2 of this point has significant participation, or a party referred to in bullet 1 above is a director or a member of the board of directors or other managing body of a such legal person;
  - a party that has participation in capital or voting rights of at least 50% in a legal person that has qualified participation in a bank.
- 14) “insolvency” means the financial situation when liabilities of a bank exceed their assets according to the balance sheet;
- 15) “illiquidity” means the situation when the bank has no cash to meet its matured obligations when required by creditor;
- 16) “party” means a domestic or foreign natural person or legal person,
- 17) “banking group” means a group of related parties in which a bank or a financial holding with the head-office in Montenegro is superior in relation to one or more banks, financial institutions and/or other parties offering financial services, the operations of which are governed by other laws.
- 18) “superior bank in a banking group” means the bank which:
- controls other members of the banking group and/or
  - has equity interest in capital or voting rights of at least 20% individually in other members of the banking group.
- 19) “financial holding” means a joint-stock company or limited liability company which has equity interest in the capital or voting rights of banks or other parties offering financial services, if it controls at least one bank;
- 20) “superior financial holding in a banking group” means the financial holding which:
- controls at least one bank with a head-office in Montenegro,
  - controls or has equity interest of at least 20% in the capital or voting rights of other members of the banking group,
  - is not at the same time controlled by a bank or financial holding with a head-office in Montenegro, and
  - is not at the same time controlled by a bank licensed in another country.
- 21) “mixed holding” means a joint-stock company or limited liability company which has equity interest in the capital or voting rights of parties engaged in financial activities as well as parties engaged in non-financial activities, if it controls at least one bank.

## **Prohibition of Performing Banking Operations**

### **Article 4**

No natural person or legal person in Montenegro may engage in the profession or activity of banking, without required license or approval of the Central Bank of Montenegro (hereinafter: the Central Bank).

Should an evidence exist that a person is engaged in the activities referred to in paragraph 1 above without required license or approval of the Central Bank, the Central Bank may perform, for the purpose of gathering additional information, a review of business books and other documentation of such party.

The party referred to in paragraph 1 above shall allow the authorized examiners of the Central Bank to review the documentation and operations of such party.

## **The Use of the Word “Bank” and Other Words**

### **Article 5**

A bank shall have the word “bank” in its title.

A bank must not have in its title the words or derivative of the words that may lead bank’s clients or other parties to incorrect conclusions on the status and/or competitive position of such bank, or that may violate the rights of other parties, particularly the words or derivatives of the words that may create a confusion regarding:

- 1) scope of bank operations,
- 2) identity of the bank, i.e. its founders,
- 3) bank’s connectivity with other legal persons, or
- 4) Competitive advantage of such bank in its relationship with clients.

No party may use the word “bank” or derivative of the word “bank” in, its title or in the title of its products or services unless in case when this word is used in accordance with the provisions of this Law.

## **Bank Business Operations**

### **Article 6**

A bank shall perform banking operations.

In addition to the operations referred to in paragraph 1 above, a bank may perform the following operations:

- 1) issue guarantees and assume other off balance sheet obligations;
- 2) purchase, sell and collect claims (factoring, forfeiting, etc.);
- 3) issue, process and record payment instruments;
- 4) domestic and foreign payment operations pursuant to the regulations governing the payment system;
- 5) financial leasing;
- 6) operations with securities in accordance with the Law governing the securities,
- 7) trade on its own behalf and for its own account or for the client's account with:
  - foreign payment funds, including exchange operations,
  - financial derivatives;
- 8) depot activities;
- 9) development of analysis and the giving of information and advices on creditworthiness of legal persons and entrepreneurs, and on other issues with respect to the operations,
- 10) safe keeping services;
- 11) activities that are part of banking operations, activities that are of ancillary nature in relation to the operations of that bank, and other activities directly related to the operations of that bank in accordance with the bank bylaws.

The bank may also perform, with the prior approval of the Central Bank, other operations in accordance with the law.

## **Bank Founders**

### **Article 7**

A bank shall be founded as joint stock company.

A bank may be founded by domestic and foreign legal persons and/or natural persons.

A bank may have one founder.

## **Initial Capital**

### **Article 8**

The financial amount of initial capital may not be less than EUR 5,000,000.

The initial capital referred to in paragraph 1 above must be paid fully before the bank is registered in the Central Register of the Commercial Court (hereinafter referred as CRCC).

## **Qualified Participation in a Bank**

### **Article 9**

No legal or natural person may acquire qualified participation in a bank without prior approval of the Central Bank.

A party with qualified participation may not further increase participation in capital or voting rights in a bank, on the basis of which it acquires 20%, 33%, or 50% or more of participation in voting rights or in capital of the bank, without the prior approval of the Central Bank.

A group of related parties shall be one acquirer of participation in capital or voting rights in the bank.

The Central Bank shall reach a decision on request for granting approval for acquisition of qualified participation in a bank within 90 days as of the day the request has been orderly submitted.

## **Restrictions of Mutual Investments**

### **Article 10**

A legal person that is engaged in financial activity and in which a bank has participation in capital or voting rights of at least 20%, shall not acquire participation in capital or voting rights in that bank of 20% or more.

A legal person that is engaged in non financial activity and in which a bank has participation in capital or voting rights of at least 20%, may not acquire participation in capital or voting rights in that bank of 5% or more.

A bank shall not acquire participation in capital or voting rights of 20% or more in a legal person that is engaged in financial activity and which has participation in capital or voting rights of at least 20% in the bank.

A bank may not acquire participation in capital or voting rights of 5% or more in a legal person that is engaged in non financial activity and which has participation in capital or voting rights of at least 20% in the bank.

## **Deciding on Granting the Approval for Acquiring Qualified Participation**

### **Article 11**

When deciding on granting the approval for acquiring qualified participation, the Central Bank shall determine eligibility of the applicant for acquiring qualified participation, evaluating:

- 1) legal and organizational framework and activity performed by the applicant;
- 2) financial condition of the applicant;
- 3) transparency of the ownership structure of the applicant;
- 4) accuracy and fairness of the financial statements of the applicant;
- 5) transparency of the financial investments of the applicant;
- 6) strategic direction when investing in financial organizations;
- 7) other indicators of the applicant that are of importance for the evaluation of its influence on implementation of the rules for risk management in a bank.

When the applicant becomes a superior member of the banking group through the acquisition of qualified participation, the Central Bank shall review whether the reputation, competency and experience of the members of the management and organizational structure and organization of the banking group provides undisturbed preparation and submission of information required for the supervision and undisturbed performance of supervision on individual or consolidated basis.

## **Denial of the Request**

### **Article 12**

The Central Bank shall deny the issuance of approval for the acquisition of qualified participation in a bank if:

- 1) the applicant does not meet eligibility criteria referred to in article 11 above;
- 2) there are restrictions of mutual investment referred to in article 10 above;
- 3) the business activities of the applicant may cause significant risk for safe and legitimate management of a bank or a banking group;
- 4) the issuance of approval would lead to the concentration of the participants at financial market which significantly prevents, restricts or violates the competition, primarily through the creation or strengthening of dominant position at financial market;
- 5) the bank would become a member of a banking group for which the effective supervision on individual or consolidated basis is impossible or difficult;
- 6) it is not possible to determine the applicant's sources of funds for the acquisition of bank's shares;
- 7) there are other facts that point out that the applicant would adversely influence on the risk management in a bank or hinder the accomplishment of supervisory function of the Central Bank.

In the process of deciding on the request of foreign parties for acquisition of qualified participation in a bank, the Central Bank of Montenegro shall cooperate and exchange information with supervisors of the parent bank on performance, reputation, experience of the members of the bodies of the applicant as well as other relevant information with regard to the applicant.

### **Acquisition of Qualified Participation without Central Bank Approval**

#### **Article 13**

A bank and the Central Depository Agency shall inform, within eight days, the Central Bank on each acquisition of shares.

If there are facts that point out that a party has a qualified participation in a bank for which it does not have appropriate approval, the Central Bank may require such party, other bank shareholders, parent legal person of such party and the bank to submit all information and documentation which is relevant for establishing the existence of qualified participation of such party in the bank.

The parties referred to in paragraph 2 above shall submit requested data and information to the Central Bank no later than eight days as of the day of the reception of the request referred to in paragraph 2 above.

If the Central Bank, on the basis of data and information referred to in paragraphs 1 and 2 of this article, or on the basis of other data and information it has available, determines that a party has acquired or increased qualified participation in a bank without appropriate approval, the Central Bank shall inform such party in writing within eight days after the day of the reception of the information that it may submit the request to the Central Bank for issuance of appropriate approval and shall notify such party on the consequences referred to in article 14 paragraph 2 of this Law.

## **Legal Consequences of Illegal Acquisition of Qualified Participation**

### **Article 14**

A party referred to in article 13 paragraph 4 of this Law may not exercise voting rights above the level of voting rights which the party had prior to the acquisition or increase of qualified participation in a bank, nor may it have a right to a dividend payment on the basis of the shares acquired in such a way until it obtains appropriate approval of the Central Bank.

The Central Bank shall order a party, which does not submit request for granting the appropriate approval within the timeframe referred to in article 13 paragraph 4 of this Law, or the request for granting the approval is denied, to dispose of shares within the timeframe that may not be shorter than three or longer than six months, on the basis of which such party would exercise rights above the level of qualified participation for which it has had appropriate approval of the Central Bank.

Votes based on shares acquired without appropriate approval of the Central Bank shall not be counted when determining quorum for the Shareholders' Assembly, nor when deciding at the Shareholders' Assembly.

If shares referred to in paragraph 2 above are alienated, the new legal acquirer of such shares shall acquire all rights on the basis of these shares.

Shareholders with qualified participation in a bank who own appropriate approval of the Central Bank and shareholders with participation in a bank for which the approval of the Central Bank is not required, shall have the right for compensation of damage from the party referred to in paragraph 2 above which has resulted from the acquisition of qualified participation without approval of the Central Bank and/or alienation of these shares.

## **Timeframes for the Acquisition of Qualified Participation**

### **Article 15**

A party that has been granted the approval for acquiring qualified participation in a bank shall acquire, within six months as of the date of the approval granted, qualified participation in the bank.

Exceptionally, the Central Bank may, upon the request of the party referred in paragraph 1 above, extend the timeframe referred to in paragraph 1 above for a period no longer than another six months.



## **Cessation of Validity of Approval**

### **Article 16**

If a party that has been granted the approval for acquisition of qualified participation in a bank does not acquire participation of at least 10% of capital or voting rights in a bank, within the timeframes specified in article 15 of this Law, granted approval shall cease to be valid.

If a party that has been granted the approval for acquisition of qualified participation in a bank acquires, within the timeframes specified in article 15 of this Law, qualified participation in a bank below the level for which the approval has been requested, the approval shall be valid only for the participation in capital or voting rights in the bank such party has acquired.

If a party with qualified participation in a bank decreases its qualified participation through the disposal of shares or in any other way, the approval shall be valid only for the level of participation in capital or voting rights which such party has had after the decrease in qualified participation.

## **Revoking the Approval for Acquisition of Qualified Participation**

### **Article 17**

The Central Bank may revoke the approval for acquisition of qualified participation if:

- 1) the acquirer of the qualified participation, which is a superior company in a banking group, violates the provisions of this law referring to the supervision of banks on consolidated basis;
- 2) any of the circumstances as listed in article 12 of this Law occurs.

Legal consequences specified in article 14 of this Law shall be applied to by revoking the approval for the acquisition of qualified participation.

## **Informing the Central Bank by Qualified Acquirers**

### **Article 18**

A party with qualified participation in a bank that intends to decrease qualified participation in the bank, through the sale of shares or in any other way below the level for which it has been granted the approval, shall previously inform the Central Bank thereof.

A legal person that has qualified participation in the bank shall immediately inform the Central Bank on restructuring of that legal person.

The financial or mixed holding that represents a superior company in a banking group shall inform the Central Bank on each change in the composition of the board of directors or on change of the executive directors.

## **Shareholder's Agreement**

### **Article 19**

A group of bank shareholders whose total participation in capital or voting rights does not represent qualified participation in a bank, and have signed written or verbal agreement on mutual performance of managerial functions (hereinafter referred to as: the Shareholder's agreement) shall inform the Central Bank on such agreement.

The Shareholder's agreement referred to in paragraph 1 above shall not be signed by the new shareholder without the prior approval of the Central Bank, if by joining of such shareholder total participation in capital or voting rights has increased up to the level that represents qualified participation in a bank.

A group of bank's shareholders whose total participation in capital or voting rights represents qualified participation shall not sign Shareholder's agreement without prior approval of the Central Bank.

Participants in the agreement referred to in paragraph 3 above shall not, without new approval of the Central Bank, increase participation in capital or voting rights which increases total participation in capital of participants in the agreement or voting rights in the bank, above the level for which the approval has been granted.

New shareholder shall not sign the Shareholder's agreement referred to in paragraph 4 above, without prior approval of the Central Bank, if by joining of such shareholder the total participation in capital of the participants in the agreement or voting rights in a bank has increased above the level for which the approval has been granted.

The provisions of this Law referring to the granting of approval for acquisition of qualified participation in a bank shall be applied to the granting of the approval for signing of the Shareholder's agreement.

Approval for the signing of the Shareholder's agreement shall be considered as approval for acquisition of qualified participation in a bank.

## **Central Bank Register**

### **Article 20**

The Central Bank shall keep the register of the banks, financial institutions, branches of the foreign banks and representative offices of the foreign banks.

Information from the register referred to in paragraph 1 above shall be public and shall be disclosed at web page of the Central Bank.

The content and the manner of keeping the registers referred to in paragraph 1 above shall be specified in more details in the regulation issued by the Central Bank.

## **II. GRANTING A LICENSE AND APPROVALS**

### **I. Granting a License**

#### **Application for a Bank License**

##### **Article 21**

The bank founders shall submit to the Central Bank the application for a bank license, supported by the following documents:

- 1) authorization for a person which will cooperate with the Central Bank in the procedure of discussions on the application for a bank license;
- 2) proposal of the bylaws;
- 3) statement of the founders on the financial amount of the founding capital and evidences on sources of these funds;
- 4) documents and information on legal persons with qualified participation in a bank, which specifically contain a statement of registration or other appropriate statement from public register, financial reports for the last three years with authorized external auditor opinion, bank related parties and their connected interest, including data on parties that have significant influence, based on ownership or in any other way, on operations of such group of related parties;
- 5) appropriate document of the supervisory authority that there are no obstacles for a foreign bank or other financial institution to be founder of a bank;
- 6) documents, data and information on natural persons with qualified participation in a bank, which specifically contain their names and addresses of permanent or temporary place of residence and other identification data, appropriate evidence on sources of financial amount of founding capital, bank related parties and their connected interest;
- 7) biography data on proposed members of the board of directors that as a minimum contains the following: information on identification, professional qualifications and working experience and information on their achieved and planned education;
- 8) business plan of the bank for the first three years, which specifically contains an overall strategy of a bank, expected targeted market, projections of the balance sheet and income statement and cash flow projections;
- 9) proposal of a strategy for capital management and strategy for risk management in a bank;
- 10) documentation on technical capabilities and organizational structure, which particularly contains evidence on the use of business premise and equipment required for the performance of projected activities, proposal of rules and regulations on organization and job position scheme, and detailed description of organization of accounting and IT support.

Besides the documentation referred to in paragraph 1 of this article the Central Bank may require the bank to submit additional information and data.

## **Meeting Prior to the Submission of Application**

### **Article 22**

A meeting of the authorized representatives of the Central Bank with potential bank founders upon the request of the parties which intend to found a bank, whose initial contribution enables qualified participation in a bank, shall be held prior to the submission of application referred to article 21 above and it may be attended by other bank founders.

The potential bank founders shall inform the Central Bank representatives at the meeting referred to in paragraph 1 above on:

- 1) planned timeframes for founding a bank and submission of the application on granting a bank license;
- 2) bank's business strategy;
- 3) its financial condition and performance, including information on related interests;
- 4) dynamics of bank's development with regard to the increase in capital, deposit and loan potential;
- 5) the manner of risk management in a bank.

Minutes from the meeting referred to in paragraph 1 above shall be held and signed by one representative of the Central Bank and one representative of potential founders.

## **Deciding on Application**

### **Article 23**

The Central Bank shall decide on the application referred to in article 21 of this Law no later than 180 days after the bank license application has been submitted.

The Central Bank shall issue a decision on application referred to in article 21 of this Law.

The decision referred to in paragraph 2 above shall be final.

The administrative dispute may be carried out against the decision specified in paragraph 2 above.

## **Denial of Application**

### **Article 24**

The Central Bank shall deny the application referred to in article 21 of this Law if:

- 1) prescribed or requested documentation and data has not been submitted by founders, or the submitted documentation contains untrue or inaccurate data;
- 2) proposed bank bylaws is not in compliance with the law;

- 3) the proposed members of the board of directors do not meet the conditions to be elected as members of the board of directors as determined by this Law;
- 4) one or more founders owning more than 5% of participation in bank's capital or voting rights do not meet the conditions for acquisition of qualified participation in a bank as specified by this Law;
- 5) the bank business plan is not qualitatively prepared using appropriate methodologies, the contradiction between particular elements of business plan is evident, or projected balance sheet and income statement of a bank or cash flows are not based on realistic assumptions;
- 6) the ownership structure of a bank disables effective bank supervision;
- 7) the law and other regulations in the country of bank founders disable supervision on consolidated basis.

### **Allowable Activities of a Bank**

#### **Article 25**

The operations that a bank may perform shall be specified in the decision on granting a license.

Besides operations specified in the decision on granting the license, the bank may also perform the following operations with prior approval of the Central Bank:

- 1) operations referred to in article 6 paragraph 2, which are not determined in the decision on issuing a license for a bank;
- 2) operations referred to in article 6 paragraph 3 of this Law.

The Central Bank shall deny granting of approval for performing the operations referred to in paragraph 2 above if:

- 1) the bank does not have sufficient technical and staffing capability to perform operations for which it requests the approval; or
- 2) the performance of such operations is not justified from cost-effectiveness, profitability or impact on the risk profile of the bank standpoint.

### **Registration**

#### **Article 26**

The application for registration of a bank in the CRCC shall be submitted within 60 days after the delivery of the decision on granting the bank license.

The bank shall start to perform its operations no later than 60 days as of the day of its registration in the CRCC.

## **2. Granting Approvals**

### **Deadline for Deciding**

#### **Article 27**

The Central Bank shall reach its decision on the approvals referred to in this law within 60 days as of the day the application for obtaining approval has been orderly submitted, unless other timeframes has been stipulated by this law.

The Central Bank shall prescribe in its regulation the documentation that is submitted together with the application for obtaining approval referred to in paragraph 1 above, and which is not prescribed in accordance with this Law.

### **Resolution upon the Request**

#### **Article 28**

The Central Bank shall decide upon the issuance, denial and revoking of approvals in accordance with this law, by way of resolutions.

The resolutions referred to in paragraph 1 above shall be final.

The administrative dispute may be conducted against the resolutions specified in paragraph 1 above.

## **III. CORPORATE GOVERNANCE**

### **Shareholders' Assembly**

#### **Article 29**

A bank's Shareholders' Assembly shall:

- 1) enact the bank's bylaws and their amendments;
- 2) review the annual report on the bank's operations with an independent external auditor's report;
- 3) elect and recall members of the bank's Board of Directors;
- 4) decide on distribution of profits;
- 5) decide on capital increases and decreases;
- 6) decide on restructuring and closing of the bank;
- 7) establish the amount of compensation for members of the Board of Directors;
- 8) decide on other issues as specified in the bylaws.

## **Board of Directors**

### **Article 30**

The bank shall be governed by the Board of Directors.

Foreign citizens may be elected members of the Board of Directors.

A member of the Board of Directors shall be a person with recognized personal reputation, appropriate professional qualifications, experience and ability to manage the bank by applying generally accepted standards of safe and sound banking operations.

The Board of Directors shall have at least five (5) members, and at least two of them must be persons independent from the bank.

A person independent from the bank shall be considered a person:

- 1) without a qualified participation in the bank or in a superior company in the banking group to which the bank belongs;
- 2) that has not been employed in that bank or its dependent legal person for the last three years.

At least one of the members of the Board of Directors must be familiar with the language that is in official use in Montenegro and have residence in Montenegro during the performance of its duties as member of the Board of Directors.

Chairman of the Board of Directors shall be elected by the Board of Directors from among their members.

The chairman of the Board of Directors and members of the Board of Directors shall be elected for period of four years and may be reelected.

Members of the Board of Directors may also be executive directors of the bank, given that the total number of executive directors in the Board of Directors may not be higher than one-third of the total number of members of the Board of Directors.

Executive director of the bank may not be chairman of the Board of Directors.

## **Requirements for the Appointment of Board Members**

### **Article 31**

A member of the Board of Director may not be:

- 1) a person who controls or is a member of the board of directors or an executive director of a bank or financial institution, a legal person controlled by other bank of financial institution, or a financial holding;

- 2) a person who is connected with a legal person:
  - in which the bank has qualified participation, or
  - which is subordinate member of a banking group to which the bank belongs;
- 3) a person who has been employed in the Central Bank for the last 12 months;
- 4) a person whose assets has been subject to bankruptcy proceedings or significant enforcement has been conducted over personal property;
- 5) a person who had been on leading positions in a bank or other business organization at the time when such organization was subject to bankruptcy or liquidation proceedings, unless the Central Bank establishes that the person was not responsible for such bankruptcy or liquidation;
- 6) a person who had been a member of the Board of Directors or an executive officer in the bank at the time when the interim administration was introduced in a bank;
- 7) a person who has been subject to a safety measure prohibiting further conduct of professional work, business activity or duty, imposed by a competent court;
- 8) a person who has been sentenced for a crime which makes him or her not worthy of performing the function of member of the Board of Directors;
- 9) a person to which the bank has a total exposure exceeding 2% of own funds or a person who is the owner, member of the Board of Directors or a director of a business organization to which the bank has a large exposure.

### **Approval of the Election of Members of the Board of Directors**

#### **Article 32**

A member of the Board of Directors may not be elected without prior approval of the Central Bank.

The request for obtaining the Central Bank's approval shall be supported by evidence of the compliance with the requirements referred to in Article 31 above.

In the process of granting approvals of the appointment of members of the Board of Directors, the Central Bank may choose to require the candidate for a Board member to submit a presentation of the risk management in the bank.

The Central Bank shall grant the approval referred to in paragraph 1 above if, on the basis of the documents referred to in paragraph 2 above, the presentation referred to in paragraph 3 above and the available information, the Central Bank evaluates that the candidate meets the requirements for the appointment as member of the Board of Directors.

The approval referred to in paragraph 1 above, given by the Central Bank, shall be a condition for the registration with the CRCC.

The Central Bank shall revoke the approval granted referred to in paragraph 1 above if it has been granted on the basis of false information, if the member of the Board of Directors has been negligent in the performance of his or her duties or has committed a serious violation of his or her duties, or if there are impediments for the appointment referred to in article 31 above.



## **Responsibilities of the Board of Directors**

### **Article 33**

The Board of Directors shall:

- 1) establish and maintain a risk management system for the risks to which the bank has been exposed in its operations;
- 2) determine the bank's objectives and strategies and ensure their implementation;
- 3) prepare risk management policies and procedures for all the risks to which the bank has been exposed in its operations;
- 4) define the bank's annual plan, including financial plan as well;
- 5) adopt the bank's annual financial statements together with external auditor's report and reports on the bank's operations during the year;
- 6) approve transactions that may significantly affect the structure of the bank's balance sheet and risks taken in its operations, in accordance with the risk management policies and procedures;
- 7) periodically consider and evaluate exemptions from the established policies and procedures;
- 8) adopt the internal audit annual plan and internal audit reports;
- 9) establish bases for the functioning of internal control systems adequate to the size, complexity of operations and the level of assumed risk;
- 10) review the Central Bank's examination reports;
- 11) elect executive directors and other persons responsible for managing the bank's operations in individual areas and set their salaries;
- 12) elect the bank's external auditor;
- 13) appoint members of the audit committee;
- 14) review annual report of the audit committee;
- 15) prepare proposals of decisions to be approved by the Shareholders' Assembly and take care of their implementation;
- 16) enact the bank's general acts, except those enacted by the Shareholders' Assembly;
- 17) enact ethical code of conduct for bank employees;
- 18) approve the introduction of new products and services in the bank's operations;
- 19) convene meetings of the Shareholders' Assembly;
- 20) perform other duties as specified in the law and the bank bylaws.

## **Responsibilities of the Board of Directors**

### **Article 34**

The Board of Directors shall:

- 1) establish the risk management system for all the risks to which the bank has been exposed in its operations;
- 2) ensure that any operation of the bank is in accordance with the law, the Central Bank's regulations and the bank's internal policies and procedures, as well as that any measures imposed by the Central Bank have been complied with;
- 3) be responsible for the operational safety and financial stability of the bank;

- 4) be responsible for the accuracy of all bank operating reports that are published and submitted to the Shareholders' Assembly, the Central Bank and competent authorities.

## **Meetings of the Board of Directors**

### **Article 35**

Meetings of the Board of Directors shall be held as needed, but at least once a month.

The Board of Directors may decide if a meeting is attended by majority members of the Board.

The Board of Directors shall decide by a majority vote of members of the Board, unless otherwise prescribed by the bylaws.

In case of a conflict of interest, a member of the Board of Directors shall inform the Board thereof and shall not have a right to vote on the matters that involve such conflict of interest.

The manner of work and other matters related to the work of the Board of Directors shall be specified in more details by the Board's Rules of Procedure.

The Central Bank may require an extraordinary meeting of the Board of Directors to be held to jointly consider individual issues relevant to the bank's safe and sound operations.

## **Executive Directors**

### **Article 36**

A bank shall have executive directors.

Executive directors shall manage key areas of the bank's operations on a daily basis.

The key areas of the bank's operations, in the meaning of this law, shall be the areas of the bank's operations containing the most significant risks to which the bank has been exposed in its operations.

The bank's bylaws shall, subject to the bank size and complexity of its products and services, determine the key areas of the bank's operations, number of executive directors, representation and acting for the bank, and the manner of daily coordination of duties in the bank.

## **Requirements for the Appointment of Executive Directors**

### **Article 37**

An executive director in a bank shall be a person that meets the following requirements, in addition to those prescribed for a board member by this law:

- 1) university degree, and
- 2) competences and professional experience on managing positions in the financial sector, corresponding in relevance and time to the characteristics of key areas of operation and size of that bank.

Foreign citizens may be elected executive directors.

At least two executive directors must be familiar with the language that is in official use in Montenegro and have residence in Montenegro during the performance of their duties as executive directors.

## **Powers and Responsibilities of Executive Directors**

### **Article 38**

Executive directors shall be full-time employees of the bank.

Executive directors shall be responsible for the enforcement of the acts passed by the Board of Directors, for the organization and management of operations and for risk management in key areas of the bank's operation that they direct in accordance with their profession.

Executive directors shall supervise the work of the employees in charge of managing key areas of the bank's operations.

## **Audit Committee**

### **Article 39**

The Audit Committee shall consist of at least three members, the majority of which are not connected to the bank and have experience on the positions in the area of finance.

Bank executive directors shall not be elected as members of the Audit Committee.

The Audit Committee shall:

- 1) analyze the bank's financial statements;
- 2) analyze and monitor the functioning of internal control systems;
- 3) discuss internal audit programs and reports and give opinion on internal audit findings;
- 4) monitor the implementation of internal audit recommendations;
- 5) monitor and analyze the bank's compliance with the law and the bank's rules and regulations,

- 6) monitor activities of executive directors and other parties for the purpose of informing the Board of Directors and evaluate the quality of reports and information before they are submitted to the Board of Directors, including but not limited to:
- application of accounting policies and procedures;
  - decisions requiring high level of evaluation;
  - impact of unusual transactions on financial reports;
  - quality of policies of data gathering;
  - changes as consequence of completed audits;
  - assumptions on permanency of operations;
  - compliance with International Financial Reporting Standards and regulations;
- 7) give opinion on the selection of external auditor and propose an audit fee.

The Audit Committee shall draw up proposals, opinions and standpoints on the issues within their scope of work that are to be decided by the Board of Directors.

The Audit Committee shall submit annual reports on its work to the Board of Directors.

### **Bodies of the Board of Directors**

#### **Article 40**

The Board of Directors may form standing or temporary bodies for the supervision over the risk management in individual areas of the bank's operations, for the proposal of the amount of salaries, for the proposal of election of executive directors and certain categories of employees with special powers and responsibilities, and the like.

The composition and scope of work of the bodies referred to in paragraph 1 above shall be specified in more details in the bank's regulations, in accordance with the law and banking regulations.

### **Compliance Monitoring Function**

#### **Article 41**

The bank shall designate in its organizational structure, subject to its size and complexity of its operations, an organizational unit or persons responsible for monitoring the bank's compliance with the law, regulations governing the prevention of money laundering and terrorism financing, the Central Bank's regulations and the bank's internal rules and policies.

Employees of the organizational unit or persons referred to in paragraph 1 above may not perform any other duties in the bank, which performance may lead to the conflict of interest.

The manager of the organizational unit or persons referred to in paragraph 1 above shall:

- 1) inform the Board of Directors immediately on any irregularities found in connection with the compliance of the bank's operations;
- 2) periodically, but at least annually, report to the Board of Directors on the bank's compliance.

#### **IV. ORGANIZATIONAL PARTS AND RESTRUCTURING**

##### **Founding an Organizational Part and a Subsidiary**

###### **Article 42**

A bank may found branches, representative offices and other organizational parts (hereinafter: the bank parts) in Montenegro and in foreign countries, which do not have the status of a legal person, and subsidiaries, under the provisions of this Law.

Bank subsidiaries and bank parts in foreign countries shall be founded with a prior approval of the Central Bank.

##### **Bank Restructuring**

###### **Article 43**

A bank may be restructured through:

- 1) bank amalgamation that may be performed through:
  - the creation of a new bank;
  - merger into other bank;
- 2) de-merger into two or more banks.

##### **Amalgamation of Banks Resulting in a New Bank**

###### **Article 44**

Banks that intend to perform restructuring through amalgamation resulting in the establishment of a new bank, shall submit to the Central Bank a request for granting the license for a bank that will be established through amalgamation, supported by the following:

- 1) decisions of banks' Shareholder's Assemblies on amalgamation;
- 2) a founding charter of the bank resulting from amalgamation;
- 3) proposal of bylaws of the bank resulting from amalgamation;
- 4) names and data on qualifications and work experience of the proposed members of the board of directors and executive directors of the bank resulting from amalgamation;
- 5) the following three-year business plan of the bank resulting from amalgamation;
- 6) consolidated balance sheet and income statement of banks subject to amalgamation, using information from the month that precedes submission of the request referred to in this paragraph;

- 7) information on technical and staffing capabilities of the bank resulting from amalgamation;
- 8) documents elaborating conditions and reasons for the amalgamation;
- 9) approval of the Central Bank for performance of concentration at financial market.

The Central Bank may require the banks subject to amalgamation to submit other data and documents.

The Central Bank shall reach a decision on the request referred to in paragraph 2 above within 120 days as of date of the receipt of the orderly submitted request.

The provisions of this Law referring to granting a bank license shall accordingly apply to granting a license for a bank resulting from amalgamation.

## **Merger of a Bank**

### **Article 45**

In the case of restructuring performed through merging a bank to another bank, a bank to which other bank is merged (hereinafter: the absorbing bank) shall submit a request to the Central Bank for granting the approval for merger, supported by the following:

- 1) decision of Shareholder's Assembly of the merged bank on merger to the absorbing bank;
- 2) decision of Shareholders Assembly of the absorbing bank on acceptance of merger;
- 3) documents elaborating conditions and reasons for merger;
- 4) consolidated balance sheet and income statement of merged bank and absorbing bank using information from the month that precedes submission of the request above;
- 5) decision on issue of shares resulting from bank merger;
- 6) approval of the Central Bank for performance of concentration at financial market.

The Central Bank may require the bank to which other bank is merged to submit other data and documents.

The Central Bank shall grant the approval referred to in paragraph 1 above if:

- 1) the merger does not jeopardize financial condition of the absorbing bank;
- 2) the absorbing bank has the system of organization, management, decision-making and information technology which enables it to integrate completely the merged bank into its system in the manner that does not jeopardize its functioning;
- 3) the merger is economically viable.

The Central Bank shall reach a decision on request referred to in paragraph 1 above within 90 days as of the day of the receipt of orderly submitted request.

## **Bank De-Merger**

### **Article 46**

A bank that intends to perform restructure through de-merger shall submit a request to the Central Bank for granting the licenses for banks that will be founded through de-merger, supported by the following:

- 1) decision of Shareholder's Assemblies of banks on de-merger;
- 2) founding act of banks resulting from de-merger;
- 3) proposed bylaws of banks resulting from de-merger;
- 4) names and data on qualifications and work experience of the proposed members of the board of directors and executive directors of the banks resulting from de-merger;
- 5) the following three year business plan of the banks resulting from de-merger;
- 6) documents elaborating conditions and reasons for the bank de-merger;
- 7) information on technical and staffing capabilities of the banks resulting from de-merger;

The Central Bank shall reach a decision on request referred to in paragraph 1 above within 90 days as of the day of the receipt of orderly submitted request.

The provisions of this Law referring to granting a bank license shall accordingly apply to granting a license for banks resulting from de-merger.

## **V. BANK PERFORMANCE**

### **1. Risk Management in Bank**

#### **Obligation for Risk Management**

##### **Article 47**

A bank shall continuously manage all risks it has been exposed to in its operations in accordance with the law, regulations of the Central Bank and best risk management practices in the bank.

The Central Bank may issue guidelines for the application of best risk management practices in the banks.

#### **Establishing Risk Management System in Bank**

##### **Article 48**

A bank shall establish risk management system that provides the following:

- 1) identification of current risks and the risks that may arise from new business products or activities;
- 2) measurement of risks through establishing the mechanisms and the procedures for the accurate and timely assessment of risks;

- 3) monitoring and analyzing of risks;
- 4) control of risks by limiting and minimizing risks.

Risk management system in a bank must correspond to the size of a bank, complexity of products and services in its operations and the level of assumed risk.

### **Elements of Risk Management System**

#### **Article 49**

Risk management system shall include, as a minimum, the following:

- 1) defined appropriate strategy for risk management;
- 2) adopted policies and developed processes for risk management;
- 3) clearly defined powers and responsibilities for risk management;
- 4) efficient and safe information technology system;
- 5) contingency plans;
- 6) stress testing.

### **Strategy for Risk Management**

#### **Article 50**

A strategy for management of risks the bank has been exposed to in its operations shall include, as a minimum, the following:

- 1) objectives, which the bank wants to accomplish with strategy;
- 2) selection of business activities, products and services that will be dominant in the bank's performance;
- 3) expected relation of returns and risks for parts of bank portfolios and total assets;
- 4) general criteria and methods which are relevant for creation of frameworks for risk management.

Strategy for management of risks the bank has been exposed to in its operations shall be adopted for period not less than three years.

The bank shall periodically, and at least annually, review adequacy of the risk management strategy.

### **Risk Management Policies**

#### **Article 51**

Risk management policies must provide accomplishment of risk management strategy on a daily basis.

Risk management policies shall include, as a minimum, the following:



- 1) areas in which the identification of risk and methods for risk identification is performed;
- 2) methods, indicators and timeframes for measurement of individual risks;
- 3) limits and control procedures of individual exposures to risks and overall exposure to individual risks that correspond to the size of a bank, complexity of products and services in its operations and the level of assumed risk;
- 4) the manner and the dynamics of reporting and informing the board of directors and bank management on management of individual risks;
- 5) the manner of connection of activities of individual risk management in bank with activities that are performed in subsidiaries and other entities subject to supervision on consolidated basis and the manner for incorporation of these activities in the structure of risk management on consolidated basis;
- 6) methods and timeframes for back-testing of quality of risks management.

A bank shall periodically, and at least annually, review adequacy of the adopted policies and processes for management of individual risks.

The Central Bank may require the bank to document processes for management of individual risks.

### **Powers and Responsibilities in Risk Management Process**

#### **Article 52**

A bank shall clearly define, in its rules and procedures, powers and responsibilities for risk management in bank for all levels of work process and decision-making.

A bank shall provide segregation of risk taking from risk identification, measurement, monitoring and control.

A bank shall designate, within its organizational structure, an organizational part or persons, depending on the size and complexity of the bank's operations, directly responsible for individual risk management on daily basis.

The organizational parts or persons referred to in paragraph 3 above shall provide reports to the bank's board of directors on risk management activities if needed, and at least once a month.

### **Information System of the Bank**

#### **Article 53**

A bank shall establish and maintain reliable information system that adequately ensures gathering and processing of information for the following:

- 1) measurement and monitoring of risk exposures on daily basis and in other determined periods;
- 2) monitoring if the established limits for risk management are met;

- 3) creation of reporting formats for bank bodies and other parties included in risk management process.

A bank shall provide preparation of secure electronic backups of information and data on daily basis and store them on a secure location.

## **Stress Testing**

### **Article 54**

A bank shall also conduct, using several types of stress scenarios, testing of the bank sensitivity to individual types of risks on aggregate basis.

Stress scenario shall include, in the context of this law, assumptions on extreme changes of market and other factors, which may have significant material impact on bank's performance.

Minimum standards for testing the bank's sensitivity to risks, by using stress scenarios, shall be set forth in a Central Bank regulation.

## **Types of Risks**

### **Article 55**

The risks the bank is exposed to in its operations and for which it must establish risk management system are the following:

- 1) liquidity risk,
- 2) credit risk,
- 3) market risks,
- 4) operational risk,
- 5) interest rate risk not resulting from bank trading activities,
- 6) country risk,
- 7) other risks (reputation risk, compliance risk, etc.)

## **Liquidity Risk**

### **Article 56**

Liquidity risk shall be the risk that the bank will not be able to provide a sufficient amount of cash to meet its obligations as they become due, or risk that the bank may obtain cash with significant expenses to meet the matured obligations.

The bank shall operate in the manner to meet all its obligations in cash as they become due.

The minimal standards for liquidity risk management shall be prescribed by the regulation of the Central Bank.

## **Credit Risk**

### **Article 57**

Credit risk shall be the risk of incurring losses in bank operations due to the debtor's failure to meet its obligations to the bank.

The minimal standards for credit risk management shall be prescribed by the regulation of the Central Bank.

## **Exposure Limits**

### **Article 58**

Total exposure of a bank to one party or group of related parties may not exceed 25% of bank's own funds.

The exposure of a bank to one party or group of related parties, in accordance with the Central Bank regulation, shall be the total amount of all bank claims on loans and other assets, including amount of off balance sheet obligations and uncollected written off assets, decreased by the amount of claims that is secured by qualitative instruments of security of claims.

The exposure of a bank to one party or group of related parties is large if it is equal to or larger than 10% of bank's own funds.

The sum of all large exposures of a bank must not exceed 800% of bank's own funds.

The bank shall apply the following limits for the exposures to bank related parties:

- 1) total exposure of a bank to all bank related parties may not exceed the amount of 200% of bank's own funds;
- 2) total exposure to a party that is member of the board of directors, audit committee or executive director, including members of its immediate family may not exceed 2% of bank's own funds;
- 3) total exposure to legal persons that are controlled by persons referred to in item 2 above and/or members of their immediate families may not exceed 10% of bank's own funds;
- 4) total exposure to an employee not referred to in item 1 above may not exceed 1% of bank's own funds;
- 5) total exposure to a shareholder that does not have qualified participation in a bank, including exposure to legal persons that are controlled by such shareholder may not exceed 10% of bank's own funds;
- 6) sum of the total exposure of a bank to the following parties may not exceed 20% of bank's own funds:
  - shareholders that have qualified participation in a bank, including exposure to legal persons that are controlled by such shareholders;
  - legal persons controlled by a party that controls the bank, and
  - legal persons controlled by the bank.

The Central Bank may also prescribe other exposure limits.

Bank shall establish and keep central register of exposures, which includes information on total exposure of a bank to a party, group of related parties and parties related with a bank.

## **Classification of Assets and Capital Requirements**

### **Article 59**

A bank shall classify all assets items on the basis of the amount of credit risk and evaluate the amount of losses that result from credit risk.

The classification of assets based on which the bank is exposed to credit risk shall depend on the evaluation of the following:

- 1) credit capacity of the debtor, taking into account:
  - current financial condition of the debtor,
  - future primary sources of funds for meeting debtor's obligations,
- 2) the quality of instruments of security of bank's claims (hereinafter referred to as the collateral), taking into account the following:
  - collateral net value,
  - market conditions for collateral foreclosure in case of debtor's failure to meet the obligations;
- 3) regularity of debtor's fulfillment of the prior obligations;
- 4) general economic conditions;
- 5) other relevant information that is significant for the assessment of credit risk exposure.

Bank shall measure exposure to credit risk and determine capital required for all assets and off balance sheet items on the basis of which the bank is exposed to credit risk.

Individual exposures to credit risk may be grouped if they have mutual risk characteristics.

Bank shall establish capital required for each individual exposure to credit risk based on the risk assessment and classification of exposure based on that assessment.

When calculating capital requirements the exposures to credit risk shall be weighted by appropriate weight for that type of risk.

Methodology and criteria for classification of individual exposures in risk groups and calculation of total risk weighted assets for credit risk shall be prescribed by the Central Bank regulation.

## **The Use of External Rating Agencies and Institutions**

### **Article 60**

A bank may use, with the approval of the Central Bank, external ratings of the debtor established by independent specialized institutions and agencies (hereinafter referred to as the external institutions and export credit agencies) for the classification of individual

exposures in risk groups applying the methodology specified in article 59 paragraph 7 of this Law.

The Central Bank shall grant the approval for the use of rating determined by the external institution or export credit agency if the criteria of fairness of assessment of the methodology, institutional independence, transparency of findings and access to information are met, as well as adequacy of resources and credibility of external institution or export credit agency.

The conditions for granting the approval referred to in paragraph 1 above shall be closely prescribed by the Central Bank regulation.

### **Internal Ratings Based Approach**

#### **Article 61**

Banks may use, with the approval of the Central Bank, internal ratings based approach for the calculation of the capital requirements for credit risk instead of the methodology referred to in article 59 paragraph 7 of this Law.

The conditions under which banks may use internal ratings based approach for the calculation of capital requirements for credit risk shall be prescribed by the regulation of the Central Bank.

### **Market Risks**

#### **Article 62**

Market risk shall be the probability of incurring losses in bank balance sheet and off-balance sheet financial instruments arising from changes in interest rates, foreign exchange rates, prices, indices and/or other market factors impacting the value of financial instruments, as well as the risks related with the marketability of financial instruments.

Market risks shall include the following;

- 1) "Interest rate risk", which means the probability of incurring losses due to interest rate changes;
- 2) "Foreign exchange risk", which means the probability of incurring losses under balance sheet and off-balance sheet positions due to changes in currency rates and/or mismatch in the volume of assets, liabilities and off-balance sheet items within the same currency;
- 3) "Price risk", which means the probability of incurring losses due to changes in the price of the financial instruments, recorded in balance sheet or off-balance sheet;
- 4) Risks related to the marketability of financial instruments:
  - "Counterparty risk", which means the probability of incurring losses due to a counterparty's failure to perform on a derivative contract during its life;
  - "Issuer risk", which means the probability of incurring losses due to changes in the value of the financial instrument arising from changes in the financial condition of the issuer of the instrument; and

- “Placement risk”, which means the probability of incurring losses due to default or deterioration in the financial condition of a financial institution where a bank holds deposits/funds.

The minimal standards for market risk management shall be prescribed by the regulation of the Central Bank.

### **Capital Requirements for Market Risks**

#### **Article 63**

Bank shall measure its exposure to market risks and determine total capital against such risks according to the standardized methodology prescribed by the Central Bank.

Bank may use, with the approval of the Central Bank, internal models for the calculation of the capital requirement for market risks instead of the methodology referred to in paragraph 1 above or in combination with the methodology referred to in paragraph 1 under the conditions prescribed by the regulation of the Central Bank.

### **Operational Risk**

#### **Article 64**

Operational risk shall be the risk of incurring losses in the bank’s operation, as a result of inadequate internal systems, processes and controls, including also inadequate information technology due to outsourcing, weaknesses and errors in performance, illegal actions and external events that may expose a bank to loss, including legal risk as well.

In case of outsourcing provided through an outsourcing agreement or otherwise, a bank shall enable the Central Bank, in the process of operational risk examination, review of quality of the services rendered, including the direct review with such service provider.

The minimum standards for operational risk management shall be prescribed by the regulation of the Central Bank.

### **Capital Requirements for Operational Risk**

#### **Article 65**

A bank shall measure its exposure to operational risk and calculate capital requirements for operational risk in accordance with the methodologies prescribed by the Central Bank.

## **Country Risk**

### **Article 66**

Country risk shall represent the possibility of incurring losses by a bank, due to inability to collect receivables from the entities outside of Montenegro, which results from political, social and economical environment of the country in which debtor has its head office or residence (hereinafter referred to as: debtor's country) and shall include:

- 1) political and economical risk, which means the possibility of incurring losses arising from inability to collect bank's receivables due to limits established by rules and procedures of government and other entities of the debtor's country, as well as from economic and systemic conditions in the country;
- 2) transfer risk, which means the possibility of incurring losses due to inability to collect receivables in currency other than the official currency of the debtor's country, arising from limits of payment of obligations to creditors from other countries in particular currency, established by rules and procedures of government and other entities of the debtor's country.

A bank shall measure its exposure to country risk and determine total capital requirements for country risk in accordance with the methodologies prescribed by the Central Bank.

## **Interest Rate Risk Not Resulting From Bank Trading Activities**

### **Article 67**

Interest rate risk that does not arise from bank trading activities shall be the risk of incurring losses in bank's operations due to the interest rate changes for balance sheet and off balance sheet items that are not intended for trade.

A bank shall identify assets, which are not intended for trade and record them in its business books separately from the assets intended for trade in accordance with International Accounting Standards.

The minimum standards for management of interest rate risk that does not arise from bank trading activities shall be prescribed by the regulation of the Central Bank.

## **2. Capital Adequacy**

### **Determining Capital Adequacy**

#### **Article 68**

A bank shall determine capital adequacy on the basis of own funds as absolute, and solvency ratio as relative indicators of bank's capital adequacy.

## **Bank Own Funds**

### **Article 69**

Own funds of a bank shall represent the sum of paid in share capital and other core and supplementary elements of own funds reduced by deductible items.

The Central Bank shall prescribe core and supplementary elements of own funds and deductible items.

Own funds of a bank must always be at the level equal to or higher than:

- 1) minimal financial portion of founding capital specified in this Law; and
- 2) Total amount of capital required for all risks.

## **Capital Adequacy Ratios**

### **Article 70**

A bank shall maintain the level of solvency ratio and other capital adequacy ratios as a minimum at the level determined by this Law and Central Bank regulation.

The solvency ratio maintained by a bank on a solo or consolidated basis shall not be less than 10% or less than the level prescribed by article 71 of this Law.

The solvency ratio shall be the percentage ratio of own funds to the sum of:

- 1) total amount of risk weighted assets for credit risk, calculated in accordance with article 59 of this Law;
- 2) risk weighted assets for market risks, calculated as the amount of capital requirement for market risk determined in accordance with article 63 multiplied by 10;
- 3) risk weighted assets for operational risk calculated as the amount of capital requirement determined in accordance with article 65 multiplied by 10; and
- 4) risk weighted assets for other risks.

The Central Bank shall prescribe in its regulation other capital adequacy indicators and the method for their calculation.

## **Additional Requirements for Capital Adequacy**

### **Article 71**

A bank shall maintain higher level of own funds, higher solvency ratio and/or higher other capital adequacy ratios than prescribed, if:

- 1) Risk management in a bank is not adequate in relation to the level of assumed risk, the size of the bank and complexity of the products and services it offers;
- 2) The volume and/or composition of risk assumed are such as it is not effectively covered by the existing level of own funds, particularly when there is:
  - Significant exposure to the risks due to the concentrations of loans and other assets or high volume of problem assets;



- Risks arising from new activities;
  - Significant interest rate risk that does not arise from bank trading activities;
  - Insufficient level of liquid funds and/or deficient liquidity risk management;
  - Significant exposure due to reputation risk:
- 3) The existence of circumstances that could lead to material losses not provided for by the existing level of own funds;
  - 4) Bank shareholders' ability to provide support to a bank is unsatisfactory;
  - 5) The bank's capital levels and assumed risks are significantly unfavorable when measured against comparable banks;
  - 6) The bank is receiving special supervisory attention due to its risk profile;
  - 7) The bank has, or is expected to have, losses resulting in capital inadequacy;
  - 8) The bank's assets and/or level of risk is growing rapidly;
  - 9) The bank may be adversely affected by the activities of its parent, and other members of banking group.

### **3. Internal Controls System and Internal Audit**

#### **Internal Controls System**

##### **Article 72**

The bank shall establish, maintain and enhance effective internal controls system, which corresponds to the size of a bank and complexity of its business activities and which, as a minimum, includes clear principles of delegation of authorities and responsibilities, delegation of duties, accounting of assets and liabilities, compliance of accounting data, insurance of bank's funds and provision of independent internal audit and compliance function for implementation and compliance with positive laws and regulations.

The basics of the internal controls system in banks shall be prescribed by the regulation of the Central Bank.

#### **Internal Audit**

##### **Article 73**

A bank shall organize the internal audit as an independent function in the bank, which shall provide:

- 1) evaluation of adequacy and effectiveness of the internal control system;
- 2) identification of key risk areas in the bank's operations and evaluation of the application and effectiveness of the procedures and methodologies for risk assessment;
- 3) evaluation of quality and reliability of the information system;
- 4) review of accuracy, timeliness and reliability of accounting and financial statements and records;
- 5) evaluation of compliance with the amount of capital and risk in bank's operations;
- 6) the testing of transactions and the functioning of specific internal control procedures;

- 7) evaluation of monitoring of compliance of the bank's rules and operations with the law, regulations and the defined policies and procedures;
- 8) the giving of appropriate recommendations for the removal of disclosed irregularities and improvement of current procedures and manner of work.

## **Internal Auditor**

### **Article 74**

Internal auditor or special organizational part of a bank shall perform the internal audit function depending on the volume and complexity of bank operations.

Exceptionally, a bank may engage a party that is not employed by the bank for the performance of internal audit with the prior approval of the Central Bank.

A person that performs internal audit operations may not perform other operations in the bank.

Internal auditor or a person that manages organizational part for internal audit must have at least a university degree and at least three-year work experience in the accounting or auditing operations in the financial sector.

Restrictions referred to in article 31 paragraph 2 of this Law, which are prescribed for the appointment of the members of Board of Directors, shall be applied to the election of internal auditor.

## **Internal Audit Plan**

### **Article 75**

A bank shall adopt annual internal audit plans based on risk assessment, which as a minimum define the following:

- 1) internal audit goals and objectives;
- 2) business areas in which the risks are particularly shown;
- 3) business areas that will be subject to the audit;
- 4) internal audit scope and details for particular business areas of the bank;
- 5) audit procedures for the most important areas of bank activities;
- 6) timeframes for the execution of projected activities;
- 7) dynamics of reporting on internal audit findings.

## **Audit Organization Standards**

### **Article 76**

The bank shall organize the internal audit in such a way as to provide permanence in the performance of internal audit, audit access to all operations in the bank, independence, fairness and impartiality in the work of internal auditor, adequate organization in the performance of internal audit function and timely reporting of internal audit findings.

The Central Bank shall prescribe in more details the principles of organizing and functioning of internal audit in banks.

#### **4. Limits and Restriction in Bank Operations**

##### **Market Competition**

##### **Article 77**

A bank shall not conduct undesirable concentration at banking market.

Undesirable concentration at banking market, in the context of this Law, shall be bank restructuring through amalgamation or other actions, if such restructuring or actions materially prevent, limit or violate competition at banking market.

Undesirable concentration shall be determined through the application of the following criteria:

- 1) share of total assets of individual bank in total assets of all banks in Montenegro;
- 2) share of bank assets of in total assets of banks in Montenegro;
- 3) the concentration of bank's credit activities to certain target groups;
- 4) other criteria important for determining undesirable concentration at the financial market.

A bank shall submit the request to the Central Bank for the approval of the accomplishment of concentration at market prior to submission of the request to the Central Bank for approval of restructuring through amalgamation of banks.

The approval for accomplishment of the concentration at financial market shall be the precondition for submission of the request for approval of bank restructuring through amalgamations.

##### **Operations with Bank Related Parties**

##### **Article 78**

When the bank provides or uses the services of bank related parties, it shall not provide them with services under more favorable conditions than the conditions under which it provides such services to other parties, or it shall not use the services of bank related parties under the conditions which are less favorable that the conditions under which other parties would provide such services to a bank.

A bank shall establish procedures to identify and record on a regular basis all bank related parties and all operations, activities or transactions with bank related parties.

Members of Board of Directors, executive directors and other employees of the bank cannot participate in the decision-making process in relation to the providing or using of the services of parties related to them.

The Central Bank shall, in its regulation, prescribe in more details operations with bank related parties.

### **Purchase of Elements of Own Funds of a Bank**

#### **Article 79**

Purchase of elements of own funds of a bank with funds which are directly or indirectly obtained from loans or other legal operations signed with that bank shall be null and void.

### **Acquisition of Elements of Own Funds of Bank**

#### **Article 80**

Total amount of own shares and other elements of own funds acquired by the bank may not exceed 5% of the bank's own funds.

The bank shall alienate its own shares acquired within six months after the day of their acquisition.

If the bank fails to do that in the time prescribed in paragraph 2 above, it shall cancel such shares.

### **Restriction of Taking as Pledge Bank's Own Shares**

#### **Article 81**

A bank must not take as pledge its own shares or other elements of own shares of that bank.

### **Acquiring Real Estates and Fixed Assets**

#### **Article 82**

Investments of a bank in real estates and fixed assets shall not exceed the level which provides required technical qualification of a bank for carrying out business activities.

The minimum standards for bank investments in real estates and fixed assets shall be prescribed by the Central Bank regulation.

## **Restrictions and Limitations of Payment of Dividends**

### **Article 83**

A bank may perform payment of dividends in monetary funds above the amount of net profit for the year in which payment of dividends is performed only with the prior approval of the Central Bank.

The Central Bank shall deny the approval referred to in paragraph 1 above if the condition of the bank is such that payment of dividends would pose adverse impact on capital adequacy or financial condition of the bank.

The Central Bank may restrict or limit payment of dividends to shareholders or interest on other elements of own funds, if payment of dividends jeopardizes or would jeopardize capital adequacy, liquidity or bank's operations.

## **5. Banking secret**

### **Definition of Banking Secret**

#### **Article 84**

The banking secret shall be:

- 1) information about the account holders and their account numbers opened in a bank;
- 2) information on individual deposit accounts and transactions at the individual accounts of legal persons and natural persons opened in a bank;
- 3) other information on a client which the bank has on the basis of providing services to bank's client.

The banking secret shall represent business secret.

### **Liability of Keeping Banking Secret**

#### **Article 85**

Members of the Board of Directors, shareholders, all bank employees and other persons that, during their operations with the bank or on behalf of the bank, have obtained information and data established by this law as banking secret, shall be obliged to keep those information and data while working in the bank and after separation from the bank and they may not use them to their personal advantage, nor reveal them any third parties.

Notwithstanding paragraph 1 of this article,

- 1) the information that represents banking secret shall be disclosed to the following institutions:
  - the Central Bank,
  - competent Court;

- other parties, based on explicit written approval of a client.
- 2) The information in accordance with the law governing prevention of money laundering and terrorism financing may be disclosed to the competent authority for prevention of money laundering and terrorism financing;
- 3) The information pursuant to the law governing deposit protection may be disclosed to the Deposit Protection Fund;
- 4) The information on number of account of legal person and entrepreneur may be disclosed to the creditor of bank's client, who presents to a bank executive court decision or other executive document determined by the law;
- 5) The information on credit capacity and credit borrowings of a client with a bank may be disclosed to another bank or a member of a banking group for the purpose of credit risk management.

### **Handling Information Representing Banking Secret**

#### **Article 86**

Parties that have obtained information that represents banking secret in accordance with article 85 paragraphs 2 and 3 of this law shall use such information exclusively for the purpose for which they were obtained and shall not make it available to third parties except in cases prescribed by the law.

## **6. Protection of Clients**

### **Liabilities of Informing Client**

#### **Article 87**

A bank shall inform the client, upon his request, on condition of the loan or deposit account and provide him with the access to other information that may be available to the client in accordance with this law.

### **Disclosing General Operating Conditions**

#### **Article 88**

A bank shall post in its business premises on a visible location general operating conditions and their amendments as well.

General operating conditions, in the meaning of this law, shall be each document that contains standard operating conditions that may be applied to all clients of the bank, general conditions that refer to the relationship between the clients and bank, communication between the clients and bank and the general conditions of performing transactions between the clients and the bank.

The client may require from the bank additional explanations and instructions that refer to the implementation of general operating conditions.

## **Calculation and Reporting of Effective Interest Rate**

### **Article 89**

A bank shall calculate and report lending effective interest rate on loans granted and effective deposit rate on deposits taken and inform clients and public on the amount of effective interest rates in the manner specified in the regulation of the Central Bank.

## **Conditioning a Client**

### **Article 90**

A bank may not condition its credit granting by the use of its other services or the services of any of the bank related parties, which are not in relation with the main business.

## **Procedure in Case of Client's Objection**

### **Article 91**

A client that deems that the bank does not meet obligations from the signed contract may submit an objection to the competent organizational unit or other body of the bank authorized for decision making upon clients' objections.

A bank shall respond to the complainant referred to in paragraph 1 of this article in a reasonable timeframe and not later than 30 days as of the day of submission of objection.

## **Banking Ombudsman**

### **Article 92**

A client of a bank or financial institution that is not satisfied by any document, action or omission to act by the bank or financial institution may appeal to the protector of client's rights (hereinafter referred to as the banking ombudsman), as an independent party which participates in out-of-court settlement in resolution of disputed issues between the clients and banks and/or financial institutions.

The banking ombudsman shall be elected by the Central Bank.

A party, which is not connected with banks and/or financial institutions, which has significant experience in the area of banking operations and in which fairness may not be doubted may be elected as banking ombudsman.

The banking ombudsman shall:

- 1) review clients' objections and propose to disputed parties a settlement or other way of completion of dispute;

- 2) give recommendations to banks and financial institutions for the improvement of their relationships with clients;
- 3) advise clients with respect to the further conduction of the dispute;
- 4) perform other operations contributing to accomplishment of protecting the rights of clients.

The banking ombudsman shall adhere, in its operations, to the principles of fairness, independence, justice, equity, availability, consistency and informality.

A client of the bank may appeal to the banking ombudsman only if it has previously used all legal possibilities of protection of its rights in the proceedings against the bank and/or financial institution.

The proceedings before the banking ombudsman shall not prevent the client from commencing the lawsuit under the same matter before the competent court.

The Central Bank shall prescribe in more details in its regulations, the conditions that the banking ombudsman should meet, the principles on which the operations of the banking ombudsman are based on, the manner of provision of material and technical conditions for its operations, and the procedure of the protection of clients' rights before the banking ombudsman.

## **VI. ACCOUNTING, AUDITING AND REPORTING**

### **1. Accounting**

#### **Maintaining Business Books**

##### **Article 93**

The bank shall maintain business books, draw up accounting statements, evaluate assets and liabilities and prepare financial statements in accordance with this Law, regulations issued on the basis of this Law, International Accounting Standards and International Financial Reporting Standards.

The bank shall maintain business books in accordance with the bank chart of accounts prescribed by the Central Bank.

### **2. External Audit**

#### **Obligatory External Audit**

##### **Article 94**

The annual financial statements of banks and annual consolidated financial statements of banking groups shall be subject to obligatory external audit.



## **Requirements for External Auditor**

### **Article 95**

Audit of annual financial statements of banks or banking groups may be performed by an auditor or the audit firm, subject to the approval of the Central Bank.

The Central Bank shall deny the approval referred to in paragraph 1 above if:

- 1) the auditor, or a person leading the audit, does not have three years of experience as bank auditor;
- 2) the auditor, the audit firm, or a person hired by the audit firm, is a party related to the bank or member of the banking group;
- 3) the auditor, the audit firm, or a person hired by the audit firm has a direct or indirect financial interest in the bank or member of the banking group deriving from the business relationship with the bank;
- 4) the auditor, the audit firm, or a person hired by the audit firm has provided consulting services to the bank in the audited year;
- 5) the auditor, the audit firm, or a person hired by the audit firm has performed the audit of financial statements of that bank for the last three consecutive years;
- 6) information available to the Central Bank indicates that the auditor or the audit firm have not audited the bank's financial statements in a satisfactory manner.

## **Audit Report**

### **Article 96**

The auditor shall draw up a report and give opinion on:

- 1) compliance of annual financial statements of a bank with this Law, International Financial Reporting Standards and/or International Accounting Standards, the law governing accounting and auditing and other regulations, and whether they reflect fairly and objectively the bank's financial position, operating results and cash flows for that year in all material matters;
- 2) compliance with the regulations governing risk management in a bank;
- 3) the quality of the information system in a bank.

The Central Bank may require the auditor to provide any additional information about the performed audit, including the review of working papers created during the audit.

## **Audit in Case of Bank Restructuring**

### **Article 97**

In case of bank restructuring, the bank that has resulted from amalgamation, or the bank to which another bank was merged, or the bank that have resulted from de-merger, shall

hire an auditor to perform the audit of its financial statements as of the date of such amalgamation or de-merger.

The bank referred to in paragraph 1 above shall supply the Central Bank, within 60 days after registering the status change with the CRCC, the auditor's report on the fairness and objectiveness of its opening balance as on the date of amalgamation, merger or de-merger.

### **Auditor's Cooperation with Central Bank and Bank's Board of Directors**

#### **Article 98**

Before the start of the audit of a bank's or banking group's financial statements, the Central Bank's authorized representatives shall hold a consultative meeting with the auditor or persons hired by the audit firm.

The auditor shall notify the bank's Board of Directors and the Central Bank, as soon as it comes to his or her knowledge, of any fact that represents:

- 1) a violation of the law and regulations issued by the Central Bank;
- 2) a material change of the financial results shown in non audited annual financial statements;
- 3) a violation of internal procedures or acts of the bank or the banking group to which the bank belongs;
- 4) a circumstance that could lead to material loss to the bank or member of the banking group or could threaten their operations.

### **Notification of Auditor Dismissal**

#### **Article 99**

In case of dismissing or otherwise terminating the employment of the auditor, a bank or a superior company in the banking group shall notify the Central Bank of reasons for the termination of employment of that auditor in writing within not later than 15 days.

### **Audit Report Submission and Disclosure**

#### **Article 100**

The bank shall submit to the Central Bank annual financial statements, with the external auditor's report and opinion, within 150 days after the end of the commercial year that the report refers to.

The superior company in the banking group shall submit to the Central Bank annual consolidated financial statements of the banking group, with the external auditor's report and opinion, within 180 days after the end of the commercial year that the report refers to.

The bank, or the superior company in the banking group, shall publish a shorter version of the external auditor's report in at least one of daily newspapers distributed on the territory of the Republic.

### **Hiring Another Auditor**

#### **Article 101**

If the Central Bank finds that the audit of annual financial statements of a bank or banking group has not been conducted in accordance with the provisions of this law, the Central Bank will not accept such audit report and will require that another auditor repeat the audit at the bank's expense.

### **Special Audit**

#### **Article 102**

The Central Bank may require a special audit of a bank or member of a banking group if their statements are incorrect or they have entered into transactions that may inflict or have inflicted a major damage to the bank.

The Central Bank may appoint an auditor for the purpose of special audit of a bank or member of a banking group.

A bank or member of a banking group shall make available to such auditor all data and documents needed for the audit.

The expenses of the special audit shall be covered by the bank or member of a banking group.

## **3. Reporting**

### **Reporting to Central Bank**

#### **Article 103**

The banks, foreign bank branches and financial institutions shall prepare and submit to the Central Bank, in a timely manner, correct reports and other data on their financial condition and operations.

The Central bank shall prescribe in its regulation types, the form and the contents of information and data referred to in paragraph 1 above and the timeframes for their submission to the Central Bank.

## **Public Disclosure**

### **Article 104**

The bank shall disclose qualitative and quantitative data that are relevant to making the public aware of its financial position and performance, and as a minimum, it shall disclose:

- 1) scope of application of internationally accepted documents on risk management in banks and determining capital adequacy;
- 2) level and adequacy of capital;
- 3) exposure to risks in operations and the manner of managing those risks.

Data referred to in paragraph 1 above shall be all data which non disclosure or incorrect disclosure may adversely impact the user of such data when deciding to establish or continue its business relationship with the bank.

The bank shall determine in its acts, depending on the size, scope and complexity of its activities, level of assumed risk and its financial position:

- 1) type of data to be disclosed;
- 2) timeframes and method of disclosure.

The Central Bank may prescribe minimum information, manner and minimum timeframes for the disclosure referred to in paragraph 1 above.

## **VII. SUPERVISION OF BANKS AND OTHER PARTIES**

### **Entities Subject to Supervision**

#### **Article 105**

In the performance of its supervisory role, the Central Bank shall supervise:

- 1) banks;
- 2) foreign bank branches;
- 3) financial institutions, and
- 4) parties involved in credit and guarantee operations

#### **1. Supervision of Banks**

### **Responsibilities for Performing Supervision**

#### **Article 106**

The Central Bank shall perform the supervision of the banks' operations, in accordance with the law and internationally accepted standards of efficient bank supervision, with a view to establishing and maintaining a sound banking system and protecting depositors

and other creditors of banks, by evaluating their capacity to manage risks and compliance of their operations with the law and the Central Bank's regulations.

The members of the Council of the Central Bank, authorized examiners and other employees in the Central Bank that perform duties referring to performance of supervisory role of the Central Bank shall not be liable for damage that might incur during the performance of duties in accordance with the law and regulations enacted on the basis of the law, unless it has been proved that the particular action has been performed deliberately or by negligence.

Expenses of the court protection of the persons referred to in paragraph 1 above shall be covered by the Central Bank for all disputes arising from the execution of duties referred to in paragraph 1 above.

### **Cooperation with Other Institutions**

#### **Article 107**

In performing its supervisory function, the Central Bank shall cooperate with representatives of foreign institutions responsible for bank supervision and with domestic authorities and institutions responsible for the supervision of financial operations, with which it has concluded appropriate cooperation and confidentiality agreements regarding the exchange of information.

The exchange of information referred to in paragraph 1 above shall not be considered as revealing a secret.

### **Communication with Banks**

#### **Article 108**

As part of its ongoing supervision process, the Central Bank shall maintain communication with banks, reflecting primarily in:

- 1) consultative meetings, as needed, with the bank management, before starting an onsite examination;
- 2) meetings with the bank board of directors and management after drawing up an onsite examination report;
- 3) presence of authorized representatives of the Central Bank at meetings of the bank board of directors;
- 4) correspondence related to the monitoring of the imposed rehabilitation measures;
- 5) meetings and correspondence related to regulatory issues, best practices of risk management in banking operations and other banking issues.

### **Methods of Supervision**

#### **Article 109**

The Central Bank shall perform the supervision referred to in Article 105 above by:

- 1) analyzing the reports, information and data that the banks deliver to the Central Bank in accordance with the law and the Central Bank regulations, information and data that the banks deliver at the Central Bank's request and other data on banks' operations available to the Central Bank;
- 2) direct review of business books, accounting and other documentation in banks and their counterparts in the supervised transactions.

### **Authorized Examiners**

#### **Article 110**

The bank supervision shall be performed by employees of the Central Bank, authorized for the conduct of such duties by the Central Bank.

Notwithstanding paragraph 1 above, the Central Bank may also hire non-employees of the Central Bank to perform individual duties in the process of bank supervision.

### **Examination Notice**

#### **Article 111**

The Central Bank shall inform a bank of a planned on-site examination, as a rule, ten days before the examination commences.

Notwithstanding paragraph 1 above, if the reports and information held by the Central Bank indicate that there are irregularities that may be relevant to the safe and sound operations of the bank, an on-site examination may start without a prior notice.

### **Bank's Obligations during Examination Procedure**

#### **Article 112**

The bank shall enable the Central Bank's authorized examiners a free insight in business books, other business documentation and records, insight in the functioning of information technology and computer database, and it shall provide, upon request of authorized examiners, copies of business books, other business documentation and records, in hard and/or electronic copy.

### **Examination Report**

#### **Article 113**

Reports shall be made on the completed examinations.

The examination reports shall be confidential and shall not be disclosed either partly or wholly without approval of the Central Bank.

## **Procedure for Raising Objections to Examination Report**

### **Article 114**

The bank may submit its objections to the Central Bank within eight days after the day of receiving the examination report.

The Central Bank may directly check the bank's remarks contained in its objections to the report and, in that case, the Central Bank shall make an addition to the report, and the bank may submit its objections to this addition within three working days after the day of its receipt by the bank.

The Central Bank shall consider the received objections and notify the bank of accepting or non-accepting those within eight days of the day of receiving objections to the examination report or objections to its addition to the examination report.

## **Process of Imposing Measures against Banks**

### **Article 115**

If a bank fails to submit objections to the examination report within the prescribed time or fails to provide reasonable grounds for its objections to the report or addition to the report that states irregularities in the bank's operations, the Central Bank shall impose measures for removal of the irregularities against that bank.

The irregularities in a bank's operations, in the context of this Law, shall mean:

- 1) the bank's actions that are not in accordance with the best risk management practices and may lead to threatening the bank's financial position;
- 2) the bank's actions, or non-actions, which are not in accordance with this law, enabling regulations and other laws.

Notwithstanding paragraph 1 above, the Central Bank may impose measures for the removal of the found irregularities during an on-site examination, if:

- 1) the bank has been found to violate the law or other regulations to the extent that necessitates urgent removal of those irregularities;
- 2) the bank's financial condition is assessed as threatening the bank's further existence.

## **Types of Measures**

### **Article 116**

If the Central Bank establishes that a bank has not managed the risks to which it has been exposed in its operation in an adequate manner or contrary to regulations, it may take one of the following measures:

- 1) warn the bank in writing about the irregularities found and make it bound to undertake one or more activities to remove irregularities found within a specified

- time, including the activities that may be imposed by the order referred to in paragraph 1 point 3 of this Article;
- 2) conclude a written agreement with the bank making the bank bound to remove the irregularities found within a specified time;
  - 3) issue an order imposing one or more of the following measures:
    - order the bank to remove the irregularities found in its operations and/or undertake other activities to improve the condition in the bank;
    - order the bank to scale down or cease one or more of the activities that, as the Central Bank has established, caused losses for the bank or are contrary to best banking practices;
    - order the bank to establish stricter limits in operations than prescribed by the Central Bank or the bank's policies;
    - order a bank classification of assets based on the exposure to credit risk in riskier group,
    - order a bank to establish higher reserves for losses based on country risk;
    - order the bank to increase the amount of own funds, higher solvency ratio and/or higher other capital adequacy indicators than the prescribed if one or more conditions referred to in article 71 above are met;
    - require the bank to suspend or replace a member of senior management or managing bodies of the bank;
    - order the bank to prepare capital restoration plan acceptable to the Central Bank, within 60 days;
    - order the bank to reduce overhead expenses, including the restriction of salaries and other benefits of the bank's executive directors and other officials with special powers and responsibilities;
    - order that all interest rates paid for deposits may not exceed market interest rates for comparable amounts and maturities;
    - order the bank to require from its subsidiary to decrease or cease the activity, which has, as established by the Central Bank, caused significant losses for the bank, or represent large risk to the bank;
    - prohibit or restrict the growth of the bank's assets;
    - order the bank to sell part of its assets;
    - prohibit further investments in other legal persons;
    - order the bank to terminate an outsourcing agreement that poses a high operational risk to the bank.
  - 4) institute interim administration in the bank;
  - 5) revoke the bank's license.

If own funds of a bank, solvency ratio and/or other indicators of bank's capital adequacy are below the prescribed levels, the Central Bank shall, before undertaking other measures foreseen by this law, prohibit the bank, by way of an order, to engage in one or more activities specified in the respective license or approval issued by the Central Bank.

The provisions of Article 114 above shall not apply in the procedure of imposing measures referred to in paragraph 2 above.



## **Assumptions for Choosing Measures against Banks**

### **Article 117**

In deciding which measures will be undertaken towards a bank, the following shall be considered:

- 1) the assessment of impact of the found irregularities on:
  - the current and future financial position of the bank;
  - the bank's exposure to individual types of risks;
- 2) number and degree of difficulty of the found irregularities, and number, frequency and duration of irregularities found in previous operations of the bank;
- 3) the assessment of readiness and capability of the bank's bodies and management to remove the found irregularities based on the evaluation of:
  - the capability of the bank's bodies and management to manage risks in the bank's operations;
  - efficiency of internal control systems in the bank;
  - efficiency of the bank's bodies and management in the removal of earlier irregularities found in the bank's operations;
  - degree of cooperation of the bank's management with authorized examiners during the bank's examination;
- 4) the assessment of the degree of impact of the found irregularities on the financial discipline, security and stability of the banking system.

## **Order Imposing Measures**

### **Article 118**

The order referred to in Article 116, paragraph 1 point 3) above shall specify:

- 1) the dates for the removal of the found irregularities;
- 2) the time frame in which the bank shall notify the Central Bank on the measures undertaken to eliminate the found irregularities;
- 3) the amount of funds that the bank will be bound to pay to the Deposit Protection Fund on account of additional depositor protection from consequences of possible bankruptcy or liquidation procedure that may be instituted in the bank, given that such amount may range from 0.1% to 1% of bank's own funds.

The order referred to in Article 116, paragraph 1 point 3) above may also indicate:

- 1) the amount of funds that the bank executive directors and members of the Board of Directors will be bound to pay to the Deposit Protection Fund for the purposes specified in paragraph 1, point 3) above, given that individual amount of such funds may range from double to 10-fold average net salary of bank employees;
- 2) an authorized person for onsite monitoring of the implementation of the imposed measures in the bank.

The order referred to in Article 116, paragraph 1 point 3) above shall be final.

The administrative proceedings may be carried out against the order specified in Article 116 paragraph 1 point 3) above.

The order referred to in Article 116, paragraph 1 point 3) above shall represent an enforceable instrument with respect to the contents set forth in paragraph 1, point 3 and paragraph 2, point 1 above.

### **Procedure after Imposing Measures**

#### **Article 119**

Once the found irregularities have been removed, and not later than upon the expiry of the dates for the removal of the irregularities found, the bank shall submit to the Central Bank the report on the removed irregularities, supported by appropriate evidence.

The Central Bank shall issue a resolution with the conclusion that the bank has removed the irregularities in its operations once, on the basis of the report referred to in paragraph 1 above or on-site examination, it determines that the bank has removed all the irregularities found in its operations.

If the bank fails to remove the found irregularities within the time stipulated in paragraph 1 above, the Central Bank shall undertake, on the basis of available evidence or, as needed on the basis of on-site examination, measures allowed by the law against the bank.

### **Conditions for Introducing Interim Administration**

#### **Article 120**

The Central Bank shall issue a resolution on introducing interim administration in a bank if own funds and/or solvency ratio is below an amount equal to one-half of the prescribed level.

The Central Bank may issue a resolution on introducing interim administration in a bank if:

- 1) the bank has been ordered to undertake one or more measures referred to in Article 116, point 3 above, and the bank has not carried out the ordered measures within the time limit prescribed for their enforcement;
- 2) own funds and/or solvency ratio is below an amount equal to two-thirds of the prescribed level;
- 3) it has been found, during the period allowed for the removal of the irregularities found in the bank's operations, the bank has become illiquid or the bank's liquidity has worsened down to the level that threatens interests of depositors and other creditors of the bank.

The resolution referred to in paragraph 1 above shall appoint the Interim Administrator and specify the period of interim administration.

The resolution referred to in paragraph 1 above shall be final.

Administrative proceedings may be brought against the resolution referred to in paragraph 1 above.

The resolution on imposing interim administration shall be published in the “Official Gazette of Montenegro” and shall be forwarded to a competent court.

### **Requirements for the Appointment of Interim Administrator**

#### **Article 121**

Interim Administrator may be a person who:

- 1) has extensive experience in banking industry,
- 2) is not a bank related party;
- 3) has not been convicted for an act that makes him/her unworthy of performing this duty.

### **Fee and Bonus for Interim Administrator**

#### **Article 122**

The Interim Administrator shall be entitled to a fee, ranging from 15-fold to 30-fold official minimum monthly salary in the Republic.

The Interim Administrator may be awarded a special bonus, in proportion to the achieved results.

The fee and the bonus referred to in paragraph 2 above, shall be determined by the Central Bank and shall be charged to the bank.

### **Assumption of Powers of Bank Management Bodies**

#### **Article 123**

On the day of appointing the Interim Administrator, all powers of the Shareholders' Assembly, except for the powers specified in Article 127 below, the management and governance bodies, and the bank's agents, shall be transferred to the Interim Administrator.

Interim Administrator shall protect the assets and documentation of the bank.

Previous members of the Board of Directors, other officials with special powers and responsibilities and other employees in the bank shall enable the Interim Administrator access to all business and other documentation of the banks and shall draw up the takeover reports.

## **Recall of Interim Administrator**

### **Article 124**

Interim Administrator may be recalled before the completion of the interim administration if:

- 1) s/he fails to perform the duties specified herein in a satisfactory manner;
- 2) upon the personal request.

In case that the Interim Administrator is recalled before the completion of the interim administration, a new Interim Administrator shall be appointed within seven (7) days after such recall.

The released Interim Administrator shall hand over to the newly appointed Interim Administrator the responsibilities and all the information and documents related to his/her work, which shall be evidenced in takeover minutes, to be signed by both the administrators.

On the occasion of handing over the duties and responsibilities to the newly appointed administrator, the recalled Interim Administrator shall prepare the balance sheet and income statement of the bank as of the date of the recall.

## **Responsibilities of the Central Bank**

### **Article 125**

The Central Bank may, upon the request of Interim Administrator, issue an order to other bank for the suspension of payments from the accounts held with such other bank by a delinquent debtor of the bank under interim administration and/or by a guarantor to such debtor until such obligations have been settled.

The Central Bank may issue obligatory instructions for managing the bank's operation during the interim administration to the Interim Administrator.

## **Interim Administrator's Report**

### **Article 126**

Within 60 days of his/her appointment, the Interim Administrator shall submit to the Central Bank:

- 1) the report on the financial position and operating conditions of the bank that must include, as a minimum:
  - data on the bank's property based on the list of inventory made;
  - balance sheet and income statement of the bank as of the appointment date of the Interim Administrator;
  - review of all claims and liabilities of the bank by individual debtors and creditors;

- assessment of possibilities for the bank's future operation, including the assessment of the bank shareholders' ability and readiness to provide additional capital for the bank,
- 2) the bank rehabilitation plan, prepared in accordance with the assessment of the bank's prospects that must include, but not be limited to the following:
- steps to remove the noted irregularities in the bank's operations;
  - time schedule for the collection of claims and payment of liabilities, by months;
  - rationalization of bank's operating expenses;
  - proposed changes to the bank's organization;
  - assessment of possibilities for increasing own funds and/or solvency ratio up to the required level.

The Interim Administrator shall submit to the Central Bank monthly reports on his/her work and implementation of the activities referred to in paragraph 1, point 2) above.

### **Convening the Shareholders' Assembly for Capital Increase**

#### **Article 127**

If the Central Bank finds, on the basis of the Interim Administrator's report, that it is necessary to increase the bank's capital and to provide the solvency ratio that is adequate to the bank's risk profile, it shall order the Interim Administrator to convene a meeting of the bank's Shareholders' Assembly within 30 days in order to pass a decision on share issuance.

In the period between convening and holding the Shareholders' Assembly, the Interim Administrator shall inform all the shareholders about the situation in the bank and warn them of consequences in the case the decision on issue of shares has not been passed or in the case the decision on issue of shares has been passed, but the issue is unsuccessful.

### **Organizing the Sale of the Bank's Shares**

#### **Article 128**

If the Shareholders' Assembly fails to pass a decision on the new issue of shares or passes such a decision but the issue is not successful, the Central Bank may order the Interim Administrator to organize the sale of existing shares of the bank to new investors in order to change the existing shareholders' and ownership structure.

In the process of preparations for the sale of existing shares of the bank, the Interim Administrator shall prepare a descriptive memorandum that shall include a statement of the bank's current condition and estimate of its future prospects.

The investors referred to in paragraph 1 above shall provide additional capital for the bank at least to a level that provides the required solvency ratio.

## **Notification on the Sale of Shares**

### **Article 129**

The Interim Administrator shall advise potential purchasers of the planned sale of existing bank shares through media.

The notice referred to in paragraph 1 above shall include:

- 1) basic information about the bank;
- 2) data about the amount of funds that the new investors are obliged to provide to re-capitalize the bank up to the level that will provide required capital and/or prescribed solvency ratio of the bank;
- 3) information that the new investor may only be the person that will purchase shares in the value ensuring such person at least qualified participation in the bank;
- 4) information that the new investor may only be the person to whom the Central Bank has issued an approval for the acquisition of qualified participation in the bank;
- 5) list of documents to be attached to the application for obtaining approval of acquiring qualified participation in the bank;
- 6) time limit and manner of submission of the application for obtaining approval of acquiring qualified participation in the bank.

## **Conditions for Purchasing the Bank's Existing Shares**

### **Article 130**

The purchaser of the bank's shares during interim administration may only be the person that will acquire qualified participation in the bank through that purchase.

The application for obtaining approval of the acquisition of qualified participation in the bank during interim administration should be accompanied, in addition to the documents specified in this law as the documents that must support an application for obtaining approval of the acquisition of qualified participation in a bank, by the following:

- 1) information about the amount of bank shares that the applicant intends to purchase;
- 2) memorandum of intentions, containing the main elements of the planned business policy of the bank and planned activities concerning bank reorganization in staffing and organizational respect;
- 3) statement of commitment to re-capitalize the bank in the meaning of Article 128, paragraph 3 above, in proportion to the applicant's participation in the purchase of existing shares of the bank.

Before the application referred to in paragraph 1 above is submitted, the Interim Administrator shall present to a potential investor the descriptive memorandum referred to in Article 128 above, on the condition that such party signs a confidentiality statement.

## **Conditions for Issuing Approval of Acquiring Qualified Participation**

### **Article 131**

The Central Bank shall issue approval for the acquisition of qualified participation in the bank to the applicants referred to in Article 130 above that meet the conditions for the acquisition of qualified participation in the bank stipulated in this law.

## **Sale of Existing Shares of the Bank**

### **Article 132**

The Interim Administrator shall give order to an authorized participant in the securities market to sell existing shares of the bank at the stock market at the best price and specify the date for the start and closing of the sale of shares. Such order shall also specify that the shares may be sold only to the parties referred to in Article 131 above.

The Interim Administrator shall notify the parties referred to in paragraph 1 above of the date of the commencement of sale of the existing shares of the bank at the stock market by not later than five days prior to the sale.

The sold existing shares of the bank shall be transferred, after clearing and settlement, to the suspense security accounts of new purchasers with the Central Depository Agency, and the purchasers shall pay the sale price of these shares to a special suspense account with the Central Depository Agency. The money will be kept on these accounts so long as the purchasers complete the required re-capitalization of the bank, i.e., until the time limit for the payment of funds for the purchase of bank new shares expires.

## **Issue of Bank Shares**

### **Article 133**

On the day following the day of sale of the bank's existing shares at the stock market, the Interim Administrator shall make a decision on the issue of bank's shares in the amount that ensures the required capital level and/or prescribed solvency ratio of the bank, in order to sell them to the purchasers of existing shares on the basis of pre-emption.

The Interim Administrator shall forward the decision on the issue referred to in paragraph 1 above to the Securities Commission for the registration purposes, on the next day following the day when the decision was made, at the latest.

After receiving the resolution of the Securities Commission on registering the issue of shares, the Interim Administrator shall notify the purchasers of existing shares of the bank of the date by which they should purchase the new shares and pay the required amount.

## **Purchase of Issued Shares**

### **Article 134**

The parties referred to in Article 133, paragraph 3 above shall purchase the portion of the new issue that is proportionate to their participation in the purchase of existing shares of the bank.

The issue referred to in Article 133, paragraph 1 above shall be considered successful only if all the shares are sold by the expiry of the time limit referred to in Article 133, paragraph 3 above.

When the Securities Commission finds that the new issue of bank shares referred to in Article 133 above is successful and passes the resolution on the issue successfulness, the Central Depository Agency shall transfer the earlier purchased existing shares of the bank and the purchased new shares of the bank to the security account of the purchaser of the bank shares and shall also transfer the money from the suspense account referred to in Article 132 above to the accounts of former holders of bank shares.

In case that the purchasers of existing shares of the bank fail to purchase the new issue and the Securities Commission finds that the issue has not been successful, the bank shares allocated to suspense account of the purchaser with the Central Depository Agency shall be returned to the accounts of former holders of bank shares, and the money allocated to the special account with the Central Depository Agency shall be returned to the purchasers who have not managed to perform the required re-capitalization of the bank.

The Interim Administrator shall submit to the Central Bank the report on the sale of shares and successful re-capitalization of the bank.

## **Completion of Interim Administration**

### **Article 135**

Interim administration may last up to one year, and may be extended for another six months, if the Central Bank estimates that in the following six months the bank may attain the required level of own funds or solvency ratio and meet the due obligations on a regular basis.

Upon the completion of interim administration of the bank, the Central Bank shall:

- 1) return the bank under the control of its shareholders, or
- 2) commence bankruptcy proceedings over the bank.

Interim administration of the bank shall be completed before the expiry of the time limit referred to in paragraph 1 above if:

- 1) the Central Bank evaluates that the bank rehabilitation measures have given satisfactory results;
- 2) bankruptcy proceedings is commenced for the bank.



In case the bank is returned under the control of its shareholders, the Central Bank shall order the Interim Administrator to prepare, within 45 days at the latest, all the required documentation and acts and convene and hold a meeting of the Shareholders' Assembly of the bank.

## **Revoking a Bank License**

### **Article 136**

The Central Bank shall revoke a bank license when:

- 1) the bank has been acted, a number of times or for a longer time, contrary to the Law, other regulations or standards of prudential operations, thereby threatening the safety of deposits;
- 2) the license was issued on the basis of false data;
- 3) the bank no longer fulfils the conditions under which the license was granted;
- 4) application for registration in the CRCC has not been submitted within the prescribed time limit or the bank did not start to perform banking operations within 60 days as of the day of registration in the court register.

The Central Bank may revoke a bank license if:

- 1) it establishes that the bank has committed one or more violations of provisions of this or other laws;
- 2) if the bank does not meet its obligations with respect to deposit protection;
- 3) if the bank ceased to engage in deposit taking and lending operations for more than six months, or if it performs these operations in a scope that is significantly disproportionate to the earlier or planned volume of such operations.

The resolution to revoke a bank license shall be final.

The administrative proceedings may be taken against the resolution referred to in paragraph 3 above.

The resolution referred to in paragraph 3 above shall be published in the "Official Gazette of Montenegro" and shall be forwarded to a competent court.

Upon the issuing of the resolution referred to in paragraph 3 above, the issued approvals for the performance of other services shall also cease to be valid.

## **2. Supervision on a Consolidated Basis**

### **Article 137**

The Central Bank shall supervise the banking groups on a consolidated basis.

The Central Bank shall perform consolidated supervision through:

- 1) analysis of consolidated financial reports of banking groups and consolidated financial statements of the parties referred to in article 142 below,
- 2) on-site examination of the accuracy of data from consolidated financial reports and risks to which banks have been exposed as members of banking groups, and
- 3) evaluation of the condition of the banking group by using applicable international methodologies for evaluating the condition of the banking group.

### **Subject of Supervision**

#### **Article 138**

Bank supervision on a consolidated basis shall encompass the consolidated financial reports of:

- 1) banking groups with a superior bank,
- 2) banking groups with a superior financial holding,
- 3) banking groups with a superior mixed holding and
- 4) parties referred to in Article 142 below.

The Central Bank may perform an onsite examination of the accuracy of data from consolidated financial reports of all bank group members.

### **Consolidation of Groups with a Superior Mixed Holding**

#### **Article 139**

The bank that is subordinate to a mixed holding is obliged to provide the Central Bank with information on all the parties subordinate to the mixed holding.

Based on the information referred to in paragraph 1 above, the Central Bank shall assess whether there is a need for consolidated reporting for the group with the mixed superior holding.

In case it is determined that consolidated financial reports must be prepared for the group of parties with the mixed superior holding, the Central Bank shall at the same time decide which subordinate parties from the group should be included in consolidated financial reports and which method and scope of consolidation shall be applied.

The banking group with a mixed superior holding shall be, in the meaning of this law, the group of parties with a mixed superior holding that the Central Bank decides is subject to the obligation of preparing consolidated financial reports.

## **Parties Obligated to Prepare Consolidated Reports**

### **Article 140**

Consolidated financial reports of a banking group with a superior bank shall be prepared by the superior bank.

Consolidated financial reports for a banking group with a financial or mixed superior holding shall be prepared by the bank that is controlled by that holding and has its head-office in the Republic.

Members of a banking group shall submit all information necessary for consolidation purposes to the party obliged to prepare consolidated reports in a timely manner.

## **Exclusions from Consolidation**

### **Article 141**

Consolidated financial reports of the banking group shall not include subordinate members of the bank group the balance sheets of which are less than 1% of the balance sheet of the superior member of the group.

If several subordinate members of the banking group meet the condition referred to in paragraph 1 above, the Central Bank may order that these members of the banking group be included in consolidated financial reports, if the sum of their balance sheets is relevant to the determination of the financial condition of the banking group.

The superior bank may exclude from consolidated financial reports, subject to the prior approval of the Central Bank, information on a subordinate member of the banking group:

- 1) the head office of which is located in the country where there are legal impediments for the submission to the superior bank of data and information necessary for the preparation of consolidated financial reports;
- 2) the inclusion of which in the consolidated financial reports would not be relevant to the determination of the financial condition of the banking group;
- 3) the inclusion of which in the consolidated financial reports would be misleading with respect to the financial condition of the bank group;
- 4) in other events specified in International Accounting Standards.

The superior bank shall submit the application for obtaining the approval referred to in paragraph 3 above, with explanation, to the Central Bank not later than 30 days before the expiry of the reporting period.

## **Consolidation on Individual Basis**

### **Article 142**

The Central Bank may order a bank that has subordinated non-financial parties to consolidate individual operations, groups of operations, or perform full consolidation of the financial condition and operations of these parties, regardless of their business, if it is necessary for the purpose of full and fair presentation of the financial condition and operations of the bank.

The parties referred to in paragraph 1 above shall have the duty to supply the bank with all the information required for the preparation of consolidated financial reports.

## **Consolidation Methods**

### **Article 143**

Consolidation methods to be applied by banks in the preparation of consolidated financial reports shall be specified in a Central Bank's regulation.

## **Obligation to Comply with Prescribed Restrictions**

### **Article 144**

The superior bank shall provide that the following operating indicators of the banking group, reported on the consolidated basis, do not exceed the limits required from banks by the law and regulations of the Central Bank:

- 1) solvency ratio,
- 2) capital, real estate and fixed asset investments,
- 3) exposure to individual party or groups of connected parties,
- 4) aggregate large exposures,
- 5) exposure to bank related parties.

## **3. Supervision Fee**

### **Determining the Fees**

#### **Article 145**

The Central Bank shall charge a fee for the performance of the supervisory functions.

The fee referred to in paragraph 1 above shall consist of:

- 1) a fee for issuing licenses to banks and financial institutions;
- 2) a fee for issuing approvals under this law;
- 3) a fee for the supervision of banks, foreign bank branches and financial institutions.

The total annual amount of the fee referred to in paragraph 2 above shall not exceed 0.5% of total amount of banks' assets in Montenegro at the end of the year that precedes the year for which the fee is charged.

The amount of the total annual fee referred to in paragraph 2 above and amounts of individual fees shall be determined by a special regulation of the Central Bank.

## **VIII. OPERATIONS OF FOREIGN BANKS IN MONTENEGRO**

### **Branches of Foreign Banks**

#### **Article 146**

A foreign bank may operate in Montenegro through its branch with prior issuance of the approval of the Central Bank for branch operations.

The approval referred to in paragraph 1 above shall specify operations which a branch of the foreign bank may perform in Montenegro.

#### **Request for Issuing Approval for Branch Operations**

#### **Article 147**

Request for issuing the approval for branch operations shall be submitted to the Central Bank.

The following documents shall be submitted with the request referred to in paragraph 1 above:

- 1) statement from appropriate register of a country in which head office of a foreign bank is located, which cannot be older than 30 days;
- 2) bylaws or other appropriate documents of a foreign bank;
- 3) policies and procedures of the foreign bank on risk management;
- 4) information on members of board of directors and other foreign bank bodies;
- 5) financial statements of a foreign bank for the last three years with external auditor's opinion;
- 6) evidence on long-term credit rating of a foreign bank, determined by an internationally recognized rating agency;
- 7) description of operations that a branch will conduct and a business plan for the following three years of operations;
- 8) information on foreign bank owners;
- 9) documents and information on foreign bank shareholders, legal entities owning 5% of voting stock, which specifically contain a statement of registration or other appropriate statement from public register, bank related parties and their connected interest;
- 10) documents, data and information on foreign bank shareholders, natural persons owning more than 5% of voting stock, which specifically contain their names and addresses of permanent or temporary place of residence and other identification data, bank related parties and their connected interest;

- 11) evidence that a foreign bank is included in a deposit protection system and information on the amount of protected deposit, as well as an evidence that a branch will be included in the deposit protection system in the country of a foreign bank to the level and extent of coverage prescribed for banks operating in Montenegro, but it will not exceed such level;
- 12) document of supervisory authority of a country in which head office of a foreign bank is located, which gives approval to a foreign bank to start with operations in Montenegro through a branch or appropriate document of such authority that such approval is not required pursuant to the regulations of that country;
- 13) data and information on persons who will conduct branch operations;
- 14) documentation on business premise and technical capabilities for branch operation.

The Central Bank may request a foreign bank to submit additional data and information in the procedure of issuing the approval referred to in paragraph 1 above.

### **Deciding Upon Request**

#### **Article 148**

The Central Bank shall decide on the request referred to in Article 147 above within 6 months after the request has been orderly submitted.

The Council of the Central Bank shall issue a decision on the request referred to in Article 147 above.

The decision specified in paragraph 2 above shall be final.

The administrative proceedings may be carried out against the decision specified in paragraph 2 above.

### **Denial of Request**

#### **Article 149**

The Central Bank shall deny the approval for branch operation if:

- 1) prescribed or requested documentation and data has not been submitted with approval, or the submitted documentation contains untrue data;
- 2) long-term credit rating of a foreign bank determined by Standard & Poor's is lower than A, or it is lower than the rating determined by other internationally recognized rating agency equivalent to the rating A;
- 3) the branch business plan does not contain prescribed elements, and projected balance sheet and income statement are not based on realistic assumptions;
- 4) deposit protection system in a country where head office of a foreign bank is located does not provide deposit protection of at least an equivalent level of deposit protection in Montenegro;

## **Registration and Start of Branch Operations**

### **Article 150**

Issuance of the approval for branch operations shall be the condition for registration in the CRCC.

A branch shall be registered within 60 days after the delivery of the approval.

The branch shall start to perform its operations no later than 60 days as of the day of its registration.

## **Limitations in Operations of Branches**

### **Article 151**

A branch of a foreign bank shall operate in a way to have towards the parent bank at all times payables above receivables.

## **Imposing the Measures**

### **Article 152**

If the branch does not have adequate liquidity risk management, the Central Bank may require the branch to:

- 1) remove the maturity mismatch of assets and liabilities;
- 2) place a deposit with the Central Bank equivalent to at least 4% of the branch liabilities to other parties in Montenegro;
- 3) maintain its performing assets in Montenegro at a level equivalent to at least the amount of liabilities to depositors - natural persons in Montenegro;
- 4) obtain from parent bank appropriate guarantee for meeting the obligations of the branch, until the correction of irregularities in liquidity risk management has been corrected.

The request referred to in paragraph 1 above shall determine the timeframes for branch compliance with the request.

The request referred to in paragraph 1 above shall be submitted to the institution authorized for supervision of the parent bank of such branch.

## **Revoking the Approval**

### **Article 153**

The Central Bank shall revoke the approval to a branch if:

- 1) supervisory authority of a foreign bank revokes license or approval for operations to a foreign bank;
- 2) the approval has been issued on the basis of false and incorrect data;

- 3) the branch is not registered within 60 days after the issuance of the approval;
- 4) the branch does not start with operations within 60 days after the registration in CRCC;
- 5) the branch cannot meet its obligations.

The Central Bank may revoke the approval to a branch if:

- 1) the branch does not operate in Montenegro in accordance with the law and regulations;
- 2) the branch does not comply with the written request of the Central Bank referred to in article 152 above;
- 3) the rating of a foreign bank significantly deteriorates in relation to the rating obtained when granting the approval to the branch;
- 4) the interim administration or other measure of intensified supervision has been introduced in a foreign bank.

### **Representative Office of Foreign Bank**

#### **Article 154**

A foreign bank may found its representative office in Montenegro with the prior approval of the Central Bank.

The representative office of a foreign bank shall present the interests of that bank and may not perform bank operations.

### **Operations and Supervision of Branch Operations**

#### **Article 155**

The provisions of this law governing banking secret (articles 84 through 86), protection of clients (articles 87 through 92) and the manner and procedure of bank supervision (articles 108 through 114) shall be also applied to foreign bank branches.

## **IX. FINANCIAL INSTITUTIONS AND PARTIES INVOLVED IN CREDIT AND GUARANTEE OPERATIONS**

### **1. Common Provisions**

#### **Granting a License**

#### **Article 156**

The Central Bank shall issue a decision on application for license to a financial institution.



The decision referred to in paragraph 1 above shall be final.

The administrative proceedings may be carried out against the decision specified in paragraph 1 above.

## **Acquiring the Status of Legal Person**

### **Article 157**

The financial institution shall acquire the status of a legal person upon registration with the CRCC.

The application for the registration of a financial institution shall be submitted within the period of 60 days after the day of licensing.

## **2. Micro-credit Financial Institution**

### **Establishing an MFI**

#### **Article 158**

A micro-credit financial institution (hereinafter: MFI) shall be established as a joint-stock company or a limited liability company.

An MFI must have the words “micro-credit financial institution” in its title.

### **Capital of MFI**

#### **Article 159**

Minimum monetary amount of the initial capital requirement for an MFI shall be EUR 100,000.

### **MFI Operations**

#### **Article 160**

An MFI may perform the following operations:

- 1) grant loans for specified purposes for development projects to business organizations, for business improvement to entrepreneurs and specified purpose loans to natural persons, from its own funds and from the funds borrowed on the money market;
- 2) invest in short-term securities issued by the Government of Montenegro and in other high quality short-term instruments of the financial market;
- 3) offer financial leasing services; and

- 4) offer consulting services.

### **Measures against MFI**

#### **Article 161**

If it determines that an MFI has acted contrary to the regulations or acts of its business policy, or has entered into unsafe and unsound operations, the Central Bank may:

- 1) warn the MFI in writing;
- 2) conclude a written agreement with the MFI which will oblige the MFI to eliminate the found irregularities within a specified period of time;
- 3) order the MFI to eliminate the irregularities found and comply its operations with the regulations;
- 4) order temporary suspension for a member of the bodies, a body or management of the MFI.

The resolution referred to in paragraph 1 point 3 above shall be final.

The administrative proceedings may be brought against the resolution referred to in paragraph 1 point 3 above.

### **Revoking a License**

#### **Article 162**

The Central Bank shall revoke a license of an MFI:

- 1) when the MFI fails to start its operations within six months as of the date of its registration with the CRCC;
- 2) when the MFI fails to act under the orders referred to in Article 161, point 3 below;
- 3) when the MFI has been included in illegal activities;
- 4) when the authorized examiners of the Central Bank are hindered in their examination of the MFI or the submission of the requested documentation is disabled or avoided;
- 5) when the MFI submits false statements of its operations to the Central Bank.

The Central Bank shall revoke a license of an MFI when it finds that the license was issued on the basis of false data.

The resolution on revoking the license of an MFI shall be final and shall be published in the "Official Gazette of Montenegro".

The administrative proceedings may be brought against the resolution referred to in paragraph 3 above.

## **Bankruptcy and Liquidation**

### **Article 163**

Bankruptcy and liquidation of MFIs shall be governed by the regulations governing the bankruptcy and liquidation of business organizations.

## **Operations and Supervision of MFI**

### **Article 164**

Provisions of this law governing granting a license to a bank (articles 21 through 24), banking secret (articles 84 through 86), protection of clients (articles 87 through 92) and the manner and procedure of bank supervision (articles 108 through 114) shall also be applied to MFIs.

Minimum standards for risk management in MFI shall be prescribed by the Central Bank regulation.

## **3. Credit Union**

### **The Term**

#### **Article 165**

Credit union (hereinafter: the Union) is a financial institution owned by its members, organized on the principles of voluntary membership, mutuality, connection and equal rights of all members of the Union that, primarily from its own funds and deposits of the Union members, grants loans and provides other financial services to its members.

### **Founders**

#### **Article 166**

A Union may be founded by at least 30 natural persons with working capacity or entrepreneurs connected through the same profession or in other way, under the conditions set forth in this law.

The connection referred to in the paragraph 1 above includes, but is not limited to, the connection of individuals on the basis of engaging in the same profession, affiliation to the same association, territorial connection, employment with the same employer, affiliation to the same trade union and other types of the connection that are acceptable to the Central Bank.

## **Initial Capital**

### **Article 167**

Minimum initial capital of the Union shall be EUR 10,000.

The capital referred to in paragraph 1 above shall be member contributions and donor funds.

## **Union Operations**

### **Article 168**

The Union may perform the following operations:

- 1) receive deposits from Union members,
- 2) grant loans to Union members, from their own funds, deposits of Union members and funds provided at the money market;
- 3) issue guarantees and other similar commitments for Union members,
- 4) perform inland payment operations services for the Union members, in accordance with the agreement signed with the banks at which the Unions have accounts for regular operation;
- 5) invest available funds in short-term securities issued by the Government of Montenegro or other high-quality short-term instruments of the money market;
- 6) provide lease financing services for Union members.

## **Bankruptcy and Liquidation**

### **Article 169**

Bankruptcy and liquidation of Credit Unions shall be governed by the regulations governing the bankruptcy and liquidation of banks.

## **Operations and Supervision of Credit Unions**

### **Article 170**

The provisions of this Law relating to the operations and supervision of banks shall also apply to the credit unions, unless otherwise prescribed by a Central Bank's regulation.

### **3. Parties Involved in Credit and Guarantee Operations**

#### **Conditions for Performing Credit and Guarantee Operations**

##### **Article 171**

Natural persons that obtain appropriate approval of the Central Bank for performing the credit and guarantee operations may engage in such operations.

The Central Bank shall reach a decision on the request for granting the approval referred to in paragraph 1 above within 120 days after its submission.

The conditions for granting the approval referred to in paragraph 1 above, as well as the minimum founding capital, operations, supervision and revoking the approval referred to in paragraph 1 above shall be prescribed in the regulation of the Central Bank.

### **X PENALTY PROVISIONS**

##### **Article 172**

A fine ranging from 50-fold to 300-fold amount of minimum official monthly salary in Montenegro shall be imposed against a bank or other legal or natural person if:

- 1) it is engaged in banking operations without required approval of the Central Bank (Article 4);
- 2) it uses in its name or in the name of its product or service the word “bank” or any derivative of the word “bank”, except when that word is used in accordance with the provisions of this Law (Article 5);
- 3) it acquires or increases qualified participation in a bank without appropriate approval of the Central Bank (Article 9);
- 4) it founds bank parts in foreign countries without approval of the Central Bank (Article 42 paragraph 2);
- 5) it fails to establish a system for risk management (Article 48);
- 6) it exceeds prescribed exposure limits (Article 58);
- 7) it fails to perform asset classification or fails to evaluate the amount of losses that result from credit risk (Article 59);
- 8) it provides or uses the services of bank related parties under more favorable conditions than the conditions under which it provides such services to other parties, or it uses the services of bank related parties under the conditions which are less favorable than the conditions under which other parties would provide such services to a bank (Article 78);

- 9) it acquires bank shares or other elements of own capital above the allowed amount or fails to dispose of acquired own shares in a prescribed timeframe (Article 80);
- 10) it has investments in real estates and fixed assets above the level prescribed by the Central Bank regulation (Article 82);
- 11) it conditions its credit granting by the use of its other services or the services of any of the bank related parties, which are not in relation with the main business (Article 90);
- 12) it fails to maintain business books under the prescribed chart of accounts or fails to prepare reports in accordance with international accounting standards, international financial reporting standards and special regulations (Article 92);
- 13) it appoints external auditor or audit firm without the approval of the Central Bank (Article 95);
- 14) it submits incorrect reports and other data on its financial condition and operations to the Central Bank, or it fails to submit them in a timely manner (Article 103);
- 15) it fails to submit, in a timely manner, to the obligor of reporting on consolidated basis its financial reports and other information required for preparation of consolidated financial reports (Article 140 paragraph 3).

For the offence specified in paragraph 1 above, a responsible person in the bank and other legal person shall be also imposed a fine ranging from 10-fold up to 20-fold amount of minimum official monthly salary in the Republic.

For the offence specified in paragraph 1, items 1) and 3), a natural person shall be imposed a fine ranging from 10-fold up to 20-fold amount of minimum official monthly salary in the Republic.

## **XI TRANSITIONAL AND FINAL PROVISIONS**

### **Adoption and Implementation of Regulations**

#### **Article 173**

The Central Bank shall issue regulations that it has been authorized to issue under this Law within not longer than six months after the effective date of this Law.

Until the regulations referred to in paragraph 1 above have been adopted, the regulations adopted under the Law on Banks (“Official Gazette of the Republic of Montenegro”, Nos. 52/00 and 32/02) shall be applied, unless they are contrary to this law.

## **Compliance Timeframe**

### **Article 174**

The banks shall:

- 1) bring acts and corporate governance into compliance with the provisions of this Law no later than six months from the day this Law comes into force;
- 2) Bring their operations into compliance with the provisions of this Law and enabling regulations issued on the basis of this Law no later than one year from the day this Law comes into force.

The Central Bank shall undertake measures foreseen under this Law against any bank that has not met the requirements referred to in paragraph 1 above.

Provisions of paragraphs 1 and 2 above shall also apply to bank affiliates that have their head offices outside of Montenegro.

## **Licenses**

### **Article 175**

Licenses of banks and foreign bank affiliates that have their head offices outside of Montenegro issued before the day this Law comes into force shall remain valid.

## **Non Government Organizations**

### **Article 176**

Non government organizations that have the approval of the Central Bank for the performance of operations referred to in article 8 of the Decision on Micro Credit Financial Institutions (“Official Gazette of the Republic of Montenegro”, No. 01/03), may perform such operations no longer than one year from the day this Law comes into force.

The granted approval referred to in paragraph 1 above shall cease to be valid after the expiration of the timeframe set forth in paragraph 1 above.

## **Parties with Qualified Participation**

### **Article 177**

Parties that have participation in capital or voting rights in a bank that represents a qualified participation under the provisions of this Law as of day this Law comes into force, and for which they do not hold appropriate approval, shall submit to the Central Bank a request for granting the approval for acquisition of qualified participation within three months from the day this Law becomes effective.

### **Pending Procedures**

#### **Article 178**

Any bank licensing procedures started before the effective date of this law and still pending shall be finalized according to the provisions of this Law.

### **Election of Banking Ombudsman**

#### **Article 179**

The Central Bank shall elect banking ombudsman within one year from the day this Law comes into force.

### **Cease of Validity of Regulations**

#### **Article 180**

On the date this Law becomes effective, the Law on Banks (“Official Gazette of the Republic of Montenegro”, Nos. 52/00 and 32/02) shall cease to apply.

### **Coming into Effect**

#### **Article 181**

This Law shall become effective on the eighth day upon its publication in the “Official Gazette of Montenegro”.



## **R A T I O N A L E**

### **CONSTITUTIONAL BASIS FOR THE ENACTMENT OF THE LAW**

The constitutional basis for the passage of this Law is incorporated in the provision of Article 16 paragraph 1 point 5 of the Constitution of Montenegro, which regulates, in compliance with the law, the issues of interest to Montenegro.

### **REASONS FOR THE ENACTMENT OF THE LAW**

The current Law on Banks was adopted in 2000 (“Official Gazette of the Republic of Montenegro”, No. 52/00) and amended in 2002 (“Official Gazette of the Republic of Montenegro”, No. 032/02). It regulated the founding, issuing of licenses, organization, status changes, ownership changes, operations, management, governance, supervision and resolution of status of any party involved in providing banking and/or financial services and/or products in the Republic of Montenegro. The prevailing Law on Banks included all key areas of bank operations with respect to the movements at market of banking products and services at that point in time, but the current solutions eventually turned out to be too narrow framework, which could not be adequately amended by further subordinate legislation acts.

The experiences in the implementation of certain provisions of the current Law pointed out the need for their precision in order to eliminate legal risks that might arise from their implementation. It particularly referred to those parts of the Law that regulated rehabilitation measures, risk management in a bank, weaknesses in bank operations, violation of the regulations, and the like.

Harmonization of banking regulations and practice was imposed as the key element with a view of maintaining safety and soundness of banking system, since every higher step out in the development of relationships at banking market in relation to the established regulatory and legal framework would bear the risk of incurring specific situations in practice that could not be included in the current legal solutions.

The accelerated dynamics of the development and the specifics of the banking system, and overall economic and financial trends in Montenegro as well, referred more and more to the conclusion that the provisions of the current Law could not further represent adequate regulatory and legal framework, which, by its structure and dynamics of development, the market of banking products and services in Montenegro is entitled to.

Besides the aforementioned requirement of harmonization of the banking regulations with the development and specifics of the banking system and economic and financial trends in Montenegro, the dynamics of the amendments to the banking regulations at international level should be born in mind as well as very intensive implementation of the improved standards and models of risk assessment in banking operations. Bearing in mind international regulations in banking industry and assessment of comparative experiences in their implementation, the requirement was observed for the enhancement of the compliance level of the local laws and subordinate legislation with the latest EU legislation and Basel framework for bank operations, with a special view to new

international documents in banking industry, particularly new EU Directive for Capital Adequacy 2006/49 from June 2006.

With respect to the solutions given in the current law, new Law on Banks includes all standards of banking operations that are in compliance with Basel framework and principles for corporate governance in banks. The new Law on Bank also gives a comprehensive definition of the system and procedures of supervisory function, the principles of consolidated supervision and the terms and conditions for the operations of financial institutions, and the like.

The main objectives that the proposed law wishes to achieve are the following:

- Provide legal prerequisites for expansion of banking market, including the introduction of foreign bank branches that does not have a status of legal entity in the banking system,
- Promote and develop solutions from the existing law, and
- Create legal background for gradual transition towards Basel II

The proposed amendments to the current Law on Banks in its volume and by its nature are such that the Law on amendments to the Law on Banks could not adequately encompass all of the proposed solutions.

#### **COMPLIANCE WITH EUROPEAN LEGISLATION AND CONFIRMED INTERNATIONAL CONVENTIONS**

The basics for the drafting of the proposed Law on Banks represented the following EU Directives relevant for the banking sector:

- Directive 2006/48/EC of the European Parliament and of the Council relating to the taking up and pursuit of the business of credit institutions, which replaced the Directive 2000/12/EC;
- Directive 2006/49/EC of the European Parliament and of the Council on the capital adequacy of investment firms and credit institutions;
- Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance companies and investment firms in a financial conglomerate.

The proposed law is highly in compliance with the Directive 2006/48, with an exception that refers to the operations of foreign banks in the Republic of Montenegro through branches that do not have a legal status. The mentioned Directive allows operations of the bank in another country without special approval of the country in which a branch is founded. The proposed law prescribes that the prior approval of the Central Bank is required for the operation of a foreign bank branch in the Republic. Since the provisions of the Directive refer to the EU countries, the conditions in Montenegro will be created only after joining EU for this part of the law to comply with the Directive.

Basel Capital Accord (so called Basel II) was legally verified by the Directive 2006/49, and dynamics and conditions for implementation of this Directive are prescribed. The proposed law gives basic elements from the mentioned Directive and simultaneously

legal prerequisites are created so as to provide legal regulation through subordinate legislation acts for full implementation of this directive.

The proposed law is also in compliance with the Directive 2002/87, which governs the supervision of banks and banking groups on consolidated basis.

## **RATIONALE TO THE BASIC LEGAL INSTITUTES**

The proposed law on banks contains 181 articles that are grouped in 11 chapters: General Provisions (articles 1 through 20), Granting a License and Approvals (articles 21 through 28), Corporate Governances (articles 29 through 41), Organizational Parts and Restructuring (articles 42 through 46), Bank Performance (articles 47 through 92), Accounting, Auditing and Reporting (articles 93 through 104), Supervision of Banks and Other Parties (articles 105 through 145), Operation of Foreign Banks in Montenegro (articles 146 through 155), Financial Institutions and Persons Involved in Credit and Guarantee Operations (articles 156 through 171), Penalty Provisions (article 172), and Transitional and Closing Provisions (articles 173 through 181).

### **I. GENERAL PROVISIONS**

This chapter of the proposed law defines the scope and objectives of the law, operations the bank can be involved in and the conditions for founding a bank that refer to the organizational framework and minimum founder's capital.

Articles 9 through 19 of the proposed law prescribe the conditions for the acquisition of qualified participation in banks, in accordance with EU directives, as well as the procedures if the qualified participation is acquired without prior approval of the Central Bank. These articles also prescribe the mechanisms for prevention parties that have not qualified for acquisition of qualified participation in the bank from having an influence on management and operations of the bank. These provisions also include the obligation of reporting the acquisition of qualified participation without proper approval, the manners and timeframe for the submission of request and the consequences in case of untimely submission of the request and/or its denial. The implementation of the proposed provisions should prevent or significantly reduce the acquisition of qualified participation in the banks without prior approval of the Central Bank which would represent significant instrument for the achievement of preventive supervisory function.

### **II. GRANTING LICENSE AND APPROVALS**

Recent experiences in the implementation of the Law on Banks have shown that the timeframes for the granting licenses (90 days) and approvals (60 days) are too short.

The practices have shown that even after the submission of the application, it is often necessary to obtain additional data and information required for the proper decision-making on the application and to verify certain facts included in the supporting documentation. This requires longer period particularly when the information is about foreign founders. Due to the aforementioned, the new law proposes timeframe for the

decision-making for granting the license to be 180 days, which is the most frequent timeframe in other legislations and 90 days for the granting of approvals.

The proposed law (article 24) mentions the reasons for the denial of license, which facilitates Central Bank to make decision of application for granting the license and, on the other hand, it provides legal safety to the founders in the procedure of licensing a bank.

### **III. CORPORATE GOVERNANCE**

Provisions of the proposed law with respect to the corporate governance significantly differ from the provision of the current law that governs the management in banks.

Bearing in mind the OECD principles for corporate governance and possible models those principles are offering, it has been estimated through the analysis of potential solutions that for the banking structure and general environment in which Montenegrin banks are operating the most adequate model is so called “unicameral” model. The provisions of the new law with respect to the corporate governance are prepared in accordance with this model.

Based on the proposed solutions, besides Shareholders’ Assembly, which competencies have not been changes, there are board of directors, audit committee and executive directors in a bank.

Board of Directors is composed of at least five members, of which at least two members must be persons independent from bank. The purpose of the proposed rule is to reduce the possibility of conflict of interest that individual members of the board of directors as a shareholders of the bank may have and at the same time have the obligations to operate in the best interest of all shareholders and the bank as a whole.

The obligations of the Board of Directors are prescribed in details by article 33 of the proposed law. In relation to the existing solutions, the powers and responsibilities are increased and the responsibility of the Board of Directors is intensified particularly in the area of risk management.

Bearing in mind the significance of this function and international standards, it has been prescribed that the members of the Board of Directors are elected with the prior approval of the Central Bank, and the reasons for the denial of the granting the approval are prescribed as well.

Members of the audit committee are elected by the board of directors. The majority of the members are persons that are not connected with a bank, which creates higher objectivity in the achievement of the prescribed authorities. The intention of the creation of audit committee is not to be the body of a bank that has supervisory function over board of directors operations, since the practices have shown that such concept does not give satisfactory results, but the audit committee should have advisory role achieving it through giving the opinion, evaluations and recommendations that should contribute to better functioning of internal controls in a bank.

In relation to the existing concept of governance and management in banks with general director and directors of organizational parts, the proposed organization should provide more efficient and more effective execution of these operations. By defining key areas of bank operations and establishing direct responsibility of executive directors, the current hierarchy system which is too heavy and slows down the work process as well. In addition, high number of responsibilities often brings to the heavy identification and spreading of individual responsibility of all participants in work process. The proposed solution strengthens the responsibility of the person that directly manages key areas of bank operations, which should represent an improvement in relation to the current solutions under which it is difficult to delegate and identify responsibilities of general director and managers of organizational parts.

The responsibility of executive directors is focused on the implementation of rules and procedures of board of directors and risk management in key areas of bank operations they manage.

Clear distribution of powers, obligations and responsibilities in the proposed concept of corporate governance, with adequate coordination of daily operations, which the banks will, depending on their size, complexity of operations and other specifics, independently determine in their internal rules and procedures (bylaws), should contribute to more qualitative corporate governance than the existing model.

Also the proposed law leave the possibility to banks that their board of directors, depending on their size, complexity of operations and other specifics, may form standing or temporary bodies for oversight of risk management in particular areas of bank operations, for proposal of salaries, proposal of selection of particular categories of employees (primarily management), and working bodies for other operations.

#### **IV. ORGANIZATIONAL PARTS AND RESTRUCTURING**

This chapter of the proposed law contains rules of status changes of the bank and it has been significantly expanded in relation to current legal solutions and harmonized terminologically with the Law on Business Organizations. The supporting documentation of the request for restructuring through banks' amalgamations and de-mergers is prescribed in details, as well as the reasons for the denial of such request.

Bearing in mind that the bank amalgamations through the creation of a new bank, and de-merger of a bank result in the new legal entity, in case of making positive decision, the Central Bank passes a decisions on issuing the license to the bank that resulted from amalgamations or de-mergers on founding a new bank and timeframe for deciding is shorter (120 days).

The estimation is that these rules will have significant practical implementation in the forthcoming period, since the restructuring of a number of banks through mergers and amalgamations is expected due to the current structure of banking sector.

## **V. BANK PERFORMANCE**

Significant changes have been made in this chapter of the existing law on banks in accordance with the international documents that refer to risk management in banks.

The provisions of risk management of the proposed law create legal prerequisites for complete implementation of prevailing standards in the areas of risk management, opening at the same time legal space for implementation of standards from new documents (Basel II) without making amendments to this law.

The provisions on risk management system have been inserted in the law, which are equal to all types of risks (articles 47 through 54). These provisions govern the obligation to continuously manage risks in the banks, establish risk management system and its elements (appropriate strategies for risk management, adopted policies and developed processes for risk management, clearly defined powers and responsibilities for risk management, efficient and reliable information technology system, adequate contingency plans and stress testing).

The proposed law establishes risks that banks have to manage and gives the basic characteristics of the risks the banks encounter in their operations. The regulation of the Central Bank will prescribe the minimum standards for individual types of risks as categories that experience frequent changes through the development of financial market and international practices.

The Central Bank prescribes standardized methodology for the calculation of capital requirement for credit risk, with the possibility of using debtors rating established by reputable external institutions or export credit agency. Simultaneously, the banks have the possibility to use internal debtors' ratings for the calculation of capital requirements for credit risk, which creates the possibility to implement IRB approach (articles 59 through 61). Similar solutions are given for the calculation of capital requirements for market and operational risks (article 63 and 65). These rules enable gradual transition towards Basel II.

The provisions of the proposed law that refer of capital adequacy completely meet requirements of Basel Capital Accord (Basel I), and at the same time provide adequate regulatory framework for gradual implementation of the new directive of capital adequacy (Basel II).

The significant innovation is in the manner of calculation of capital adequacy as relative indicator of bank exposures to risks. Current regulation only deals with credit risk, so capital adequacy is observed through the ratio of risk based capital and credit risk weighted assets. Bearing in mind that own funds of the bank must always be at the level that may absorb losses resulted from all risks and not only from credit risk as a dominant one, article 70 of the proposed law prescribes that the solvency ratio represents the percentage of own funds to total sum of risk weighted assets for credit, market and operational risks.

The same article prescribes minimum solvency ration of 10%. Recent experiences and the analyses of our banking sector and environment in which the banks operate have shown that capital adequacy level of 8% is too low and does not provide the amount of capital that may represent a good guarantee that the bank will absorb losses against

capital and meet its obligations to depositors and other creditors. It should be born in mind that capital adequacy ratio of 8% was determined based on statistical data from developed and stable western European banking market, and that EU directives authorize national authorities of those countries to establish even higher percentage of the aforementioned.

The proposed law (articles 77 through 83) contains certain restrictions and limitations in bank operations. These provisions refer to the limitation of undesirable concentrations and achievement and misuse of dominant position of participants at market of banking products and services, restrictions in operations with bank related parties, purchase or pledging of particular elements of own funds and limitations in dividend payments to shareholders where such payment would negatively influence on parameters of bank performance.

Articles 83 through 86 of the proposed law refer to the banking secret. These articles prescribe the data and information that represent banking secret, persons that these data can be communicated to and their obligation to keep obtained data. These rules represent the balance between the requirement to completely protect data on bank's client, which contributes to the strengthening of clients' confidence in banks and the strengthening of banking sector, and the requirement of communicating these data, under strictly defined conditions, to other persons when there are clear and justified interests of those persons.

The proposed law contains rules on consumer protection (articles 87 through 92), which determine particular obligations of banks for the purpose of protection of their clients and in accordance with internationally accepted practices. These rules include minimum obligations of the bank that refer to informing the clients, calculation and reporting of effective interest rate on loans, restrictions for conditioning a client and obligatory procedure in case of client's objection.

Also, additional protection of clients is established which is provided to them through banking ombudsman as independent party that acts as mediator in resolution of disputes between clients and bank. This should contribute to more efficient resolution of disputes between banks and clients and reduction of the number of lawsuits from this area.

## **VI. ACCOUNTING, AUDITING AND REPORTING**

The proposed law substantially strengthens the external audit function. Besides the audit of the financial statements of the bank, the obligation of external audit of financial statements of the banking groups is included for the purpose of having supervision on consolidated basis.

The cooperation of the auditors with Central Bank in the process of audit of financial statements is prescribed. It represents harmonization with international standards that promote the cooperation of auditors with supervisors during the determination of the areas that should be audited and where the audit disclosed significant irregularities in bank operations during the audit.

Also, as a part of internationally accepted standards, article 100 of the proposed law prescribes that the Central Bank may not accept the external auditor reports if the audit

has not been conducted in accordance with the law, and in that case it may engage other auditor on bank's expense.

In the part of reporting (article 104), banks are required to publicly disclose data on their financial condition and operations, which should be important to the depositors and other creditors when deciding upon business relations with a bank. Additionally, this creates a space for implementation of Pillar 3 of Basel II through the regulation of the Central Bank and internal rules and procedures of banks.

## **VII. SUPERVISION OF BANKS AND OTHER PARTIES**

This chapter contains the manner and the procedure of bank supervision, including imposing of the measures against the banks, as well as the supervision on consolidated basis. The provisions of this chapter of the proposed law are dominantly based on the risk based supervision concept, which is performed through the evaluation of capability in risk management and compliance of operations with the Central Bank laws and regulations.

The types and the procedure of supervision of banks are prescribed in more details in articles 105 through 145 of the proposed law.

The measures imposed against the banks are adjusted to the risk based supervision concept and are taken against the banks in the form of written warning, written agreement of correction of irregularities, order on imposing measures against the bank, resolution on introduction of interim administration in a bank and order on revoking the license. The basics for decision making of the Central Bank on type of measures that will be undertaken against the banks are also determined. Where the measures are imposed through order (article 115 paragraph 1 point 3), the same order serves to determine the amount the bank is required to pay to the Deposit Protection Fund for depositors' protections in order to additionally protect the depositors from the consequences of opening bankruptcy or liquidation proceedings. Also, depending on the responsibility for the condition in which the bank has been found, members of the board of directors and executive directors may be charged for a certain amount that is put aside for the same purposes, which should contribute to more responsible behavior of these persons in execution of their obligations.

Provisions of interim administration in a bank, as significant instrument used for bank rehabilitation in the proposed law (articles 120 to 135) regulate in more details the conditions for introduction of interim administration, rights and obligations of interim administrator, the duration of interim administration and other issues relevant for the interim administration in banks.

The proposed law also contains provisions on the supervision of banks on consolidated basis (articles 137 to 144), which define the manner of supervision on consolidated basis, persons obliged to submit reports on consolidated basis (including members of the banking group that do not belong to financial sector) and performance indicators that banking group as a whole should meet.



### **VIII. OPERATIONS OF FOREIGN BANKS IN MONTENEGRO**

The current Law on Banks does not contain the provisions on operations of foreign banks in Montenegro through its branch operations that have a status of legal person. Therefore, banking legislation is not harmonized with EU rules in this area. After the completion of the reform of banking system and privatization of banks, the conditions have been created to approve foreign banks to operate through branches that will not have the status of a legal person.

The analysis of impact of foreign banks entrance our financial market shows that, with certain limits with respect to the access of foreign banks to our financial markets, and appropriate restrictions in operations and adequate supervision, foreign bank branches may contribute to development and sound competition of financial sector in Montenegro, without jeopardizing the existing banking system.

The proposed law approves entrance our financial market only to the qualitative banks and as prerequisite for issuing approval it is prescribed that the foreign bank must have rating of at least A or its equivalent. In addition, the existence of adequate system of deposit protection in a country of the parent bank is mentioned as prerequisite for the issuance of approval in which the branch will be included as well.

The new law also prescribes the restrictions in branch operations with parent bank (article 153) so as that the branch in any time must have higher amount of liabilities than claims to parent bank i.e. its subsidiaries. This disables the flow of funds from the branch for the parent bank requirements and it disables the endangerment of branch operations that might arise from such transactions.

### **IX. FINANCIAL INSTITUTIONS AND PARTIES INVOLVED IN CREDIT AND GUARANTEE OPERATIONS**

Current experiences on the operations of the financial institutions in Montenegro show that the existing solutions in this area does not need to be materially changed, so the proposed law (Articles 156 through 170) gives the basic elements for the founding, operations and supervision of micro credit financial institutions and credit unions (the terms for founding, allowable activity, restrictions in operations, supervision including measures against those financial institutions, and the like).

Bearing in mind that the performance of credit and guarantee operations by parties other than banks may significantly influence the risk management in banks, it is essential that such parties go through the appropriate process of granting the approval for performing such operations. The Central Bank should have an insight in their operations to the extent which enables it to make an assessment of impact of their operations to riskiness of banks' operations (article 171).

### **X. PENALTY PROVISIONS**

Article 172 of the proposed Law prescribes the actions and/or failures that represent violations sanctioned by the appropriate fines.

Fines for the offenses are prescribed within the limits of general minimum and maximum, which leaves the possibility to the bodies for administrative offences to adjust the fine for the commenced offenses on individual level.

The fines are prescribed for both legal persons and responsible individuals within those legal persons.

#### **XI. TRANSITIONAL AND CLOSING PROVISIONS**

Transitional and closing provisions prescribe the timeframes for the enactment of the subordinate legislation act for the implementation of this Law and timeframes in which the banks are required to harmonize their internal rules and procedures, operation and corporate governance with this Law. It has been estimated that the timeframes set forth in the Law are reasonable for the banks to perform the required harmonization.

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No budgetary funds of Montenegro are required for the enforcement of this Law.