

Montenegro: Technical Assistance
Report-Financial Soundness Indicators
Mission (November 29 - December 5,
2017)



MONTENEGRO

March 2019

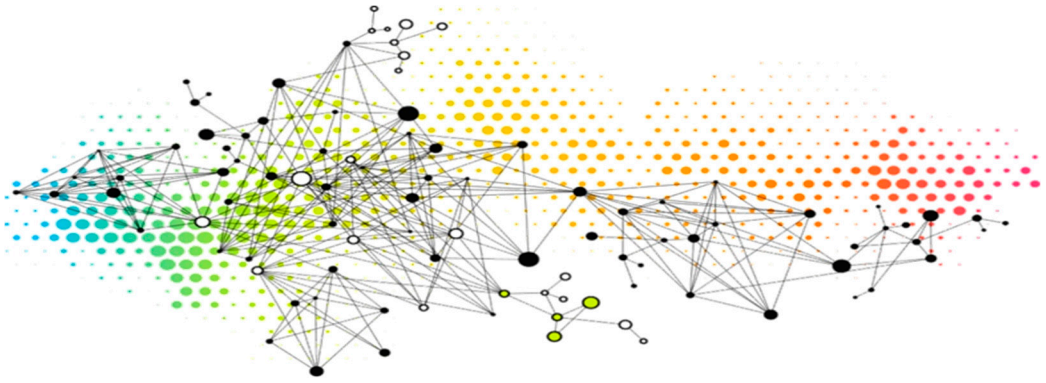
TECHNICAL ASSISTANCE REPORT—REPORT ON THE FINANCIAL SOUNDNESS INDICATORS MISSION

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REPORT ON THE FINANCIAL SOUNDNESS INDICATORS MISSION (NOVEMBER 29–DECEMBER 5, 2017)

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Glossary

CBCSDI	Cross-border, cross-sector, domestically incorporated
CBM	Central Bank of Montenegro
COA	Chart of accounts
DCCBS	Domestically controlled, cross-border, cross-sector
DC	Domestic consolidation
DT	Deposit taker
EUR	IMF's European Department
FSD	Directorate for Financial Stability and Payment System Oversight, CBM
FSI	Financial soundness indicator
<i>FSI Guide</i>	<i>Financial Soundness Indicators Compilation Guide</i>
HHs	Households
IAS	International Accounting Standards
IC	Insurance corporation
IFRS	International Financial Reporting Standards
SDDS	Special Data Dissemination Standard
STA	IMF's Statistics Department
TA	Technical assistance

SUMMARY OF MISSION OUTCOMES AND PRIORITY RECOMMENDATIONS

1. **As part of the technical assistance (TA) for Montenegro and with the support of the IMF's European Department (EUR), a financial soundness indicators (FSIs) TA mission from the IMF's Statistics Department (STA) visited Podgorica, Montenegro, during November 29–December 5, 2017.** The main objectives of the mission were to develop a framework for compiling FSIs based on the IMF's *FSIs Compilation Guide (FSI Guide)*. The mission was conducted with financial support from the government of the Netherlands.
2. **The Central Bank of Montenegro (CBM) is keen to regularly compile and disseminate the FSIs based on the *FSI Guide*.** The importance of closing the data gaps for financial stability analysis is also emphasized in the October 2017 IMF Report "Montenegro: Technical Assistance Report—Macroprudential Policy Framework." With the release of the FSIs on the CBM website, Montenegro will also take a step towards a possible subscription to the Special Data Dissemination Standard (SDDS).
3. **The CBM compiles and reports FSIs to EUR for the purpose of Article IV consultations, but no FSIs are reported to STA for posting on the IMF's FSI website or disseminated by the CBM on its website.** This mission was the first STA mission on financial sector statistics to work with the CBM to develop FSIs based on the *FSI Guide* to support macroprudential analysis and for dissemination.
4. **The mission mainly focused on the compilation of FSIs for the deposit takers (DTs), which cover 15 commercial banks, using the chart of accounts (COAs) and supervisory series as source data.** The commercial banks dominate the financial system of Montenegro, accounting for more than 90 percent of total financial system assets. No other financial corporations take deposits. In consultation with the Directorate for Financial Stability and Payment System Oversight (FSD), the mission used data reported by banks in the form of the COAs and supervisory data as source data for compiling FSIs as the COAs provide detailed breakdowns by counterpart sector and by type of financial instrument.
5. **The regulatory and accounting practices of the DTs are broadly in line with the *FSI Guide*, which defers to Basel principles and International Accounting Standards (IASs).** All commercial banks follow Basel II to calculate regulatory data, such as Tier 1 and Tier 2 capital and risk-weighted assets, and apply the IASs to record gains and losses and to value assets and liabilities.¹

¹ These findings are also consistent with the findings of the IMF FSAP "Banking Supervision and Regulation—Technical Note," June 2016. See <http://www.imf.org/en/Publications/CR/Issues/2016/12/31/Montenegro-Financial-Sector-Assessment-Program-Banking-Supervision-and-Regulation-Technical-44026>.

- 6. The mission, in collaboration with the FSD officials, mapped the COAs to the IMF’s FSI reporting templates for sectoral financial statements (balance sheet and income statement), providing a tool to automatically calculate FSIs from source data.** This compilation framework reduces manual work and ensures sustainability of the FSI compilation. The source data are of high quality, but in a few cases, clarification would be needed to further improve classification by counterpart sector and by type of financial instrument. Data from 2013 were used to validate the mapping.
- 7. The FSD officials confirmed that they can regularly compile FSIs using the framework developed during the mission and report them to STA on an ongoing basis.** All 12 core FSIs, as well as 9 of the 13 additional FSIs for DTs and 2 FSIs for real estate markets, have been compiled using data in the COAs and regulatory data that commercial banks report to the CBM for supervisory purposes. In addition, the mission assisted in developing FSI metadata and completing a template detailing the institutional coverage of the financial sector.
- 8. It is important that the CBM officially designates a unit to be responsible for compilation, reporting, and dissemination of FSIs.** This would help coordination of the provision of timely source data and facilitate training and other staff development. Although the responsibility for compiling FSIs has not yet been officially assigned, the mission closely worked with the FSD officials on developing FSIs for DTs.
- 9. There is scope for improving the quality of FSI data by further investigating the nature of selected accounts identified during the mission and updating their classification in the compilation spreadsheets.** The FSD officials should work with the relevant units of the CBM to address the identified data or classification issues based on the methodology set forth in the *FSI Guide*. Any departures from the *FSI Guide* that cannot be avoided should be documented in the FSI metadata.
- 10. To support progress in the FSI compilation, the mission recommended an action plan with the following priority recommendations. Further details can be found in the section *Detailed Technical Assessment and Recommendations*.**

Table 1. Priority Recommendations

Target Date	Priority Recommendation	Responsible Institutions
August 2018	Officially designate a specific unit within the CBM to work on FSIs.	CBM Management
August 2018	Finalize and report to STA the sectoral income statement (FSI template Annex 2), the sectoral balance sheet (FSI template Annex 3), and memorandum series (FSI template Annex 4) for DTs using the compilation spreadsheets developed during the mission, including data beginning from 2013 with a quarterly periodicity as a minimum.	CBM [FSD]
October 2018	Start regular reporting to STA, for posting on the IMF's FSI website, the sectoral income statement (FSI template Annex 2), the sectoral balance sheet (FSI template Annex 3) and memorandum series (FSI template Annex 4) for DTs including data beginning with the first quarter of 2013 at a quarterly frequency, the institutional coverage (FSI template FS1) for 2017 at an annual frequency, and FSI metadata (FSM template).	CBM [FSD]

BACKGROUND

A. Context

11. This technical assistance mission to develop FSIs was the first IMF Statistics Department mission on financial sector statistics with the Central Bank of Montenegro. STA has fielded multiple missions to Montenegro in real sector, government finance, and external sector statistics during the last ten years. The CBM is now keen on improving their financial sector statistics by compiling FSIs using the *FSI Guide* as reference and reporting them to STA.

12. No FSIs are yet being reported to STA for dissemination on the IMF's FSI website, nor disseminated by the CBM on its website. However, the CBM compiles and reports some FSIs to IMF's European Department (EUR) for the purpose of IMF Article IV consultations as well as Financial Sector Assessment Program (FSAP).

13. The importance of closing the data gaps for financial stability analysis is also emphasized in the October 2017 IMF Report "Montenegro: Technical Assistance Report-Macroprudential Policy Framework."² The report indicates that "in monitoring risks in the financial sector, the CBM relies mainly on core FSIs of the banking sector. As the financial sector is bank dominated, these indicators are a natural starting point for monitoring systemic risks."

² <http://www.imf.org/en/Publications/CR/Issues/2017/10/19/Montenegro-Technical-Assistance-Report-Macroprudential-Policy-Framework-45325>.

Ensuring that FSIs are compiled in accordance with international standards will further support the CMB's effort to monitor financial sector risks.

B. Financial System in Montenegro

14. The CBM performs traditional central bank functions including responsibility for financial stability as well as licensing and supervision of financial institutions.³ Even though Montenegro is not part of the European Union, the euro is used as the legal tender. The financial stability mandate is being carried out by the Department for Financial Stability, Statistics and Research Department (FSD) of the CBM.

15. The CBM is responsible for the oversight of the commercial banks and all other credit institutions. Legislative amendments were made and are expected to be implemented by April 2018 to extend the regulatory perimeter to capture the activities of all credit institutions, including nonbank factoring and leasing companies, microcredit finance institutions, as well as purchase of receivables and credit-guarantee operations. Insurance companies and investment and pension funds are supervised by insurance supervisory agency and securities exchange commission, respectively.

16. The financial system of Montenegro is dominated by banks, which constitute around 90 percent of the financial system assets (about 96 percent of GDP). Fifteen banks operate in Montenegro. Foreign-controlled banks (9 out of 15 banks) hold around 74 percent of the banking sector's assets. Lending to the household sector accounts for almost 50 percent of total loans. The six microcredit finance institutions, which are not allowed to perform deposit taking operations, constitute 1.3 percent of the financial sector assets. Insurance sector, while small in terms of market share, has been growing.

³ Except some nonbank financial institutions such as insurance companies and investment funds.

Table 2. Financial System
(thousand Euros, end-2016)

Financial Corporations (FC) Sector	Asset Size	# of Institutions	Share in Total Assets of Sub-Sector (%)	Share in Total Financial Sector Assets (%)
Central Bank of Montenegro				
Other Depository Corporations				
Commercial Banks				
Domestically controlled	980,918	6	25.9%	23.5%
Foreign controlled	2,809,337	9	74.1%	67.2%
Total ODCs	3,790,255	15	100.0%	90.6%
Other Financial Corporations				
Insurance Companies	196,681	11	50.1%	4.7%
Pension Funds	566	2	0.1%	0.0%
Other Financial Intermediaries	194,981	19	49.7%	4.7%
Leasing Companies	45,209	4	11.5%	1.1%
Micro-credit Finance Institutions	55,576	6	14.2%	1.3%
Investment Funds	94,196	9	24.0%	2.3%
Total OFCs	392,228	32	100.0%	9.4%
Total Financial Sector	4,182,483	47		100.0%

DETAILED TECHNICAL ASSESSMENT AND RECOMMENDATIONS

A. Source Data

17. **The mission reviewed source data for DTs (COAs and supervisory series) and found them broadly adequate for the compilation of FSIs based on the methodology set out in the *FSI Guide*.** The COAs include data on assets and liabilities broken down by type of financial instrument and by counterpart sector, and data on incomes and expenses with required details for compiling FSIs based on the *FSI Guide*. However, in a couple of cases, further clarification on the nature of data items would be required for a precise classification by counterpart sector and by type of financial instrument. These issues stem from the account descriptions used in the COAs (such as non-amortized discount Dr/Cr, receivables purchased (factoring) Dr, accruals: loans Dr) that serve the accounting purposes, but are not sufficiently clear in terms of the counterpart sectors and the type of financial instrument for statistical purposes. The clarification from the accounting experts at the CBM will further improve the details of source data for compiling FSIs.

18. **In addition to the availability of breakdowns, the building blocks underlying the source data for deposit takers are found to be broadly in line with the related international regulatory, accounting, and statistical standards.** These building blocks include the distinction

between residents and nonresidents, the application of accrual accounting, the sectoring of institutional units, the classification of assets and liabilities by type of financial instrument, and the calculation of supervisory series (such as regulatory capital, risk-weighted assets, nonperforming loans etc.). The FSI Guide allows the application of the national practices to measure some underlying series for FSIs, such as large exposures, which is also the case for Montenegro.

19. The current data collection system is adequate for compiling FSIs in terms of data frequency and timeliness. As noted earlier, two key data sources for DTs are (1) COAs and (2) supervisory series. The former are collected with a monthly frequency. The latter are collected with a quarterly frequency and include supervisory series (e.g., Tier 1, Tier 2 capital) as well as other data on DTs for supervisory purposes. Quarterly and monthly data are collected within 20 days and 8 days after the end of the reference period, respectively. Annual data are collected within 1.5 month after the end of the reference year.

20. The understanding of how key underlying series are calculated is important for a proper interpretation of FSIs. Although the *FSI Guide* provides guidance on the calculation of the FSI underlying series, the calculation of some data series used by national FSI compilers is not always fully in line with the *FSI Guide* due to lack of required detail. Furthermore, there might be some adjustments to the underlying series for the FSI calculation. The *FSI Guide* also defers to national practices for the calculation of some underlying series. This situation applies to Montenegro, and details of deviations and country specific practices are provided in the FSI metadata which are presented in Appendix II.

21. Recommended Action:

- Address the data issues identified during the mission and update the compilation spreadsheets as needed.

B. Regulatory and Accounting Framework Underlying the FSI Source Data

22. All banks operating in Montenegro follow Basel II regulatory framework since 2009. In this regard, the calculation of supervisory series, such as Tier 1 capital, Tier 2 capital, and risk-weighted assets is in line with the *FSI Guide*, which fully defers to Basel principles regarding the definition and calculation of these data series. In addition, as part of the process of aligning its policies and practices with those of the European Union (EU), Montenegro is also working towards implementation of the EU Capital Requirements Regulation and Directive (CRR/CRD IV). The CBM is implementing a conservative approach to Basel II implementation by requiring higher minimum capital ratio (10 percent), as well as additional capital requirement for individual banks as relevant.

23. Commercial banks in Montenegro have been implementing IAS39 since 2013 and are expected to start implementing the International Financial Reporting Standards 9 (IFRS9) in 2018. In this regard, the recording of gains and losses, as well as asset/liability valuations applied by banks are in line with the *FSI Guide*, which defers to IASs or IFRSs regarding the accounting rules that should be used in the recording of gains and losses. Some amendments would also be made in the COA based on the implementation of IFRS9, but these amendments will not have any substantial effects on the mapping exercise and the compilation of the FSIs.⁴

C. Consolidation Basis

24. FSIs for Montenegro are compiled using a “domestic consolidation” (DC) basis, which is appropriate as the banks in Montenegro do not have subsidiaries abroad. The DC basis includes data for resident DTs along with those of their branches and subsidiaries in the same sector that are also resident in the domestic economy. Although the *FSI Guide* recommends using either a “cross-border, cross-sector, domestically incorporated” (CBCSDI)⁵ or a “domestic controlled, cross-border, cross-sector” (DCCBCS)⁶ basis, it also provides the DC basis as an alternative when resident DTs have no nonresident subsidiaries and few or no domestically controlled non-DT subsidiaries, which is the case for Montenegro.

D. Compilation and Reporting Framework

25. The mission discussed with CBM officials basic concepts, data requirements, and usefulness of FSIs. The CBM already compiles some FSIs for the purpose of Article IV consultations and FSAP. However, these indicators are not published on the CBM’s website nor reported to STA. No FSI underlying series or metadata are being disseminated.

26. The mission developed a tool to automatically calculate FSIs from source data. In collaboration with the FSD officials, the mission mapped the COAs to the IMF’s FSI templates for sectoral financial statements (balance sheet and income statement). This compilation framework would reduce manual work and ensure sustainability of the FSI compilation. Using the available source data, all 12 core FSIs, 10 of the 13 additional FSIs for DTs, as well as two FSIs for real estate markets were compiled. Available source data allows for quarterly compilation of most of the FSIs for DTs, and monthly compilation of those indicators that are derived only from COAs. In addition, the mission assisted in developing a template for the institutional coverage as well as

⁴ Based on IFRS9, banks are obliged to take into account both expected and contingent losses, and it is expected that the existing prudential filters will help ease the transition to IFRS9.

⁵ CBCSDI covers the data of domestically incorporated, domestically controlled entities in the sector, as well as domestically incorporated subsidiaries of foreign entities classified in the same sector, along with the data of these domestically incorporated entities’ branches and subsidiaries (both domestic and foreign residents), as well as in other sectors.

⁶ DCCBS covers the data of domestically incorporated, domestically controlled entities in the sector, their branches (domestic and foreign), and all their subsidiaries (domestic and foreign) that are classified in the same sector as well as in other sectors.

FSI metadata. The FSD officials confirmed that they are able to compile FSIs using the framework developed during the mission and report them to STA on a regular basis.

27. The mission found minor deviations between the FSIs calculated during the mission with those that have been used for national analysis. The mission and CBM officials understand the reasons for these minor differences⁷ and therefore aim to further improve the data.

28. The CBM aims to regularly provide FSIs to STA at a minimum of quarterly frequency, with data going back to 2013. The underlying methodology of the source data for DTs was amended in January 2013, particularly due to the adoption of the International Accounting Standards. It will thus be challenging to provide consistent data prior to 2013.

29. The CBM is keen for the regular compilation of FSIs based on the *FSI Guide* for reporting to the IMF. This will support the CBM's key responsibility to safeguard financial sector stability. With the release of the FSIs on the CBM's website, Montenegro will also take a step towards a possible subscription to SDDS.

30. Recommended Actions:

- Finalize and report to STA the sectoral income statement (FSI template Annex 2), the sectoral balance sheet (FSI template Annex 3), memorandum series (FSI template Annex 4), and FSIs with underlying series (FSD template) for DTs using the compilation spreadsheets developed during the mission including data beginning from 2013.
- The CBM to start regular reporting to STA, for posting on the IMF's FSI website, the sectoral income statement (FSI template Annex 2), the sectoral balance sheet (FSI template Annex 3), memorandum series (FSI template Annex 4), and FSIs with underlying series (FSD template) for DTs including data from the first quarter of 2013, and the institutional coverage (FSI template) for 2017.

E. Metadata

31. The mission highlighted the need to complement the FSI data with the corresponding metadata. Metadata are key to interpret FSIs and to allow for cross-country comparisons. Any deviations from the recommendations of the *FSI Guide* should be explained in the metadata and updated when necessary. Metadata should also contain information on the content and coverage of the FSIs, as well as the accounting conventions and other national guidelines. The information should be updated when changes are observed, for instance, when commercial banks adopt Basel III.

⁷ For examples, such minor differences include the calculation of "NPLs Net of Provisions to Capital" and "Large Exposures to Capital" ratios where the mission used total regulatory capital as denominators based on the 2017 amendments to the *FSI Guide*, while the national calculations used the balance sheet capital.

32. Recommended Action:

- Finalize the FSI metadata developed during the mission and submit it to STA.

F. FSIs for Other Sectors

33. The financial performance of commercial banks' counterpart sectors as well as key markets has direct impact on the soundness of the financial sector. These sectors include nonbank financial institutions, nonfinancial corporations, and households as well as real estate markets. Given the nonavailability of source data for these other sectors, the mission did not focus on the compilation of FSIs for these sectors, but stressed the importance of the CBM's coordination with other relevant agencies to explore the possibility of receiving source data for these sectors and markets.

34. Recommended Actions:

- Coordinate with regulators of other financial institutions that are not under the CBM's supervision to draw a work program to collect data for compiling FSIs for other financial corporations.
- Coordinate with other relevant statistical agencies to explore the possibility to collect data for compiling FSIs for nonfinancial corporations and households.

G. Resources, Training, and Technical Cooperation

35. The CBM would be expected to officially designate a unit to be responsible for the regular compilation, reporting, and dissemination of FSIs. Although official designation has not yet been made, the FSD worked with the mission to develop the FSI compilation framework. As data reported by commercial banks are already validated by the bank supervisors and monetary statisticians, the FSD only needs to prepare source data using the COAs and supervisory series for inclusion in the compilation spreadsheets. The designation of a specific unit to work on FSIs is important to ensure that the FSI compilers can coordinate and obtain source data in a timely manner and to facilitate training and other staff development.

36. Recommended Action:

- Officially designate a specific unit within the CBM to work on FSIs.

37. It is important to ensure that FSI compilers in Montenegro receive training on FSI methodology to contribute to a continued improvement of the FSI production process. As of December 2017, the FSD has three officials, including the FSD director. The CBM officials were of the view, and the mission agreed, that staff training is required to enhance their understanding of FSI concepts and definitions as well as their interpretation of FSIs in the context of financial stability analysis. One CBM official has already participated in a training course on FSIs at the Joint-Vienna Institute and found it very useful.

38. Recommended Action:

- Support FSD officials for their participation in the IMF's FSI courses to improve their methodological knowledge and skills in compilation and interpretation of FSIs.

39. The CBM officials indicated that no further TA on FSIs for DTs would be needed at this stage. The mission and the CBM officials were of the view that technical support to address pending issues can be provided by STA staff from the IMF's headquarters through e-mail.

Table 3. List of Recommended Actions

Priority	Action/Milestone	Risk/Assumption/Verifiable Indicator	Target Completion date
Outcome: Core and encouraged FSIs are compiled for official dissemination and for posting on the IMF's website			
H	Officially designate a specific unit within the CBM to work on FSIs.	A unit in the CBM officially responsible for compiling and disseminating FSIs, including the FSI reporting to STA for posting on the IMF's FSI website. Benchmark.	August 2018
H	Finalize and report to STA for review the sectoral income statement (FSI template Annex 2), the sectoral balance sheet (FSI template Annex 3), memorandum series (FSI template Annex 4), and FSIs with underlying series (FSD template) for DTs using the compilation spreadsheets developed during the mission including data beginning from 2013.	The compilation spreadsheets developed during the mission, including data from the first quarter of 2013, reported to STA for review. Benchmark.	August 2018

Table 3. List of Recommended Actions (concluded)

Priority	Action/Milestone	Risk/Assumption/Verifiable Indicator	Target Completion date
H	Start regular reporting to STA, for posting on the IMF's FSI website, the sectoral income statement (FSI template Annex 2), the sectoral balance sheet (FSI template Annex 3), memorandum series (FSI template Annex 4), and FSIs with underlying series (FSD template) for DTs including data from 2013 with a quarterly frequency, and the institutional coverage (FS1 template) from 2017 at annual frequency.	FSIs for DTs together with the associated sectoral financial statements and memorandum series with data from the beginning of 2017, on a quarterly basis, and with data from 2013 to 2016, on an annual basis, published on the IMF's FSI website along with the institutional coverage for 2017. Benchmark.	October 2018
H	Finalize the FSI metadata developed during the mission and submit it to STA.	The FSI metadata published on the IMF's FSI website. Benchmark.	October 2018
H	Address the compilation and data issues identified during the mission and update the compilation spreadsheets as needed.	The FSI data quality improved.	October 2018
M	Coordinate with regulators of other financial institutions that are not under the CBM's supervision to draw a work program to collect data for compiling FSIs for other financial corporations.	A work program agreed with the relevant regulators and ready for implementation.	December 2018
M	Coordinate with other relevant statistical agencies to explore the possibility to collect data for compiling FSIs for nonfinancial corporations and households.	Coordination established with other relevant statistical agencies to discuss the data need and possibility of data collection.	December 2018

Appendix I. Officials Met by the Mission

Name	Title, Institutions
Mr. Nikola Fabris	Vice-governor for Financial Stability and Payment Systems
Ms. Marijana Mitrovic Mijatovic	Head, Department of Financial Stability, Research and Statistics
Mr. Borko Bozovic	Head of Directorate for Financial Stability and Payment Systems Oversight
Mr. Mladen Radulovic	Head of Division for Financial Stability
Mr. Srdan Sukovic	Special Advisor to the Director of Bank Supervision Department
Ms. Ivana Jolicic	Division for Prudential Regulation, Supervision Department
Ms. Tanja Teric	Supervision Department
Ms. Danijela Vukajlovic	Advisor to Vice Governor for Bank Supervision (for cooperation with IFIs)
Ms. Darja Milic	Head of Monetary Policy and Research Division

Appendix II. Financial Soundness Indicators Metadata

1. The mission discussed with the CBM officials FSI metadata for DTs. Metadata are disseminated together with FSI data to facilitate data interpretation.

Metadata include information about FSIs and their compilation, such as data definitions, data consolidation, regulatory and accounting rules adopted by the reporting banks, and institutional coverage, which are deemed useful to data users. The FSI metadata are documented based on the information that was made available to the mission.

2. In Montenegro, only commercial banks meet the definition of DTs, with very few subsidiaries in the financial corporations sector.

In this regard, FSIs for DTs are compiled on a domestic consolidation basis as defined in the *FSI Guide*. The domestic consolidation basis includes data for resident DTs along with those of their branches and subsidiaries in the same sector that are also resident in the domestic economy. As banks have no subsidiaries in the same sector FSIs compiled for DTs include resident DTs and only their resident branches. The intra-group consolidation with subsidiaries as recommended in the *FSI Guide* is not applicable. Based on Montenegro's banking system structure discussed above, the resident DTs consist of only 15 commercial banks, and the mission focused on compiling FSIs for these commercial banks on a minimum of quarterly basis¹

3. All banks have adopted Basel II to compile and report data for supervisory purposes, including the calculation of underlying data on capital adequacy without material deviations from Basel II.²

The accounting principles underlying the calculation of source data are based on the International Accounting Standards (IASs). The reporting banks implement IASs without material deviations regarding the recording of gains and losses and asset/liability valuation. As of the beginning of 2018, all commercial banks in Montenegro are expected to implement IFRS9.

4. While the chart of accounts (COAs), which is used as source data, is considered in general adequate for compiling FSIs, some accounts require further clarification of their nature to provide precise classification by counterpart sector and by type of financial instrument in the FSI compilation.

5. The following are data definitions and issues that are useful to the FSI compilers and users:

- The distinction between residents and nonresidents is in line with the international standards (2008 System of National Accounts or the Balance Payments Statistics Manual).

¹ Some FSIs are also compiled monthly for internal use as monthly source data are available.

² Include Tier 1 capital, Tier 2 capital, and risk-weighted assets (RWAs). RWAs reported by banks cover credit risk, market risk, and operational risk.

- Data on accrued interest are separately identified in source data, but they are not split by counterpart sector. Breakdown of accrued interest by counterpart sector is needed for loans and deposits. This breakdown allows incorporating accrued interest in the value of the underlying instruments. The mission estimated the figures based on their shares in total loans.
- The reporting of specific provisions for loan losses is important for the construction of the sectoral balance sheet and for the calculation of the FSI “Nonperforming loans net of provisions to capital”. In this context, the specific loan loss provisions cover the full amount of provisions for loan losses as prescribed by supervisors. It is calculated by summing “the value adjustments for loans” from the COA and “provisions for estimated losses under regulatory requirement.” The latter records only the difference between the supervisory requirements and the provisions that are calculated as per IAS39. Based on IRFS 9, banks are obliged to consider both expected and contingent losses. It is expected that the existing prudential filters will help ease the transition to IFRS9.
- Loans are defined as nonperforming using the 90-days past due criterion, or if there is high probability of incurring losses due to clearly disclosed weaknesses jeopardizing their repayment. According to CBM's "Decision on Minimum Standards for Credit Risk Management in Banks" loans are classified in five categories (A, B, C, D, E) depending on probability of incurring losses. Loans that fall into C, D and E categories are considered as nonperforming loans. A loan that is over 90 days past due may not be classified in higher classification category other than C. However, banks may designate a loan as nonperforming if they have evidence suggesting the inability of the borrower to repay its debt. This definition is basically in line with the *FSI Guide*.
- Large exposures include those exposures of a bank to one party or group of related parties that are equal to or larger than 10 percent of bank's own funds (total regulatory capital). According to Montenegro's Banking Law, total exposure of a bank to one party or group of related parties may not exceed 25 percent of bank's own funds. In addition, the sum of all large exposures of a bank must not exceed 800 percent of bank's own funds. For compiling FSIs, national figures, which include the exposures to central government³ and take into account the effects of credit risk mitigants, are used.
- Government securities are classified as “securities” as they could be converted into cash (e.g., through trading between banks), even though an active secondary market does not always exist.
- For FSI calculation, short-term liabilities include all liabilities with a remaining maturity of three-months or less.

³ Zero credit risk weight is assigned to exposures to central government.

- According to the Banking Law, liquid assets include: (1) cash; (2) funds on the settlement account at the Central Bank; (3) checks and other cash receivables; (4) funds on accounts at domestic banks (demand deposits); (5) funds at payment system agents; (6) funds on accounts at foreign banks (demand deposits); (7) a part reserve requirement funds which may be used for maintaining bank's daily liquidity, as regulated by a special regulation of the Central Bank. Only 50 percent of required reserves are treated as liquid assets, as banks can use these as liquid assets at any time free of charge without any penalties if the balances are restored by the end of the day. The core measure of liquid assets in the context of FSIs include the liquid assets listed above. A broad measure of liquid assets is not calculated as securities held by banks are not considered liquid.
- Net income before extraordinary items and tax is used to calculate return on assets and return on equity. Income and expense data are reported on an accumulative basis.

6. The underlying series for income/expense items and for financial assets/liabilities used in the construction of FSIs (in FSD template) are derived directly from income statement (FS2 Annex 2) and balance sheet (FS2 Annex 3), respectively. The links provided in the compilation spreadsheets show the source of these underlying series.