

CENTRAL BANK OF MONTENEGRO
Council of the Central Bank of Montenegro

OPINION
regarding the Draft Law on the Development Bank of Montenegro

I. On 22 July 2024, the Central Bank of Montenegro received the request of the Minister for Finance for submitting the opinion regarding the **Draft Law on the Development Bank of Montenegro**, proposed by 21 members of Parliament.

The Draft Law on the Development Bank of Montenegro regulates the establishment, activity, operations, organisation and the supervision of the Development Bank of Montenegro (Development Bank).

According to the Draft Law, the Development Bank has the status of a legal entity established as a joint stock company, with a view to developing the Montenegrin economy through financial support from this bank through accelerated economic development of Montenegro, improved economic companies' growth, more balanced regional development and competitiveness, economic companies' liquidity, export-oriented production and services, production that reduces import dependence, infrastructure projects, water supply projects, wastewater treatment and environmental protection and other projects of local, regional and national importance.

The Government of Montenegro shall guarantee for the obligations of the Development Bank unconditionally and irrevocably, except for deposits with the Development Bank.

Moreover, the Draft Law stipulates that the founder of the Development Bank is the state of Montenegro, the Government of Montenegro performs all rights and duties of the founder, the founding capital amounts to not less than 90 million euros, and includes the capital taken from the Investment and Development Fund of Montenegro A.D.

Article 9 of the Draft Law stipulates that, *inter alia*, the Development Bank shall provide financial and thus related services, including granting of loans, performing factoring and other forms of receivables and issuing guarantees, ensuring exports against non-market risks, deposit-taking and payment services provision.

In the similar way as the Law on Credit Institutions has regulated credit institutions' operations, the Draft Law regulates requirements for risk management, establishment of a management system and internal control system, capital requirements, restrictions of operations, client protection, accounting and auditing of financial statements, the governance of the Development Bank, financing and publicity of the work, and reporting to and supervision of the Development Bank's operations by the Central Bank of Montenegro (CBCG).

The Development Bank of Montenegro will be established by transforming the Investment and Development Fund.

As indicated in the Draft Law's rationale, with a view to fostering a balanced, sustainable economic development, competitiveness and liquidity of economic entities, the inclusion of vulnerable segments, and finance infrastructure projects, the transformation of the Investment and Development Fund of Montenegro into the Development Bank is intended to implement additional incentives for the Montenegrin economy's competitiveness through intensifying access to grants available through EU funds that would also become part of the support for the Montenegrin economy, the creation of new financial instruments modelled on state development banks in the EU member states, and strengthening the Montenegrin companies' export potential through insuring export against non-market risks.

II. At its meeting of 6 August 2024, the Council of the Central Bank of Montenegro discussed the Draft Law on the Development Bank of Montenegro and issued the following

O P I N I O N

1. The existence of an institution, i.e. the Development Bank, which will be engaged in financing development and infrastructure projects, encouraging the establishment, development and sustainability of micro, small and medium-sized businesses, and large companies and entrepreneurs, ensuring exports against non-market risks, including support for the green economy, etc., is crucial for valuing growth potential, increasing the competitiveness of Montenegrin products and more rational management of national resources. Moreover, improving the institutional framework with the Development Bank will create a systemic approach for more balanced regional development and the long-term sustainability of the Montenegrin economy.

Examples of countries from the region and the European Union in which such institutions exist point to the justified operations of the development bank.

The Central Bank of Montenegro (hereinafter: the CBCG) supports the establishment of the Development Bank.

2. However, in addition to the aforesaid, the CBCG deems it important to highlight certain provisions within the Draft Law on the Development Bank of Montenegro (hereinafter: the Draft Law) that should be further reviewed before the enactment of this legislation, as indicated below.

a) Deposit-taking Activities

Article 9 paragraph 1 item 3 of the Draft Law stipulates that the Development Bank will engage in deposit-taking activities.

Furthermore, provision of Article 5 paragraph 3 of the Draft Law stipulates that its establishment, operations, and supervision **will not be governed by the laws and regulations applicable to the establishment, operations**, and supervision of credit institutions, except for the provisions specified in this Law.

In light of the above, we note that the recital of the Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (the so-called CDR) **states that the scope of measures should therefore be as broad as possible, covering all institutions whose business is to receive repayable funds from the public, whether in the form of deposits or in other forms.** The exemptions to the scope of the Directive's application have been agreed in advance between the Member States and they have been regulated in its Article 2, which contains the list of all institutions by individual Member States to which the provisions of the Directive do not apply. These mostly include credit unions, development banks and export banks, which liabilities are guaranteed by the Member States themselves. Considering the aforesaid, the CBCG believes that it is essential to obtain the opinion from the European Commission regarding the deposit-taking activities of the Development Bank.

Additionally, there is a concern that granting the Development Bank the authority to take deposits may undermine one of the fundamental principles governing the operation of government development financial institutions, namely the principle of non-competition with the banking sector.

If the Development Bank would take deposits from clients (natural and legal persons) and place them, *inter alia*, as loans as credit institutions do, and thus perform the principal core operations of the credit institutions, this institution would be privileged compared to credit institutions which must meet all relevant regulatory requirements and consequently pay fees for compensations to the Deposit Protection Fund and the Resolution Fund in accordance with the Law. Granting a privileged position to an institution subject to less strict prudential requirements than those for other financial market participants could jeopardize the stability of the financial system, especially given its size and considering that it is being formed by transforming the Investment and Development Fund which, as of 30 June 2024, had assets larger than those of six credit institutions combined, four of which are systemically important.

Moreover, the CBCG finds it necessary to point out that the Draft Law does not clearly define the nature of the deposits (whether from the public, government authorities, or other entities), but instead its Article 9 paragraph 5 specifies that the receipt, management, and protection of deposits shall be regulated by the Government of Montenegro.

In line with the above, these relations must be subject to a law, and not the Government's bylaw, especially considering that such significant activities may have negative implications on the depositors' interests. This is primarily since Article 4 of the Draft Law

stipulates that the government shall guarantee for the obligations of the Development Bank, **except for deposits**, thus, the lack of guaranteeing deposits in this Law raises concerns about depositor protection which, we reiterate, may not be subject to the Government's bylaw, but subject to the Law solely.

In light of the above, it raises the issue whether depositors who may not be adequately informed would be able to differentiate the Development Bank from other credit institutions, in which they will deposit funds motivated by higher interest rates, led by the fact that this is a state credit institution where their deposits are guaranteed, not knowing that they neither have deposit protection rights under the Deposit Protection Law, nor that their deposits will be guaranteed by the Deposit Protection Fund.

On the other hand, as a less-regulated institution with a founding capital of not less than 90 million euros, which exceeds the total capital of eight credit institutions as of 30 June 2024, the Development Bank may significantly impact the liquidity of credit institutions.

Considering the mission of development banks, which are established by the states where they operate and raise funds under more favourable conditions for the purpose of economic development, allowing funding from citizens whose funds are not secure or protected by the law deviates from the mission of development banks and from deposit insurance standards.

b) Payment Services Provision

Provision of Article 9 paragraph 1 item 4 of the Draft Law stipulates that the Development Bank will provide payment services in accordance with specific legislation. In this context, the CBCG highlights that EU regulations governing payment services, specifically the Payment Services Directive (PSD2), which is a "full harmonization directive" (i.e. the directive the application of which Member States may not limit nor they may introduce provision other than those determined therein) **explicitly defines the providers of payment services, with no additional entities**. The Directive leaves no room for additional entities like the proposed Development Bank to be considered as payment service providers.

The Payment System Law, which is harmonised with the aforesaid Directive, payment services in Montenegro may be provided by entities listed in its Article 4 paragraph 1:

- 1) a bank and other credit institution established in Montenegro;
- 2) a payment institution established in Montenegro;
- 2a) registered account information service provider with head office in Montenegro;
- 3) an electronic money institution established in Montenegro;
- 4) a branch of a third-country credit institution established in Montenegro;
- 5) the Central Bank;
- 6) the State of Montenegro and local self-government units when not acting in their capacity as public authority.

We also refer to Article 80 paragraph 3 of the Payment System law, which stipulates that a payment institution shall perform payment transactions using funds received from payment service users for the purpose of providing payment services via transaction accounts to be opened with banks.

In light of the above, we also note that under Article 5 of the Law on the Prevention of Illegal Business, legal entities and entrepreneurs are required to open a bank account as prescribed by the law, maintain monetary assets in that account, and perform fund transfers through that account, including the payment of taxes, surtaxes and contributions on calculated gross wages, as well as net wages and salaries to employees. Consequently, the Development Bank would not be allowed to perform these payment services.

In addition, concerning the payment services provision by the Development Bank, we note that the comparative experience with development banks in the region shows that there is no legal provision for the provision of payment services by development banks.

c) Client Protection at the Development Bank

Provision of Articles 38 to 44 of the Draft Law regulate the calculation and disclosure of the effective interest rate of credit institutions, variable interest rates, client protection, and procedures for complaints and out-of-court dispute resolution.

According to the proposed solution (Article 44 of the Draft Law), the CBCG is responsible for out-of-court dispute resolution. However, this law does not regulate the method of out-of-court dispute resolution, as is stipulated for clients of credit institutions under the Law on Credit Institutions (Article 219). Given that the Law on Credit Institutions does not apply to the Development Bank, this issue remains unresolved and unregulated.

d) Governance of the Development Bank

The Draft Law establishes a two-tier governance system, comprising the Assembly, Supervisory Board, and Management Board of the Development Bank. The Supervisory and Management Boards are the governing bodies of the Development Bank.

Articles 55 and 65 of the Draft Law also stipulate that members of the Supervisory and Management Boards must meet certain fitness criteria such as good reputation, honest and fair conduct, independent judgment, relevant professional knowledge, and experience and the like, while Article 65 paragraph 2 provides that the Management Board must, subject to prior consent of the Supervisory Board, adopt an appropriate policy for the selection and assessment of individual members of the Management Board, as well as for the Management Board as a whole, **which the Development Bank is required to implement.**

However, the Draft Law does not include a provision for further regulation of these criteria, the assessment process, or who is to be responsible for assessing the suitability of members of the Supervisory and Management Boards.

Given the proposed activities of this financial institution, we emphasize the importance of preventive oversight by the CBCG and consider it necessary for the CBCG to participate in the process of appointing members of the Bank's governing bodies. This is particularly important given that the Development Bank has all the characteristics of a commercial bank and therefore, the CBCG's expert and professional approach in assessing the fulfilment of these conditions (as is the case with commercial banks) is crucial for the protection of all creditors/depositors and the budget of Montenegro.

d) Funding and Public Accountability of the Development Bank

Articles 68 and 69 of the Draft Law establish the sources of funding for the Development Bank's operations and their use, as well as the public accountability of the Development Bank. Article 69 paragraphs 2 and 3 stipulate that public accountability is to be achieved through the submission of operational reports and annual financial statements, accompanied by an auditor's opinion, to the Government for review, as well as by disclosing the conditions for utilising the Development Bank's funds.

Given the significance of establishing and operating the Development Bank and its potential impact on further economic development, competitiveness, liquidity of business operators, inclusion of vulnerable segments, and the funding of infrastructure projects, the CBCG believes that the Draft Law should provide for additional disclosure of non-confidential business data and information in the interest of greater transparency and better client and public awareness.

f) Reporting and Supervision of the Development Bank's Operations

Articles 70 to 75 of the Draft Law establishes the obligation for the Development Bank to submit accurate and complete reports and other data to the CBCG in the form, manner, and timeframe prescribed by a separate regulation of the Central Bank. It also stipulates the CBCG's authority to supervise the Development Bank's operations, as well as the authority to issue a written warning in case of irregularities in the Development Bank's operations.

Furthermore, Article 71 paragraph 2 of the Draft Law stipulates that in supervising the operations of the Development Bank, the CBCG assesses the compliance with this law and regulations adopted pursuant to this law. To achieve a clearer formulation, we propose that the Article 71 paragraph 2 of the Draft Law includes *reference to the CBCG regulations* instead of *regulations adopted in accordance with this law*. We also propose that the provisions of Article 75 paragraph 2 item 2 the Draft Law, which establish

irregularities in operations based on which the CBCG may issue a written warning, be expanded to include the regulation under Article 33 of the Draft Law.

The CBCG also highlights that the Central Bank of Montenegro Law specifies the CBCG's responsibility of maintaining a **credit registry of indebtedness** of individual entities with the entities supervised by the CBCG and other entities determined by the law or a CBCG regulation. In this context, the Draft Law should also establish the obligation for the Development Bank to submit reports to the Central Bank for the credit registry, with the deadlines and content to be prescribed by the CBCG.

3. In view of the above, the CBCG believes that it is necessary to further review the provisions of the Draft Law on the Development Bank of Montenegro and, as previously indicated, obtain the opinion from the European Commission to ensure compliance with European standards.

COUNCIL OF THE CENTRAL BANK OF MONTENEGRO

No.: 0101-6230-2/2024
Podgorica, 6 August 2024

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