BOSNIA AND HERZEGOVINA
FEDERATION OF BOSNIA AND HERZEGOVINA
BANKING AGENCY OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

I N F O R M A T I O N
ON THE BANKING SYSTEM OF THE FEDERATION OF BOSNIA AND HERZEGOVINA AS OF 30. 09. 2010.

Sarajevo, November 2010.

Information on banking system of the Federation of BiH (as of September 30th, 2010) is prepared by the Banking Agency of the Federation of BiH, as a regulatory authority conducting supervision of banks, based on reports of banks, and other information and data submitted by banks. Findings and data from on-site examinations and analysis performed at the Agency (off-site financial analysis) have also been included.

I INTRODUCTION

Although in 2010, after the decline caused by recession in 2008, and in 2009, there were first signs of slight improvement of the economic activity (growth of the industrial production, export growth, slight incline of the GDP etc.), banking sector is still under the impact of the global economic crises, weakening of the local economy and buying power. Adverse effects, although in a weaker form, are mostly reflected on the banks' key activity, which are the lending segment and the loan portfolio quality, due to increase in the provisioning for loan losses and significant decline in the profitability in the banks' performance.

As of 30.09.2010., there were 20 banks with banking license issued in the Federation of BiH, of which two banks were under provisional administration (UNA bank d.d. Bihać and Hercegovačka bank d.d. Mostar). In October 2010, Postbank BH Postanska bank BiH d.d. Sarajevo also got under provisional administration. Number of organizational units of banks from the Federation of BiH, as of 30.09.2010. compared to the end of 2009, decreased by 1,4%, amounting to 626 organizational units. In 2010, the trend of decrease of the number of employees in banks continued, which is another adverse effect of the economic crises on the banking system in FBiH. As of 30.09.2010., the number of employees in banks was 7.517, which are 139 employees less or 2% compared to the end of 2009.

The aggregate balance sheet of the banking sector, as of 30.09.2010., amounted to 15,1 billion KM, representing a decrease by 1% or 148 million KM compared to the end of 2009. Although in the first quarter there was a minor increase by 1%, in the next two quarters there was a downfall of 2% or 324 million KM. The decrease of the aggregate balance sheet in 2010 is a result of the payment of the past due liabilities and simultaneously the growth of deposits had slightly improved its downfall.

In terms of concentration in the banking system, there have been no significant changes in the last several years, so evident is the dominant position of the five largest banks in terms of market share (loans and deposits) which still hold approximately 80% of the market.

In assets, cash funds are 4,4 billion KM and they decreased by 8% or 388 million KM in relation to the end of 2009, mostly due to repayment of matured loan liabilities. During this year, the banks have increased their term deposits on their accounts at foreign banks by 96% or 106 million KM and as of 30. 09. 2010., they were 217 millon KM. Also, the banks increased the investment in securities, mostly state bonds of the EU countries, so that at the end of the third quarter of 2010 the securities portfolio was 388 million KM. Due to high liquidity, the banks, mostly the large ones, are trying to realize higher income by placing funds in securities and term deposits in foregin banks and with that try to positevely impact the decline of the interest income resulted from the decrease of loans.

Capital and net capital of banks in the FBiH, amounted to two billion KM, as of 30.09.2010. In the three quarters of 2010, the capital decreased by 2% or 46 million KM in relation to 2009. The core capital increased by 1% or 18 million, and supplementary capital decreased by 12% or 63 million KM. Although the increase of the core capital is minimal, it should be noted that stopping the decline and weakening of the capital base, under the influence of the high losses in performance and maintaining it on the same level is a result of two important events: first, that the banks retained the realized profit from 2009 in capital, and second that the additional capitalization of two banks was completed in the third quarter of 2010. The capital adequacy ratio at the level of the banking sector as of 30.09.2010 is 15,7% or by 0, 4% less than at the end of 2009, and the reason is the decrease of capital and slight increase of the total risk weighted items.

Credit placements, at the end of the third quarter of 2010, amounted to 9,9 billion KM. After five consecutive quarterly downturns in credit placements (all quarters in 2009, and the first one in 2010), credits in the second and third quarter of 2010 recorded an increase of 1% or 99 million KM, or for the nine months of 2010 the total growth of credit was 1% or 70 million KM. The slight credit growth can be assessed as a positive sign, since it indicates that the banks' credit activities, after several months of decrease, intensified in 2010. In the third quarter there was a slowdown of the negative trends of decline of asset quality and deterioration of the loan portfolio quality, since the growth of the nonperforming loans significantly decreased, especially in comparison to prior quarter experiencing enourmous increase of bad placements, primarily due to impact of one bank. This resulted by significantly lower increase of relative indicator in participation of nonperforming assets to total loans in third quarter of 2010, as well as other indicators of asset quality in comparison to prior periods.

The trend of changes in participation of banks' two most important sources of financing, deposits and loan liabilities, continued in 2010, on one hand the increase of deposits and on the other hand the decrease of loan liabilities, due to the payment of past due liabilities. In the bank's sources of financing in the Federation of BiH the largest participation of 74,4% is still represented by the deposits that are 11,2 billion KM and they increased in comparison to the end of 2009 by 2% or 184 million KM. The second largest source with participation in the sources of 10,2% (12,8 at the end of 2009) are loan funds that the banks received mostly through borrowings from foreign financial institutions.

Positive changes in the segment of savings deposits as the most significant segment of deposit and financial potential of banks continued in 2010, the savings as of 30.09.2010 were 4,8 billion KM, which is the highest amount up to date and by 278 million higher than the level as of 30.09.2008, which just before the crises was the highest amount ever. In the three quarters of 2010, the savings increased by 10,2% or 446 million KM. Such movements are mostly the result of the decreased spending due to the crises, difficult condition in which the economy is and because of the fear the citizens have due to the uncertainty related to prospects for improvements, realization of positive movements and changes for better.

According to the income statement, the banks in the Federation of FBiH for the nine months in 2010, had a negative financial result – loss was reported in the amount of 59 million KM. The main reason for such poor financial result is primarily the influence of the high losses in one bank. Positive financial result was generated by 13 banks, while 7 banks reported loss in their performance. The significant increase of expenses for provisioning for loan losses, which was the result of the significant downfall in the quality of loans, had the largest impact on the deterioration of the profitability. Analyses of the changes in different quarters in 2010 can lead to conclude that there were positive changes in the third quarter; the realized losses in this quarter are significantly lower than in the previous two while the profit is higher. It is expected that these positive movements will continue in the last, fourth quarter.

And finally, we could conclude that the downfall of the lending was stopped in 2010, that in the third quarter noted was the slowdown of the negative trends of the decline of quality of loan portfolio and that the overall capitalization of the banking sector was satisfactory. Due to high liquidity and decreased loan activities, the banks are reconstructing the funding sources by decreasing the loan obligations and increasing the deposits and in such manner decrease the financing expenses, and by increasing the investments in securities and time placements at foreign banks slow down the decline of the interest income. On the basis of this and the expected slow and low economic recovery it is evident that the coming period the growth of the loans will be low, the quality of the existing loan portfolio will continue to deteriorate, the poor quality placements will increase and as a result the loan losses, and that will have negative effects on the banks' financial result.

II BUSINESS PERFORMANCE OF BANKS IN THE FEDERATION OF BIH

1. STRUCTURE OF THE BANKING SECTOR

1.1. Status, number and business network

As of 30.09.2010., there were 20 banks with the banking license issued in the Federation of BiH. Number of banks remained the same as of 31.12.2009. There is a special law regulating establishment and work of the Development Bank of the Federation of BiH, Sarajevo which is a legal successor of the Investment Bank of the Federation of BiH d.d., Sarajevo, as of 01.07.2008.

As of 30.09.2010., there were two banks under provisional administration (UNA bank d.d. Bihać and Hercegovačka bank d.d. Mostar).

In 2010, the banks continued expanding the network of their organizational units, but at a significantly lower level. At the same time, some banks had to close their organizational units, that is, they reorganized and merged their organizational units for purpose of cost cutting. Consequently, as of 30.09.2010., the banks from the Federation of BiH had a total of 626 organizational units. This represents a downfall of 1,4% when compared to 31.12.2009., as of which date the banks had 635 organizational units.

As of 30.06.2010., seven banks from the Federation of BiH had 56 organizational units in the Republic Srpska and nine banks had 13 organizational units in District Brcko. Five banks from the Republic Srpska had 13 organizational units in the Federation of BiH.

As of 30.09.2010., all the banks had the license for inter-bank transactions in the internal payment system and 15 banks were under the deposit insurance program.

1.2. Ownership structure

As of 30.09.2010., ownership structure in banks[1] based on the available information and on-site visits to banks[2] is the following:

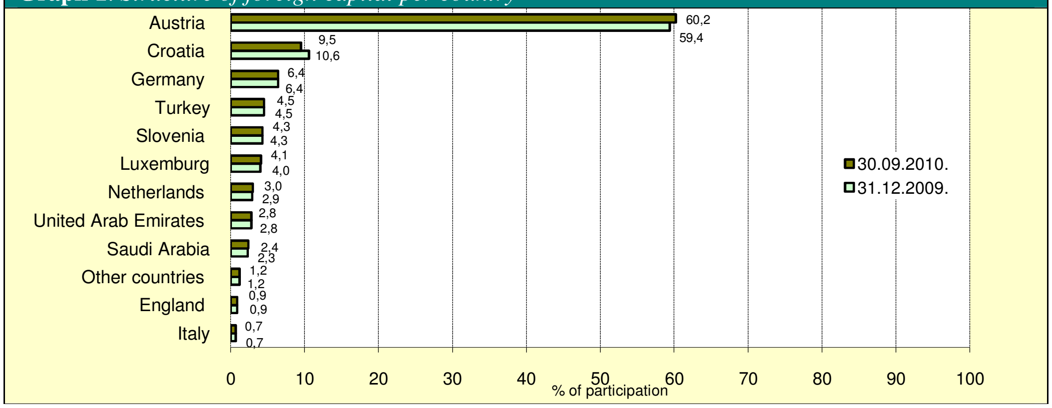
- Private and majority private ownership 18 banks (90%)
- State and majority state ownership[3] 2 banks (10%)

[1] A bank classification criterion is ownership over banks' share capital.
[2] The ownership structure of banks in the FBiH as of 30.09.2010., resulted from received documentation and registrations at authorized courts changes in capital and shareholders structure.
[3] State ownership refers to domestic state capital of BiH.

Seven banks, of 18 banks with majority private ownership, are majority owned by domestic legal entities and individuals (residents), while 11 banks have majority foreign ownership.

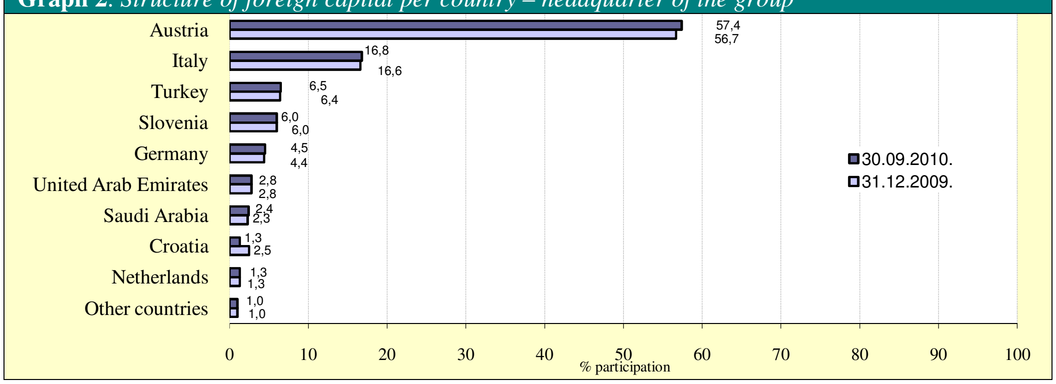
If only foreign capital is analyzed, according to the criteria of the shareholders' home country, as of 30.09.2010., the balance is almost the same as of the end of 2009: shareholders from Austria owned 60,2% of foreign capital; the shareholders from Croatia owned 9,5% of foreign capital; and other countries participated less than 7%.

Graph 1: *Structure of foreign capital per country*



However, if capital correlations are taken into account, the structure of foreign capital could be viewed according to the criteria of the parent-bank or the group's headquarter that has majority ownership (directly or indirectly over the group members) of the banks in the Federation of BiH. According to these criteria, situation as of 30.09.2010. has slightly changed in comparison to the end of 2009: banking groups and banks from Austria with participation of 57,4%, followed by the Italian banks with participation of 16,8%, while other countries had individual participation of below 6,5%.

Graph 2: *Structure of foreign capital per country – headquarter of the group* [4]



The ownership structure could be viewed from the aspect of financial indicators, which is based on the value of total capital [5].

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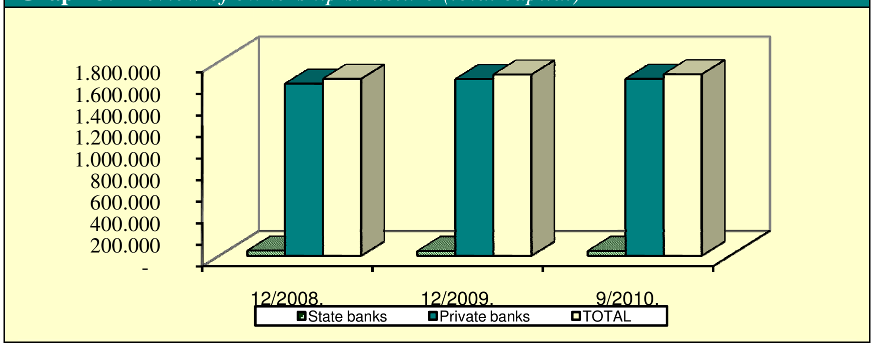
[4] Apart from the country of the headquarter of the parent-group whose members are the banks from the FBiH, the countries of all other foreign shareholders of the banks from the FBiH are also included.
[5] Information from balance sheet – FBA schedule: shareholder's capital, premium issue, undistributed profit and reserves, and other capital (financial results of current period).

-in 000 KM-

Table 1: *Ownership structure by total capital*

31.12.2009.	31.12.2008.		31.12.2009.		30.09.2010.		INDEX	
							3/2	4/3
1	2		3		4		5	6
State banks	42.593	3%	41.736	2%	42.231	3%	98	101
Private banks	1.594.261	97%	1.635.962	98%	1.638.805	97%	103	100
TOTAL	1.636.854	100%	1.677.698	100%	1.681.036	100%	102	100

Graph 3: *Preview of ownership structure (total capital)*



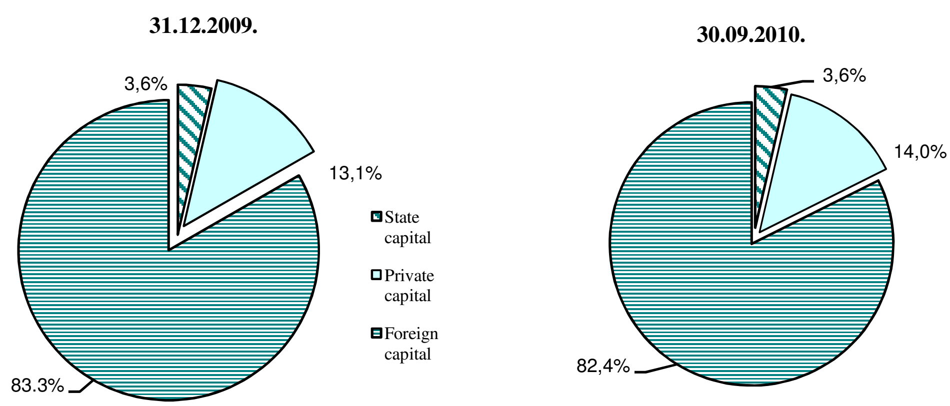
Analysis of participation by state, private and foreign capital in the share capital of banks shows more precise picture of the capital ownership structure in banks of the Federation of BiH.

- in 000 KM-

Table 2: *Ownership structure by participation of state private and foreign capital*

SHARE CAPITAL	31.12.2008.		31.12.2009.		30.09.2010.		INDEX	
	Amount	Partic %	Amount	Partic. %	Amount	Partic. %	5/3	7/5
1	2	3	4	5	6	7	8	9
State capital	46.100	4,1	41.860	3,6	41.860	3,6	91	100
Private capital (resident)	142.469	12,8	153.365	13,1	163.997	14,0	108	107
Foreign capital (nonresident)	929.447	83,1	975.943	83,3	965.440	82,4	105	99
TOTAL	1.118.016	100,0	1.171.168	100,0	1.171.297	100,0	105	100

Graph 4: *Ownership structure (share capital)*



The share capital of banks in the Federation of, for the first nine months of 2010, is the same as of 31.12.2009. Structure of share capital insignificantly changed: private capital (residents) increased by 10,6 million KM, while private capital (nonresidents) decreased by 10,5 million KM.

Analysis of the banks' ownership structure shows in the most explicit way, from the aspect of share capital, the changes and trends in the banking system of the FBiH, and especially the changes of the ownership structure.

Participation of the state capital in total share capital, as of 30.09.2010., was 3,6%, which is the same as of 31.12.2009.

Participation of private capital (residents) in total share capital of 14,0% is representing a 0,9 per cent increase in comparison to the end of 2009. Nominal increase of 10,6 million KM refers to the increase with one bank in the net amount of 12,4 million KM (additional capital of 15,3 million KM and decrease of 3,9 million KM due to covering the losses from previous years), the decrease in the turnover with nonresidents in three banks in the net amount of 1,3 million KM and the decrease due to the withdrawal of the ownership shares in one bank in the amount of 0,5 million KM.

Participation of foreign capital (nonresidents) in total share capital has decreased by 0,9 per cent in comparison to 31.12.2009. There was a decrease of 10,5 million KM in the absolute amount. This decrease refers to the decrease in the amount of 11,8 million KM due to 50% decrease of the nominal value of shares in one bank, and the increase in the turnover with residents at three banks in the net amount of 1,3 million KM.

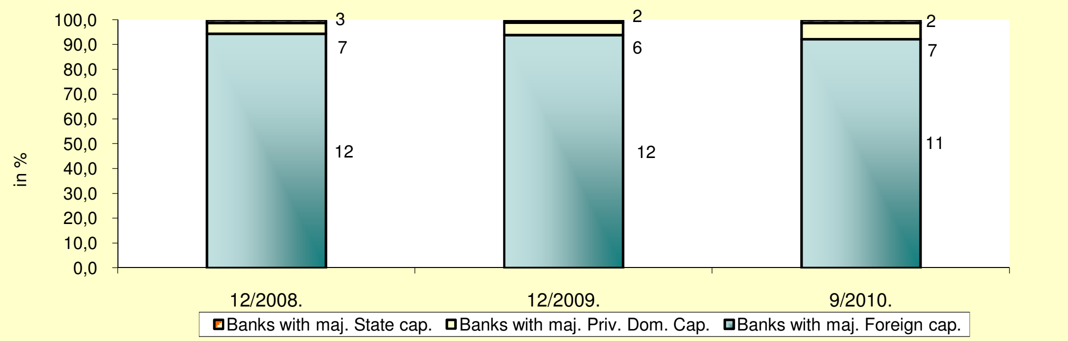
As of 30.09.2010., the market share of banks with majority foreign ownership was a high 92,2%, of banks with majority domestic private capital was 6,6%, and the share of banks with majority state capital was 1,2%.

- in %-

Table 3: *Market share of banks per ownership type (majority owned capital)*

BANKS	31.12.2008.			31.12.2009.			30.09.2010.		
	No. of banks	Partic. in total capital	Partic. in total assets	No. of banks	Partic. in total capital	Partic. in total assets	No. of banks	Partic. in total capital	Partic. In total assets
1	2	3	4	5	6	7	8	9	10
Banks with majority state capital	2	2,6	1,3	2	2,5	1,1	2	2,5	1,2
Banks with majority private domestic capital	6	10,5	4,4	6	10,7	5,0	7	12,4	6,6
Banks with majority foreign capital	12	86,9	94,3	12	86,8	93,9	11	85,1	92,2
TOTAL	20	100,0	100,0	20	100,0	100,0	20	100,0	100,0

Graph 5: *Market share per ownership type*



1.3. Employees

As of 30.09.2010., there were a total of 7.517 employees in the banks of the Federation of BiH, of that number 3% is in the banks with a majority state capital and 97% in private banks.

Table 4: *Bank employees in the FBiH*

BANKS	NUMBER OF EMPLOYEES						RATIO	
	31.12.2008.		31.12.2009.		30.09.2010.		3:2	4:3
1	2		3		4		5	6
State banks	234	3%	231	3%	232	3%	99	100
Private banks	7.763	97%	7.425	97%	7.285	97%	96	98
TOTAL	7.997	100%	7.656	100%	7.517	100%	96	98
Number of banks	20		20		20		100	100

Decreasing trend in number of employees from the past year has continued through the first half of 2010, which is one of adverse effects of the economic crisis to the banking sector in the FBiH. Number of employees decreased by 139 or 2%, primarily referring to one bank with decrease of 116 or 17%.

Table 5: *Qualification structure of employees*

EDUCATION	NUMBER OF EMPLOYEES						RATIO	
	31.12.2008.		31.12.2009.		30.09.2010.		4:2	6:4
1	2	3	4	5	6	7	8	9
University qualifications	3.007	37,6%	3.104	40,5%	3.219	42,8%	103	104
Two-year post secondary school qualifications	861	10,8%	774	10,1%	719	9,6%	90	93
Secondary school qualifications	4.054	50,7%	3.719	48,6%	3.523	46,9%	92	95
Other	75	0,9%	59	0,8%	56	0,7%	79	95
TOTAL	7.997	100,0%	7.656	100,0%	7.517	100,0%	96	98

The employees' qualification structure has been recording a slight trend of improvement over longer period of time through an increase of participation of the employees with university qualifications, and negative trend of decrease of employees in the prior period, primarily with secondary school qualifications, that has a positive effect to the qualification structure.

One of the indicators influencing an evaluation of performance of a respective bank, and the banking system, is effectiveness of employees and it is shown as a ratio of the assets and the number of employees, that is, the amount of assets per an employee. The higher ratio, the better the performance effectiveness of both the bank and the entire system.

Table 6: *Assets per an employee*									
BANKS	31.12.2008.			31.12.2009.			30.09.2010.		
	No. of empl.	Assets (000 KM)	Assets per empl.	No. of empl.	Assets (000 KM)	Assets per empl.	No. of empl.	Assets (000 KM)	Assets per empl.
State	234	187.157	800	231	161.619	700	232	183.617	791
Private	7.763	14.882.747	1.917	7.425	15.074.741	2.030	7.285	14.904.347	2.046
TOTAL	7.997	15.069.904	1.884	7.656	15.236.360	1.990	7.517	15.087.964	2.007

At the end of the third quarter of 2010, there was a two million KM asset per an employee on the level of the banking system. This indicator is significantly better with the private bank sector, as expected taken the stagnation or the decreased volume of activities of state banks and their consequent excessive number of employees.

Table 7: *Assets per an employee by groups*			
Assets (000 KM)	31.12.2008.	31.12.2009.	30.09.2010.
	Number of banks	Number of banks	Number of banks
Up to 500	2	1	1
500 do 1.000	9	8	6
1.000 do 2.000	3	5	7
2.000 do 3.000	5	5	5
Over 3.000	1	1	1
TOTAL	20	20	20

Analytical indicators of respective banks range from 254 thousand KM to 3,6 million KM of assets per an employee. Six banks have a better indicator than the one for the whole banking sector, and three banks in the system have one that exceeds 2,4 million KM.

Finally, we can say that the banks have made a significant progress in improving the quality and conditions in which they offer their services to clients, legal entities and individuals, as well as the conditions under which they offer services and finance clients.

2. FINANCIAL INDICATORS OF BANKS' PERFORMANCE

Examination of banks based on reports is performed through using the reports prescribed by the FBA and the reports of other institutions creating a database constructed of three sources of information:

1. Information on balance sheet for all banks submitted monthly, including quarterly attachments, containing more detailed information on funds, loans, deposits and off-balance sheet items, and some general statistic information,
2. Information on bank solvency, data on capital and capital adequacy, asset classification, concentrations of certain types of risks, liquidity position, foreign exchange exposure, loan and deposit interest rates based on the reports prescribed by the FBA,
3. Information on performance results of banks (income statement – FBA format) and cash flow reports submitted to the FBA quarterly.

Aside from the mentioned standardized reports, the database includes the information obtained from additional reporting requirements prescribed by the FBA in order to have the best conditions for monitoring and analysis of banks' performance in the Federation of BiH. The database also includes audit reports of financial statements of banks prepared by independent auditor, as well as all other information relevant to the assessment of performances of individual banks and the entire banking system.

In accordance with the provisions of Law on Opening Balance Sheet of Banks, banks with majority state owned capital have to report to the FBA "full" balance sheet divided into: passive, neutral and active sub-balance sheet. In order to obtain realistic indicators of banks' performance in the Federation of BiH, all further analysis of the banking system will be based on the indicators from the active sub-balance sheet of banks with majority state owned capital[6].

2.1. Balance sheet

Aggregate balance sheet of the banking sector, as of 30.09.2010., amounted to 15,1 billion KM that is by 1% or 148 million KM higher than at the end of 2009. After a slight increase in the first quarter of 1% or 176 million KM, mostly through the inflow of funds received from the IMF Stand-by arrangement (second and third tranche in the amount of 180,4 million KM), there was a decrease in the following two quarters of 2% or 324 million KM, which in the nine months of 2010 resulted with a decrease of 1% or 148 million KM. Taken the crisis impact and condition of the real sector, as well as situation and state in the economy and financial sector of the owners' home countries of the banks in the FBiH, such movements and trends in the banking sector have been expected.

Table 8: Balance sheet

DESCRIPTION	AMOUNT (IN 000 KM)							
	31.12.2008.		31.12.2009.		30.09.2010.		RATIO	
	AMOUNT	Partic. %	AMOUNT	Partic. %	AMOUNT	Partic. %	3/2	4/3
1	2		3		4		5	6
ASSETS:								
Cash funds	4.207.559	27,9	4.782.301	31,4	4.393.960	29,1	114	92
Securities[7]	18.814	0,1	119.157	0,8	387.332	2,6	633	325
Placements to other banks	90.415	0,6	111.019	0,7	217.500	1,4	123	196
Loans	10.434.377	69,2	9.796.800	64,3	9.866.549	65,4	94	101
Loan loss provisions (LLP)	381.215	2,5	458.803	3,0	570.925	3,8	120	124
Loans – net value (loans minus LLP)	10.053.162	66,7	9.337.997	61,3	9.295.624	61,6	93	100
Business premises and other fixed assets	467.507	3,1	528.910	3,5	559.820	4,2	112	106
Other assets	232.447	1,6	356.976	2,3	233.728	1,1	154	65
TOTAL ASSETS	**15.069.904**	**100,00**	**15.236.360**	**100,00**	**15.087.964**	**100,00**	**101**	**99**
LIABILITIES:								
LIABILITIES								
Deposits	10.461.850	69,4	11.045.868	72,5	11.230.189	74,4	106	102
Borrowings from other banks	3.089	0,0	3.089	0,0	5.089	0,0	100	165
Loan Commitments	2.176.594	14,4	1.771.978	11,6	1.372.026	9,1	81	77
Other liabilities	791.517	5,3	737.727	4,9	799.624	5,4	93	108
CAPITAL								
Capital	1.636.854	10,9	1.677.698	11,0	1.681.036	11,1	102	100
TOTAL LIABILITIES (LIABILITIES AND CAPITAL)	**15.069.904**	**100,0**	**15.236.360**	**100,00**	**15.087.964**	**100,00**	**101**	**99**

[6] Some state banks in their "full balance sheet" report passive and neutral items, which will be taken over by the state upon finalization of the privatization process. As of 30.09.2010., these items amounted to KM 647 million.

[7] Trading securities and securities held to maturity.

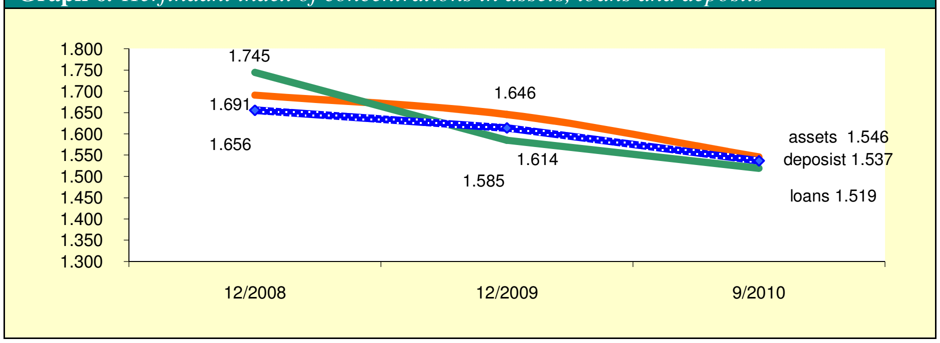
Table 9: *Assets of banks based on the ownership structure*

BANKS	31.12.2008.			31.12.2009.			30.09.2010.			RATIO	
	No. banks	Assets (000 KM)		No. banks	Assets (000 KM)		No. banks	Assets (000 KM)		5/3	7/5
1	2	3		4	5		6	7		8	9
State	2	187.157	1%	2	161.619	1%	2	183.617	1%	86	114
Private	18	14.882.747	99%	18	15.074.741	99%	18	14.904.347	99%	101	99
TOTAL	20	15.069.904	100%	20	15.236.360	100%	20	15.087.964	100%	101	99

The assets of majority of banks (14) were higher than at the end of 2009, ranging from 1% to 28%. The remaining six banks recorded the aggregate balance sheet decline from 1% to 15%. Of the three largest banks in the system, two banks recorded balance sheet decline of 14,3% and 7,2%, and the third bank recorded a relatively minimal growth of 2,6%.

Indicator of concentrations in the three most significant segments of banking performance, in assets, loans and deposits is the value of the Herfffindahl index[8].

Graph 6*: Herfindahl index of concentrations in assets, loans and deposits*



In the reviewed period of 2010, the Herfindahl index in all three relevant categories (loans, deposits and assets) recorded a slight decline in comparison to the end of 2009: by 100 units in assets, 66 in loans and 77 in deposits. Their value, as of 30.09.2010., was 1.546 for assets, 1.537 for deposits and 1.537 units for deposits, indicating a moderate concentration[9].

Another indicator of concentration in the banking system is the ratio of market concentration, that is the concentration rate[10] (hereinafter: CR), which indicates the total market participation of the largest institutions in the system per relevant chosen categories: assets, loans and deposits. The CR5 for market participation, loans and deposits of the five largest banks in the system, at the end of the third quarter of 2010, was 76,7%, 77,4% and 76,4% respectively which is a slight change in comparison to the end of 2009. The situation has almost not changed over the past

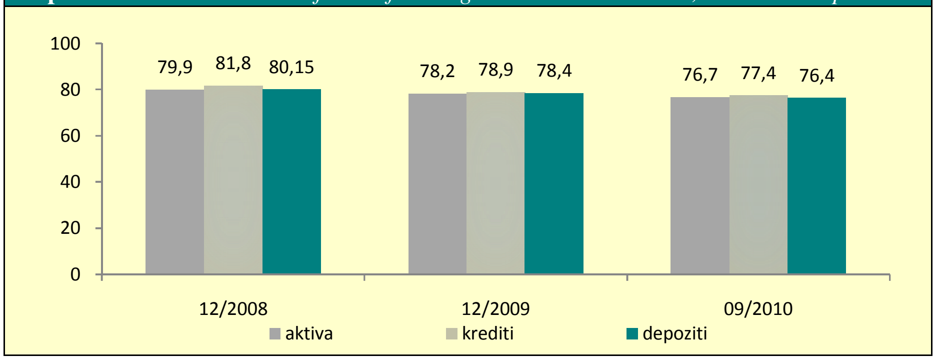
[8] It is also called the Hirschmann-Herfindahl index or HHI as calculated in the formula $HI = \sum_{j=1}^{n} (S)_j^2$, representing the sum of square of percentage shares of concrete values (e.g. assets, deposits, loans,…) of all market participants in the system. We should mention that the index is not linearly increasing, and the value of e.g. 3000 does not mean the concentration in the system is 30%. Hypothetically, if there is only one bank in the system, the HHI would be maximum at 10000.

[9] If the HHI value is below 1000, the opinion is that there is no concentration in the market; for the index value between 1000 and 1800 units, concentration in the market is moderate; and if the HHI value exceeds 1800, it indicates high concentration.

[10] Engl.: concentration ratio (CR), assigned to the number of institutions inlcuded in the calculation.

several years, and dominant is the position of five largest banks in the system that 'hold' approximately 80% of the market, loans and deposits.

Graph 7: *Concentration rates for the five largest banks-CR5: assets, loans and deposits*



The banking sector could be analyzed from the aspect of several groups established according to the asset size[11]. The minor changes in relation to the end of 2009 refer to the participation of certain groups which is a result of changes of assets with several banks.

The participation of three largest banks (Group I) decreased from 65,1% to 62,4%, while the participation of banks from Groups II, III and IV increased by 0,6%, 0,8 p.p. and 1,3 p.p. The participation of these groups as of 30.09.2010., were: Group II (one bank) 8,2%, Group III (three banks, assets between 500 million KM and one billion KM) 15,9% and Group IV (the most numerous group with nine banks, assets between 100 and 500 million KM) 12,1 %. The last Group V (four banks, assets less than 100 million KM) still has the same lowest participation of 1,4%.

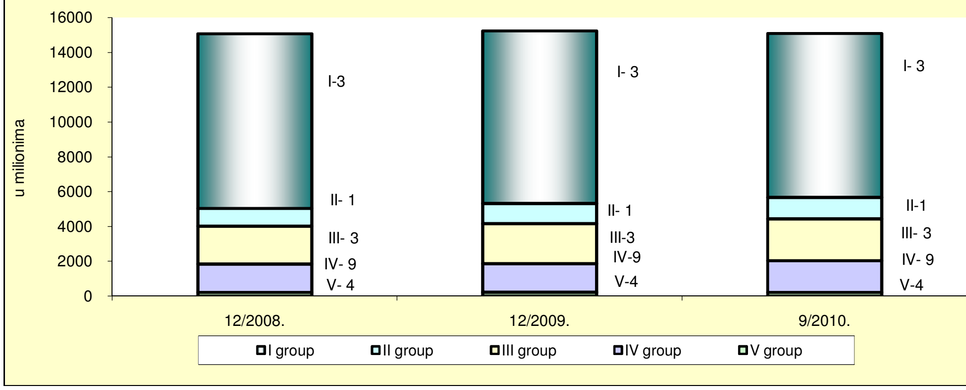
The following table presents a preview of amounts and participations of individual groups of banks in total assets by periods (amounts presented in KM millions).

Table 10: *Participation of individual groups of banks in total assets through periods*

ASSETS	31.12.2008.			31.12.2009.			30.09.2010.		
	Amount	Partic. %	No. of banks	Amount	Partic. %	No. of banks	Amou nt	Partic. %	No. of banks
I- Over 2.000	10.036	66,6	3	9.912	65,1	3	9.424	62.4	3
II- 1000 do 2000	1.017	6,7	1	1.165	7,6	1	1.233	8,2	1
III- 500 do 1000	2.180	14,5	3	2.293	15,1	3	2.400	15,9	3
IV- 100 do 500	1.627	10,8	9	1.648	10,8	9	1.821	12,1	9
V- Below 100	210	1,4	4	218	1,4	4	210	1,4	4
TOTAL	15.070	100,0	20	15.236	100,0	20	15.088	100,0	20

[11] Banks are divided into five groups depending on the assets size.

Graph 8: *Participation of individual groups of banks in total assets by periods*



The slight decrease of the aggregate balance sheet in 2010 of 1% or 148 million KM is a result of the collection of the liabilities from loans, that decreased by 23% or 400 million KM (they were 1,4 billion KM as of 30.09.2010.). At the same time, the growth of deposits of 2% or 184 million KM alleviated the decline of the aggregate balance sheet, and as of 30.09.2010 the deposits were 11,2 billion KM. However, it has to be emphasized that this growth is primarily the result of the funds received through the second and third tranche from the IMF of 180 million KM in the first quarter of 2010.

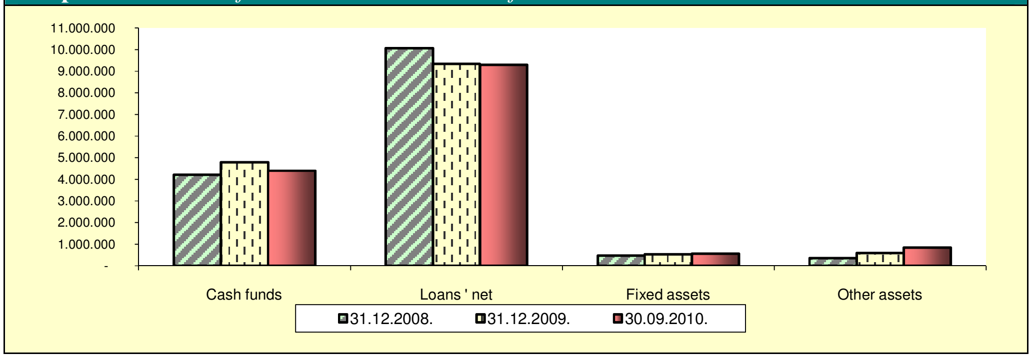
In the assets, cash funds (4,4 billion KM) are by 8% or 388 million in comparison to the end of 2009 mostly due to collection of matured loans liabilities. Also, banks increased the term deposits on the accounts in the foreign banks by 96% or 106 million KM (as of 30.09.2010., they were 217 million KM), and placed around 120 million KM in securities[12], mostly EU countries state bonds (at the end of the third quarter of 2010 the securities portfolio is 388 million KM). Significant funds were placed in the IV quarter of 2009 with the same purpose, purchase of securities (around 180 million KM, of which trading securities are 120 KM[13]). Due to too high liquidity and minimal return on funds over the obliged reserves on the reserve account in Central Bank of BiH, the banks, mostly the large ones, through placements in the securities and time deposits in foreign banks, are trying to realize higher income and by doing that mitigate the decline of the interest income due to decrease in loan placement.

In the second and third quarter of 2010, the loans increased by 1% or 99 million KM (or for nine months of 2010 the total loan growth was 1% or 70 million KM) for the first time after five consecutive quarterly rates of decline of loans (all quarters in 2009 and the first in 2010), which was primarily the consequence and the result of restrictive lending policies of banks and decreased level of lending activities of banks in the conditions of economic crises and recession. It should be noted that the banks, in the three quarters of 2010, after classifying them in category E-loss, transferred to off balance sheet the loans in the amount of 131 million KM, which is almost equal to the total amount of the written off loans in 2009 (136 million KM). Such slight credit growth can be considered as a positive sign since they indicate that the banks' activities had, after several months of decrease, intensified which resulted in a slight loan growth. At the end of the third quarter of 2010 loans were 9,9 billion KM.

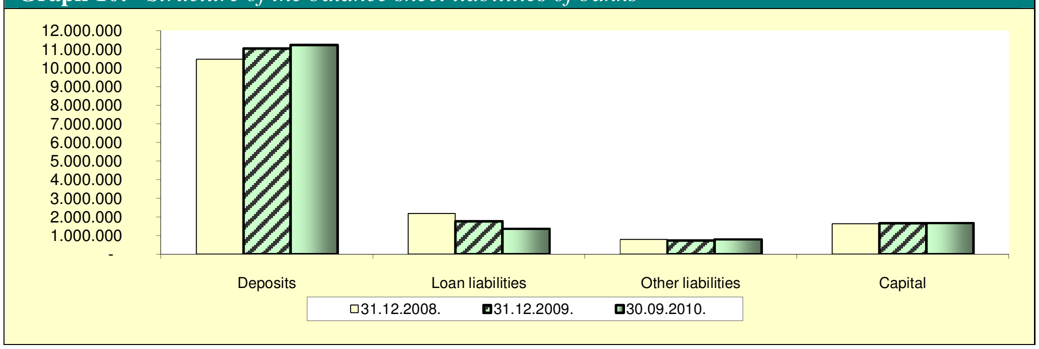
[12] In the Balance sheet position 2 – Trading Securities also includes the financial instruments (debt and equity securities) available for sale.
[13] In the II quarter of 2010, these funds were repositioned from other assets to the position 2 - Trading securities.

The following table and graph present the structure of the most significant balance sheet positions of banks.

Graph 9: *Structure of the balance sheet assets of bank*



Graph 10: *Structure of the balance sheet liabilities of banks*



In the structure of banks' balance sheet liabilities, deposits in the amount of 11,2 billion KM and participation of 74,4% is still the dominant source of financing for banks in the Federation of BiH. Participation of credit liabilities has decreased from 11,6% to 9,1%, and participation of capital decreased from 11,0% to 11,1%.

The structure of assets, as well as the structure of sources, had relatively significant changes related to two key assets items: increased participation of loans from 64,3% to 65,4% and decreased participation of cash funds from 31,4% to 29,1%.

- in 000 KM-

Table 11: *Cash funds of bank*

CASH FUNDS	31.12.2008.		31.12.2009.		30.09.2010.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Cash	344.618	8,2	355.419	7,4	374.994	8,5	103	106
Reserve accounts with CBBiH	2.228.687	53,0	2.455.505	51,4	2.513.208	57,2	110	102
Accounts with deposit institutions in BiH	12.341	0,3	441	0,0	4.243	0,1	4	962
Accounts with deposit institutions abroad	1.621.449	38,5	1.970.473	41,2	1.500.995	34,2	122	76
Cash funds in collection process	464	0,0	463	0,0	520	0,0	100	112
TOTAL	4.207.559	100,0	4.782.301	100,0	4.393.960	100,0	114	92

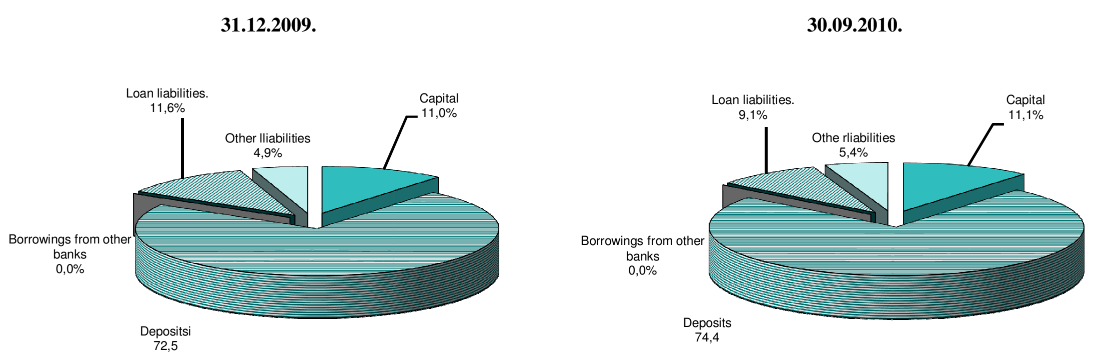
Cash funds of the banks on the reserve accounts of CBBH, over the observing period of 2010, increased by 2% or 58 million KM, amounting to 2,51 billion KM or 57,2% of total cash funds as of 30.09.2010., representing the participation increase of 5,9% in relation to the end of 2009. Banks' funds on the accounts with the depository institutions abroad have decreased by 24% or 469 million KM, amounting to 1,5 billion KM or 34,2% of total cash funds at the end of the third quarter of 2010 (41,2% at the end of 2009). The banks have increased their cash on hand and in vaults by 6% or 20 million KM. At the end of the observing period, those funds amounted to 375 million KM, representing 8,5% of total cash funds (7,4% at the end of 2009).

The noted movements had a significant impact on the change of the currency structure of the cash funds, participation of domestic currency in the currency structure of cash funds, over the observing period, has increased from 55,8% to 62,7%, while the participation of funds in foreign currency has decreased by the same amount of change.

2. 1. 1. Liabilities

Structure of liabilities (liabilities and capital) in the balance sheet of banks, as of 30.09.2010. is presented in the following graphs:

Graph 11: *Liabilities structure of banks*



Trends in changes of participation of the two most significant funding sources of banks (deposits and credit liabilities) continued developing through 2010. On one hand, the deposit growth was mostly based on the funds from the arrangement with the IMF, and decrease of credit liabilities due to payment of past due liabilities on the other hand, resulted with an increase of the participation of deposits from 72,5% to 74,4% and credit liabilities decreased from 11,6% to 9,1%.

Deposits participating with 74,4% or 11,2 billion KM still represent the most significant funding source of banks in the Federation of BiH. In comparison to the end of 2009, these items increased by 2% or 184 million KM. Second source, per its size are credit funds obtained by banks primarily through indebtedness with foreign financial institutions. During 2009 the banks had significantly lower debt abroad, and the payment of due liabilities had as a net effect the decrease of loan liabilities by 19% or 405 million KM. In the observed period of 2010, the same trend continued, the credit funds decreased by 23% or 400 million KM. If subordinate debts of 165 million KM, which were withdrawn by banks to strengthen capital base and capital adequacy, are added to the credit liabilities then the participation of total credit funds in the sources would be 10,2% (12,8% at the end of 2009).

Capital, at the end of the observed period of 2010, amounted to 1,68 billion KM, which is the same as at the end of 2009. Although significant losses were reported at the level of the banking system for the nine months of 2010, the realization of the additional capitalization of two banks in the third quarter neutralized the negative effect on the total banks' capital in FBiH.

As of 30.09.2010., the highest bank commitments were towards the following creditors (eight of total 44), representing 69% of total credit commitments: European Investment Bank (EIB), Central Eastern European Finance Agency (CEEFA), EBRD, European fund for Southeast Europe (EFSE), Council of Europe Development Bank, ComercBank AG Frankfurt, Raiffeisen Zentralbank Osterreich A.G. (RZB) and Nova Ljubljanska bank (NLB).

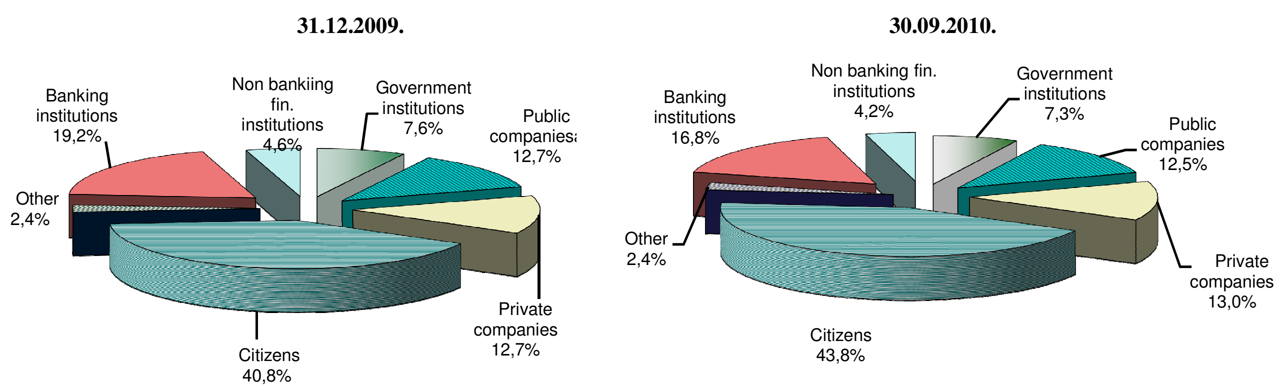
According to the data submitted by banks, out of total deposits as of 30.09.2010., only 5,8% was deposits collected by organizational units of banks from the Federation of BiH operating in Republic Srpska and Brcko District.

- in 000 KM-

Table 12: *Deposit structure by sectors*[14]

SECTORS	31.12.2008.		31.12.2009.		30.09.2010.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Governmental institutions	701.520	6,7	839.926	7,6	817.583	7,3	120	97
Public enterprises	1.245.793	11,9	1.400.839	12,7	1.398.759	12,5	112	100
Private enterprises and assoc.	1.490.139	14,2	1.403.465	12,7	1.456.963	13,0	94	104
Non-profit. organizations	2.172.860	20,8	2.120.143	19,2	1.889.066	16,8	98	89
Banking institutions	403.295	3,9	509.769	4,6	471.675	4,2	126	93
Citizens	4.181.882	40,0	4.506.881	40,8	4.920.739	43,8	108	109
Other	266.361	2,5	264.845	2,4	275.404	2,4	99	104
TOTAL	10.461.850	100,0	11.045.868	100,0	11.230.189	100,0	106	102

Graph 12 : *Deposit structure by sector*



Under the crises conditions, the high liquidity and decreased loan activity, the banks tend to restructure the funding sources and in such manner decrease the expenses. Apart from the significant decrease of loan liabilities, a change occurred in the sector structure of the deposits, the banking institution deposits decreased (mainly deposits from the parent bank or other members of the group) and in the banks in the Federation of BiH they were substituted by deposits to citizens.

[14] Information from the attached form BS-D, each quarter submitted by banks with bbalance sheet - FBA format.

Namely, the positive movements in the segment of citizen deposit continued through the third quarter of 2010 with growth of 67 million KM, which is significantly lower than for the first two quarters when they increased by 8% or 347 million KM, which in total for nine month amounts to 9% or 414 million KM. The citizen deposits amounting to 4,92 billion KM and participation of 43,8% in total deposits, still represent the largest funding source of banks in the Federation of BiH.

Banking institutions deposits are second largest sector source of funds in the banks' deposits potential. At the end of the reported period, after the decline of 11% or 231 million KM in the three quarters of 2010, they were 1,89 billion KM representing 16,8% of total deposits. As of 30.09.2010. the deposits of the banking institutions are by 517 million KM higher than the loan liabilities (at the end of 2009 the difference was 317 million KM), which are, after the deposits, the second most significant source of funding for bank in the FBiH. This leads to conclude that the debt the banks from FBiH has significantly decreased, whether at foreign credit institutions or parent groups, which as a consequence had a decline of banks' credit activities and high liquidity.

It should be emphasized that 96% or 1,82 billion KM of banking institutions' deposits refers to deposits of banks-members of groups (primarily shareholders). Financial support of the groups is present in nine banks in the Federation of BiH, with a concentration on four large banks (88%), with only one bank representing 45% of total deposits received from the group. In this manner, the domestic banks-members of the groups receive financial support and have secured inflow of new funding sources by the group whose members they are, which is especially important in times of crisis and more difficult access to money market and new funds, as well as the increase of liquidity risk as result of deterioration in collection of loans and increase of nonperforming claims. If credit liabilities and subordinate debts (loans and deposits in supplementary capital) are added to these funds, the financial support the banks receive from their groups becomes higher (in ten banks), amounting to 2,44 billion KM or 16,2% of total liabilities of the banking sector as of 30.09.2010. In comparison to the end of 2009, these funds were reduced by 602 million KM or 20% (deposits by 277 million KM or 13%, credit liabilities by 306 million KM or 41% and subordinated loans by 19 million or 9%).

Under the support of IMF and other financial institutions, the FBA has been involved in activities related to signing of the Memorandum of Understanding with parent-banks from the European Union countries whose daughter-banks operate in the territory of BiH, the so called "Vienna Initiative", by which the parent banks have taken the obligation to maintain the exposure in Bosnia and Herzegovina at the level from 31.12.2008., during the IMF program (2009 -2012), taken into account the availability of adequate credit possibilities in BiH within the defined good practices for managing the credit risk, capital and liquidity. Since, due to the economic crises, the banks' credit activities have significantly decreased, which resulted with high liquidity, as well as the good capitalization of almost all banks in FBiH which parent banks signed the "Vienna Initiative", in 2010 the risk exposure decreased in collection of past due credit liabilities, as well as the return of portions of deposit funds after the maturity. That had a positive impact on the profitability of those banks, through decrease of the interest expenses.

Deposits of other sectors had minor changes: growth of the public enterprises' deposits of 4% or 54 million KM, as of 30.09.2010 amounted to 1,46 billion KM, which is 13% of total deposits. The public enterprises' deposits, the same as at the end of 2009, amounted to 1,4 billion KM, while the participation decreased from 12,7% to 12,5%. Deposits of government institutions, after a slight decrease of 3% or 22 million KM, at the end of the third quarter of 2010, amounted to 820 million KM, which is 7,3% of total deposits.

Currency structure of deposits, as of 30.09.2010., was the following: deposits in foreign currencies (with the dominant participation of EURO) in the amount of 6,6 billion KM participated with 59,1% (59,6% at the end of 2009) and deposits in domestic currency in the amount of 4,6 billion KM participated with 40,9% (40,4% at the end of 2009).

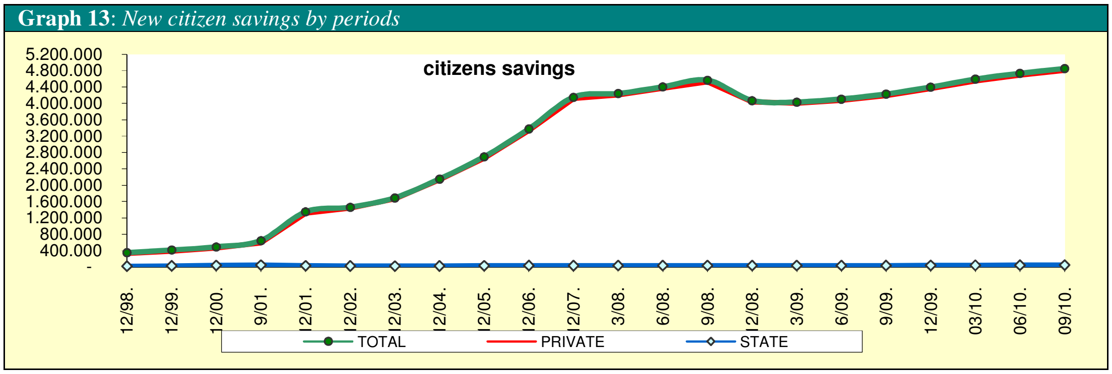
Saving deposits, as the most significant segment of deposits and financial potential of banks, following many years of a stable and continuous growth, with the first signs of the economic and financial crisis in the fourth quarter of 2008, decreased by 11% or 494 million KM. The most critical withdrawal was recorded in October. After this period, the condition stabilized, shaken confidence in banks retrieved, resulting by majority of deposits being placed back on bank accounts in 2009.

Positive trends continued in 2010, and, as of 30.09.2010., savings reached the amount of 4,8 billion KM , which is the highest amount until now, and by 278 million KM higher than the level of savings as of 30.09.2008. that right before the crisis was the highest amount until that time. In the three quarters of 2010, the savings increased by 10,2% or 446 million KM. Those changes were primarily the result of the crisis and decreased spending, difficult situation in the economy in general and citizens' fear due to uncertainty whether the situation will get better or whether positive development or changes to the best will evolve.

Table 13: *New citizen savings by periods*

BANKS	AMOUNT (in 000 KM)			RATIO	
	31.12.2008.	31.12.2009.	30.09.2010.	3/2	4/3
1	2	3	4	5	6
State	32.481	35.275	43.166	109	122
Private	4.003.184	4.325.926	4.764.185	108	110
TOTAL	4.035.665	4.361.201	4.807.351	108	110

Graph 13: *New citizen savings by periods*



The largest three banks hold 71% of savings, while participation of 10 banks has an individual participation of less than 1%, representing only 5,5% of total savings in the system.

Savings deposits in local currency represent 29% and in foreign currency 71% of total savings amount.

Table 14: *Maturity structure citizen saving deposits by periods*								
BANKS	AMOUNT (in 000 KM)						RATIO	
	31.12.2008.		31.12.2009.		30.09.2010.		3/2	4/3
1	2		3		4		5	6
Short term saving deposits	2.119.669	52,5%	2.054.196	47,1%	2.210.116	46,0%	97	108
Long term saving deposits	1.915.996	47,5%	2.307.005	52,9%	2.597.235	54,0%	120	113
TOTAL	4.035.665	100,0 %	4.361.201	100,0 %	4.807.351	100,0 %	108	110

Maturity structure of savings has maintained the trend of positive changes from the past period by further increase of the long term savings participation, as result of higher increase of long term savings (by 13% or 290 million KM) than short term (by 8% or 156 million KM), so as of 30.09.2010. the per cent of their participation was 54% and 46% respectively.

Long term continuous growth and positive trends in the savings segment of banks in the F BiH result, on the one hand, from strengthening of safety and stability of the overall banking system, giving the key importance to the existence of functional, effective and efficient banking supervision conducted by the FBA, and, on the other hand, deposit insurance system with the main purpose to increase stability of the banking, that is, financial sector and protection of depositors. In December 2008, with purpose to preserve citizens' trust in safety and stability of the banking system in BiH, the amount of insured deposit increased to KM 20.000. Subsequently, initiated was the increase of insured deposit, so as of 01.04.2010 it was increased to 35.000, and all the taken actions are directed to mitigating the impact of the global economic crises on the banking system and the economic system as a whole in FBiH and BiH.

As of 30.09.2010 there are 15 banks in total from the Federation of BiH that were accepted to the deposit insurance program (they hold the Deposit Insurance Agency of BiH license), and according to the submitted data, there is total 97% of total deposits and 98,5% of total savings deposited in these banks.

Upon the change of the Law on the deposit insurance in the banks in BiH[15] and elimination of the ownership criteria (participation of private and state capital), in the first quarter of 2010, one state owned bank was accepted to the insurance program. Remaining five banks cannot apply to be admitted since they do not qualify to the criteria prescribed by the Deposit Insurance Agency: three banks due to the existing composite rating and two banks (one private and one state) are under provisional administration.

2.1.2. Capital – strength and adequacy

Capital[16] of banks in the Federation of BiH, as of 30.09.2010., amounted to two billion KM.

[15] „Official Gazette of BiH" No.75/09.
[16] Regulatory capital as defined by Article 8 and 9 of Decision on Minimum Standards for Capital Management in Banks (Official Gazette of the Federation of BiH, 3/03, 18/03, 53/06, 55/07, 81/07, 6/08).
[17] Data source is the quarterly Report on Capital Positions of Banks (Form 1-Schedule A) regulated by the Decision on Minimum Standards for Managing Capital in Banks.

-in 000 KM-

Table 15: *Regulatory capital*

DESCRIPTION	31.12.2008.		31.12.2009.		30.09.2010.		RATIO 3/2	RATIO 4/3
1	2		3		4		5	6
STATE BANKS								
1. Core capital before reduction	44.852		44.906		45.418		100	101
2. Offsetting items	2.752		3.796		4.108		138	108
a) Core capital (1-2)	42.100	97%	41.110	97%	41.310	97%	98	100
b) Supplementary capital	1.335	3%	1.294	3%	1.497	3%	97	116
c) **Capital (a + b)**	43.435	100%	42.404	100%	42.807	100%	98	101
PRIVATE BANKS								
1. Core capital before reduction	1.610.692		1.708.796		1.783.154		106	104
2. Offsetting items	170.042		195.208		252.156		115	129
a) Core capital (1-2)	1.440.650	72%	1.513.588	75%	1.530.998	78%	105	101
b) Supplementary capital	574.370	28%	506.458	25%	443.071	22%	88	87
c) Capital (a + b)	2.015.020	100%	2.020.046	100%	1.974.069	100%	100	98
Total								
1. Core capital before reduction	1.655.544		1.753.702		1.828.572		106	104
2. Offsetting items	172.794		199.004		256.264		115	129
a) Core capital (1-2)	1.482.750	72%	1.554.698	75%	1.572.308	78%	105	101
b) Supplementary capital	575.705	28%	507.752	25%	444.568	22%	88	88
c) Capital (a + b)	2.058.455	100%	2.062.450	100%	2.016.876	100%	100	98

In the three quarters of 2010, capital[17] was decreased by 2% or 46 million KM in comparison to 2009, while the changes in core and supplementary capital reflected to changes in the structure of regulatory capital. The core capital increased by 1% or 18 million KM, and supplementary capital decreased by 12% or 63 million KM.

Although the growth of the core capital is minimal, it should be noted that stopping the decline and the weakening of the capital base, under the influence of the major losses i performance, and its maintainance on the same level, that is slightly higher level, is a result of two significant events: first, the FBA's request to banks to, under adverse circumstances for performance and acces to external sources of funds, increase of the loan losses and decrease of profitability and loan activities, keep the realized profit for 2009 in capital, which all banks implemented.Naimly, upon implementation of the legal procedures of issuing and accepting teh decisions about the distribution of the revised profit by the banks' assemblies, the realized profit for 2009 in the amount of 54 million KM (13 banks, while seven banks realized losses in the amount of 53 million KM) was distributed into core capital (into reserves or retained-not distributed profit 94% and covering the losses 5%).

The second important event is the completion of the additional capitalization of two banks in the third quarter of 2010, that were under capitalized: one bank implemented capitalization of 50 million KM with payment into the reserve fund, and teh second with a new emission of shares of 15,3 million KM (this bank had previously covered losses from previous years against the shareholders capital in the amount of 14,6 million KM).

Offsetting items (that reduce the core capital) increased by 57 million KM, mostly based on the increase of the current loss (99 million KM), with a simultaneous decrease based on partial covering of uncovered losses in the amount of 39 million KM.

Supplementary capital decreased by 63 million KM, with major changes in the structure: the 2009 profit of 49 million KM moved to the core capital, subordinate debts decreased by 21 million KM, while items of general loan loss provisions increased by seven million KM. Capital calculations during the year have not included current non audited profit that also resulted by decrease of supplementary capital.

The mentioned changes influenced the structure of the regulatory capital, so participation of core capital has increased from 75% to 78%, while the supplementary capital has decreased from 25% to 22%.

Net capital, as well as regulatory capital decreased by 2% or 46 million KM, amounting to two billion KM as of 30.09.2010. The largest influence of the decrease of capital was realized at one bank (that reported a loss of 84 million KM). In the third quarter, additional capital was added to that bank in the amount of 50 million KM, which partly neutralized the adverse impact on capital.

The banks capital level rate is expressed as a ratio od capital and assets and as of 30. 09. 2010 it was 12,9%, by 0,2 per cent less than at the end of 2009.

One of the most significant indicators of capital strength and adequacy[18] of banks is capital adequacy ratio calculated as a ratio of net capital and risk weighted assets. As of 30.09.2010., this ratio at the banking system level was 15,7% which is lower by 0,4% than at the end of 2009. The reason was the increase of total risk weighted risk by 2% or 46 million KM and increase of the total risk weighted items by 36 million KM. While the operating risk of risk-weighted assets increased by 62 million KM (945 million KM), the credit risk of the risk-weighted assets, due to the reduced loan activities, remained the same (decreased by 26 million KM), which resulted with the mentioned increase of the overall risk-weighted risks. At the end of the third quarter of 2010, structural participation of risk-weighted assets exposed to credit risk was 93%, and to operating risk 7%.

In process of conducting supervision of operations and financial positions of banks in the FBiH, as regulated by the Law, the FBA issues orders to banks to undertake actions for strengthening of capital base and provision of adequate capital in order to improve safety of both banks individually and the entire banking system, according to the level and profile of existing and potential exposure to all risks relevant to the banking operations. Under the conditions of economic crisis and the increase of the loan risk caused by the decline of the credit portfolio quality, this request has a priority and that is why the segment of capital is under a continuous enhanced supervision. One of the measures is also a requirement imposed on banks not to distribute the 2009 profit they generated to pay out dividends, but to rather strengthen their capital base, which was accepted by all banks.

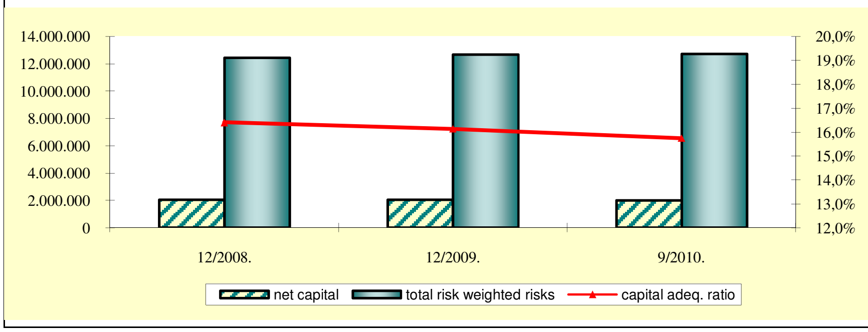
- 000 KM-

Table 16: *Net capital, risk-weighted assets and capital adequacy rate*

DESCRIPTION	31.12.2008.	31.12.2009.	30.09.2010.	RATIO	
				3/2	4/3
1	2	3	4	5	6
1. NET CAPITAL	2.038.997	2.046.414	2.000.840	100	98
2. RISK WEIGHTED ASSETS AND CREDIT EQUIVALENTS	12.301.441	11.790.234	11.763.973	96	100
3. POR (RISK WEIGHTED OPERATING RISK)	130.975	882.928	944.967	674	107
4. TOTAL RISK WEIGHTED RISKS (2+3)	12.432.416	12.673.162	12.708.940	102	100
5. NET CAPITAL RATE (CAPITAL ADEQUACY) (1/ 4)	16,4%	16,1%	15,7%	98	98

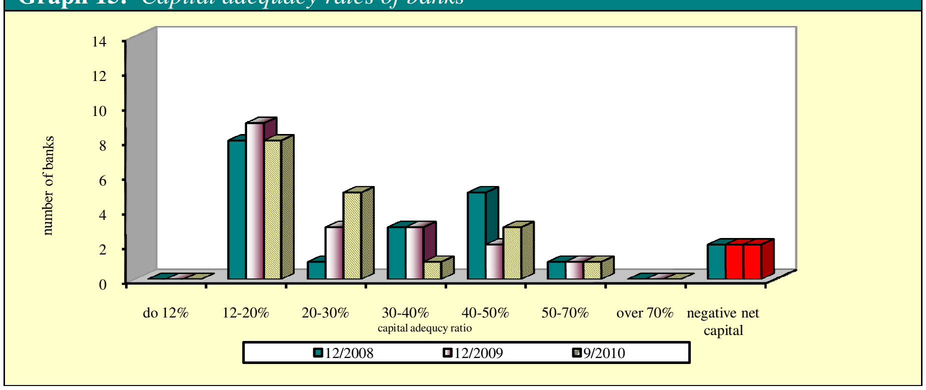
[18] The Law prescribes minimum capital adequacy rate of 12%.

Graph 14: *Net capital, risk-weighted assets and capital adequacy rate*



The global financial crisis effects are also evident in the segment of capital, that is, in the capital adequacy rate, mostly due to the profitability decline in almost all banks in the system (profit decline, that is, loss increase. Capital adequacy rate of the banking system, as of 30.09.2010., was 15,7%, which is still much more than the minimum prescribed by the law (12%), representing satisfactory capitalization of the entire system and very strong basis and foundation to preserve its safety and stability. Capital base and/or by law regulated minimal standard of capital adequacy had been jeopardized in several banks. In compliance with the Agency's request they provided additional capital, so additional capitalization was completed in two banks in the third quarter, and at the beginning of October provisional administration was introduced in one bank that did not provide additional capital.

Graph 15: *Capital adequacy rates of banks*



Of total 20 banks in the FBiH, as of 30.09.2010., capital adequacy rate of 18 banks was higher than minimum prescribed by the law of 12%, while four banks recorded capital adequacy rate below 12% (two of them under provisional administration had, negative adequacy rate). According to analytical data at the end of the third quarter of 2010, 12 banks recorded the capital adequacy rate lower than prior year, five banks recorded better rate, one bank the same, while two banks under provisional administration recorded negative rate.

Preview of capital adequacy rates of 18 banks in comparison to the minimum prescribed by the law of 12% is the following:

- Eight banks had the rate between 12,6% and 17,8%, and three largest banks from 12,6% to 14,9%,
- nine banks had the rate between 21% and 50%,
- One bank had the rate between 51% and 70%.

Further strengthening of capital base will be priority task in majority of banks as it has been the case so far, especially in the largest banks of the system, which is necessary to strengthen stability and safety of both banks and the entire banking system, especially due to changes in business and operating environment under which banks in the Federation operate, because of the global financial crisis expansion to the area of our country and adverse effects this crisis may have on the banking sector and the entire economy of BiH. Following bank expansion and performing regular supervision of this segment, when acting towards banks, depending on the evaluation of their capital adequacy and risk profile, the FBA takes different corrective and supervisory measures, such as: adoption of strategy to maintain certain level of capital and plan which will provide for quantity and quality (structure) of that capital in accordance with the nature and complexity of bank's present and future business activities and the undertaken and potential risk, then intensified supervision and monitoring of bank, request to supply additional capital in order to strengthen capital base, and elimination of excessive credit risk concentrations and related limitation and decrease of credit risk exposure related to certain types of concentrations, monitoring of implementation and realization of adopted capital plans, especially for additional capital supplied from external resources, supervision of compliance and implementation of the ordered measures, etc.

2.1.3. Assets and asset quality

Decision on Minimum Standards for Loan Risk Management and Assets Classification of Banks determines the criteria for evaluation of bank's exposure to loan risk based on evaluation of their assets quality and adequacy of reserves for loan and other losses according to the risk of placements and balance sheet and off-balance sheet items.

Total assets with off-balance sheet items (assets)[19] of banks in the FBiH as of 30.09.2010., amounted to 18 billion KM, representing an increase of 127 million KM in comparison to the end of 2009. Gross assets[20] in the amount of 15,7 billion KM are lower by 31 million KM.

-in 000 KM-

Table 17: *Assets, off-balance sheet items and potential loan losses*

DESCRIPTION	AMOUNT (in 000 KM)						RATIO	
	31.12.2008.	Struct. %	31.12.2009.	Struct. %	30.09.2010.	Struct. %	4:2	6:4
1.	2	3	4	5	6	7	8	9
Loans	10.200.134	66,0	9.442.600	60,1	9.355.881	59,6	93	99
Interests	59.564	0,4	61.797	0,4	51.407	0,3	104	83
Past due claims	231.890	1,5	352.580	2,2	508.784	3,3	152	144
Claims for paid guarantees	2.353	0,0	1.620	0,0	1.884	0,0	69	116
Other placements	39.393	0,2	276.693	1,8	425.119	2,7	702	154
Other assets	4.937.976	31,9	5.581.877	35,5	5.343.297	34,1	113	96
TOTAL ASSETS	15.471.310	100,0	15.717.167	100,0	15.686.372	100,0	102	100
OFF-BALANCE SHEET	2.582.093		2.271.512		2.429.864		88	107
ASSETS WITH OFF-BALANCE SHEET	18.053.403		17.988.679		18.116.236		100	101
RISK ASSETS WITH OFF-BALANCE SHEET	13.304.610		12.583.315		13.112.394		95	104
General loan risk and Potential loan losses	461.839		534.721		654.892		116	122
General and Special loan loss reserves already established	461.687		534.749		654.806		116	122

[19] Assets defined by Article 2 of Decision on Minimum Standards for Loan Risk Management and Assets Classification of Banks („Official Gazzette of FBiH“, number 3/03, 54/04, 68/05).
[20] Data source: Report on classification of balance sheet assets and off-balance sheet items of banks.

Non-risk items amount to five billion KM or 28% of total assets with off-balance sheet, and they are lower by 7% than as of the end of 2009. On the other hand, risk assets with off-balance sheet items amount to 13 billion KM, and they increased by 4% or 529 million KM . Off balance sheet risk items amounted to 2,4 billion KM and are higher by 7% or 158 million KM.

The impact and negative consequences of the global financial and economic crisis in BiH are increasingly more apparent in banks' operations, as result of the transfer of crisis from real to the banking sector, with the largest impact on banks' key operation and that is the segment of lending and asset quality. Following significant downfall of credit placements of 6% or 638 million KM in 2009, in the first three quarters of 2010 there was a minor growth of 70 million KM that could be assessed positive, since banks have increased their volume of new placements based on which the negative trend from the past five quarters came to an end. As of 30.09.2010., loans amounted to 9,9 billion KM with participation in the assets of 65,4%, which is lower by 1,1 per cent than at the end of 2009. However, due to deepening of the crisis and deterioration of the entire economic condition in BiH, no significant growth of loan activities is expected to the end of the year and indication of that is the level of the newly approved loans. Indeed, in the first nine months of 2010 there were only 17% more loans placed in relation to the same period of 2009, and 28% less than the same period of 2008.

The most significant limiting factor to the credit growth is adverse impact of the crisis to the entire economy in BiH and deterioration of condition in the real sector, then decreased citizen's spending, as well as more restrictive and prudent lending policies of banks. Based on that, as well as on the basis of the expected slow and low economic development, it is evident that in the forthcoming period the loan growth will be low, there will be further deterioration in quality of the credit portfolio, increase of bad placements and consequently credit losses, which will have an adverse reflection to the financial result of banks. Still, expected is a slow down o the negative trends which is already noticeable in the third quarter of 2010, with the slowdown of the growth of the poor performing loans, especially in relation to the previous quarter when there happened a enormous increase of the poor performing loans (mostly due to one bank), which resulted in a much smaller increase of the relative indicators of the participation of the nonperforming loans in the total loans in the third quarter of 2010, as well as other asset quality indicators, in comparison to the previous periods.

The FBA has been involved in the activities aimed at signing of the Memorandum of Understanding with parent-banks from the European Union countries whose daughter-banks operate in the territory of BiH, so called „Vienna Initiative", which will secure additional financial funds for lending to the real sector, since any deterioration of the economy could adversely reflect to the rating of daughter-banks, and consequently weaken the rating of parent banks.

Three largest banks in the FBiH with credit amount of 6,2 billion KM have participation of 62,5% in total loans at the system level.

In the aspect of sectors to which banks originate their loans, changes over the three quarters of 2010 could be assessed positive due to increase of placements to private companies along with simultaneous decrease of placements to citizens. Namely, in comparison to the end of 2009, loans originated to private companies increased by 1% or 55 million KM, amounting to 4,75 billion KM or 48,2% of total loans (47,9% at the end of 2009). Loans originated to citizens increased for the insignificant 0,2% or 10 million KM, and they are 4,77 billion KM, representing participation of 48,4% (48,6% at the end of 2009). With an aim to overcome the existing financial crises government institutions have taken loans from two banks in FBiH, so the loans in this sector increased by 42% or 32 million KM. The data submitted by banks, as of 30.09.2010., in the aspect of loan structure originated to citizens (based on the purpose), do not record any change over longer period of time, that is, the highest participation of approx. 72% have loans originated to finance consumer goods[21], 25% have housing loans, and remaining 3% have loans for SMEs and agriculture.

Three largest banks in the system financed 65,5% of total loans originated to citizens, and to private companies 59,8% of total loans to all sectors (at the end of 2009 to citizens 66,4%, private companies 63,1%).

Trend and changes in participation of individual sectors in the overall structure of loans are presented in the following table:

-in 000 KM-

Table 18: *Structure of loans per sectors*

SECTORS	31.12.2008.		31.12.2009.		30.09.2010.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Government institutions	76.964	0,7	74.609	0,8	106.338	1,1	97	142
Public enterprises	175.424	1,7	184.005	1,9	167.317	1,6	105	91
Private enterprises and assoc.	4.881.526	46,8	4.696.276	47,9	4.751.513	48,2	96	101
Banking institutions	5.805	0,1	6.755	0,1	7.318	0,1	116	108
Non-banking financial instit.	105.352	1,0	51.255	0,5	38.299	0,4	49	75
Citizens	5.146.963	49,3	4.765.656	48,6	4.775.051	48,4	93	100
Other	42.343	0,4	18.244	0,2	20.713	0,2	43	114
TOTAL	10.434.377	100,0	9.796.800	100,0	9.866.549	100,0	94	101

Currency structure of loans has also been unchanged for longer period: loans financed with currency clause had the highest participation of 74% or 7,3 billion KM, loans in domestic currency of 25% or 2,4 billion KM, while loans in foreign currency had the lowest participation of only 1% or 116 million KM.

Since placements, that is, loans represent the most risky portion of banks' assets; their quality represents one of the most significant elements of stability and successful performance. Evaluation of assets quality is actually evaluation of exposure to loan risk of banks' placements, that is, identification of potential loan losses that are recognized as loan loss provisioning.

Quality of assets and off-balance sheet risk items, general loan risk, potential loan losses by classification categories[22] and off-balance sheet items are presented in the following table:

[21] Card-based operations included.
[22] As regulated in the Article 22 of the Decision on Minimum Standards for Managing Credit Risk and Assets Classification in Banks, banks have to allocate and maintain reserves for general and special loan losses in percentages according to classification categories: A 2%, B 5% to 15%, C 16% to 40%, D 41% to 60% and E 100%.

Table 19: *Asset classification, general loan risk (GLR),potential loan losses (PLL) and off-balance sheet items (charged off assets and suspended interest)*

Classification category	AMOUNT (in 000 KM) and PARTICIPATION (in%)									RATIO	
	31.12.2008.			31.12.2009.			30.09.2010.				
	Assets classif.	Partic. %	GLR PLL	Assets classif.	Partic. %	GLR PLL	Assets classif.	Partic. %	GLR PLL	5/2	8/5
1	2	3	4	5	6	7	8	9	10	11	12
A	11.534.783	86,7	230.749	10.260.601	81,5	205.228	10.645.358	81,2	212.845	89	104
B	1.446.503	10,9	103.385	1.804.767	14,4	136.973	1.638.901	12,5	131.747	125	91
C	165.309	1,2	40.558	307.892	2,5	72.970	468.035	3,6	113.174	186	152
D	154.168	1,2	83.300	206.201	1,6	115.703	356.220	2,7	193.271	134	173
E	3.847	0,0	3.847	3.854	0,0	3.847	3.880	0,0	3.855	100	101
Risk ass. (A-E)	13.304.610	100,0	461.839	12.583.315	100,0	534.721	13.112.394	100,0	654.892	95	104
Clasified (B-E)	1.769.827	13,3	231.090	2.322.714	18,5	349.493	2.467.036	18,8	442.047	131	106
Non performing(C-E)	323.324	2,4	127.705	517.947	4,1	119.550	828.135	6,3	310.300	160	160
Nonrisk assets[23]	4.748.793			5.405.364			5.003.842			114	93
TOTAL (risk and no risk)	18.053.403			17.988.679			18.116.236			100	101
OFF BALANCE SHEET											
Charged off assets	429.419	89,0		505.635	89,7		599.203	89,9		118	118
Susp. interest	54.479	11,0		57.959	10,3		67.541	10,1		114	116
TOTAL	483.898	100,0		563.594	100,0		666.744	100,0		117	118

Risk assets with off-balance sheet items (A-E) amounted to 13 billion KM, and, as of 30.09.2010., these items increased by 4% or 529 million KM. Non-risk items amounted to 5 billion KM, and decreased by 7% or 401 million KM in relation to the end of 2009.

If an analysis of the risk assets quality is performed, it could be concluded, over the observing period, there was a continued downfall of asset quality and its deterioration as an impact of the economic crisis and the increase of non-payable claims, that is, delinquency of customers to pay past due loan liabilities. However, it must be noted that the largest impact on the significant deterioration of the indicators of the total system had one large bank, which in 2009 started and in 2010 intensified the “clean-up” of the loan portfolio, which resulted with significantly worse indicators of the asset quality of this bank and the whole banking system. The participation of the loan portfolio of that bank as of 30. 09. 2010 was 16,9%,, the participation of its clasified and nonperforming assets was 32% and 53%, and the increase of the poor loans (nonperforming) mostly refers to that bank (231 million KM or 75%). The other banks had mild oscilationse (improvement or deterioration), actually only three banks have asset quality indicators that are worse than the banking system

Classified assets (B – E), in the observed period recorded growth of 6% or 144 million KM, the category B was decreased by 9% or 166 million KM, and nonperforming assets (C-E) increased by a high 60% or 310 million KM. In the same period performed was the write off of the assets and interest (transferred to off balance sheet) in the amount of 154 million KM. The noted indicators are of concern and that is underlined by the fact that in 2009 the total increase of the classified assets was 31% or 553 million, from which the category B was increased by 25% or 358 million KM, nonperforming by 60% or 195 million KM, the written off assets and interest were 157 million KM. In 2010 due to poor collection and increase of due days of the past due receivables, the banks had to perform a reclassification and a significant amount of loans were

[23] Assets items that are not, according to Article 22, Paragraph 7 of Decision on Minimum Standards for Bank Credit Risk and Assets Classification Management, subject to accrual of general loan loss provisions of 2%.

moved from category B to nonperforming category resulting in the increase of the loan loss provisioning expenses.

The classified assets as of 30.09.2010 was 2,5 billion KM, and nonperforming 828 million KM (31.12.2009: 2,3 billion KM and 518 million KM).

As result of the mentioned, the indicators of asset quality expressed as ratio, that is, participation of individual categories in risky assets have deteriorated in comparison to the end of 2009, and it is expected that the negative trends will continue in the coming quarters, although at a slower rate and lower intensity, which is already noticeable in the third quarter of 2010. The classified assets to risky assets ratio has deteriorated by 0,3 per cent due to the increase of classified assets (6%) over the risky assets (4%) in comparison to the end of 2009, which is currently representing 18,8% (at the end of the first half of 2010 the ratio was 19,3%, which was by 0,8% higher than at the end for 2009).

If an analysis is performed of only the ratio and trend of nonperforming assets and risk assets, as of 30.09.2010., this ratio was 6,3%, which is still relatively low ratio, and, if compared to the end of 2009, it is higher by 2,2 per cent. However, if we take into account that participation of category B in the risk assets is 12,5% and the increasing doubt that portion of placements reported under this category deteriorated in quality and should be categorized as nonperforming assets, in other words that some banks still practice not to timely establish adequate loan loss provisioning (as confirmed through on-site examinations, resulting by insufficient loan loss reserves), it could be concluded that the assets quality still has a decreasing trend. That is why it is of key importance that banks more realistically evaluate quality of their placements and establish adequate loan loss reserves, especially due to the fact that under an impact of the crisis delinquency concerning payment of past due claims increase, provisioning increases, and the earnings of banks decrease.

The analysis of data by sectors is based on the indicators of the quality of loans granted to the two most significant sectors: legal entities and citizens. The two mentioned indicators for these sectors are significantly different and indicate higher loan risk exposure, and also the exposure to potential loan losses with the loans originated to legal entities.

Table 20: *Classification of loans originated to citizens and legal entities*

Kategorija klasifikacije	AMOUNT (in 000 KM) and PARTICIPATION (in%)												RATIO
	31.12.2009.						30.09.2010.						
	Citizens	Partic. %	Legal entities	Partic. %	TOTAL Amount	TOTAL Partic.	Citizens	Partic. %	Legal entities	Partic. %	TOTAL Amount	TOTAL Partic.	12/6
1	2	3	4	5	6 (2+4)	7	8	9	10	11	12 (8+10)	13	14
A	4.311.231	90,46	3.421.255	68,00	7.732.486	78,93	4.294.574	89,94	3.354.140	65,88	7.648.714	77,52	99
B	260.509	5,47	1.298.642	25,81	1.559.151	15,91	185.392	3,88	1.215.338	23,87	1.400.730	14,20	90
C	108.969	2,29	193.570	3,85	302.539	3,09	177.184	3,71	284.858	5,59	462.042	4,68	153
D	84.947	1,78	117.677	2,34	202.624	2,07	117.894	2,47	237.162	4,66	355.056	3,60	175
E	0	0,00	0	0,00	0	0,00	7	0,00	0	0,00	7	0,00	100
TOTAL	4.765.656	100,0	5.031.144	100,0	9.796.800	100,00	4.775.051	100,0	5.091.498	100,0	9.866.549	100,00	101
Classi.loans B-E	454.425	9,53	1.609.889	32,00	2.064.314	21,07	480.477	10,06	1.737.358	34,12	2.217.835	22,48	107
NPL C-E	193.916	4,07	311.247	6,19	505.163	5,16	295.085	6,18	522.020	10,25	817.105	8,28	162
		48,64		51,36		100,00		48,40		51,60		100,00	
Participation by sectors in classified loans, nonperforming loans and category B:													
Classification B-E		22,02		77,98		100,00		21,66		78,34		100,00	
NPL C-E		38,39		61,61		100,00		36,11		63,89		100,00	
Category B		16,71		83,29		100,00		13,23		86,77		100,00	

The observed indicators of the quality of loans originated to legal entities and citizens, as well as already stated indicators of the quality of total risky assets, show a decreasing trend in the three quarters of 2010, which is primarily a result of growth in poor quality loans of 62% or 312 million KM (in the sector of citizens 52% or 101 million KM and legal entities 68% or 211 million KM), resulting by the increase of participation of the poor quality loans from 5,16% to 8,28%, as well as other indicators for those two sectors and the entire loan portfolio have deteriorated.

As of 30.09.2010., of total loans originated to legal entities in the amount of 5,09 billion KM, 1,7 billion KM or 34,12% was classified in categories B to E (1,6 billion KM or 32% at the end of 2009), while of total loans originated to citizens in the amount of 4,8 billion KM, classification categories B to E represent 480 million KM or 10,06% (454 million KM or 9,53% at the end of 2009).

Of loans financed to legal entities, 522 million KM were classified as nonperforming loans or 10,25% of total loans originated to this sector (as of 31.12.2009., these items amounted to 311 million KM or 6,19%). Nonperforming loans, in the sector of citizens, amounted to 295 million KM or 6,18% of total loans originated to this sector (as of 31.12.2009., these items amounted to 194 million KM or 4,07%).

For more realistic assessment, it should take into account the amount of loans that banks, during the observing period, charged off to the off-balance sheet, as presented in the following table.

-000 KM-

Table 21: *Off-balance sheet records: charged off assets and suspended interest*

DESCRIPTION	CITIZENS		LEGAL ENTITIES		TOTAL	
	Charged off assets	Suspended interest	Charged off assets		Charged off assets	Suspended interest
1	2	3	4	5	6	7
Opening balance as of 31.12.2009.	146.613	12.559	359.019	45.398	505.632	57.957
Changes in 2010:						
- new charge offs (current year)	62.005	7.317	68.811	15.669	130.816	22.986
- payments made in the current year	14.155	4.631	11.798	5.076	25.953	9.707
- permanent charge off	316	167	10.979	3.530	11.295	3.697
Balance as of 30.09.2010.	194.147	15.078	405.056	52.463	599.203	67.541

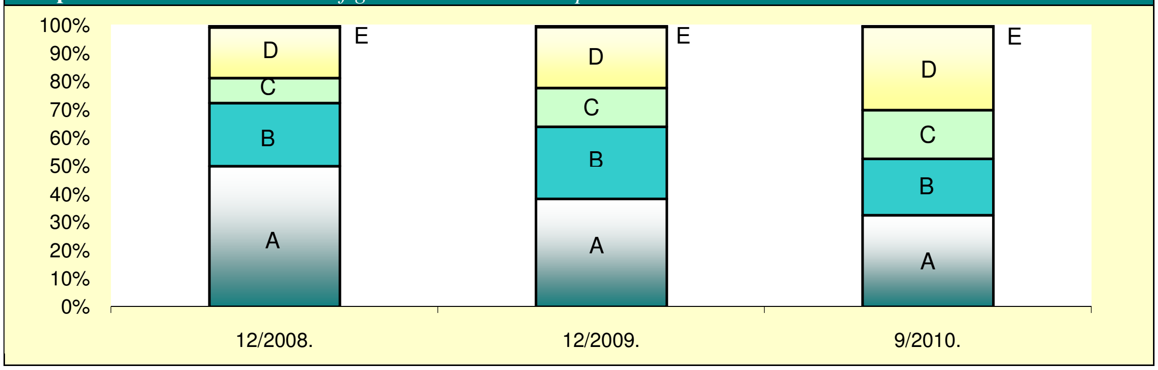
Balance of the charged off assets, as of 30.09.2010. (599 million KM) and the suspended interest (67 million KM) generated the increase of 18%, that is, 16% in comparison to 2009.

Level of general loan risk and estimated potential loan losses in the classification categories, as determined in accordance with the criteria and methodology prescribed by the FBA's decisions, their trend and structure at the level of the banking sector are presented in the following tables and graphs.

Table 22 : *Structure and trend of general loan risk and potential loan losses*

Classification category	AMOUNT (in 000 KM) and STRUCTURE (in%)						RATIO	
	31.12.2008.		31.12.2009.		30.09.2010.		4/2	6/4
1	2	3	4	5	6	7	8	9
A	230.749	50,0	205.228	38,4	212.845	32,5	89	104
B	103.385	22,4	136.973	25,6	131.747	20,1	132	96
C	40.558	8,8	72.970	13,7	113.174	17,3	180	155
D	83.300	18,0	115.703	21,6	193.271	29,5	139	167
E	3.847	0,8	3.847	0,7	3.855	0,6	100	100
TOTAL	461.839	100	534.721	100	654.892	100	116	122

Graph 16: *Structure and trend of general loan risk and potential loan losses*



As reported, banks have established loan loss provisions in accordance with the regulations and level of the estimated credit risk.

Based on an analysis of the established provisions, in total amount and by classification categories, if compared to the end of 2009, general loan risk (for category A) and potential loan loss provisions have increased by 22% or 120 million KM, amounting to 655 million KM (increased just in the second quarter of 2010 by 80 million KM). One of the most important indicators of asset quality, the ration of the potential loan losses and risk asset to off balance sheet, increased from 2,8% to 3,4%. As of 30.09.2010., banks in average allocated reserves for category B 8%, for category C 24,2%, category D 54,3% and E 100% (at the end of 2009: B 7,6%, C 23,7%, D 56,1% and E 100%).

The asset quality analysis, that is, the loan portfolio analysis of individual banks, as well as on-site examinations at banks, indicate loan risk as still dominant risk with majority of banks, raising a concern that some banks still have inadequate management practices, that is, evaluation, measuring, monitoring, and control of loan risk and assets classification, which was determined in on-site examinations through significant amount of insufficient loan loss reserves that banks have established based on the orders issued by the FBA. However, this is not adding to an essential resolution of the problem.

The FBA has ordered corrective measures to those banks whose assets quality was rated poor by the examination in sense of preparation of the operating program that has to contain action plan aimed to improve existing practices for loan risk management, that is, assets quality management, decrease of existing concentrations and resolution of the nonperforming assets issue, and prevention of their further deterioration. Implementation of the FBA's orders is continuously monitored through an intensified follow-up procedure based on reports and other documentation submitted by banks, as well as their verification in targeted on-site examinations. Supervision of this segment has been intensified due to obvious adverse trends, which has a significant impact through deterioration of banks' profitability and declining of their capital base, which is a reason for banks to timely take actions to raise capital from external sources.

Transactions with related entities

While operating, banks are exposed to different types of risks, of which the most significant is the risk of transactions with related entities of banks.

In accordance with the Basle Standards, the FBA has established certain prudential principles and requirements related to transactions with related entities of banks, as regulated in Decision on Minimum Standards for Bank's Operations with Related Entities, prescribing requirements and method of operations with related entities. The Decision and Law on Banks regulate the duty of Supervisory Board of a bank, which has to adopt, upon the proposal of the General Manager, special policies regulating operations with related entities and to monitor their implementation.

The FBA Decisions prescribe a special set of reports, including transactions with one segment of related entities, such as loans, and potential and undertaken off-balance sheet liabilities (guarantees, letters of credit, undertaken loan commitments), as the most frequent and the most riskiest form of transactions between a bank and related entities. The set of prescribed reports include data on loans originated to the following categories of related entities:

- Bank's shareholders over 5% of voting rights,
- Supervisory Board members and bank management and
- Subsidiaries and other enterprises related to a bank.

-000 KM-

Table 23: *Transactions with related entities*

Description	ORIGINATED LOANS[24]			RATIO	
	31.12.2008.	31.12.2009.	30.09.2010.	3/2	4/3
1	2	3	4	5	6
Shareholders over 5% of voting rights, subsidiaries and other related enterprises	26.823	29.191	81.811	109	280
Supervisory Board and Audit Board members	304	470	445	155	95
Bank Management	2.315	2.193	2.233	95	102
TOTAL	29.442	31.854	84.489	108	265
Potential and undertaken off-balance sheet liabilities	10.304	5.137	18.602	50	362

In the observed period, credit exposures to persons related to banks increased by 165, and potential liabilities by 262% % (the increase mainly relates to one large bank in the system). Based on the presented data, we could conclude that it is a question of a small amount of loans-guarantees operations with related entities, and the level of risk is low. The FBA pays special attention (in on-site examinations) to banks' operations with related entities, especially in assessing identification system and monitoring of risk exposure to related entities operations. The FBA on-site examiners issue orders for elimination of determined weaknesses within certain deadlines and initiate violation procedures. Part of these activities is also to monitor and supervise implementation of the issued orders in the follow up procedure. This has had a positive influence on this segment of operations, since the risk management quality in this segment has improved.

2.2. Profitability

According to the income statement data, banks in the Federation of BiH, for the nine months of 2010, realized negative financial result – loss in the amount of 59 million KM, while in the same period in 2009, there was profit generated at the banking system level in the amount of 21 million KM. Main reason to realizing this negative financial result is primarily the impact of high loss with one bank, which is by 25 million KM higher than the loss on the level of the system. In the same period last year this bank had a significantly lower, but still the largest loss

[24] Apart from loans, it includes other claims, deposited funds and the placements to shareholders (financial institutions) exceeding 5% of voting rights.

in the system, in the amount of 15 million KM. In comparison with the same period in 2009, it is evident that the profitability of majority of banks that had positive performance in 2009, is worse, that is the profit is much smaller in 2010, especially for two largest banks in the system. On the other hand, although the total loss on the level of the system is high, as it is stated mostly due to one bank, majority of banks that operated with losses in the observed period in 2010, had a loss that was smaller than in the observed period in 2009, and the number of banks that operate with losses has decreased from nine to seven. However, after further analyzing the quarters in 2010, it can be concluded that there were positive changes in the third quarter, the realized loss in this quarter is significantly lower than in the other two, while the profit is much higher. It is expected that these positive movements continue in the last, fourth quarter.

The biggest influence on deterioration of profitability of almost all banks is the increase of loan loss provisions, as result of considerable decline in quality of loan repayments, that is, increased loan delinquency, as well as downfall in interest income and similar income with majority of banks.

Positive financial result of 40 million KM was generated by 13 banks, which is less by 31% or 18 million KM than in the same period in 2009. At the same time seven banks reported loss of 99 million KM, this is higher by two times or 61 million KM in comparison to the same period in 2009.

High oscillations in the reported financial result at the sector level, if compared to the periods over the past three years, were mainly under influence of the events in stock exchanges related to price changes in securities trading, such as high income in 2007, that is, high expenses in 2008, while in 2009, their influence was at minimum, almost insignificant.

Detailed data is shown in the following table:

-000 KM-

Table 24: *Financial result reported: profit/loss*

Date/Description	At the system level		State banks		Private banks	
	Amount	No. of banks	Amount		Amount	No. of banks
30.09.2008.						
Loss	-32.508	6	-	-	-32.508	6
Profit	89.304	14	2.656	2	86.648	12
Total	56.796	20	2.656	2	54.140	18
30.09.2009.						
Loss	-37.396	9	-870	1	-35.809	8
Profit	58.286	11	629	1	57.657	10
Total	20.890	20	-241	2	21.848	18
30.09.2010.						
Loss	-98.836	7	-316	1	-98.520	6
Profit	40.095	13	817	1	39.278	12
Total	-58.741	20	501	2	-59.242	18

Similar to other segments, this segment has also encountered concentrations: of total profit generated (40 million KM), 67% or 27 million was generated by two largest banks in the system, whose participation in the banking system assets was 48,7%. In the total loss of 99 million KM, 84 million KM or 84,7% refers to only one large bank which is in the foreign ownership, with asset participation of 13,8% on the third place in the system. Analytical data indicate that a total of eleven banks reported significantly deteriorated financial result (for a high 94 million KM, of which 69 million Km refer to the mentioned bank), and nine banks have slightly better results (for 15 million KM).

The financial result of state owned banks does not have any significant influence to the overall profitability of the banking sector.

Based on the analytical data and the indicators of the quality evaluation of the profitability (the amount of the generated financial result – profit/loss and ratios used for evaluation of profitability productivity and efficiency of operation as well as other parameters related to evaluation of operation) it can be concluded that profitability had declined under the impact of the economic crises from the beginning of 2009, and the overall profitability of the system drastically deteriorated in 2010. Indeed, after 2001 (when loss was reported on the system level of 33 million), initiated was the trend of successful performance that was stopped due to expansion of global and financial crisis, so in 2010 loss was being reported on the banking system level again, as result of the fact that generally in the system, and especially in large banks that generate profitability, interest and net interest income decreased and loan loss provisions recorded high increase, as a consequence of deterioration of loan quality in all banks .

At the system level, total income was realized in the amount of 620 million KM with increasing rate of 2% or 14 million KM in comparison to the comparative period of 2009. Total noninterest bearing expenses were 679 million KM, and growth rate was 16% or 96 million KM, which had negative reflection to the overall financial result of the sector.

Stagnation and the subsequent downfall of lending activities in 2009 and the slight increase in 2010 had negative reflection to the level of interest income. Indeed, total interest income amounts to 641 million KM and it decreased by 8% or 55 million KM in comparison to the same period last year, and their participation in total income decreased from 114,8% to 103,3%. In the structure of interest income, highest participation was realized by interest income on loans that amount to 584 million KM or 94,2% of total income, and they decreased by 9% or 56 million KM. Significant downfall of 49% or 10 million KM was recorded by income on interest-bearing accounts with depository institutions, and their participation decreased from 3,3% to 1,6%. Opposite trend and changes were recorded in securities held to maturity that amount to three million KM and that in comparison to the same period last year increased by more than 4 times or two million KM, which under the circumstances of decline in lending activities is result of placing surplus of liquid assets to the securities in order to realize better return on the invested assets as well as the effect to profitability.

On the other hand, positive changes were recorded in interest expenses that had a faster decreasing rate (18%) in comparison to the interest income with decreasing rate of 8%. Interest expenses amount to 249 million KM, and their participation in the structure of total income decreased from 50% to 40,2%. In the structure of interest expenses, we should point out a significant downfall of 43% or 24 million KM of interest expenses on loans taken and other borrowings, with decreased participation from 9,4% to 5,3% as result of decrease in long term credit indebtedness of banks, primarily with foreign financial institutions (“parent” banks or related banks from the group and in the financial markets with other creditors) of around 20% due to regular payments, and less significantly due to premature payments that the banks practice in order to decrease the expenses due to high liquidity. Interest expenses on deposits with downfall of 11% or 25 million KM amount to 205 million KM with decreased participation in total income from 37,9% to 33,1% as a result of decreased interest rates on short term and long term deposits for legal entities and citizens.

Net interest income in the amount of 391 million KM insignificantly decreased by 0,4% or one million KM in comparison to the same period last year, with decreased participation in total income from 64,8% to 63,1%.

Operating income amounts to 229 million KM, and, if compared to the prior year, it records an increase of 7% or 16 million KM, and the increase in structure of total income from 35,2% to 36,9%. The increase of the operating income is primarily related to the increase of the service fees.

Total noninterest expenses had a faster growth (16%) than the net interest income (0,4%) and in the observed period amount to 679 million KM and in comparison to the same period last year they increased by 96 million KM, primarily based on the increase of loan loss provisions. At the same time, their participation in the structure of total income increased from 96,2% to 109,5%.

Within the noninterest expenses, both nominally and relatively significant increase of 63% or 102 million KM was recorded by loan loss provisions of 265 million KM, and their participation in the structure of total income increased from 26,9% to 42,7%. Opposite trend and changes were recorded by salary and contribution expenses with decreasing rate of 4%, amounting to 181 million KM (average number of employees for the first half of 2010 decreased by 4,5% in comparison to the first half of 2009) and fixed assets expenses with decreasing rate of 3% amounting to 112 million KM.

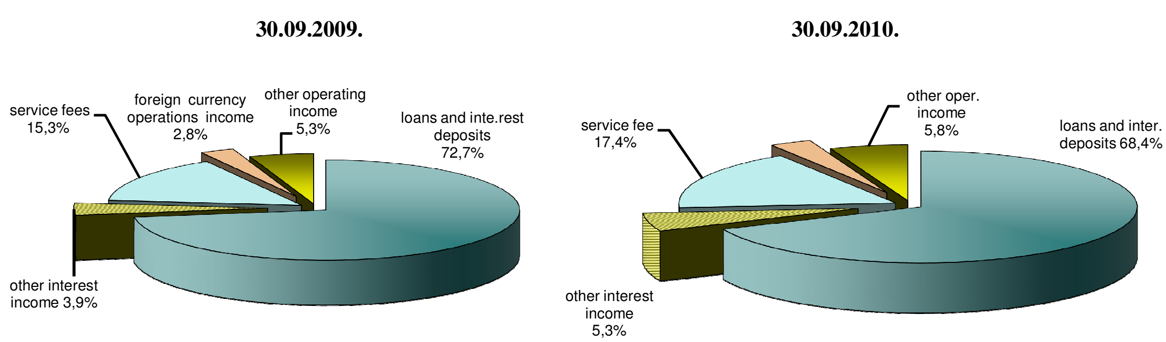
Trend and structure of total income and expenses is presented in the following tables and graphs:

\- in 000 KM-

Table 25: *Structure of total income*

Structure of total income	30.09.2008.		30.09.2009.		30.09.2010.		RATIO	
	Amount	%	%	%	Amount	%	4/2	6/4
1	2	3	4	5	6	7	8	9
I Interest income and similar income								
Interest bearing deposit accounts with depository institutions	67.208	7,4	19.974	2,2	10.117	1,2	30	51
Loans and leasing	591.322	64,6	640.202	70,5	584.168	67,2	108	91
Other interest income	33.504	3,7	35.607	3,9	46.669	5,3	106	131
TOTAL	692.034	75,7	695.783	76,6	640.954	73,7	101	92
II Operating income								
Service fees	135.647	14,8	138.627	15,3	150.973	17,4	102	109
Foreign exchange income	27.003	2,9	25.667	2,8	27.097	3,1	95	106
Other operating income	59.993	6,6	48.668	5,3	50.831	5,8	81	104
TOTAL	222.643	24,3	212.962	23,4	228.901	26,3	96	107
TOTAL INCOME (I + II)	914.677	100,0	908.745	100,0	869.855	100,0	99	96

Graph 17: *Structure of total income*

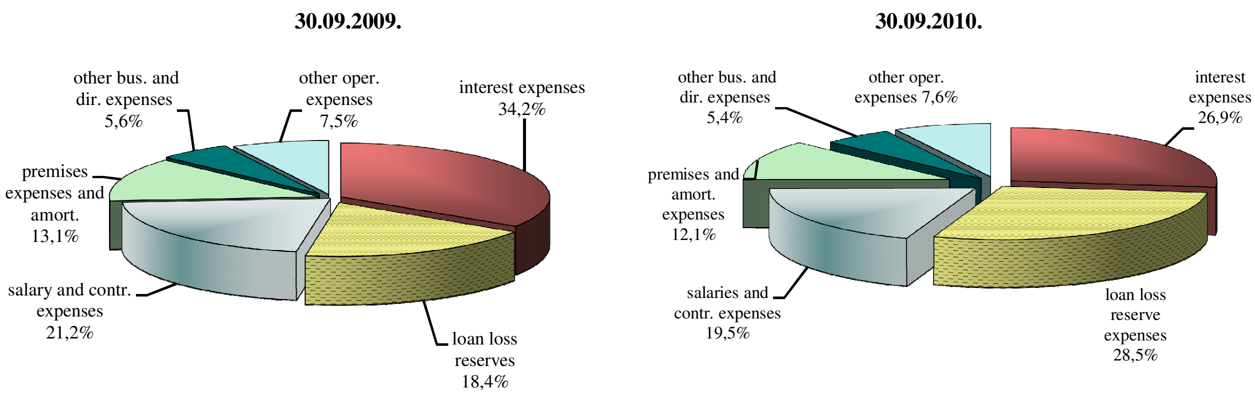


- in 000 KM-

Table 26: *Structure of total expenses*

Structure of total expenses	30.09.2008.		30.09.2009.		30.09.2010.		RATIO	
	Amount	%	Amount	%	Amount	%	4/2	6/4
1	2	3	4	5	6	7	8	9
I Interest expenses and similar expenses								
Deposits	213.720	25,0	229.884	26,0	205.259	22,1	108	89
Liabilities for borrowings	79.893	9,3	57.003	6,4	32.669	3,5	71	57
Other interest expenses	16.320	1,9	16.009	1,8	11.614	1,3	98	73
TOTAL	309.933	36,2	302.896	34,2	249.542	26,9	98	82
II Total non-interest bearing expenses								
General loan risk and potential loan losses Provisioning	122.045	14,3	162.847	18,4	264.900	28,5	133	163
Salary expenses	174.920	20,5	188.083	21,2	181.300	19,5	108	96
Business premises and depreciation expenses	107.796	12,6	115.612	13,1	111.980	12,1	107	97
Other business and direct expenses	44.922	5,3	49.802	5,6	50.400	5,4	111	101
Other operating expenses	94.605	11,1	66.585	7,5	70.435	7,6	70	106
TOTAL	544.288	63,8	582.929	65,8	679.015	73,1	107	116
TOTAL EXPENSES (I + II)	854.221	100,0	885.825	100,0	928.557	100,0	104	105

Graph 18: *Structure of total expenses*



The following tables give the most significant ratios for evaluation of profitability, productivity and efficiency of banks:

- in %-

Table 27: *Ratios of profitability, productivity and effectiveness by periods*

RATIOS	30.09.2008.	30.09.2009.	30.09.2010.
Return on Average Assets	0,40	0,14	-0,39
Return on Average Total Capital	3,88	1,26	-3,54
Return on Average Equity	5,83	1,85	-5,03
Net Interest Income/Average Assets	2,69	2,59	2,57
Fee Income/Average Assets	1,57	1,41	1,50
Total Income/Average Assets	4,26	4,00	4,07
Operating and Direct Expanses25/Average Assets	1,18	1,40	2,07
Operating Expenses/Average Assets	2,66	2,44	2,38
Total Non-interest Expanses/Average Assets	3,83	3,85	4,45

-in %-

Table 28: *Ratios of profitability, productivity and effectiveness as of 30.06. 2010.*

RATIOS	30.09. 2010.		
	STATE BANKS	PRIVATE BANKS	AVERAGE IN THE FBiH
Return on Average Assets	0,27	-0,39	-0,39
Return on Average Total Capital	1,19	-3,67	-3,54
Return on Average Equity	1,47	-5,23	-5,03
Net Interest Income/Average Assets	1,42	2,58	2,57
Fee Income/Average Assets	4,57	1,46	1,50
Total Income/Average Assets	5,99	4,04	4,07
Operating and Direct Expanses/Average Assets	1,18	2,08	2,07
Operating Expenses/Average Assets	4,54	2,36	2,38
Total Non-interest Expanses/Average Assets	5,72	4,44	4,45

Reported loss at the banking system level for the first half of 2010 resulted by negative key profitability indicators: ROAA (Return on Average Assets) and ROAE (Return on Average Equity). However, productivity of banks, measured as ratio of total income and average assets (4,07%) was slightly lower than the same level as the same period last year (4,00%) due to faster growth of the average total assets than the total income, or the minimum growth of the total income in the compared period for the past three years. It should be emphasized a high increase of business and direct expenses per average assets (from 1,40% to 2,07%), which is related to the increase of loan loss provisions.

All key financial indicators of profitability analyzed based on the ownership criteria in banks indicate that private banks operate more cost-effectively, productively and efficiently, which gives them competitive advantage if compared to state banks, emphasizing the need to finish privatization process in remaining state banks.

Under a more deteriorated performance conditions of banks, and due to adverse effects of the economic and financial crisis to the banking sector in the FBiH, profitability of banks, in the forthcoming period, will mostly depend on deterioration of asset quality, that is, continued increase of loan losses and loan risk, and will depend on effective management and operating income and expenses control. The most important condition for improving the banks' earnings is increasing the level of lending activities, not only to ensure increase of interest income, but to utilize their social core function of the collected financial assets allocation to the economic flows and the economy in compliance with the standards of prudent performance and sound practices of risk management, primarily of credit risk.

25 Expenses include provisions for potential loan losses.

In addition, profit of banks, that is, financial result will mostly depend on price and interest rate risk, both in the sources and price changes in funding sources of banks, and possibility to realize interest rate margin sufficient to cover all non-interest bearing expenses, and, eventually, to provide for satisfactory profit on the invested capital for bank owners. That is why the key factor is effectiveness and profitability of each bank's management quality and its business policy since this is the most direct way to affect its performance.

2.3. Risk-weighted nominal and effective interest rates

In order to increase transparency, and to make easy a comparability of conditions of banks in process of originating loans and accepting deposits and protection of customers through a transparent disclosure of loan expenses versus deposit income, and, in accordance with the international standards, criteria and practices in other countries, the FBA, as of 01.07.2007., prescribed unified method of computation and disclosure of effective interest rate[26]for all banks that have their seat in the Federation of BiH, and their organizational units, regardless of the territory in which they operate, including organizational units of the banks operating in the Federation of BiH. Effective interest rate represents a real relative price of a loan, that is, an income generated from a deposit, expressed as per cent at the annual level.

Effective interest rate is a discursive interest rate computed at the annual level. It applies a compound interest rate in a way to equal discounted cash inflows with discounted cash outflows for the originated loans, that is, accepted deposits.

Banks are obliged to monthly report to the FBA of risk-weighted nominal and effective interest rates on loans and deposits originated or accepted within the reporting month, in accordance with the methodology prescribed[27].

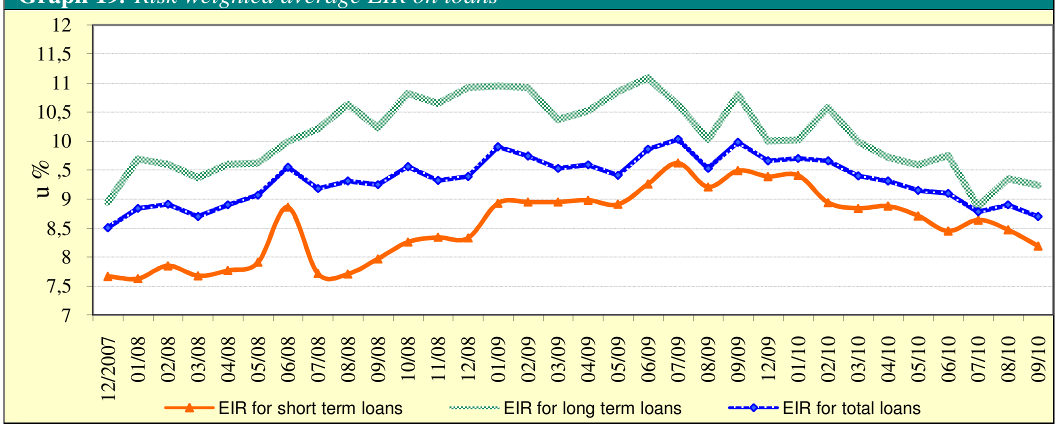
The following table presents risk-weighted nominal and effective interest rates (hereinafter: NIR and EIR) for loans on the banking system level for the two most important sectors (economy and citizens) for December of 2008, June, September and December of 2009, and June and September of 2010:

[26] Decision on unified method of computation and disclosure of effective interest rates on loans and deposits ("Official Gazette of the FBiH", number 27/07).
[27] Guidelines for implementation of Decision on unified method of computation and disclosure of effective interest rates on loans and deposits and Guidelines for computation of risk-weigthed nominal and effective interest rate.

Table 29: *Risk-weighted average NIR and EIR on loans*

DESCRIPTION	31.12.2008.		30.6.2009.		30.09.2009.		31.12.2009.		30.06.2010.		30.09.2010.	
	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR
1	2	3	4	5	6	7	8	9	10	11	12	13
1. Risk-weighted interest rates for short-term loans	7,82	8,33	8,41	9,26	8,77	4,49	8,55	9,39	7,90	8,45	7,70	8,19
1.1. Economy	7,74	8,19	8,40	9,10	8,71	9,16	8,51	9,27	7,86	8,34	7,69	8,08
1.2. Citizens	10,25	13,04	10,03	13,94	9,81	13,31	9,51	12,9	8,97	12,28	8,42	12,57
2. Risk-weighted interest rates for long-term loans	9,95	10,92	9,92	11,09	9,7	10,8	9,16	10,00	8,89	9,75	7,75	9,24
2.1. Economy	8,33	8,92	8,70	9,62	8,77	9,64	8,46	9,15	8,40	8,90	8,07	8,45
2.2. Citizens	11,16	12,54	10,82	12,20	10,57	11,87	10,21	11,32	9,35	10,56	7,48	9,93
3. Total risk-weighted interest rates for loans	8,69	9,39	8,91	9,86	9,12	9,98	8,82	9,66	8,40	9,10	7,73	8,70
3.1. Economy	7,88	8,37	8,45	9,19	8,73	9,27	8,50	9,23	8,04	8,53	7,81	8,19
3.2. Citizens	11,09	12,58	10,75	12,34	10,59	12,08	10,17	11,42	9,34	10,64	7,53	10,05

Graph 19*: Risk weighted average EIR on loans*



When analyzing the trend of interest rates, it is relevant to monitor risk-weighted EIR, while a difference in the risk-weighted NIR is exclusively the result of fees and provisions paid to banks for originated loans, which is included in the computation of the loan price. That is the reason why the EIR represents a real loan price.

The risk-weighted EIR for loans, for the first half of 2010, had slight decreasing trend. In comparison to the level of 9,66% in December 2009, following minor increase of 0,04 per cent in January 2010, in records a continuous decrease and in September of 2010 are 8,70%.

During the first nine months of 2010, higher oscillations are recorded by the EIR for short-term loans, within 1,2%, than the long term that oscillated within 1,14%.

The risk-weighted EIR for short-term loans, in September 2010, was 8,19%, which was lower by 1,2 per cent in comparison to December 2009.

The risk-weighted EIR for long-term loans, in September 2010, was 9,24%, which was lower by 0,77 per cent in comparison to December 2009.

Interest rates for loans originated in the two most significant sectors: economy and citizens[28], over the observing period of 2010, had the decreasing trend. However, the risk weighted EIR for loans originated in the economy, although still much lower than the EIR for loans to citizens, decreased from 9,23% in December 2009 to the level of 8,19% in September 2010. As for long term loans, downfall was 0,70 per cent (from 9,15% to 8,45%), while EIR for short-term loans recorded higher downfall of 1,19 per cent (from 9,27% to 8,08%).

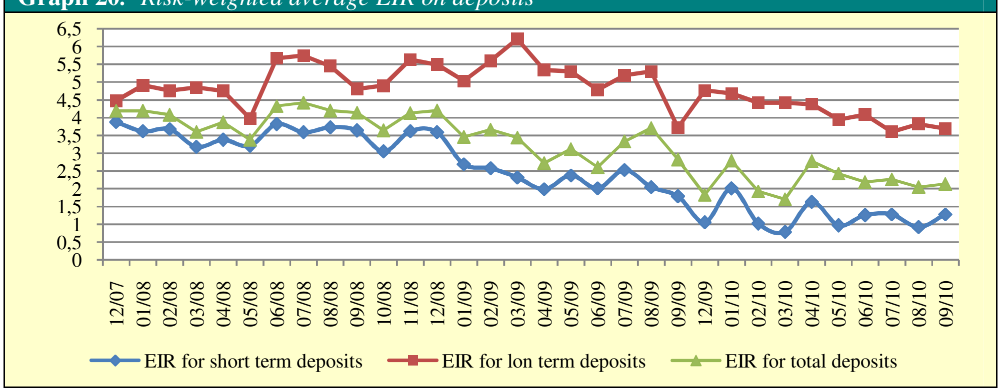
Changes of the overall EIR on loans financed to citizens for the first three quarters of 2010 oscillated within 1,85%, and in April of 2010 recorded was the lowest rate of 10,03%, and the highest 11,88% in February, while in September it was 10,05%, which is by 1,37% less than in December of 2009. EIR for long term loans to the same sector, from the 2009 December level of 11,32%, decreased to 9,93% in September 2010. EIR for short term loans in September 2010 was 12,57%, which was lower by 0,34 per cent than in December 2009.

Risk-weighted NIR and EIR for term deposits, computed based on monthly statements, for the banking sector are presented in the following table:

Table 30: *Risk-weighted average NIR and EIR on deposits*

DESCRIPTION	31.12.2008.		30.06.2009.		30.09.2009.		31.12.2009.		30.06.2010.		30.09.2010.	
	NIR	EIR	NIR	EIR	NIR	NIR	EIR	NIR	EIR	NIR	NIR	EIR
1	2	3	4	5	6	7	8	9	10	11	12	13
1. Risk-weighted interest rates on short term deposits	3,59	3,59	1,99	2,01	1,79	1,79	1,06	1,06	1,26	1,26	1,28	1,28
1.1. up to 3 months	3,48	3,49	1,74	1,74	0,88	0,88	0,72	0,72	0,39	0,39	0,69	0,69
1.2. up to 1 year	4,13	4,14	3,8	3,95	3,63	3,64	2,90	2,91	3,25	3,26	2,59	2,6
2. Risk-weighted interest rates on long term deposits	5,48	5,49	4,72	4,78	3,7	3,72	4,75	4,77	4,08	4,09	3,65	3,69
2.1. up to 3 years	5,41	5,42	4,58	4,66	5,24	5,28	4,72	4,74	3,86	3,87	3,44	3,47
2.2. over 3 years	6,34	6,33	6,14	6,11	2,13	2,13	5,12	5,13	5,45	5,47	4,58	4,64
3. Total risk-weighted interest rates on deposits	4,2	4,2	2,57	2,6	2,8	2,82	1,82	1,83	2,19	2,19	2,13	2,14

Graph 20*: Risk-weighted average EIR on deposits*



As opposed to loans, where the real price is influenced by the expenses associated with loan origination and servicing (under condition they are known at the time of origination), deposits do not show almost any difference between nominal and effective interest rates.

[28] Based on the methodology of classification in sectors: entrepreneurs are included in the sector of citizens.

If compared to December 2009, risk-weighted EIR for total term deposits, in September 2010, increased by 0,31 per cent (from 1,83% to 2,14%). Risk-weighted EIR on short term deposits shows fluctuations within 1,22 per cent, with the highest in January 2010 when it was 2,01 per cent, the lowest in March 0,79%, and in September 2010 it was 1,28% (2009: 1,06). Risk-weighted EIR on long term deposits recorded a downfall of 1,08 per cent in comparison to December 2009, and it was 3,69% in September 2010.

Risk-weighted EIR on long term deposits with term up to three years decreased in comparison to the level from December by 1,27 per cent, and it was 3,47% in June. EIR on deposits over three years was 4,64% in September, which is by 0,49% less than in December of 2009 when it was 5,13%.

As for interest rates on short term deposits, after the decrease of 0,03 per cent in relation to the level in December, the EIR on deposits with term up to three months was 0,69% in September, and on deposits with term up to one year the EIR was 2,6%, which is by 0,31 per cent less in relation to December of 2009.

Banks, in September 2010, paid to the economy much lower EIR on term deposits (1,59%) than to citizens (2,97%), which is directly correlated with the structure of term deposits. However, the economy deposits are usually short term up to three months (smaller portion to one year), and such deposits bare much lower interest rate. On the other hand, in the structure of deposits with term over one year (majority of deposits have term up to three years), dominant are citizens deposits. EIR on term deposits of the economy and citizens, in September 2010, decreased in comparison to December 2009, when they were 3,75., while on the economy deposits they are higher in relation to the December of 2009 (1,1%)

Risk-weighted interest rates for loans referring to the contracted overdraft and demand deposits, computed based on monthly statements, are presented in the following table:

Table 31: *Risk-weighted average NIR and EIR on loans-overdrafts and demand deposits*

DESCRIPTION	31.12.2008.		30.06.2009.		30.09.2009.		31.12.2009.		30.06.2010.		30.09.2010.	
	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR
1	2	3	4	5	6	7	8	9	10	11	12	13
1. Risk-weighted interest rates for loans-overdrafts	8,62	8,81	8,56	9,00	8,71	8,72	8,96	8,96	8,83	8,84	8,78	8,78
2. Risk-weighted interest rates for demand deposits	0,40	0,40	0,40	0,40	0,42	0,42	0,41	0,41	0,23	0,23	0,23	0,23

The EIR for the above items of assets and liabilities, in general, should be equal to the nominal interest rate. The risk-weighted EIR for total loans in overdrafts for the banking sector, in September 2010, was 8,78% (an increase of 0,18 per cent in comparison to December 2009), and 0,23% for demand deposits, which was lower by 0,18 per cent in comparison to December 2009.

2.4. Liquidity

Liquidity risk management, along with credit risk, is one of the most compound and most important segments of banking operations. Maintaining liquidity in market economy is a permanent task of a bank and main precondition for its sustainability in financial market. This is also one of the key preconditions for establishment and maintenance of the confidence in the banking system of any country, as well as its stability and safety.

Under normal circumstances of banks' performance and stable environment, until the global financial and economic crisis occurred, liquidity risk has had a secondary significance, that is, credit risk was first priority and management systems established, that is, identification, measurement, and control of such risks were under continuous supervision with purpose of its enhancement and improvement. It should be emphasized, however, that during the course of its performance, a correlation of all risks that any bank is or may be exposed to is very high.

Along with turbulences in the financial market due to the global crisis, liquidity risk has rapidly increased and the risk management has become a key factor for normal operating of a bank, as well as timely meeting of past due liabilities and maintenance of a long term position of a bank in regard of its solvency and capital base.

In the last quarter of 2008 the liquidity risk increased after the expansion of the global crises and its adverse impact on the financial and economic system in BiH. Although a part of the savings was withdrawn and the trust in banks was impaired, it was evaluated that the banking system liquidity was not in danger in any given moment, since the banks in FBiH, due to regulatory requirements and proscribed limits, based on a conservative approach, had significant liquid funds and a good liquidity position.

In 2009 the adverse movements from the last quarter of 2008 were stopped, and general liquidity indicators were improved thanks to primarily decreased lending activity, with a tendency of slight deterioration in the first half of 2010 due to decrease of cash funds from investment in securities and payment of loan liabilities. The statement remains that liquidity of the banking system in the Federation of BiH is still good, with satisfactory participation of liquid assets in total assets and coverage of short term liabilities by liquid assets. However, since the financial crisis is still present worldwide which has an adverse reflection to the banking systems of certain European countries, and since majority of banks in FBiH are owned by the European banking groups that provide financial support to our banks through deposit and credit funding, it is estimated that liquidity risk still needs to be under enhanced supervision.

In addition, we should have in mind the fact that impact of the crisis is higher in the real sector, adverse consequences are being reflected to the entire economy environment under which banks operate in BiH, causing delinquency of debtors and increase of nonperforming claims, which is causing decrease in inflow of liquid assets of banks.

Decision on Minimum Standards for Liquidity Risk Management prescribes minimum standards a bank has to establish and maintain in the process of managing this risk, that is, minimum standards to create and implement liquidity policy, which assures bank's ability to fully and immediately perform its liabilities as they become due.

The mentioned regulation represents a framework for liquidity risk management and qualitative and quantitative provisions and requirements towards banks. It prescribes limits banks have to meet in regard to average ten-day minimum and daily minimum of cash assets in relation to short-term sources, as well as minimum limit of maturity adjustment of the instruments of financial assets and liabilities up to 180 days.

Liquidity risk is closely correlated with other risks and often has an adverse effect on banks' success and profitability.

In the structure of financing sources of banks in the Federation of BiH, as of 30.09.2010., deposits still have the highest participation of 74,4%, followed by loans taken (including the subordinated debt[29]) with participation of 10,6% with longer maturity, representing quality

[29] Subordinated debt – loans taken and permanent liabilities.

source for long term placements, and have made a significant contribution to maturity match between assets and liabilities.

On the other hand, the structure of deposits is considerably unfavorable, and after a long period of improvements, has a trend of deterioration in 2010..

- in 000 KM-

Table 32: *Maturity structure of deposits*

DEPOSITS	31.12.2008.		31.12.2009.		30.09.2010.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Savings and demand deposits	4.186.773	40,0	4.490.845	40,7	4.908.078	43,7	107	109
Up to 3 months	460.100	4,4	322.763	2,9	214.527	1,9	70	66
Up to 1 year	979.516	9,4	833.089	7,5	1.057.607	9,4	85	127
1. Total short term	5.626.389	53,8	5.646.697	51,1	6.180.212	55,0	100	109
Up to 3 years	3.018.766	28,9	3.292.619	29,8	2.988.135	26,6	109	91
Over 3 years	1.816.695	17,4	2.106.552	19,1	2.061.842	18,4	116	98
2. Total long term	4.835.461	46,2	5.399.171	48,9	5.049.977	45,0	112	94
TOTAL (1 + 2)	10.461.850	100,0	11.045.868	100,0	11.230.189	100,0	106	102

Analysis of maturity structure of deposits in two main groups, if compared to 2009, shows an increase in participation of short term deposits by 3,9 per cent, and by the same percentage a decrease of long term deposits, so their participation, as of 30.09.2010., was 55% and 45% respectively.

Total short term deposits, in comparison to 2009, increased by 9% or 534 million KM, while long term deposits declined by 6% or 349 million KM.

The increase of short term deposits was realized from increased demand deposits of 9% or 414 million KM, while deposits up to three months were decreased by 34% or 108 million KM, along with decrease in participation from 2,9% to 1,9%, and deposits up to one year increased by 27% or 225 million KM, which is why their participation in total deposits increased from 7,5% to 9,4%. Demand deposits still have the highest participation of 43,7% in total deposits, while deposits up to three months have the lowest participation (1,9%). In total demand deposits, the highest participation is still recorded by citizen deposits (37,7%), which, in comparison to 2009, have increased by 14,2% or 229 million KM.

Total long term deposits in 2010 had declined by 6% or 349 million KM. It should be emphasized that of long term deposits, two sectors show dominant participation: citizens of 49% and banking institutions of 30,3%. Citizen deposits in term deposits up to three years show the highest participation of 65,4% (58,2% at the end of 2009), while banking institutions' deposits over three years show the highest participation of 65,8% (72% at the end of 2009).

In the function of planning for the necessary level of liquid resources, banks have to plan for sources and structure of adequate liquidity potential, along with planning of credit policy. Maturity of placements, that is, credit portfolio is determined by maturity of sources. Since maturity transformation of assets in banks is inherently connected to the functional characteristics of banking performance, banks continuously control and maintain maturity imbalance between sources and placements within prescribed minimum limits.

-in 000 KM-

Table 33: *Maturity structure of loans*

LOANS	31.12.2008.		31.12.2009.		30.09.2010.		INDEX	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Past due claims and paid off-balance sheet liabilities	234.178	2,2	354.200	3,6	510.668	5,2	151	144
Short term loans	2.337.251	22,4	2.159.008	22,0	2.134324	21,6	92	99
Long term loans	7.862.948	75,4	7.283.592	74,4	7.221.557	73,2	93	99
TOTAL LOANS	10.434.377	100,0	9.796.800	100,0	9.866549	100,0	94	101

Over the observing period of 2010, long term loans decreased by 1% or 62 million KM (since loans originated to citizens have the highest participation in the structure of long term loans, it should be pointed out that only a decrease in this segment represents 52 million KM), short term loans also recorded a decrease of 1% or 25 million KM, while past due claims increased by 44% or 156 million KM, of which the largest amount refers to private companies that represent 129 million KM, citizens represent 27 million KM, while there was a decline recorded with public companies, and non banking organizations recorded an increase in the amount of about two million KM. In the structure of past due claims, 75% are private companies, 20% are citizens, and 5% are other sectors.

Sector analysis by maturity, in two most significant sectors, indicates that loans to citizens represent 89% of long term loans, and loans to private companies, of total originated loans, represent 58% of long term loans.

Sektorska analiza po ročnosti za dva najznačajnija sektora pokazuje da su krediti plasirani stanovništvu 89% dugoročni, a od ukupno odobrenih kredita privatnim preduzećima na dugoročne se odnosi 58%.

In the assets structure, as the most significant category, loans still have the highest participation of 65,4%, which has increased by 1,1 per cent in comparison to the end of 2009 due to a slight growth of loans of 0,7% or 70 million KM and increase of assets of 148 million KM or 1%. Cash funds decreased by 8% or 388 million KM and their participation, in comparison to 31.12.2009., decreased from 31,4% to 29,1%.

In 2010, banks were regularly meeting a commitment to maintain required reserves with the Central Bank of BiH. The required reserve rate, as of 11.10.2008., decreased to 14% with purpose to enable additional liquidity for banks. In addition, with the same purpose, the CBBiH's decision has been to change basis of the required reserve's computation, so the funds borrowed from nonresidents, based on the contracts signed after 01.11.2008., would not be subject to the basis for computation. As of 01.01.2009., a differentiated required reserve rate has been introduced with regard to the maturity of sources (10% for long term and 14% for short term) and as of 01.05.2009., the rate for long term deposits and borrowings decreased to 7%. Required reserve, as significant instrument of monetary policy in BiH, under the Currency Board and financially underdeveloped market, represents the only instrument of monetary policy used to realize monetary control, in sense of stopping fast credit growth from the past years, and decrease multiplications, as well as an increase of banks' liquidity under an impact of the crisis and intensified outflow of funds from banks that in BiH was experienced after 01.10.2008. On the other hand, implementation of regulation on foreign exchange risk and maintenance of currency adjustment within prescribed limits, also significantly influence the amount of funds banks maintain on the reserve account with the Central Bank in domestic currency, which provides for high liquidity of individual banks and the banking sector.

In liquidity analysis, we use several ratios, and preview of the most significant ones is presented in the following table:

- in % -

Table 34: *Liquidity ratios*

Ratios	31.12.2008.	31.12.2009.	30.09.2010.
1	2	3	4
Liquid assets[30] / Total assets	28,3	31,9	30,1
Liquid assets / Short term financial liabilities	51,2	54,2	51,4
Short term financial liabilities / Total financial liabilities	62,9	66,9	66,8
Loans / Deposits and Borrowings[31]	82,6	76,4	78,3
Loans / Deposits, borrowings and subordinate debts[32]	80,9	75,0	76,9

All banks continuously meet, considerably above the prescribed minimum, their obligation of a ten-day average of 20% on a comparable basis with the short term funding sources, and daily minimum of 10%, on the same basis, as presented in the following schedule.

- in 000 KM-

Table 35: *Liquidity position – ten-day average and daily minimum*

Description	31.12.2008.	31.12.2009.	30.09.2010.	RATIO	
	Amount	Amount	Amount	3/2	4/3
1	2	3	4	5	6
1. Average daily balance of cash assets	3.687.406	3.789.107	3.797.776	103	100
2. Minimum total daily balance of cash assets	3.310.173	3.341.965	3.410.130	101	102
3. Short term sources (accrual basis)	5.821.848	5.431.143	6.183.540	93	114
4.Liabilities:					
4.1. ten-day average 20% of Item 3	1.164.370	1.086.229	1.236.708	93	114
4.2. daily minimum 10% of Item 3	582.185	543.114	618.354	93	114
5.Meeting requirement :ten-day average					
Surplus = Item 1 – Item 4.1.	2.523.036	2.702.878	2.561.068	107	95
6. Meeting requirement :daily minimum					
Surplus = Item.2 – Item 4.2.	2.727.988	2.798.851	2.791.776	103	100

Apart from the mentioned prescribed minimum standards, monitoring of remaining maturity of financial assets and liabilities, according to the time scale, is of crucial significance for the liquidity position analysis. The time scale is from the aspect of prescribed minimum limits created based on time horizon up to 180 days.[33]

[30] Liquidity assets in the narrow sense: cash and deposits and other financial assets with maturity below three months, except inter-banking deposits.

[31] Empiric standards: below 70%-very solid, 71%-75%-satisfactory, 76%-80%-marginal to satisfactory, 81%-85%-insufficient, over 85%-critical.

[32] Prior ratio has been modified. Subordinated debts are included in the sources, which gives more realistic indicator.

[33] Decision on Changes and Amendments to Decision on Minimum Standards for Liquidity Risk Management in Banks (Official Gazette of the FBiH, number 88/07) dated of 01.01.2008. sets new percentages for maturity matching between financial assets and liabilities: minimum 85% of funding sources (used to be 100%) with maturity up to 30 days must be engaged in placements with maturity up to 30 days; minimum 80% of funding sources (used to be 100%) with maturity up to 90 days in placements with maturity up to 90 days and minimum 75% of funding sources (used to be 95%) with maturity up to 180 days in placements with maturity up to 180 days.

- in 000 KM -

Table 36: *Maturity match between financial assets and financial liabilities up to 180 days*

Description	31.12.2008. Amount	31.12.2009. Amount	30.09.2010. Amount	INDEX 3/2	INDEX 4/3
1	2	3	4	5	6
I. 1- 30 days					
1. Financial assets	5.126.920	5.719.878	5.718.530	112	100
2. Financial liabilities	4.763.530	5.070.291	5.554.979	106	110
3. Difference (+ or -) = 1-2	363.390	649.587	163.551	179	25
Accrual of requirement in %					
a) Performed %= Item 1 / Item 2	107,6%	112,8%	102,9%		
b) Required minimum %	85,0 %	85,0 %	85,0%		
Surplus (+) or shortage (-) = a – b	22,6 %	27,8 %	17,9%		
II. 1-90 days					
1. Financial assets	5.892.107	6.479.395	6.494.447	110	100
2. Financial liabilities	5.441.072	5.745.023	6.182.620	106	108
3. Difference (+ or -) = 1-2	451.035	734.372	311.827	163	42
Accrual of requirement in %					
a) Performed %= Item 1 / Item.2	108,3%	112,8 %	105,0%		
b) Required minimum %	80,0%	80,0%	80,0%		
Surplus (+) or shortage (-) = a – b	28,3%	32,8%	25,0%		
III. 1-180 days					
1. Financial assets	6.999.103	7.469.752	7.435.281	107	100
2. Financial liabilities	6.477.230	6.956.965	7.097.478	107	102
3. Difference (+ or -) = 1-2	521.873	512.787	337.803	99	66
Accrual of requirement in %					
a) Performed %= Item 1 / Item.2	108,1 %	107,4%	104,8%		
b) Required minimum %	75,0 %	75,0 %	75,0%		
Surplus (+) or shortage (-) = a – b	33,1%	32,4%	29,8%		

Based on the presented data, we may conclude that banks, as of 30.09.2010., were able to meet the required limits, and have managed to realize better maturity match between financial assets and financial liabilities in relation to the limits prescribed.

Based on all of the above presented indicators, it may be concluded that the negative movements from the last quarter of 2008 were stopped, and the trend of improvement from 2009 continued through the first half of 2010, so the liquidity of the banking system of the Federation of BiH is still assessed as satisfactory. Since this segment of performance and level of liquidity risk exposure correlates to credit risk, having in mind the effects of global financial crisis expansion in BiH and an impact to the banking sector of the FBiH (primarily through a stronger pressure on banks' liquidity), on one side, due to slower inflow of deposits, and, on the other side, poor inflow of liquid assets due to downfall in collection of loans, it should be emphasized that, in the forthcoming period, banks will have to pay more attention to the liquidity risk management by establishing and implementing liquidity policies, which will make sure that all matured liabilities of banks are timely realized, based on continuous planning of future liquidity needs, and taking into account changes in operating, economic, regulatory and other segments of business environment of banks.

The FBA will, both through reports and on-site examinations of banks, monitor how banks manage this risk, and whether they act in accordance with the adopted policies and programs

2.5. Foreign exchange risk – foreign currency matching between assets and liabilities from balance sheet and off-balance sheet items

In their operations, banks are exposed to significant risks coming from potential losses in balance sheet and off-balance sheet items created as a result of price changes in the market. One of those risks is foreign exchange risk (FX) created as a result of changes of exchange rates and/or the imbalance in assets, liabilities and off-balance sheet items of the same currency – individual foreign currency position or all currencies together used by a bank in its operations – overall foreign currency position of a bank.

In order to enable application and implementation of prudential principles in foreign exchange activities of banks and to decrease influence of foreign exchange risk to their profitability, liquidity and capital, the FBA has issued Decision on Minimum Standards for Foreign Exchange Risk Management in Banks[34] that regulates minimum standards for adoption and implementation of programs, policies and procedures for undertaking, monitoring, control and management of foreign exchange risk, and restrictions prescribed for opened individual and overall foreign exchange position (long or short), calculated in relation to the amount of bank's core capital.[35]

The banks are obliged to report on daily basis to FBA so that FBA can monitor the banks compliance with the prescribed limits and the exposure to the foreign currency risk. Based on examination, monitoring and analysis of submitted reports on foreign currency position of banks, we can conclude that banks meet prescribe limits and perform their FX activities within these limits.

Since the Central Bank functions as the Currency Board and EUR is an anchor currency of the Currency Board, in practice banks are not exposed to foreign exchange risk in case of the most significant currency EUR.

According to the balance as of 30.09.2010., currency structure of banks' assets on the level of banking system recorded participation of items in foreign currencies of 15,7% or 2,4 billion KM (17,1% or 2,6 billion KM at the end of 2009). On the other hand, currency structure of liabilities is essentially different, since participation of liabilities in foreign currency is significantly higher of 55% or 8,3 billion KM (56,7% or 8,6 billion KM at the end of 2009).

The following table presents structure and trend of financial assets and liabilities and foreign currency position for EUR as the most significant currency[36] and total.

[34] "Official Gazette of F BiH", Number. 3/03, 31/03, 64/03, 54/04.
[35] Article 8 of Decision on Minimum Standards for Capital Management of Banks determines limits for individual foreign currency position in EUR up to 30% of core capital, for other currencies up to 20% and foreign currency of a bank up to 30%.

[36] Source: Form 5-Foreign currency position.

- In million KM-

Table 37: *Foreign currency adjustment of financial assets and liabilities (EUR and total)*

Description	31.12.2009.				30.09.2010.				RATIO	
	EURO		TOTAL		EURO		TOTAL		EURO	TOTAL
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	6/2	8/4
1	2	3	4	5	6	7	8	9	10	11
I. Financial assets										
1. Cash assets	1.697	19,4	2.150	22,2	1.257	15,0	1.664	17,9	74	77
2. Loans	90	1,0	124	1,3	77	0,9	109	1,2	86	88
3.Loans with currency clause	6.713	76,6	7.095	73,1	6.561	78,5	6.925	74,5	98	98
4. Other	269	3,0	336	3,4	470	5,6	592	6,4	175	176
Total (1+2+3+4)	8.769	100,0	9.705	100,0	8.365	100,0	9.290	100,0	95	96
II. Financial liabilities										
1. Deposits	5.704	68,9	6.585	71,5	5.742	72,5	6.614	74,8	101	100
2. Borrowings	1.689	20,4	1.727	18,7	1.292	16,3	1.327	15,0	76	77
3.Deposits and loans with currency clause	577	6,9	577	6,3	545	6,9	545	6,2	94	94
4.Other	313	3,8	322	3,5	338	4,3	350	4,0	108	109
Total (1+2+3+4)	8.283	100,0	9.211	100,0	7.917	100,0	8.836	100,0	96	96
III. Off-balance sheet										
1.Assets	50		57		31		38			
2.Liabilities	500		505		357		358			
IV.Position										
Long (amount)	36		46		122		134			
%	2,3%		3,0%		7,7%		8,5%			
Short										
%										
Limit	30%		30%		30%		30%			
Below limit	27,7%		27,0%		22,3%		21,5%			

If we analyze the structure of foreign currencies in the financial assets[37] we see a dominant participation of EUR of 76,3, which decreased somewhat in comparison to the participation as of 31.12.2009. (78,8%) with slight decline in nominal amount from 2,1 billion KM to 1,8 billion KM. Participation of EUR in the liabilities has slightly decreased from 89,3% to 88,9%, with decline in nominal amount from 7,7 billion KM to 7,4 billion KM.

However, calculation of the FX risk exposure also includes the amount of indexed items of assets (loans) and liabilities[38], which are especially significant in the assets (74,5% or 6,9 billion KM) this is slightly lower in relation to 31.12.2009. (73,1% or 7,1 billion KM). Other foreign currency assets items represent 25,5% or 2,4 billion KM, of which EUR items make 19,4% or 1,8 billion KM, and other currencies 6,1% or 0,6 billion KM (at the end of 2009, loans contracted with currency clause amounted to KM 7,1 billion with participation of 73,1%, and other items in EUR of 21,2% or 2,1 billion KM). Of total net loans (9,3 billion KM), 74,5% were contracted with currency clause, primarily tied to EUR (94,8%).

On the other hand, the structure of financial liabilities stipulates and determines the structure of financial assets, for each currency individually. In foreign currency liabilities (8,8 billion KM)

[37] Source: Form 5-Foreign currency position: portion of financial assets (in foreign currencies denominated in KM). According to the methodology, financial assets are expressed based on net principle (reduced by loan loss reserves).

[37] In order to protect from changes of the exchange rate banks contract certain items of assets (loans) and liabilities with currency clause (regulation allow only two-way currency clause).

items in EUR (primarily deposits) had the highest participation of 83,4% or 7,4 billion KM, while participation and amount of indexed liabilities was at minimum, amounting to 6,2% or 0,5 billion KM (at the end of 2009, participation of liabilities in EUR was 83,7% or 7,7 billion KM, while indexed liabilities were 6,3% or 0,6 billion KM).

Observed by banks and overall on the level of the banking system of the FBiH, we can conclude that foreign exchange risk exposure of banks and the system, through the first half of 2010, ranged within the prescribed limits.

As of 30.09.2010., there were 13 banks with long foreign currency position, and seven banks with short position. At the system level, long foreign currency position represented 8,5% of banks' core capital, which is lower by 21,5% than the limit. Individual foreign currency position for EURO was 7,7%, with financial assets items being higher than financial liabilities (long position), representing a decline of 22,3% than the limit.

Although in the environment of the Currency Board banks are not exposed to foreign exchange risk in the most significant currency EUR, they are still required to operate within prescribed limits for individual currencies and for total foreign currency position and to daily manage this risk in accordance with adopted programs, policies, procedures and plans.

III CONCLUSION AND RECOMMENDATIONS

After consolidation, development and stabilization of the banking sector of the Federation of BiH during the period of implementation of the reform has reached an enviable level, the upcoming activities should be aimed at preserving its stability as priority task in the current stressful conditions, and its further progress and development. These goals require continuous and vigilant engagement of all parts of the system, legislative and executive authorities, which is a prerequisite to create the most favorable economic environment that would be stimulating to both banks and consequently to the real sector of the economy and citizens.

In the upcoming period, the Banking Agency of the Federation of BiH shall:

- Take measures and activities within its powers to overcome and mitigate adverse effects to the banking sector of the FBiH caused by the global financial crisis,
- Continue implementing activities, from the scope of its authority, to consolidate supervision on state level,
- Proceed with a continues supervision of banks through on-site and off-site examinations, focusing on targeted examination of dominant risk segments of banking operations, which will make supervision more effective, in regard to:

  - Persist on capital strengthening of banks, especially those recording outstanding assets growth,
  - Continue permanent monitoring of banks, primarily those with systemic importance to development of credit activities with the highest concentration of savings and other deposits in order to protect depositors,
  - Continue a systematic monitoring of banks' activities in prevention of money laundering and terrorism financing and improve cooperation with other supervisory and examination institutions,
  - Maintain continuity in payment system examinations,

- Continue working on further development of regulation based on the Basle Principles, the Basle Capital Accord, and the European Banking Directives, as part of BiH's preparation to join the European Union,
- Establish and expand cooperation with home country supervisors of the investors present in the banking sector of the FBiH, and other countries in order to have more effective supervision,
- Improve cooperation with the Banks Association in all banking performance segments, organization of counseling and professional assistance in the area of implementation of banking laws and regulations, advancement of cooperation in regard to professional development, proposed changes of all legislative regulations that have become a limiting factor to banks' development, introduction of new products, collection of claims and fully involve in building up and functioning of the unified registry of irregular debtors – legal entities and citizens, with daily data update.

- Continuous operational development of the IT system for early warning and prevention in elimination of weaknesses in banks;
- Work on continuous education and training of staff;
- Make effort to accelerate finalization of the remaining provisional administrations and liquidations based on the conclusion made by the Management Board;
- Particularly, accelerate resolution of unsettled issues with the Government of BiH in relation to the Provisional Administration of Hercegovačka Bank d.d. Mostar related to terminal Dretelj.

In addition, it is necessary to have stronger involvement of other authorized institutions and bodies of Bosnia and Herzegovina and the Federation of BiH in order to:

- Realize Program of measures to mitigate effects of the global economic crisis and improve the business environment, as accepted by the Economic Social Council in the territory of the FBiH in December 2008, pursuant to the document issued by the FBiH Government;
- Realize the conclusion made by the Federation of BiH Parliament to establish banking supervision on state level;
- Form an opinion about status of banks owned by the Federation of BiH;
- Create and further develop the financial sector regulation related to the activity, status and performance of micro-credit organizations, leasing companies, insurance companies;
- Accelerate implementation of economic reform in the real sector in order to reach the level of the monetary and banking sector;
- Prepare for creation of legislative regulation for the banking sector and financial system based on the Basle Principles, the Basle Capital Accord, and the European Banking Directives,
- Establish specialized court departments for economy,
- Establish more efficient process for realization of pledges,
- Adopt law on protection of creditors and full responsibility of debtors,
- Adopt law or improve existing legislation regulating the area of safety and protection of money in banks and in transportation.

Banks, as the most important part of the system, have to concentrate their actions to:

- Full dedication to good quality and prudent performance, and actions to cope with the crisis impact that presently represents the greatest danger for banks and the real sector of the economy and citizens;
- Further capital strengthening and level of solvency proportional to the growth of assets and risk, higher profitability, more consistent implementation of adopted policies and procedures

in the area of prevention of money laundering and terrorism financing, and safety and protection of money in banks and in transportation, in accordance with laws and regulations;

- Strengthen internal control systems and internal audit functions as fully independent in performing their duties and roles;
- Regular, updated and accurate submission of data to the Central Loan Registry and Unified Central Account Registry with the Central Bank of BiH.

Number: U.O.-25-8 /10
Sarajevo, 09.12.2010.

ATTACHMENTS

ATTACHMENT 1………… General data about banks in the F BiH

ATTACHMENT 2………… Balance sheet of banks, FBA Schedule

ATTACHMENT 3………… Citizen savings in banks of the F BiH

ATTACHMENT 4………… Report on changes in balance sheet assets and off-balance sheet risk items

ATTACHMENT 5………… Income statement of banks

ATTACHMENT 6………… Report on capital balance and adequacy

ATTACHMENT 7…………. Information about employees in banks of the F BiH

ATTACHMENT 1

Banks in the Federation of Bosnia and Herzegovina - 30.09.2010.

No.	BANK	Address		Telephone	Director
1	BOSNA BANK INTERNATIONAL dd - SARAJEVO	Sarajevo	Trg djece Sarajeva bb	033/275-100, fax:203-122	AMER BUKVIĆ
2	BOR BANKA dd - SARAJEVO	Sarajevo	Obala Kulina bana 18	033/663-500, fax:278-550	HAMID PRŠEŠ
3	FIMA BANKA dd - SARAJEVO	Sarajevo	Kolodvorska br. 5	033/720-070, fax:720-100	EDIN MUFTIĆ
4	HERCEGOVAČKA BANKA dd - MOSTAR	Mostar	Nadbiskupa Čule bb	036/332-901, fax:332-903	Privr.upravitelj - Nikola Fabijanić - 16.04.2007.
5	HYPO ALPE-ADRIA-BANK dd - MOSTAR	Mostar	Kneza Branimira 2b	036/444-444, fax:444-235	MICHAEL VOGT
6	INVESTICIONO-KOMERCIJALNA BANKA dd - ZENICA	Zenica	Trg B&H 1	032/448-400, fax:448-501	SUVAD IBRANOVIĆ
7	INTESA SANPAOLO BANKA D.D. BOSNA I HERCEGOVINA	Sarajevo	Obala Kulina bana 9a	033/497-555, fax:497-589	ALMIR KRKALIĆ
8	KOMERCIJALNO-INVESTICIONA BANKA DD V.KLADUŠA	V.Kladuša	Ibrahima Mržljaka 3	037/771-253, fax:772-416	HASAN PORČIĆ
9	NLB TUZLANSKA BANKA dd - TUZLA	Tuzla	Maršala Tita 34	035/259-259, fax:250-596	ALMIR ŠAHINPAŠIĆ
10	POŠTANSKA BANKA BiH dd - SARAJEVO	Sarajevo	Put života 2	033/564-000, fax: 564-050	ADNAN ZUKIĆ
11	PRIVREDNA BANKA SARAJEVO dd - SARAJEVO	Sarajevo	Alipašina 6	033/277-700, fax:664-175	AZRA ČOLIĆ
12	PROCREDIT BANK dd - SARAJEVO	Sarajevo	Emerika Bluma 8	033/250-950, fax:250-971	FRIEDER WOEHRMANN
13	RAIFFEISEN BANK dd BiH - SARAJEVO	Sarajevo	Zmaja od Bosne bb	033/755-010, fax: 213-851	MICHAEL MÜLLER
14	RAZVOJNA BANKA FEDERACIJE BIH	Sarajevo	Igmanska 1	033/277-900, fax: 668-952	RAMIZ DŽAFEROVIĆ
15	SPARKASSE BANK dd - SARAJEVO	Sarajevo	Zmaja od Bosne br. 2	033/280-300, fax:280-230	SANEL KUSTURICA
16	TURKISH ZIRAAT BANK BOSNIA dd - SARAJEVO	Sarajevo	Dženetića Čikma br. 2	033/252-230, fax: 252-245	KENAN BOZKURT
17	UNA BANKA dd - BIHAĆ	Bihać	Bosanska 25	037/222-400, fax: 222-331	Privr.upravitelj - Stjepan Blagović - 01.05.2005.
18	UNICREDIT BANK dd - MOSTAR	Mostar	Kardinala Stepinca bb	036/312-112, fax:312-121	BERISLAV KUTLE
19	UNION BANKA dd - SARAJEVO	Sarajevo	Dubrovačka 6	033/561-000, fax: 201-567	ESAD BEKTEŠEVIĆ
20	VAKUFSKA BANKA dd - SARAJEVO	Sarajevo	M. Tita 13	033/280-100, fax: 663-399	AMIR RIZVANOVIĆ
21	VOLKSBANK BH dd - SARAJEVO	Sarajevo	Fra Anđela Zvizdovića 1	033/295-601, fax:295-603	REINHOLD KOLLAND

ATTACHMENT 2

BALANCE SHEET OF BANKS IN THE FBiH - FBA SCHEDULE
ACTIVE SUB-BALANCE SHEET

In 000 KM

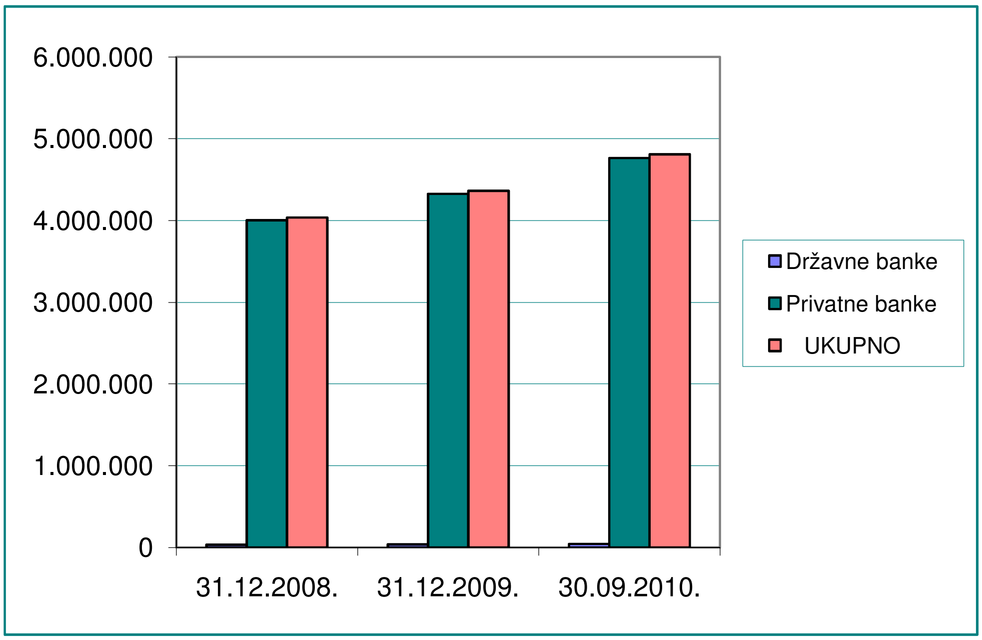
No.	DESCRIPTION	31.12.2008.	31.12.2009.	30.09.2010.
	ASSETS			
1.	Cash funds and deposit accounts at depository institutions	4.207.559	4.782.301	4.393.960
1a	Cash and non-interest deposit accounts	417.601	490.171	434.179
1b	Interest deposit accounts	3.789.958	4.292.130	3.959.781
2.	Trading securities	11.184	12.884	250.763
3.	Placements in other banks	90.415	111.019	217.500
4.	Loans, receivables in leasing and past due receivables	10.434.377	9.796.800	9.866.549
4a	Loans	10.199.978	9.442.455	9.355.745
4b	Receivables on leasing	221	145	136
4c	Past due receivables - loans and leasing	234.178	354.200	510.668
5.	Securities held until maturity	7.630	106.273	136.569
6.	Premises and other fixed assets	442.739	503.157	531.633
7.	Other real estate	24.768	25.753	28.187
8.	Investments in non-consolidated related enterprises	40.471	42.693	45.617
9.	Other assets	212.167	336.287	215.595
10.	MINUS: Reserves for potential losses	401.406	480.807	598.409
10a	Reserves on item 4 in Assets	381.215	458.803	570.925
10b	Reserves on Assets except item 4	20.191	22.004	27.484
11.	**TOTAL ASSETS**	**15.069.904**	**15.236.360**	**15.087.964**
	LIABILITIES			
12.	Deposits	10.461.850	11.045.868	11.230.189
12a	Interest deposits	9.586.215	10.180.008	10.221.888
12b	Non-interest deposits	875.635	865.860	1.008.301
13.	Loans - past due	3.025	2.744	2.696
13a	Balance of payable loans, unpaid	0	0	0
13b	Unpaid - called for payment off-balance sheet items	3.025	2.744	2.696
14.	Loans from other banks	3.089	3.089	5.089
15.	Payables to Government	0	0	0
16.	Payables on loans and other borrowings	2.176.594	1.771.978	1.372.026
16a	payable within one year	793.837	678.608	294.058
16b	payable longer than one year	1.382.757	1.093.370	1.077.968
17.	Subordinated debts and subordinated bonds	267.737	250.483	231.199
18.	Other liabilities	520.755	484.500	565.729
19.	**TOTAL LIABILITIES**	**13.433.050**	**13.558.662**	**13.406.928**
	CAPITAL			
20.	Permanent priority shares	26.136	25.028	25.028
21.	Common shares	1.091.879	1.145.627	1.146.269
22.	Shares issued	152.892	143.725	136.485
22a	Permanent priority shares	8.420	8.420	8.420
22b	Common shares	144.472	135.305	128.065
23.	Undistributed income and capital reserves	307.465	358.480	431.803
24.	Currency rate difference			
25.	Other capital	58.482	4.838	-58.549
26.	**TOTAL CAPITAL (20. TO 25.)**	1.636.854	1.677.698	1.681.036
27.	**TOTAL LIABILITIES AND CAPITAL (19+26)**	**15.069.904**	**15.236.360**	**15.087.964**
	PASSIVE AND NEUTRAL SUBBALANCE	**626.468**	**622.094**	**647.128**
	TOTAL BALANCE SHEET IN BANKS	**15.696.372**	**15.858.454**	**15.735.092**

ATTACHMENT 3

NEW CITIZEN SAVINGS BY PERIODS

in 000 KM

	31.12.2008.	31.12.2009.	30.09.2010.
State banks	32.481	35.275	43.166
Private banks	4.003.184	4.325.928	4.764.185
TOTAL	**4.035.665**	**4.361.203**	**4.807.351**



ATTACHMENT 4

CLASSIFICATION OF ASSETS AND OFF-BALANCE SHEET RISK ITEMS
As of 30.09.2010.

- ACTIVE BALANCE SHEET -

in 000 KM

No.	BALANCE SHEET ASSETS AND OFF-BALANCE SHEET ITEMS	CLASSIFICATION					TOTAL
		A	B	C	D	E	
1.	Short-term loans	1.727.160	381.512	21.250	4.402	-	**2.134.324**
2.	Long-term loans	5.848.496	935.056	320.060	117.945	-	**7.221.557**
3.	Other placements	424.107	923	39	50	-	**425.119**
4.	Interest accrued	38.205	13.202	-	-	-	**51.407**
5.	Past due receivables	72.928	83.235	119.904	232.710	7	**508.784**
6.	Receivables on guarantees paid	130	927	827	-	-	**1.884**
7.	Other assets	5.305.151	31.920	1.949	429	3.848	**5.343.297**
8.	**TOTAL ACTIVE BALANCE SHEET**	**13.416.177**	**1.446.775**	**464.029**	**355.536**	**3.855**	**15.686.372**
	a) Guarantees payable	321.454	53.222	713	341	-	**375.730**
9.	b) Performing guarantees	493.947	83.713	447	49	-	**578.156**
10.	Unsecured LoC	47.544	11.342	72	-	-	**58.958**
11.	Irrevocable loans	1.354.461	43.847	2.774	294	25	**1.401.401**
12.	Other potential liabilities	15.617	2	-	-	-	**15.619**
13.	TOTAL OFF-BALANCE SHEET	**2.233.023**	**192.126**	**4.006**	**684**	**25**	**2.429.864**
14.	TOTAL BALANCE AND OFF-BALANCE SHEET (8+13)	**15.649.200**	**1.638.901**	**468.035**	**356.220**	**3.880**	**18.116.236**
15.	General credit risk and potential loan losses (#14 x % of loss)	212.845	131.747	113.174	193.271	3.855	**654.892**
16.	Allocated general reserves (A) and special reserves (B, C, D, E)	212.746	131.754	113.173	193.278	3.855	**654.806**
17.	**MORE (LESS) of the allocated reserves (#16 - 15) +or -**	**-99**	**7**	**-1**	**7**	**-**	**-86**

ATTACHMENT **5**

INCOME STATEMENT

in 000 KM

ELEMENTS	PERFORMED **30.09.2009.**		PERFORMED **30.09.2010.**		RATIO 4 : 2
	Amount	Partic.in total income	Amount	Partic. in total income	
INCOME					
Interest income	695.783	115%	640.954	103%	92
Interest expenses	302.896	50%	249.542	40%	82
Net interest income	392.887	65%	391.412	63%	100
Fee income and other operating income	212.962	35%	228.901	37%	107
TOTAL INCOME	605.849	100%	620.313	100%	102
EXPENSES					
Reserves for potential losses	162.847	27%	264.900	43%	163
Salaries and contribution expenses	188.083	31%	181.300	29%	96
Fixed assets and overhead expenses	115.612	19%	111.980	18%	97
Other expenses	116.387	19%	120.835	19%	104
TOTAL EXPENSES (without interests)	582.929	96%	679.015	109%	116
NET INCOME BEFORE TAX	22.920	4%	-58.702	-9%	-256
Income Tax	2.030	0%	39	0%	0
NET INCOME	20.890	4%	-58.663	-9%	-281

ATTACHMENT 6

COMPARATIVE SCHEDULE OF CAPITAL BALANCE AND ADEQUACY
ACTIVE SUB-BALANCE SHEET

in 000 KM

Ord. No.	DESCRIPTION	31.12.2008.	31.12.2009.	30.09.2010.
1	**BANK'S CORE CAPITAL**			
1.a.	Share capital, reserves and income			
1.1.	Share capital - common and perm. priority non-cumulat. shares - cash payments	1.102.636	1.155.790	1.155.918
1.2.	Share capital - comm. and perm. prior. non-cumul. shares-invested posses. And rights	12.550	12.550	12.550
1.3.	Issued shares income at share payments	152.892	143.725	136.485
1.4.	General regulatory reserves (reserves as regulated by the Law)	84.319	78.317	128.408
1.5.	Other reserves not related to assets quality assessment	168.927	201.758	229.872
1.6.	Retained - undistributed income from previous years	134.220	161.562	165.339
1.a.	**TOTAL (from 1.1. to 1.6.)**	**1.655.544**	**1.753.702**	**1.828.572**
1.b.	Offsetting items from 1.a.			
1.7.	Uncovered losses transferred from previous years	73.464	82.324	95.746
1.8.	Losses from current year	38.938	52.966	98.835
1.9.	Book value of treasury shares owned by the bank	81	595	81
1.10.	Amount of intangible assets	60.311	63.119	61.602
1.b.	**TOTAL (from 1.7.to 1.10.)**	172.794	199.004	256.264
1.	**AMOUNT OF CORE CAPITAL: (1.a.-1.b.)**	**1.482.750**	**1.554.698**	**1.572.308**
2	**BANK'S SUPPLEMENTARY CAPITAL**			
2.1.	Share capital - common and perm. priority non-cumulat. shares - cash payments	2.829	2.829	2.829
2.2.	Share capital - comm. and perm. prior. non-cumul. shares-invested posses. And rights	0	0	0
2.3.	General reserves for losses on loans from class. A - performing assets	230.596	205.254	212.746
2.4.	Accrued income for current year audited and confirmed by external auditor	74.543	49.186	0
2.5.	Income under FBA's temporary restriction on distribution	0	0	0
2.6.	Subordinated debts, the most 50% of core capital	211.360	184.093	162.603
2.7.	Hybrid convertible items - the most 50% of core capital	0	0	0
2.8.	Items-permanent liabilities without repayment duty	56.377	66.390	66.390
2.	**AMOUNT OF SUPPLEMENTARY CAPITAL: (from 2.1. to 2.8.)**	**575.705**	**507.752**	**444.568**
3	**OFFSETTING ITEMS FROM BANK'S CAPITAL**			
3.1.	Part of invested share capital that according to FBA's assessment represents accepted and overestimated value	0	0	0
3.2.	Investments in capital of other legal entities exceeding 5% of bank's core capital	16.036	16.036	16.036
3.3.	Receivables from shareholders for significant voting shares - approved aside from regulations	0	0	0
3.4.	VIKR to shareholders with significant voting shares in the bank without FBA's permission	3.422	0	0
3.	**AMOUNT OF OFFSETTING ITEMS FROM BANK'S CAPITAL (3.1. to 3.4.)**	**19.458**	**16.036**	**16.036**
A.	**AMOUNT OF BANK'S NET CAPITAL (1.+2.-3.)**	**2.038.997**	**2.046.414**	**2.000.840**
B.	**RISK FROM RISK-WEIGHTED ASSETS AND CREDIT EQUIVALENTS**	**12.301.441**	**11.790.234**	**11.763.973**
C.	**POR (RISK-WEIGHTED OPERATING RISK)**	**130.975**	**882.928**	**944.967**
D.	**PTR (RISK-WEIGHTED MARKET RISK)**	**0**	0	0
E.	**TOTAL RISK-WEIGHTED RISKS B+C+D**	**12.432.416**	**12.673.162**	**12.708.940**
F.	**NET CAPITAL RATE (CAPITAL ADEQUACY) (A.:B.) X 100**	**16,4%**	**16,1%**	**15,7%**

ATTACHMENT 7

NUMBER OF EMPLOYEES BY BANKS

Ord. No.	BANK	31.12.2008.	31.12.2009.	30.09.2010.
1	BOR BANKA dd SARAJEVO	45	51	56
2	BOSNA BANK INTERNATIONAL dd Sarajevo	171	185	199
3	FIMA BANKA dd SARAJEVO	149	133	140
4	HERCEGOVACKA BANKA dd MOSTAR	87	77	75
5	HYPO ALPE ADRIA BANK dd MOSTAR	626	600	576
6	INTESA SANPAOLO BANKA dd BiH	501	514	515
7	INVESTICIONO KOMERCIJALNA BANKA dd ZENICA	179	174	179
8	KOMERCIJALNO INVESTICIONA BANKA dd VELIKA KLADUŠA	67	68	67
9	NLB TUZLANSKA BANKA dd TUZLA	507	473	475
10	POŠTANSKA BANKA dd SARAJEVO	119	111	99
11	PRIVREDNA BANKA dd SARAJEVO	175	195	209
12	PROCREDIT BANK dd SARAJEVO	888	662	546
13	RAIFFEISEN BANK BH dd SARAJEVO	1.745	1.669	1.644
14	SPARKASSE BANK dd SARAJEVO	379	426	429
15	TURKISH ZIRAAT BANK dd SARAJEVO	149	152	153
16	UNA BANKA dd BIHAĆ	59	56	54
17	UNI CREDIT BANKA BH dd MOSTAR	1.418	1.389	1.374
18	UNION BANKA dd SARAJEVO	175	175	178
19	VAKUFSKA BANKA dd SARAJEVO	204	212	218
20	VOLKSBANK BH dd SARAJEVO	354	334	331
	TOTAL	**7.997**	**7.656**	**7.517**