

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 deposits.

4) "credit and guarantee operations" means the operations of issuing deposits.

- 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 participa

- 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,
 -

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.

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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 Prip-003ron

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.

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

- 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:

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;
- 2) decide on the appointment, remuneration and dismissal of the members of the Board of Directors.

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

- 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

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;

- 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,

- 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:

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;

- 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.

- 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;

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

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

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;

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

- 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

- 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

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 appor 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

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;

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

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

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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;

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

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;

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.

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

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

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- 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.

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

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

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

- 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.

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 statements (Article 105).

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.

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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

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

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

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

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

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

