

**Standard Summary Project Fiche – IPA 2008 centralised National and CBC
Programmes
Strengthening the Regulatory and Supervisory Capacity of Financial Regulators**

1. Basic information

1.1 CRIS Number: 2008/020-316

1.2 Title: Strengthening the regulatory and supervisory capacity of the financial regulators

1.3 ELARG Statistical code: 03.09

1.4 Location:
Podgorica, Montenegro

Implementing arrangements:

1.5 Contracting Authority:
Delegation of the European Commission

1.6 Implementing Agency:
Delegation of the European Commission

1.7 Beneficiaries (including project manager contact details):
Central Bank of Montenegro (CBM) - Ms Radica Zekovic, Director Phone: +382 81 403 191 e-mail: radica.zekovic@cb-cg.org
(Contact point: Marija Labudovic, marija.labudovic@cb-cg.org).

Securities and Exchange Commission (SEC) - Mr Zoran Djikanovic, President Phone +381 81 231 525 e-mail: zdjikanovic@scmn.cg.yu
(Contact point: Neda Iovic, nivovic@scmn.cg.yu)

Insurance Supervision Agency (ISA) - Vladimir Kavaric, Director Phone: +382 442 824, e-mail: vkavaric@cg.yu
(Contact point: Natasa Popovic, natasa.popovic@ano.cg.yu)

1.8 Overall cost (VAT excluded):
€1 200 000

1.9 EU contribution:
€1 200 000

1.10 Final date for contracting:
Two years from the conclusion of the Financing Arrangement

1.11 Final date for execution of contracts:
Two years after the final date for contracting

1.12 Final date for disbursements:

One year after the final date for execution of the contract

2. Overall Objective and Project Purpose

2.1 Overall Objective

To create conditions for long term economic stability and growth by strengthening the regulatory and supervisory framework of the capital and financial markets

2.2 Project purpose

Improve institutional and regulatory capacities of the financial sector regulators to supervise financial market and institutions in line with EU *acquis*

2.3 Link with the AP/NPAA/ EP/SAA

The **European Partnership** calls on Montenegro to: “strengthen the regulatory and supervisory framework for financial institutions and markets, consistent with current EU practices, in particular concerning the banking sector” and to “reinforce cooperation with the home supervisors of foreign banks with significant subsidiaries in Montenegro, including by concluding cooperation agreements.”

Montenegro is also expected to “ensure efficient implementation and coordination of the anti money laundering legislation and strengthen the financial intelligence unit.”

The **SAA** stresses the importance of further determined action and sustained progress in strengthening administrative capacity and in the area of rule of law, including the fight against organised crime and corruption.

2.4 Link with MIPD

According to the **MIPD 2008 - 2010** support will be provided for developing the regulatory environment and strengthen the supervisory authorities in the fields of banking, insurance and capital markets. This should result in the banking, insurance and capital markets being in line with the EU *acquis*; the introduction and implementation of good practices in financial supervision; and putting in place the institutional framework for financial regulation and the fight against money laundering and organised crime.

2.5 Link with National Development Plan

N/A

2.6 Link with national/ sectoral investment plans

N/A

3. Description of project

3.1 Background and justification

The Montenegrin financial system is undergoing a significant transformation, with major increase in the volume of transactions (e.g. total credit tripled in a couple of years), the emergence of new financial products, and the establishment of new institutions. While the increased depth and sophistication of the financial sector is a positive development, this must be accompanied by the strengthening of the regulatory framework, in order to ensure stability.

Strengthening a financial market and enhancing financial stability and harmonisation within the European financial market environment requires regulatory and legal measures that also include preventing criminal behaviour, damaging the reputation of the market participants, the financial market as well as of the whole economy as such.

Money laundering is considered to be a problem for the economy of Montenegro, especially as it is a small open economy, it has many neighbouring countries which are characterised by weak financial and anti crime institutions and it can be used as a safe haven for investments, due to its approximation towards the EU and its use of the euro as legal tender.

The fight against money laundering and organised crime is one of the concerns of the EU when it comes to appreciating Montenegro's respect of the SAA and a possible future EU membership.

Three institutions are in charge of the supervision of the financial system: the Central Bank, the Securities and Exchange Commission and the Insurance Supervisory Agency. Their organisations and functions are described in Annex 3 of this fiche.

The process of EU accession is a major challenge for the Montenegrin supervisors. Future EU membership of the country, and as a consequence ESCB (European System of Central Banks) membership requires that the CBM identifies and reduces the existing deficiencies, including lack of specific knowledge and skills for new operations, and existing regulation not fully aligned with the *acquis communautaire*. The 2006 IMF/World Bank Financial Sector Assessment Programme (FSAP) and subsequent EU expert missions concluded that the CBM had adopted a number of relevant international standards. It also identified the need to develop capacity in the area of consolidated supervision and effective interaction with banking sector regulators in other countries. This is important because the recently adopted Law on Banks allows branches of foreign banks to operate in Montenegro. In addition, further efforts must be invested in improving the internal audit systems in the supervised banks.

The SEC, in turn, will need assistance in dealing with challenges of a rapidly developing and very lively stock market, and in educating consumers to understand market risks and make informed decisions on their investments. Therefore, the regulatory and supervisory skills of its staff need to be upgraded.

The ISA is a new institution, whose staff will thus require continued education and training, manuals for supervision procedures, introduction to new EU concepts and assistance in bringing Montenegrin laws and regulations in line with EU law and best practice

Montenegrin financial regulators have received limited and rather fragmented donor support for institution building in the field of financial sector regulation and supervision. On the other hand, the EU has harmonised regulation in this area over the last years in such a way that same rules are implemented by the different supervisors. Therefore, capacity building and training activities in the future need to be common to the staff of the supervisors involved and/or staff members and executives responsible for internal audit and compliance in the supervised entities. In addition, future assistance must take into account that the Montenegrin economy uses the Euro as legal tender and is surrounded by countries with weak financial institutions, which makes it particularly vulnerable to money laundering and organised crime.

Consequently, support is needed to improve the functioning of the financial authorities in the following areas:

1. Banking supervision operations and in bringing them in line with the EU *acquis communautaire* and best practice
2. CBM capacity to ensure financial stability, among else, through development of cooperation with other financial regulators
3. SEC operations and in bringing their regulatory activity in line with the EU *acquis communautaire* and best practice

4. ISA capability to understand and transpose relevant EU *acquis communautaire* and best practice

5. Combating money laundering and financial crime

3.2 Assessment of project impact, catalytic effect, sustainability and cross border impact

An improved regulatory and supervisory framework in line with EU legislation and standards will have a significant positive **impact** on the development of a sound and stable financial system on Montenegro, something which has a fundamental impact on the sustainable economic expansion. It will also have a positive impact on the well functioning of the EU financial markets.

The improved functioning of the supervisors will act as a catalyst for the functioning of all private commercial, financial and capital market institutions, because they will be forced to improve their standards up to the level of the international standards concerning solvability, liquidity and risk monitoring. The improved fight against money laundering will contribute to a reduction of organised crime.

The improved functioning of the supervisors will have significant positive **cross border impact** in reducing money laundering and other financial crimes.

A major risk to the sustainability is the rather high turnover of staff of the CBM, SEC and ISA, which remuneration packages cannot match those of the private sector.

3.3 Results and measurable indicators

Expected results and their related measurable indicators are:

1. EU *acquis communautaire*, other international rules and best practices in financial regulation and supervision are introduced and effectively implemented, with emphasis on money laundering and other forms of financial crime.

Indicators

- Laws, regulations and operations of financial supervisors aligned with EU Directives and good practices in accordance with NPI timetable;
- Assessment of implementation of IOSCO principles and objectives of securities regulation;
- CBM – preparation and implementation of the new CAD;
- CBM – transposition and implementation of Directive on Financial conglomerates;
- Timetable for transitional measures developed by Q4 2011;
- Reports and data for market users in accordance with new legislation by Q4 2011;
- Montenegro's ranking on internationally comparable scales measuring money laundering, corruption and investment climate is improved¹, if available in the future, the assessment of Montenegro by the FATF (Financial Action Task Force).

2. Improved capacity and operation of the CBM, SEC and ISA in accordance with EU standards;

Indicators:

- At least 30% of staff of beneficiary institutions (CBM, SEC, ISA) is trained 30 days on site;
- New and/or improved operational manuals and supervision guidelines produced

¹ In 2007 Transparency International Corruption Perception Index report, Montenegro ranked 84 on 179 countries surveyed. According to World bank report on investment climate

within first 12 months of project implementation for each of the three institutions;

- New on-site and off-site supervision procedures and standards based on best EU practices adopted and implemented.

3. Financial regulators cooperate and coordinate their activities in order to ensure financial stability and fight money laundering and other forms of financial crimes.

Indicators:

- Permanent cooperation framework ("financial stability committee" type) is established between financial regulators within three months upon project inception to ensure financial stability;
- Financial regulators cooperation framework is fully operational and implemented by end of the project
- Process for the production of annual Financial Stability report at the level of EU standards are defined and adopted;
- At least one Financial Stability report at the level of EU standards is produced by end of the project.
- The rules regarding anti money laundering are more effectively applied and the EU 3rd Directive on that matter is implemented;

3.4 Activities

Component 1 : Activities related to support the CBM Banking Supervision and Financial Stability function:

The new Law on Banks provides a broad framework and high level principles, and entrusts the CBM with authority to issue secondary legislation dealing with concrete implementation aspects of the Law. Therefore, advisory support and various forms of training will be provided to help CBM prepare the corresponding secondary legislation and develop new procedures and manuals for their implementation, including:

A. Preparation of the New Decision on Capital Adequacy and Capacity Building for Its Implementation.

1. Selection of a dominant approach towards the risk management, elaboration of discretionary rights in the process of applying specific approaches from EU Directive, formulation of regulation for recognizing rating agencies, preparation of a quantitative impact study;
2. Introduction of CAD for Market Risk: general industry problems, difficulties, support problems, common mistakes (banks, supervisors), quantitative impact on the capital ratio, standardized approach vs. internal models (impact of the use of internal models);
3. Introduction of CAD for Operational Risk: general industry problems, difficulties, support problems, common mistakes (banks, supervisors), quantitative impact on the capital ratio;
4. Training of a team of supervisors with specializations in specific approaches, with a special emphasis of training on assessment of IRB approach;
5. Elaboration of reporting system in compliance with ECB and Pillar II of Basle II requirements.

B. Research on applicability of EU Directive on Financial Conglomerates on the character of supervision on a consolidated basis.

1. Review of harmonization of existing regulation on supervision on a consolidated basis with EU Directive and proposing the character of the regulation on financial conglomerates (law vs. decision, i.e. bylaw);
2. Definition of the content and character of financial conglomerate and determination of standards for a direct control and financial reporting on a consolidated basis;

3. Training of supervisors for performing the supervision on a consolidated basis.

C. Other domains

1. Assistance in the implementation of the best practices in the field of the so-called Pillar II and Pillar III (Supervisory review process and Disclosure) provisions of the Basle II accord as they have been introduced in the CRD Directive. Relevant CEBS (Committee of European Banking Supervisors) Guidelines are to be included, such as the Guidelines on Supervisory Disclosure, the criteria & methodologies used by supervisors in the Supervisory Review and Evaluation Process (SREP), the minimum requirements for Institutions own Internal Capital Adequacy Assessment Process (ICAAP);
2. Assistance in the implementation of best practices in the field of the requirements resulting from the MIFID Directive and Regulation i.a. in the field of compliance, outsourcing of activities, operational requirements for banks providing investment services. In this field there is a cross-over in the assistance to be provided to both CBM and SEC, which can lead to important synergies;
3. Assistance in the implementation of best practices in the field of the Anti Money Laundering Directive, for example EC Regulation 1781/2006 of 15 December 2006 on the measures to be taken in the field of the necessary information on the initiator of fund transfers.

Component 2: Activities related to Securities and Exchange Commission

Advisory support and training will be provided, as follows:

A. Developing regulatory and supervisory Skills

1. Developing procedural manuals on the principle-based supervision and risk-based and proportionate approach to regulation and supervision including following:
 - a. About procedure of “systemic oversight” supplementing traditional, one-firm-at-a-time oversight with more systematic inquiries;
 - b. enforcement of international standards of supervision of market participants;
2. Designing and delivering internal and external training for SEC staff, focusing on the regulatory and supervisory functions of the SEC including following:
 - a. performing control and supervision of voluntary pension fund management companies and voluntary pension funds;
 - b. performing control and supervision of collective investment schemes – open end and close end investment funds;
 - c. Performing of broker–dealer supervision, licensing requirements, key compliance activities, etc.
3. Preparing working materials (Q&A – Questions and Answers – and workflow plans) and examinations for new employees;
4. Designing and developing internal procedures for optimising the SEC’s collection and use of management information

B. Preparing for the EU Financial Services Action Plan (FSAP)

1. Assistance in transposing all relevant EU directives such as:
 - Directive 2002/47 FSAP financial collateral arrangements
 - Directive 2003/6 FSAP insider dealing market manipulation
 - Directive 2003/71 FSAP prospectuses
 - Directive 2004/109 FSAP transparency
2. Developing and delivering targeted short term training for SEC staff on the relevant European measures to be transposed including following:
 - Cross-border access to trading venues and potential to increase competition and

- decrease the costs of trading;
 - Practical constraints arising from the inter-operability of national clearing and settlement systems.
 - Regulatory and legislative co-operation to facilitate a supra-national settlement agency and cross-product netting as between different clearing houses;
3. Identifying and exploiting appropriate opportunities for longer term training for SEC staff, including secondments to national and supranational regulators including following:
- New EU directives in this filed particularly: MiFID, Transparency and Prospectus Directive;
 - Mutual recognition of securities offerings;
 - “Remote membership” of exchanges, in which a financial intermediary licensed in one jurisdiction is permitted to be a member of an exchange in another without additional formalities in the exchange's jurisdiction.
 - Exemptions for “qualified investors” regarding offerings restrictions, conducts of business rules and licensing requirements;

C. Developing Financial Awareness of Capital market participants in Montenegro

SEC shall be assisted to develop and promote a consumer protection strategy, aimed at improving the financial awareness of capital market participants in Montenegro. The strategy would target specific groups of participants, including the young, the elderly, members of ethnic minorities, women, and workers, and increase their capability to understand investment risks and rewards and make informed decisions.

Component 3 Activities related to the Support to the Insurance Supervision Authority

This support will include:

1. Assistance in transposing all relevant EU directives with direct or indirect impact on operations of insurance companies.
2. Training ISA staff to understand and apply new concepts introduced by the EU legislation Solvency II, such as:
 - Understanding, quantitative analysis and control of the identified risks arising from each company’s management of specific assets and liabilities
 - Present value approach of all contractual components of the insurance policies in force: market consistent admitted assets and technical liabilities valuation, including embedded options, costs charge and risk or service margins
 - Detailed impact on accounting procedures originated by all the new approaches listed in the previous points, in accordance with the IFRS rules.
 - Set up of a computerized statistical analysis process of all the actors present on the insurance market, usually described as an “early warning statistical tool”.
 - Staff training at reacting immediately to a pre-set alert signal.
 - The process to be set up in the ISA, in order to authorise internal models proposed by insurance companies aiming at a reduced capital base as compared to the standard approach of their SCR (solvency capital requirement)
 - The process to decide on the amount of capital add-on to be required from one specific insurance company involved in risky underwriting (such as aggressive or blind rating, or abrupt change in market conditions making the policies in force original rating outdated).

Component 4: Activities related to the prevention of money laundering, terrorism financing and other forms of financial crime

The Law on Prevention of Money Laundering and Terrorism Financing (and the 3rd Directive still to be implemented with the extended risk based approach) includes the obligation for financial supervisors to control the reporting requirements of all financial and capital market actors to the Administration for the Prevention of Money Laundering. Due to the constant changes of the regulations in this area, a training programme will be designed and delivered to the employees of the supervisory institutions and, as appropriate, to the employees of financial and capital market agents.

A strong public education and information campaign, aimed at educating all staff of regulatory and supervised institutions and the general public on prevention of money laundering, terrorism financing and other forms of financial crime is prepared and implemented in cooperation with NGOs and media.

3.5 Conditionality and sequencing

Full commitment and support is required of the supervisory institutions and the government, including their readiness to establish and take active part in a Steering Committee that will coordinate the implementation of the technical assistance project.

The beneficiary institutions should in particular:

- Appoint the counterpart personnel
- Appoint the relevant staff to participate in capacity building and training activity in accordance with the approved training programme
- Allocate working space and facilities

In the event that these conditions are not met, suspension or cancellation of project will be considered.

3.6 Linked activities

USAID/Bearing Point has been the major provider of technical assistance to CBM since its establishment (approx. €3 million), but this support is being phased out.

CBM also benefited from support of various European central banks (among them, Deutsche Bundesbank, Banque de France, Czech National Bank, Bank of England, National Bank of Poland, Swiss National Bank, De Nederlandsche Bank), the Federal Reserve Bank of New York and the IMF, but on a small scale basis (total approx. €1 million).

USAID/Bearing Point also provided short term assistance to the SEC during the very early stage of its operations (approx. €0.3 million) and is now supporting the creation of the ISA through a project whose completion is expected in October 2008 (€0.2 million).

3.7 Lessons learned

Studies and lessons of experience show that the more integrated financial markets are, the more efficient the allocation of economic resources and long-run economic performance will be. Well-functioning financial markets influence the prosperity of citizens and businesses, and are the motor for growth and jobs. The value of savings and pensions, the cost of mortgages and the cost of capital are ultimately determined in financial markets. Deep, liquid, dynamic financial markets will ensure the most efficient allocation and provision of capital and services throughout the economy.

In Europe, significant progress has already been made towards an integrated, open, and more competitive and efficient financial market. However, much remains to be done to improve national regulations and supervisory practices and standards, which need to converge across

Europe. Market participants should be allowed to buy and sell financial instruments freely across borders; the freedom to raise capital in other countries on the basis of domestic financial disclosure documents; and the freedom for financial institutions to provide services to EU consumers on the same terms and conditions as they do domestically. Therefore, EU policy and action are directed at enhancing competition and choice, delivering efficiency gains, fuelling investment and facilitating job-creation.

Another important lesson learned is the need for increased awareness and direct involvement of citizens in financial issues. In order to promote good investment choices –e.g.. for pensions - it is essential to increase transparency and comparability and to help consumers understand financial products. Consequently, it is important to integrated consumer education in this technical assistance programme.

4. Indicative Budget (amounts in EUR)

			TOTAL EXP.RE	SOURCES OF FUNDING								
				IPA COMMUNITY CONTRIBUTION		NATIONAL CONTRIBUTION					PRIVATE CONTRIBUTION	
ACTIVITIES	IB	INV	EUR (a)=(b)+(c)+(d)	EUR (b)	%	Total EUR (c)=(x)+(y)+(z)	%	Central EUR (x)	Regional/ Local EUR (y)	IFIs EUR (z)	EUR (d)	%
contract 1	X		1,200,000	1,200,000	100							-
TOTAL IB			1,200,000	1,200,000	100							
TOTAL INV												
TOTAL PROJECT			1,200,000	1,200,000	100							

Amounts net of VAT

This project will be implemented through one twinning contract. For more details see Annex 5.

5. Indicative Implementation Schedule (periods broken down per quarter)

Contracts	Start of the Tendering	Signature of contract	Project Completion
All four components in one twinning contract	Q1 2009	Q3 2009	Q2 2011

6. Mainstreaming of Cross-cutting issues

Cross-cutting issues must be mainstreamed at two levels: (1) in project's training activities (across all components) in order to ensure a balanced participation of men and women as well as the inclusion of minority members of the staff (reflecting their role in the beneficiary organisation); (2) in project's fourth component on *Prevention of money laundering and terrorism financing* where trainees' awareness on financial implications resulting from trafficking in human beings and pollution crimes must be raised.

Education and training core activities will be conceived and implemented with special attention to fair and non-discriminatory practices towards minority groups and women whose access to, and participation in training activities should be facilitated. In particular, place and time schedule of training activities should be thought of so as to favour women's participation. This is important in view of the fact that participation in training often comes as a requisite for further career advancement and/or professional opportunities

6.1 Gender equality:

The improved fight against money laundering must tackle the financial implications of trafficking in human beings, with special emphasis on women and children. The trafficking of human beings for prostitution and slave labour has become a growing problem in recent years in central and Eastern Europe where it generates high profits enabling traffickers to engage in other criminal activities and achieve economic, social or political power. The project – in its 4th component – shall pay specific attention to this phenomenon in its training curricula so as to ensure that supervisory staff acquires an exhaustive understanding of financial criminality, including its gender dimension.

6.2 Environment:

Education and training activities will also address the growing presence of organised crime in the area of environment through, for instance, illegal import and export of waste; disposal of hazardous waste; movement of ozone depleting substances, etc. The fight against pollution crime is particularly important in Montenegro which is aiming to enforce strict environmental standards (Montenegro has declared itself to be an “ecological state”).

6.3 Minorities:

The financial implication of trafficking human beings (as explained above) also extends to minority groups who may be subject to discrimination in their place of origin and submitted to labour exploitation.

ANNEXES

- 1- Log frame in Standard Format
- 2- Amounts contracted and Disbursed per Quarter over the full duration of Programme
- 3- Description of Institutional Framework
- 4- Reference to laws, regulations and strategic documents:
 - Reference list of relevant laws and regulations
 - Reference to AP /NPAA / EP / SAA
 - Reference to MIPD
 - Reference to National Development Plan
 - Reference to national / sector investment plans
- 5- Details per EU funded contract

ANNEX 1: Logical Framework Matrix

LOGFRAME PLANNING MATRIX FOR Project Fiche		Programme name and number:	
Strengthening the regulatory and supervisory capacity of the financial regulators of Montenegro		Contracting period expires: two years from the signing of the Financial Agreement	Disbursement period expires: One year after the final date for execution of the contract
		Total budget: 1 200 000 Euro	IPA budget: 1 200 000 Euro
Overall objective			
Create conditions for long term economic stability and growth by strengthening the regulatory and supervisory framework of the capital and financial markets	<p>Steady growth of GDP, low inflation and stable capital and financial markets</p> <p>Upgraded credit rating</p> <p>CBM, SEC and ISA meet all procedures, standards and knowledge required to function within the EU and the ESCB.</p>	<p>Official statistics</p> <p>Assessments of the EC, IMF and other relevant institutions</p>	
Project purpose			
Improve efficiency and effectiveness of institutional and regulatory capacities of the financial sector regulators to supervise financial market and institutions in line with EU <i>acquis</i>	<p>Irregularities detection rate increased</p> <p>Increased number of various forms of financial crimes detected and penalized by 10%</p> <p>Membership in international organizations of financial market supervisors approved (ESCB and IAIS)</p> <p>Signing of Multilateral Memorandums of Understanding with foreign counterparts</p>	<p>Official annual reports of regulators submitted by respective regulator to the Parliament</p> <p>Surveys performed by respective authorities</p> <p>Official documents (minutes from annual conferences) from CEBS, IOSCO and IAIS</p>	<p>Montenegro remains committed to the EU association process</p> <p>Full commitment and support to the project by the supervisory institutions and the Government, including readiness to establish a joint Project Steering Committee</p> <p>CBM, SEC and ISA provide the consultants with all the information, materials, interpretation and facilities to operate effectively.</p> <p>A major risk to the sustainability is the rather high turnover of staff of the CBM, SEC and ISA.</p>

Results	Objectively verifiable indicators	Sources of Verification	Assumptions
Result 1. EU <i>acquis communautaire</i> , other international rules and best practices in financial regulation and supervision are introduced and effectively implemented, with emphasis on money laundering and other forms of financial crime	<p>Laws, regulations and operations of financial supervisors aligned with EU Directives and good practices in accordance with NPI timetable</p> <p>Assessment of implementation of IOSCO principles and objectives of securities regulation</p> <p>CBM – preparation and implementation of the new CAD</p> <p>CBM- transposition and implementation of Directive on Financial conglomerates</p> <p>Timetable for transitional measures developed by Q4 2011</p> <p>Reports and data for market users in accordance with new legislation by Q4 2011</p> <p>Montenegro's ranking on internationally comparable scales measuring money laundering, corruption and investment climate is improved. (Montenegro ranks 84/179 in 2007 Transparency International Corruption Index)</p>	<p>Official Gazette of Montenegro</p> <p>IOSCO assessment</p> <p>Public reports of the CBM, SEC and ISA posted, among else, on their web sites</p> <p>Reports of the Consultants</p> <p>Reports and rules issued by CBM, SEC and ISA.</p> <p>Annual and other reports of the public institutions in charge of anti money laundering and other forms of financial crime</p> <p>Reports by Transparency International, OECD-FATF, local NGOs and media</p> <p>Reports by the Consultants.</p>	<p>Full commitment to adoption of legal and regulatory improvements by the Government and CBM, SEC and ISA</p> <p>The Government processes in a timely manner regulators' initiatives to amend the existing or adopt new laws</p> <p>Parliament adopts laws according to the NPI timetable</p> <p>Full commitment of the Government, supervisory and anti money laundering institutions and their readiness to collaborate in combating money laundering and other forms of financial crime</p> <p>Commercial banks and other supervised financial institutions collaborate with supervisory authorities in their anti money laundering activity</p> <p>Transparent procedures and operations of supervisory institutions,</p> <p>Good cooperation of supervisory institutions with NGO and media in designing and implementing the public education and information campaign on prevention of money laundering, terrorism financing and other forms</p>

			of financial crime
Result 2. Improved capacity and operation of CBM, SEC, and ISA in accordance with EU standards	<p>30% of staff in the three beneficiary institutions trained.</p> <p>New and/or improved operational manuals and supervision guidelines produced within first 12 months of project implementation for each of the three institutions</p> <p>On site and Off site supervisors new procedures and standards of best practices adopted and implemented</p>	<p>Training programme documents</p> <p>Internal acts of the CBM, SEC and ISA</p> <p>Project's Reports</p> <p>Annual reports from CBM, SEC and ISA</p> <p>Assessment of the implementation of the IOSCO objectives and principles.</p> <p>Reports from international organization (IMF, World bank, IOSCO. etc)</p> <p>Reports from on site and off site supervisors</p>	<p>The regulatory institutions are allowed to assert their independent role</p> <p>Full commitment of senior management of CBM, SEC and ISA</p> <p>Involvement of all relevant junior staff of the supervisory institutions</p> <p>Commercial banks and other supervised financial institutions provide the necessary collaboration to apply new supervisory procedures</p> <p>Managements of beneficiary institutions adopt and support implementation of training programmes developed by the Consultant</p>
Result 3. Financial regulators cooperate and coordinate their activities in order to ensure financial stability and fight money laundering and other forms of financial crimes	<p>Permanent cooperation framework is established by financial regulators within 3 months upon project inception to ensure financial stability</p> <p>Process to produce annual Financial Stability report is prepared and adopted.</p> <p>At least one annual Financial stability report is prepared and endorsed within project duration.</p> <p>Eu 3rd directives on anti money laundering is enforced.</p>	<p>Report from the Establishment of the Project Steering Committee made up of high ranking representatives of supervisory institutions as a first step towards creation of a permanent coordination framework is publicly announced</p> <p>Financial stability report produced and posted on CBM web site</p> <p>Technical Assistance Project Team Leader and EC Delegation Project Manager are members of the Project Steering Committee</p>	<p>Supervisory institutions and Government are ready cooperate and discuss financial stability issues in the Steering Committee</p>

Activities:	Means:	Cost:	Preconditions
<p>Component 1 – Central Bank of Montenegro</p> <ul style="list-style-type: none"> - Support for the transposition and implementation of the new Capital Requirement Directives - Support for the implementation of supervision on a consolidated basis and transposition of the EU Directive on Financial Conglomerates - Training supporting the implementation MiFID (Market in Financial Instruments Directive), and of the best practices in the field of the so-called Pillar II and Pillar III provisions of the Basel II 			Adequate staff available
<p><u>Component 2 Securities and Exchange Commission</u></p> <ul style="list-style-type: none"> - Developing procedural manuals on the principle-based supervision and risk-based and proportionate approach to regulation and supervision; - Internal and external training for SEC staff on the regulatory and supervisory functions of the SEC - Preparing working materials and examinations for new employees; - Designing and developing internal procedures for optimising the SEC’s collection and use of management information - Short and longer term training for SEC staff, including secondments to national and supranational regulators preparing for the implementation of EU Financial Services Action Plan (FSAP) - Training supporting the implementation of FSAP (Financial Services Action Plan) directives and on other relevant regulations (MiFID, Transparency and Prospectus directive) - Development and promotion of a consumer protection strategy, aimed at improving the financial capability of consumers in Montenegro 	Twinning	€1.2 million	
<p><u>Component 3 Support to the Insurance Supervision Authority</u></p> <ul style="list-style-type: none"> - support transposing all relevant EU directives with direct or indirect impact on operations of insurance companies - Training ISA staff to understand and apply new concepts introduced by the EU legislation Solvency II 			
<p>Component 4 - Money laundering and Financial crime</p> <ul style="list-style-type: none"> - support to both CBM and SEC in the implementation of best practices in the field of the requirements resulting from the MIFID Directive and Regulation - Assistance in the implementation of best practices in the field of the Anti Money Laundering Directive, - Survey on level of knowledge regarding trading with securities and capital market issues performed and statistical data obtained <p>Preparation and implementation of public education and information campaign on prevention of money laundering, terrorism financing and financial crimes</p>			

ANNEX 2: indicative amounts (in €) Contracted and disbursed by quarter for the project

	2009	2009	2010	2010	2010	2010	2011	2011
	Q 3	Q4	Q1	Q2	Q3	Q4	Q 1	Q2
Contracted								
EC support	1.200.000							
Total	1.200.000							
Cumulated	1.200.000							
Disbursed								
EC support		400.000			400.000			400.000
Total		400.000			400.000			400.000
Cumulated	0	400.000			800.000			1.200.000

ANNEX 3: Description of Institutional Framework

A. The Central Bank of Montenegro.

The Central Bank of Montenegro (CBM) was established by the Law on the Central Bank of Montenegro adopted by the Parliament of Montenegro in October 2000. The CBM's monetary policy is based on the euro as the legal tender.

In implementing its function, the Central Bank of Montenegro, inter alia:

- issues and removes licences for banks and other financial institutions and regulates and controls their operation;
- prescribes and implements measures, regulates and controls payment operations, manages banks' accounts and interbank payments in Montenegro;
- manages currency reserves;
- acts as a banker, advisor and fiscal agent of Montenegro's state authorities;
- renders banking services in favour of foreign governments, foreign central banks, as well as in favour of international organisations and other international institutions in which the Central Bank of Montenegro participates.

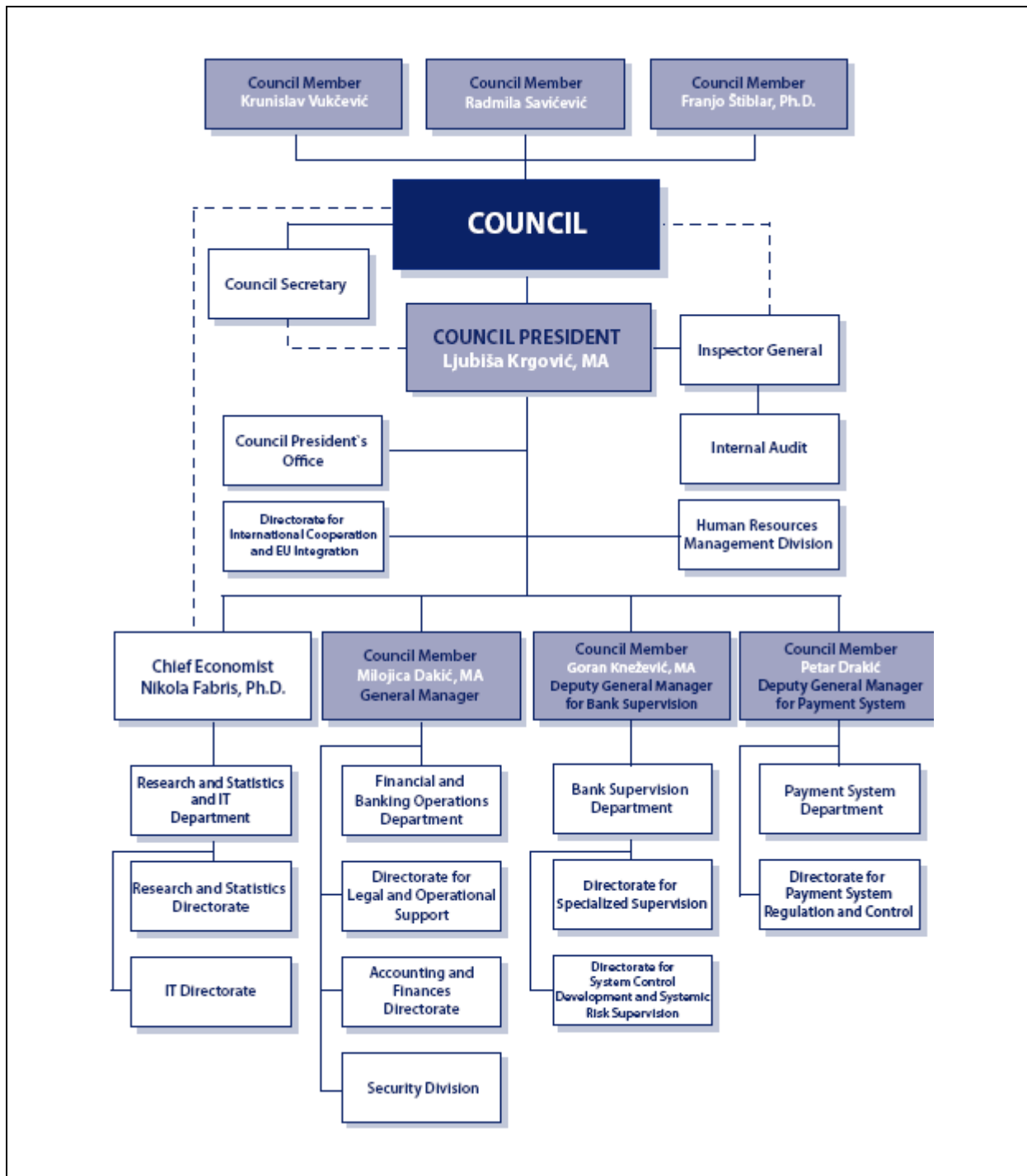
The Central Bank of Montenegro is managed by the Council of the Central Bank, consisting of seven members, appointed by the Parliament of Montenegro. The CBM comprises the following organisational units: Internal Audit, Banking Supervision, Research and Statistics with the Information Technology, Payment Operations, Payment Regulation and Control, Financial and Banking Operations, Legal Affairs and Business Support, Human Resources Management, International Cooperation and European Integration, Accounting and Finance and Logistic Service. The Office of the President of the Council is a unit which, in addition to strictly managerial activities, deals with public relations, protocol, etc.

The 27th of December 2006 the CBM adopted the 'Central Bank Policy for 2007' which includes the principles on which the requested EU support is based.

The new Constitution of Montenegro states that the Central Bank is an independent institution, which is responsible for monetary policy, for the financial stability and for the functioning of the banking system. The second function, financial stability, is new for the CBM and needs to be made fully operational.

The Organisational Chart of the Central Bank of Montenegro is detailed in the following page.

Organisational Chart of the Central Bank of Montenegro



B. The Securities and Exchange Commission.

The SEC was established by the Law on Securities (Nos 59/00, 10/01/43/05, 28/06) adopted by the Parliament of Montenegro, and amended in June 2007. The Law on Securities sets out the organisation, scope and powers of the SEC and the types of securities regulated as well as the provisions in relation to the issuing and trading of securities and the rights and obligations of entities on the securities markets.

For the purposes of the Law on Securities, “securities” are defined as documents granting rights to its owners in relation to the issuer in accordance with the Law on Securities and under the terms of their issuance. The Law defines securities as being of two types: equity securities and debt securities. Equities for these purposes includes shares of a joint stock company and units of a closed ended collective investment scheme issued in accordance with the Law on Investment Funds as well as securities granting the right of acquisition for such securities e.g. convertible bonds, options and futures. Debt securities includes bonds, certificates of deposit and treasury bills issued by the state but not checks and bills of exchange, commercial paper or any other instrument prescribed by the SEC as not being securities for the purposes of the Law on Securities.

The definition, issuing and monitoring financial instruments for the financial market in Montenegro shall match with the EU and international standard. It will need regular review and possible amendments of the laws, which can be facilitated more easily by the supervisor’s right of issuing decrees and ordinances.

In connection with the above-mentioned law, but also in general, it may be added that laws and regulations of European (Civil Law) countries have in general been following - for some years already - a different approach of law structures, which has been more according to the idea of single/separate laws instead of having different legal aspects in one law only. This would include separate laws such as Stock Exchange Act, Capital Market Law, Take-Over Law, Company Law, Commercial Law, Investment Funds Act, etc. This should be considered in the future for a number of legislative and regulatory reasons.

The SEC is an independent body established as an agency of the state and reports directly to the Parliament (EU Directives emphasise on independent bodies which have to be judged under national constitutional law). It has a wide range of responsibilities (which is assumed to be in line with constitutional and administrative law provisions) including:

- To make rules to implement the Law on Securities when authorised to do so by the legislation;
- To ensure that the Law on Securities and any Rules made under this Law are complied with;
- To approve and supervise public offers of securities and keep records of issues of securities which are not sold by public offer (if this is done in the sense of a private placement no regulation for supervision is needed, however, if it is publicly offered (definition need to be included in the law) but with a listing at the stock exchange then certain capital market and prospectus requirements (ie Prospectus Directive) have to be fulfilled);
- To license and approve relevant bylaws of securities markets, authorised market participants and the central depository agency;
- To authorise and regulated collective investment scheme established in accordance with the Law on Investment Funds;

- To approve the nomination of executive directors of the entities licensed by the Commission;
- To promote and encourage high standards of investor protection (by setting up an appropriate investor scheme applying to all market participants) and integrity among licensees (such as ie fit & proper);
- To support the operation of an orderly, fair and properly informed securities market (such as transaction reporting and ad hoc disclosure requirements, ie in MiFID and Market Abuse Directives);
- To take all reasonable steps to safeguard the interests of persons who invest in securities (focus on rules of conduct and consumer protection), and to suppress illegal, dishonourable and improper practices in relation to dealings in securities (focus on market abuse - ie Market Abuse and MiFID Directives);
- To take actions and perform control and examination to prevent any frauds on the securities market;
- To co-operate with other related authorities in Montenegro or elsewhere; and
- To take any other actions and perform other duties under the Law (this is to be seen in connection with administrative law).

The SEC also supervises the still infant voluntary private pension pillar.

The Law on Securities provides the SEC with the power to regulate market participants carrying on “securities business”. Securities business is defined as brokerage in the purchase and sale of securities upon the order of the client (on its own behalf and for the client’s account in exchange for a commission (a “broker”); securities trading by a market participant on its own behalf and for its own account in order to make a profit (a “dealer”); managing a portfolio of securities belonging to another person (an “investment manager”); underwriting of new securities for the purposes of public resale on behalf of the issuer or guaranteeing to an issuer that the unsold residue of the issuer’s public issue or sale will be taken up (“underwriting”); giving to investors or potential investors advice on the merits of the purchasing, selling, subscribing for or underwriting securities (an “investment adviser”) or any other activity that the SEC deems to constitute securities business. This is characterised as a “functional” approach. The definitions given shall be in line with EU and international practice, especially with a focus on the legal definitions used in neighbouring countries, in order to avoid legal arbitrage, especially in the field of the so called financial services providers, as well as securities dealings (ie best execution or inducement in the sense of the MiFID).

Without specific limitation, the SEC may make rules (which shall then become part of administrative common practice applying to all market areas) for or with respect to:

- Applications for licenses, the issue of licenses and incidental matters;
- The qualifications (ie fit and proper requirements), experience and training required of licensees, the examinations (ie criminal record procedures in connection with criminal law) that applicants for licenses may be required to take and the circumstances in which they may be excused from such requirements;
- The making of annual or other regular returns to the SEC by licensees; and
- executing custody operations (which might have to be seen in close connection with banking supervision).

The SEC may also issue from time to time guidance notes, bulletins, advice or other

regulatory statements as it may consider necessary or desirable for the administration of the Law on Securities. It also authorises and regulates securities exchanges established in Montenegro and the SEC may issue directions to the stock exchange[s] with respect to listing, delisting (ie various EU Stock Exchange regulations) and trading on or through the facilities or systems of the stock exchange generally or with respect to the trading of a particular securities on that exchange to ensure that an orderly and fair market in securities is maintained. SEC needs to have the right (and obligation) to define “regulated markets” and “liquid shares” (ie MiFID, Market Abuse Directives) and to implement and supervise the laws and regulations accordingly.

The SEC is also authorised to approve and have oversight over the rules made by authorised stock exchanges as well as the supervising the clearing, settlement and registration of securities and the regulation of the Montenegrin Central Registry and Depository which operates as an electronic clearing, settlement and registry service for transactions effected on the stock exchanges.

Structure

The SEC consists of five members appointed by Parliament from persons nominated by the Government of the Republic of Montenegro. These members include the chairman, deputy chairman and three members. Each of the five Commission’s members has the overall responsibility for the activities of a department. These are:

- The Corporate Activities Department oversees the registration and issuance of securities and make rules relating to the public offering of securities including defining those exemptions from the definition of a public offer;

- The Capital Markets Department is concerned with the supervision of licensed market participants including companies and individuals. It has wide supervisory and investigative powers and may, in

certain circumstances, propose to the Commission the imposition of penalties on those persons who breach the Law on Securities or the Commission’s Rules made under it;

- The Pension and Investment Fund Department is responsible for licensing and supervision of closed-ended investment funds established under the Law on Investment Funds and their management companies as well as voluntary pension funds which are yet to be established under the recent Law on Voluntary Pensions Funds. The department also reviews the periodic reports of these investment funds and maintains statistical information regarding these funds including information regarding their net asset value;

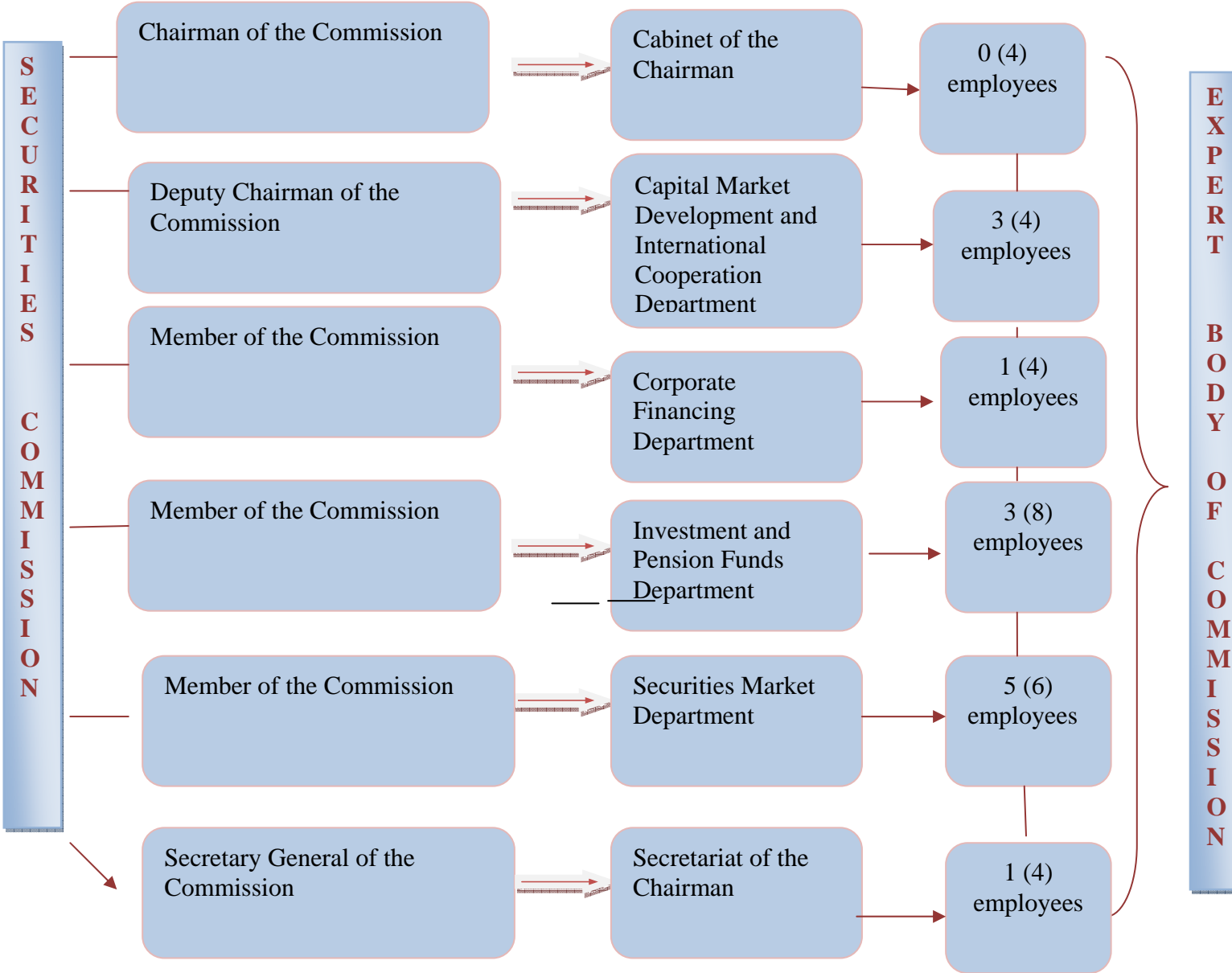
- The Capital Markets Development and Co-operation Department has been recently established to oversee proposals for changes to the applicable laws and to develop the SEC’s overall policy. It also is involved in the drafting of various memoranda of understanding with other regulators and the preparation of laws, rules and other instruments required to exercise the SEC’s powers;

The Commission’s Secretariat is a separate department and the Secretary General is responsible for the overall functioning of the Commission including matters relating to personnel and the Commission’s day-to-day operations as well as providing legal advice to the Commission.

By the recent changes of the internal organization and systematization, Securities Commission established Cabinet of the Chairman as separate department in charge for public relations of the Commission and issuing of expert advices and performing analytical and professional tasks as needed.

Below is organizational chart stating current number of employees and planned number (within the brackets). The Commission plans to employ the employees needed within period of two years.

Organisational chart of the Securities Commission (provided by SEC)



C. The Insurance Supervision Agency.

Placed under the aegis of the Parliament, ISA is a recently established institution, still in the process of becoming operational. The law is clear about the principle of independence of the ISA.

ISA's basic role is to protect interests of policyholders and other insurance beneficiaries and provide stability and development on the insurance activities based on sound competition and equal operating conditions.

In performing its role, the ISA:

- issues licences and approvals for operating insurance business,
- performs constant control over carrying out insurance activities,
- imposes measures on insurance companies in order to stabilize their business operations,
- keeps registers of all the actors in insurance market,
- prescribes the chart of accounts for insurance companies,
- develops and monitors the insurance market,
- considers appeals and complaints of policyholders,
- proposes solutions for issues arisen in the insurance area
- cooperates with other insurance supervisors in abroad, etc.

Currently, ISA is preparing 12 by laws, out of which only 2 have to be approved by the Ministry of Finance, which proves the status of ISA as an independent body. Out of these 12 bylaws, two refer to the education, approvals and opinion of certified actuaries.

In this initial stage, ISA starts to receive broadly defined support from other donors (USAID, which provided support since the last years to help creating the ISA), who will contribute basic training, equipment and organisational support.

The IPA project will complement these interventions with the provision of technical assistance, which will be aimed at ensuring that all relevant elements of the EU *acquis communautaire* in the insurance sector are duly taken into consideration.

Organisational structure of ISA is as follow:

ORGANIZATION STRUCTURE OF THE INSURANCE SUPERVISION AGENCY

COUNCIL OF AGENCY

PRESIDENT OF THE COUNCIL
MEMBERS OF THE COUNCIL – 2
(1 adviser)²

DIRECTOR

DEPARTMENT FOR INSURANCE MARKET SUPERVISION	DEPARTMENT FOR REGULATION, DEVELOPMENT AND INTERNATIONAL COOPERATION	DEPARTMENT FOR GENERAL AFFAIRS
1 Assistant to the director	1 Assistant to the director	1 Assistant to the director
3 Senior Advisors	1 Senior Advisor (2)	1 Senior Advisor
0 Advisor (2)	0 Advisor (2)	0 Advisor (1)
		1 Business Secretary

If not corresponding to the number of current employees in September 2008, are indicated between brackets, the number of employees as planned in Internal Organization Act of the ISA.

² According to the Organizational Chart, there can be one or more advisers to the President of the Council, employed full or part time, for performing advisory and highly professional jobs. Currently one person is full-time employed at this position.

ANNEX 4: Reference list of relevant laws and regulations, and strategic documents

Reference list of relevant laws and regulations:

- Guideline of the European Central Bank of 1 July 2004 on the Eurosystem's provision of reserve management services in euro to non-European Union central banks, countries outside the European Union and international organisations.
- Regulation of the Council of 23 November 1998.
- Guideline of the European Central Bank of 16 July 2004 concerning the Statistical reporting requirements for balance of payments statistics, international investment positions and the template of the international reserves.
- Law on the Central Bank of Montenegro (Official Gazette of RM, nos. 52/00, 53/00, 47/01 and 04/05)
- Law on Banks(Official Gazette of Montenegro, Nos. 17/08).
- Law on Secured Transactions (Official Gazette of Montenegro, Nos 38/02
- Law on Securities (Official Gazette of Montenegro, Nos. 59/00, 10/01 and 28/06).
- Law on Investment Funds (Official Gazette of the Republic of Montenegro 49/04)
- Law on Voluntary Pension funds (Official Gazette of the Republic of Montenegro 78/06 and 17/07)
- Decision on Credit Unions(Official Gazette of the Republic of Montenegro 01/03 and 53/03)
- Law on the Takeover of Joint Stock Companies (Official Gazette of the Republic of Montenegro 81/05);
- The Act on the Fiduciary Transfer of the right of Ownership. Official Gazette of Montenegro, Nos. 23/96
- Law on Insurance (Official Gazette of the Republic of Montenegro, No 78/06 and 19/07).
- Law on Financial Leasing (Official Gazette of the Republic of Montenegro, No 81/05).

Reference to AP/NPAA/EP/SAA

European Partnership with Montenegro (Official Journal of the European Union of 27/01/2007) and Interim Stabilisation and Association Agreement.

Reference to MIPD

(see 2.4)

Reference to National Development Plan

(see 2.5)

Reference to national/sectoral investment plans

Not relevant

ANNEX 5: Details per EU funded contract

Twinning contract

Based on the type of activities and having in mind the size of the proposed project, the technical assistance should be provided through one twinning contract. A high level Steering Committee for financial sector supervision should be established to supervise the project, coordinate the three beneficiaries involved, and provide guidance in the implementation of the technical assistance.

Experts to be engaged for the project shall be professionals with a thorough knowledge and understanding of EU legislation, system and best practice as they relate to financial supervision practice and regulatory issues. As know-how transfer is at the centre of this project, international experts need to be accomplished practitioners, proficient writers and capable of delivering inputs to beneficiaries both through written recommendations and oral trainings. To that aim they should have a pronounced ability to speak in public, convey messages by using modern communication technology, appraise beneficiaries' staff, provide corresponding training on the job and design training programmes to close the skill gaps observed.

A Resident Twinning Adviser will be responsible for managing the whole experts' team, for advising the beneficiaries, for maintaining the liaison with the partner teams and for managing and overseeing the specific tasks. This adviser will be also responsible for one component of the project, either in the banking or capital market fields.

Besides, there should be at least one long term expert for each beneficiary: in Banking supervision for the CBM, in Capital market regulation/supervision for the SEC, and in insurance regulation/supervision for the ISA

Finally, a pool of specific short term experts in highly specialised areas will be included in the project.