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

INFORMATION

ON BANKING SYSTEM OF THE FEDERATION OF BOSNIA AND HERZEGOVINA As of December 31st, 2007

Sarajevo, March 2008

Information on banking system of the Federation of BiH (as of December 31st, 2007 upon the final non-audited data) 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

We may conclude, based on the essential quantitative and qualitative performance indicators realized, that the banking system of the Federation of Bosnia and Herzegovina in 2007 has demonstrated a successful performance, continuing with ongoing growth and development followed by strengthening of its stability and safety. The following has contributed this sector to maintain the positive trends in 2007, while remaining to be the most regulated and significant part of the overall financial system in the country: regulatory framework established to regulate performance of banks, professional and effective bank supervision and examination of legitimacy, implementation of regulations and compliance with the prescribed standards, along with improvements of management and governance quality in majority of banks.

Performance of banks as based on the international standards and principles has also been, in the past year, in function of development, strengthening and progress of the entire system, its effectiveness, stability, solvency, achievements, profitability and liquidity. Inflow of new foreign investments has resulted by strengthening of capital base, increased deposits (especially savings deposits) and credit sources, creating opportunity for some new placements. Banks have also taken some significant activities aimed to implement the new modern technologies and to raise quality and diversification of products and services, which is resulting by intensified competition and struggle for better market positioning.

The most evident changes in 2007 could be summarized as further growth and development of the system, strengthening of capital base, inflow of new foreign investments in credit and deposit funds and additional capitalizations, which is resulting by changes in the ownership structure and participation of state, foreign and private domestic (residents) capital in total share capital.

Integration process in 2007 has been directed towards better market positioning, resulting by the largest banks becoming larger, decreased number of banks, and more intensified competition. As of 31.07.2007., integration process of the banks-members of the Intesa Sanpaolo Group was finalized (LT Gospodarska Bank d.d. Sarajevo to UPI Bank d.d. Sarajevo), and another integration process, integration of the members of the UniCredit Group (HVB Central Profit Bank to UniCredit Zagrebačka Bank Mostar) that was planned for the end of 2007, has been rescheduled for 01.03.2008.

As they engage in the international financial performance and markets, banks will in future, with no doubt, be more exposed to market risks: interest rate, foreign exchange and price risk, which will require further strengthening of capital base of banks.

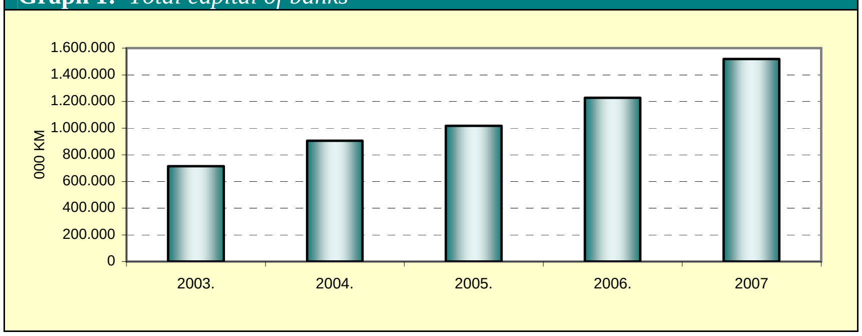
- ***Growth and Development:*** At the end of 2002, there were 29 licensed banks in the FBiH, while, at the end of 2007, there were 22 banks operating in the system. The banking system in the past five years has experienced some very intensive changes and processes, resulting by number of banks decreasing by seven: status changes of mergers/acquisitions, license revoking, and licensing of two new banks (one as result of merger of two banks in 2003, and establishment of a new bank in 2006). The following table demonstrates the changes in number and ownership structure of bank for the past five years.

Table 1: *Review of changes by number and ownership structure of banks*

	State banks	Private banks	TOTAL
31. 12. 2002.	6	23	29
Changes in 2003:			
- changed ownership structure	+1	-1	
- new license		+1	+1
- merger/acquisition		-3	-3
31.12. 2003.	7	20	27
Changes in 2004:			
- license revoked	-1		-1
- merger/acquisition		-2	-2
31.12.2004.	6	18	24
No changes in 2005			
31.12. 2005.	6	18	24
Changes in 2006:			
- license revoked	-1		-1
- new license		+1	+1
-merger/acquisition		-1	-1
31.12.2006.	5	18	23
Changes in 2007:			
-merger/acquisition		-1	-1
- changed ownership structure	-2	+2	
31.12.2007.	3	19	22

As prior years, all significant performance indicators of the banking sector have recorded growth in 2007. The assets of banks have realized growth of 24% or KM 2,7 billion, reaching the amount of KM 14,2 billion. Total capital of banks as of 31.12.2007. amounted to KM 1,5 billion (share capital of KM 1,05 billion). If compared to prior year, this represents increase of 24% or KM 291 million. The mentioned growth has primarily come from the inflow of new, green capital – additional capitalization in eight banks of KM 182,4 million, representing an increase of 33% or KM 45 million if compared to the end of 2006.

Graph 1: *Total capital of banks*



Banks have continued in 2007 expanding the network of their organizational units. Banks from the Federation have founded 77 new organizational units (56 in the Federation of BiH, 18 in Republic Srpska and three in District Brčko), representing an increase of 15,6%, if compared to 31.12.2006., when banks had 492 organizational units.

There was total of 7.361 employees in 22 banks of the Federation of BiH at the end of 2007, representing an increase of 11% or 755 employees if compared to the end of 2006.

• ***Ownership structure:*** At the end of 2007, ownership structure of banks in the Federation of BiH was the following: three banks with majority state ownership, and, of 19 banks with majority private ownership, seven banks are majority owned by domestic legal entities and individuals (residents), while 12 banks are majority foreign owned.

According to the criteria of home country owner-shareholder, that is, the criteria of direct or indirect majority ownership through the group members, the banking groups and banks from Austria recorded the highest participation at the end of 2007 (48,7%), followed by the Italian banks with participation of 21,9%, while other countries recorded participation less than 10%.

In 2007, there were some changes in the ownership structure of state banks. Two banks, after additional capitalization was performed, have moved to the group with majority private capital, resulting by the assets decrease in state banks by 20% or KM 94 million, so their participation (three banks) in total assets of the banking system is now minimized to only 3%.

There have also been some changes in participation of state, foreign and private domestic (residents) capital in total share capital. Participation of state capital has decreased from 15,2% to 12,8%. Foreign capital has nominally increased by KM 105,2 million, primarily as a result of additional capitalization in the amount of KM 121 million with 10 banks (five majority foreign owned banks and five banks majority owned by residents). However, if compared to 2006, their participation decreased from 75,5% to 74,2%. Due to highest growth of 63% or KM 53 million, private capital of residents has increased its participation from 9,3% to 13%.

All key financial indicators analyzed, based on the criteria of ownership in banks, have indicated that private banks operate more cost effectively, productively and efficiently, making sure they have greater competitive advantage than state banks.

- ***Competition and Concentrations:*** As for opportunities in the banking market of the Federation of BiH, where in order to struggle for customers and greater market share banks enter into acquisitions and integration processes through mergers, upon finalization of those processes in the system, the estimate of some financial experts is there will remain 15 to 20 strong banks. However, five to six large foreign owned banks will control 90% of the market, in which they already sovereignty rule, while smaller banks will stick to the region.

While majority of banks (15) range with the assets below KM 500 million (their market participation is 15,5%), of which seven banks have assets below KM 100 million, it is to expected the status of majority of smaller banks will change through integration processes with other banks or sale to strategic investors.

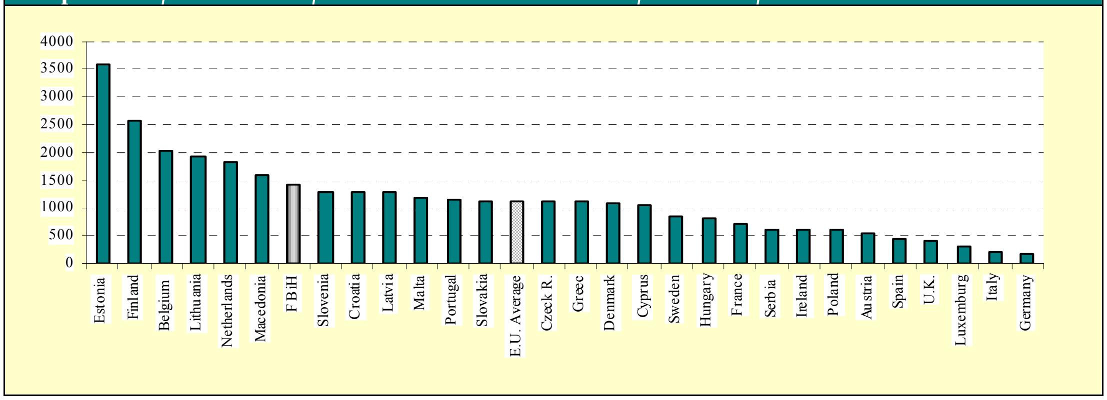
How much the banking system is being concentrated or if there are any concentrations, we can see in the Herfindahl index[1]. At the end of 2006, as a measure of market concentration in the balance sheet assets of the banking system of the Federation of BiH, this index was 1.428 units (1.420 as of 31.12.2007.). If compared to other countries (E.U. and countries from the region[2]) and generally acceptable standards, this index is acceptable, that is, the concentration is moderate[3].

[1] 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%. Hypotetically, if there is only one bank in the system, the HHI would be maximum at 10000.

[2] Source of data ECB: EU Banking Structures, October 2007., and for Croatia, Macedonia and Serbia annual reports of these countries on their banking conditions, that is, financial systems.

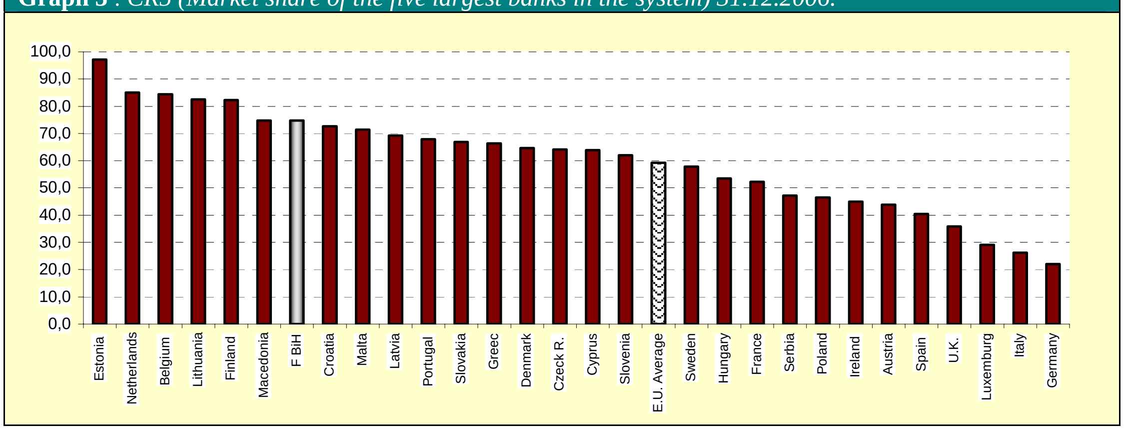
[3] If the HHI value is below 1000, the opinion is that there is no concentration in the market; for the index value between 1000 and 1800 units, concentration in the market is moderate; and if the HHI value exceeds 1800, it indicates high concentration.

Graph 2: *Herfindahl index of concentrations in total assets of banks as of 31.12.2006.*



Second indicator of concentration in the banking system is the ratio of market concentration, that is, the concentration rate[4] (hereinafter: CR), which indicates total market participation of the largest institutions in the system. The CR5 is an indicator of assets participation of the five largest banks, which at the end of 2007 in the banking system of the Federation of BiH amounted to 74,4% (74,7% as of 31.12.2006.), but there is still dominant participation of the four largest banks in the system that „hold“ 67,7% of the market (69 at the end of 2006). If compared to other countries in the E.U.[5] and countries in the region, the five largest banks in the banking system of the Federation of BiH still have high participation, which, after longer period of growth, has decreased in 2007 by only 0,3%.

Graph 3 : *CR5 (Market share of the five largest banks in the system) 31.12.2006.*



As part of their preparation for better market positioning, banks perform additional capitalization through public subscription of shares, which was successfully completed in banks that experienced this way of additional capitalization, which is at the same confirmation of confidence in the banking system, its safety and stability. On the other hand, expansion and business development raise new risks in banks, which has to be followed by adequate increase of capital.

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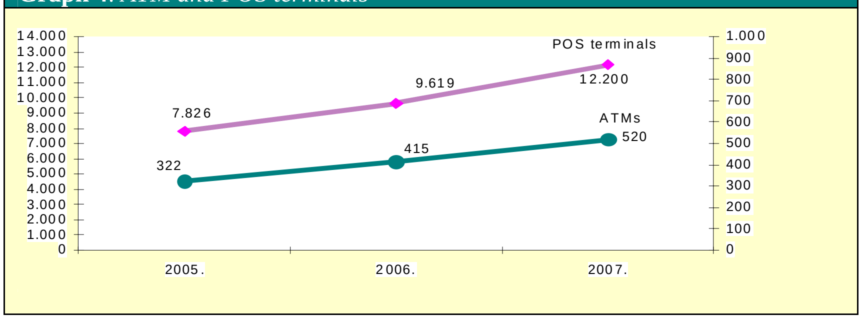
[4] Engl.: Concentration Ratio (CR), assigned according to the number of institutions included in the calculation.
[5] The same as number 2).

In the market „game“, banks use various instruments, from interest rate policy, organization improvement, staff strengthening, to business network expansion, financial support by "parent" bank or group member bank.
Card based operations in majority of banks in the Federation of BiH represent a significant business activity, which is reflected through more massive use of credit and debit cards and increased volume of non-cash payments.

During 2007, 105 new ATMs have been installed, and at the end of the same year their number increased to 520. Number of POS terminals has also increased by 2.581, so there was total of 12.200 points of sale at the end of 2007 with possibility to pay commodities by cards.

Graph 4: *ATM and POS terminals*



Banks strongly entered the market of micro-crediting in 2006 (through credit support to microcredit organizations), while in 2007 the microcredit sector is becoming more significant in the overall financial system.

Many activities of the FBA in 2007 have also been highlighted in the area of microcredit sector. However, according to the Law on Microcredit Organizations, supervision over these institutions is placed under the authority of the FBA, as its entirely new responsibility. In 2007, according to this Law, the FBA has completed development of the overall regulation that has been adopted within the anticipated timeframe. During 2007, the FBA has issued license to 17 microcredit organizations (hereinafter: MCO), with deadline of 30 days to submit their application for registration in the register of the Federal Ministry of Justice. By the end of 2007, there were no new registrations of the MCOs in the mentioned register.

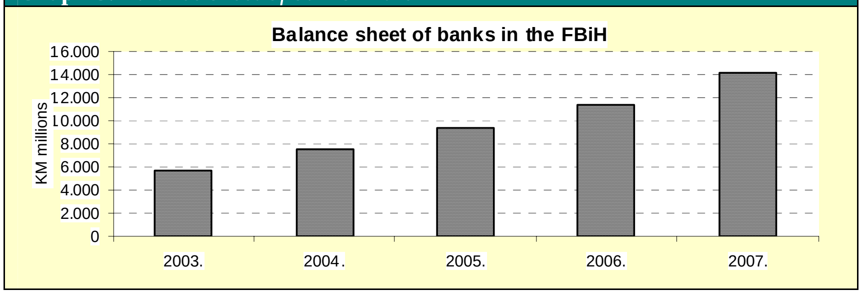
Banking and microcredit sector has experienced significant news in 2007. However, in order to protect customers of banks and MCOs, starting from 1.07.2007. all banks and MCOs are required to present effective interest rate in all elements influencing money price. Specifically, they are obliged towards customers, before they receive request for loan approval, that is, before deposit is taken, to inform them about all expenses related to that contract, and not just about nominal interest rate. This has been prescribed in the Decision on Unified Accrual and Declaration of an Effective Interest Rate on Loans and Deposits.

The effective interest rate, besides the nominal interest rate on loans and deposits, has to include all fees and commissions bank is charging while approving loan, that is, taking deposit, such as loan application processing fee, loan application approval fee, loan administration fee, loan servicing, account statement delivery, etc. Banks are obliged to present the effective interest rate clearly and transparently in the bank premises, in advertisements and in the media. However, banks will be required in the process of concluding loan or deposit relationship to submit to the customer a repayment schedule with clear presentation of an effective interest rate. This new responsibility of commercial banks and MCOs will, with no doubt, add to better transparency in the financial market.

Balance sheet

As derived from the final non-audited data, aggregate balance sheet sum of banks in the Federation of BiH as of 31.12.2007. amounted to KM 14,2 billion, representing an increase of 24% or KM 2,7 billion if compared to the end of 2006. During the last five years, that is, during the period from beginning of 2003 to the end of 2007, the balance sheet sum has increased 2,5 times.

Graph 5: *Balance sheet of banks in the F BiH*



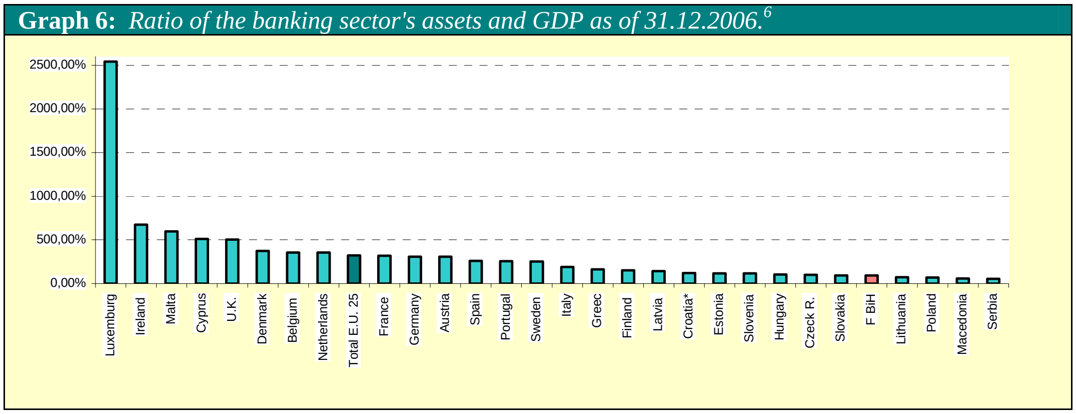
Growth of the balance sheet sum in its sources is primarily the result of increase in deposits by KM 1,8 billion or 22%, then borrowings of KM 435 million, which is increase of 31% if compared to 2006 and capital growth by KM 291 million or by 24%.

Total deposits, as the essential source of financial potential of banks, has reached the amount of KM 10,2 billion, while total capital of banks is amounting to KM 1,5 billion.

In the assets of banks, credit placements represent the most significant item with participation of 62,5%. In 2007, they recorded significant growth of KM 2,1 billion or 30%, and have reached the amount of KM 8,9 billion. In 2007, banks have primarily originated loans to private companies and citizens, which are the two dominant sectors with total participation of 95,3%.

One of the indicators of strength and development of the banking system of any country is ratio between assets and Gross Domestic Product (GDP) . In developed countries, assets are twice or more higher than their GDP, while in transition countries this indicator is below 100%. According to these criteria, banking sector of the Federation of BiH has solid performance, and according to the data for 2006, the assets reached 95% of the GDP for the F BiH (108% in 2007).

Graph 6: *Ratio of the banking sector's assets and GDP as of 31.12.2006.*[6]



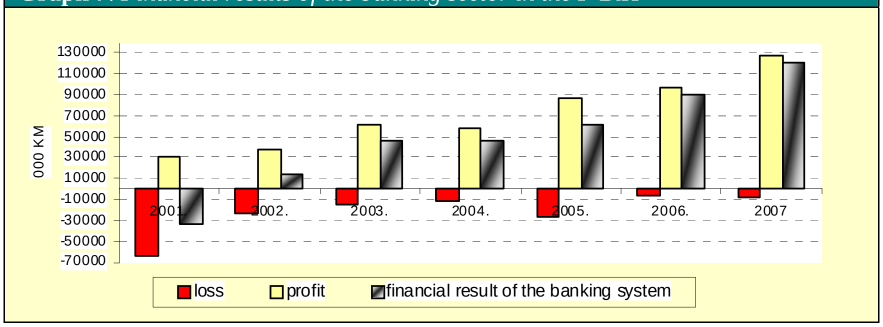
[6] Source of data ECB: EU Banking Structures, October 2007., and for Croatia, Macedonia and Serbia annual reports of these countries on their banking conditions, that is, financial systems.

Income statement

Since 2001, when the banking system reported loss of KM 33 million, a positive trend of a successful performance has begun. As derived from the final non-audited data for 2007, banks in the Federation of BiH have gained a positive financial result-profit of KM 115,2 million, which is higher by significant 30,5% or KM 27 million than in 2006. Permanent trend of increasing success of the entire system, as measured through the level of realized profit, is the result of general trend of improvement and stabilization of the banking sector.

Positive financial result was reported by 18 banks in total amount of KM 123,4 million, which is higher by 29,5% or KM 28 million than in 2006 (the same number of banks), while four banks reported loss of KM 8,3 million, which is higher by 17,5% than last year.

Graph 7: *Financial results of the banking sector in the F BiH*



Total income in 2007 amounted to KM 807 million, which is higher by 18% than in 2006. Structure of total income of banks has been improved from qualitative aspect through both nominal and percentage based faster growth and higher participation of interest income in comparison to 2006, which has significantly influenced the growth of total profit. At the end of 2007, participation of net interest income was 63,2% and operating income 36,8%. This is also a positive indicator of improvement in quality and stability of earnings, as part of the overall positive movements and trends in the banking system of the Federation of BiH.

II TRANSITION OF THE BANKING SYSTEM

The implemented reforms of the banking system of the Federation of BiH have shown positive effects and successful transformations into a stable and safe banking system whose performance is based on the international standards and principles.

A significant support through the reform was provided to bankers by the local and international institutions, especially by the World Bank, USAID and International Monetary Fund. The banking sector's reform is presently believed to be the most successful reform in BiH, and it is especially significant due to the fact that no budget or public funds were allocated for this purpose.

As the international experts have assessed, the banking system of BiH of all transition countries is the soundest system, and even USAID has rated its banking supervision in BiH as one of its most successful projects worldwide.

We have witnessed, during the year 2007, a significant progress that has been made in development of the financial market in the Federation of BiH, while the latest statistics show increase of foreign investments in our country. If we observe the countries in the region that have progressed far more in the transition process, we could assume that in near future the financial market in the Federation of BiH will rapidly develop, and the development is only possible in positive environment.

At the beginning of 2007, after legal prerequisites have been set, Bosnia and Herzegovina received the International Bank Account Number– IBAN. The IBAN represents an extended version of the main or transaction account which is used to identify financial institution customers in a unified way. The advantages of using IBAN reflect through easier international payments, electronic data processing, and a bank assigning IBAN to its participants in the international and domestic payment system.

Taking into account a dominant position of the banking system in the financial sector of the Federation of BiH, its condition, with no doubt, is of special significance to the overall economic development. We could draw a conclusion that this sector has been rehabilitated and that consolidation of banking is reaching its final stage:

- Majority of the problems inherited from the previous system and those caused by war have been eliminated,
- Privatization process of the remaining three state banks is expected to be finalized in 2008,
- The banking capital basis has been increased, effectiveness has been improved and performance efficiency is getting closer to the international standards,
- International supervision principles have been accepted and applied, risk management has been improved, etc.

Firm and energetic attitude and activities of the FBA's Managing Board and professional and effective actions taken by the FBA's offices in 2007 have made contribution towards concrete progress in finalizing provisional administrations: incompliance with the Law has been eliminated in Investment Bank of the Federation of BiH and Poštanska bank d.d. Sarajevo and the initiated provisional administrations in those banks have been successfully finalized in 2007.

1. BANKING AGENCY

Banking Agency of the FBiH has given its full contribution to the banking sector reform, but often there was lack of understanding for the measures that were taken. As an independent and sovereign authority for bank supervision and licensing, it has been established in the second half of 1996 and its work from the initiation has been directed towards a strong and stable banking system, as market-oriented and based on the international standards for performance and supervision of banks. Law on Banking Agency sets its main tasks, such as issuance of banking license, adoption of regulations, supervision of banks and measures to be taken in accordance with the Law, including provisional administration and liquidation in banks, that is, initiation of procedure for bank bankruptcy.

Based on the assessments conducted by domestic and international officials, in the past 11 years the FBA has achieved the high professional level, and its staff has gained expertise and skills from the area of supervision through various educations in country and abroad.

With the main purpose to protect money and interests of depositors, the FBA, from its initiation to the end of 2007, has introduced measures (provisional administrations, liquidations or bankruptcies) at 25 banks, and provisional administration at one bank was introduced by the order of the High Representative of BiH. The provisional administration has been introduced in 23 banks.

Of 26 banks at which the measures were taken, the procedure was completed in 12 banks. As of 31.12.2007., there were 14 banks under the measures.

Of 26 banks with the measures initiated:

- Bankruptcy process at the authorized courts was initiated in seven banks,
- Liquidation process was initiated in ten banks. Liquidation process was finalized in five banks (four banks paid out all liabilities towards their creditors and shareholders, and one bank was sold out),
- Four banks were integrated with other banks,
- Two banks have been rehabilitated and continued working. One bank has been additionally capitalized and privatized (Poštanska bank d.d. Sarajevo), and at the other one (Investment Bank of the Federation of BiH) the bank status has been resolved, the bank management bodies have been elected and it continued operating.,
- Provisional administration process in three banks is still pending. It is expected that the provisional administration in one bank will be finalized at the beginning of 2008 (Privredna Bank Sarajevo d.d. Sarajevo) with the additional capitalization performed and the activities regarding election of senior management bodies are ongoing.

2. COMBAT AGAINST MONEY LAUNDERING AND TERRORISM FINANCING

Assessment of the banking system in the segment of prevention of money laundering and terrorism financing is based on condition of banks as determined during full-scope and targeted examination reviews and based on the financial statements submitted by banks to the Agency. Risk management quality, which may occur in banks performance as a result of money laundering and terrorism financing (reputation risk, operating risk, legal risk, assets and deposit concentration risk), in the banking sector of the Federation of Bosnia and Herzegovina during this year is not continuing with increasing trend, but it has retained the level from prior year. The main reason to this assessment is a bad risk management in the area of money laundering, which may result from development and exploitation of certain banking products in the segment of loans (citizen investment loans) where large number of banks have not adequately identified fund source which customers use for annuity payments based on those loans, which represents a possibility to include money from illegal sources into the legal payment system. Quantity of risk has greatly influenced the supervisory assessment, which has retained within the limits of moderate and at the level of last year.

Implementation of policies, in general, is the following:

- *Customer Acceptance Policy:* Customer acceptance criteria have been defined as basis for banks to establish their special customer profile registries. Banks face certain problems related to functioning of those registries when trying to update data on customers classified in the riskiest groups.

- *Customer Identification Policy:* Banks have adopted customer identification as the main standard element of the «Know Your Customer». Banks apply the customer identification policy when establishing business relationships with customers. However, there is still the problem related to updating of the records supporting establishment of those relationships when business relationship is already established.

- *Continuous Monitoring of Accounts and Transactions Policy:* This policy is applied and there is less formal monitoring of customer accounts and transactions. In order to reach the essential monitoring of customer accounts and transactions, banks have started, based on the «Know Your Customer » Policy, preparing the list of customers with the transactions exceeding of KM 30.000,00 or more to be excluded from the reporting requirement, which should eventually result by reporting of suspicious customer transactions. However, transaction limits based on certain types of accounts and transactions have not been defined in an optimum way, so in the case when there is suspicion about money laundering and terrorism financing, the defined limits usually do not serve as preventive, but rather subsequent monitoring of accounts and transactions.
- *Money Laundering and Terrorism Financing Risk Management Policy:* Elements of the mentioned policy have been defined in the programs of banks. They define reporting lines, both external and internal. Staff training, as an essential segment of the money laundering and terrorism financing risk management policy, has become a permanent process in the banking system, as set by the Decision. The training has been organized by both domestic and international institutions. The Banks Association of the BiH in cooperation with the FBA, Financial Intelligence Unit and Consulting Firm Revicon d.o.o. Sarajevo, and in cooperation with the ATTF (Agency for Transfer of Technology in Finance) Luxemburg, has two times organized training for bank representatives. We should also mention the training organized by the USA Government with the following topic:„Combat against Financial Crime” with special focus on prevention of money laundering and terrorism financing that was organized in Sarajevo and Washington.

Therefore, quality of the risk management coming from money laundering and terrorism financing is satisfactory, while the risk quality is moderate.

3. BANKING SUPERVISION

Starting with the overall need of the macroeconomic and financial stability, in the year 1997 the Basel Committee for Bank Supervision adopted the twenty five core principles to be respected in order for any supervisory system in banking to be efficient.

The principles set minimum requirements to be fulfilled and in many cases they need to be supplemented with other measures in order to satisfy specific conditions or to regulate risks of the financial system of respective country. The principles refer to the prerequisites for effective bank supervision, issuance of banking license, prudential regulations and requirements, continuous bank supervision methods, necessary information, authorizations for supervisors and cross-border banking.

Legislation and regulations for bank performance in the Federation of BiH are consistent with the international standards. Law on Changes and Amendments to the Law on Banks from August 2002 determine (Article 69) that “The regulations issued by the Agency … are based on the core principles for bank supervision issued by the Basel Committee for Bank Supervision”. The FBA has fully respected this standard while preparing and adopting its regulations applied since the beginning of 2003, along with some standards of the European Banking Directives that have been built in.

Bank supervision - on site and off site bank examinations have been conducted upon plan and program for 2007. Upon preparation of the examination report all banks subject to examination receive orders to execute and eliminate determined deficiencies. The examinations determined that all banks were regularly and mostly meeting the orders in a timely manner. Concrete, competent and professional approach by the supervision in the examination of banks has its purpose to further improve quality of banks performance, their profitability, solvency and safety in the performance, which is a mutual interest.

As for the plans in 2008, the FBA will keep offering a strong support to the consolidation of bank supervision on state level, since it has recognized that as the only right way to the stronger and more effective supervisory role in development of the financial sector for the whole country. Development of the banking system in BiH has arrived at such level (bank expansion to both entities, mutual owners) of having a consolidated banking market that needs consolidated laws and consolidated supervision.

The above has been confirmed in the recent conclusions of the International Monetary Fund (IMF), concretely stating the following: "BiH needs consolidated, independent and effective bank supervision, at the Central Bank of BiH or as a separate agency, which would strengthen the financial sector and be beneficial to the economy and both entities. However, as all other measures of the economic politics, this decision is also a hostage of the politics".

As for the reasons of creation of the Basel II, it should be pointed out that the Basel I, or more precisely "The International Capital Accord (of banks)" in the recent year has been generally accepted worldwide and it has a positive effect on the level of capital in banks around the world, but for us the most importantly is that it has influenced the banks, that is, the banking system in the Federation of BiH. When presented as the international experience, this framework has even stopped the trends of capital downfall worldwide, and its implementation in the Federation of BiH has raised compliments for the positive trends. However, due to its negative side of „egalitarism" in evaluation of credit risk especially, which was a bad side of this framework (that was primarily an impediment in strong and highly complex and sophisticated banks), this framework has not succeeded fully and adequately to address all important issues of banking prudency and capital management.

Due to all the mentioned reasons, the Basel Committee, after a long period of research and analysis and several different proposals and consultation papers, in 2004 and the final version at the end of 2006, published its New Capital Accord – that is Basel II, which represents a completely new concept for capital adequacy calculation of banks, that is, the new overall approach for risk management and bank supervision.

The Basel I and Basel II in the European Union have been implemented or are in the implementation process in the form of its Directives for credit institutions. Our country is certainly striving for membership in the European Union, so it is required until that moment to make preparations for adoption of the Basel II through the form of special EU Directives. This has created a commitment for the FBA, as regulatory and supervisory authority for banks in the Federation of BiH, to already in 2008 initiate preliminary steps to create and prepare its own role, along with readiness of banks to function under the framework set by the regime of the Basel II.

III BUSINESS PERFORMANCE OF BANKS IN THE FEDERATION OF BIH

1. STRUCTURE OF THE BANKING SECTOR

1.1. Status, number and business network

As of 31.12.2007., there were 22 banks with the banking license issued in the Federation of BiH. Number of banks has decreased by one if compared to 31.12.2006. Approval was issued for a status change of integration of LT Gospodarska bank d.d. Sarajevo to UPI bank d.d. Sarajevo as of 31.07.2007., so as of 01.08.2007. there were 22 banks in the Federation of BiH. Also, provisional administration in Poštanska bank BiH d.d. Sarajevo was terminated as of 01.07.2007.

As of 31.12.2007., there were three banks under provisional administration (UNA bank d.d. Bihać, Hercegovačka bank d.d. Mostar and Privredna bank Sarajevo d.d. Sarajevo).

Over the year 2007, banks have continued expanding the network of their organizational units. Banks from the Federation of BiH have founded 77 new organizational units, of which 56 in the Federation of BiH, 18 in Republic Srpska and three in District Brčko. If compared to 31.12.2006., when banks had 492 organizational units, this represents an increase of 15,6%.

As of 31.12.2007., seven banks from the Federation of BiH had 52 organizational units in Republic Srpska, while 11 banks had 15 organizational units in District Brčko. Six banks from Republic Srpska had 21 organizational units in the Federation of BiH.

The license for inter-bank transactions in the internal payment system was issued to all banks as of 31.12.2007. There were 14 banks with deposit insurance program.

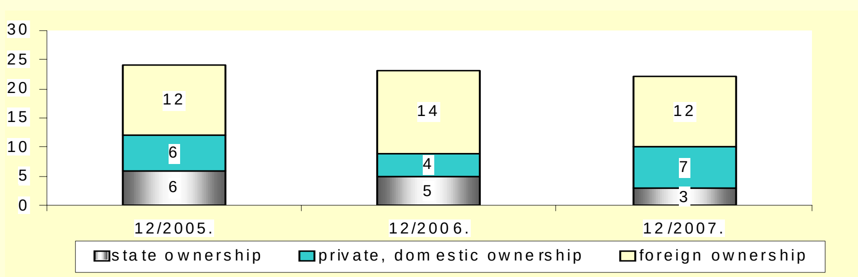
1.2. Ownership structure

As of 31.12.2007., ownership structure in banks[7] was assessed based on the available information and on-site visits to banks[8], which is the following:

- Private and majority private ownership 19 banks (86%)
- State and majority state ownership[9] 3 banks (14%)

Seven banks, of 19 banks with majority private ownership, are majority owned by domestic legal entities and individuals (residents), while 12 banks have majority foreign ownership.

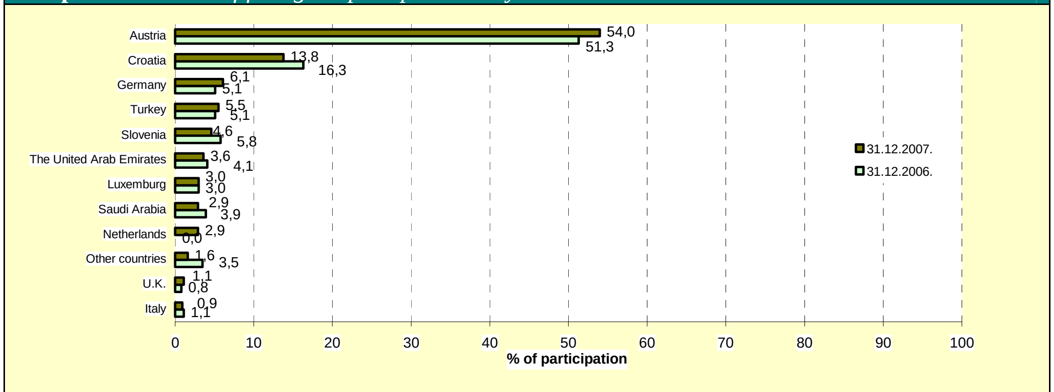
Graph 8: *Number of banks according to the ownership structure*



[7] Criteria for bank by type of ownership are ownership over banks' share capital.
[8] General overview of ownership structure of banks in the F BiH as of 31.12.2007. resulted from received documentation, and registrations at authorized courts (changes in capital and shareholders structure).
[9] State ownership refers to domestic state capital of BiH.

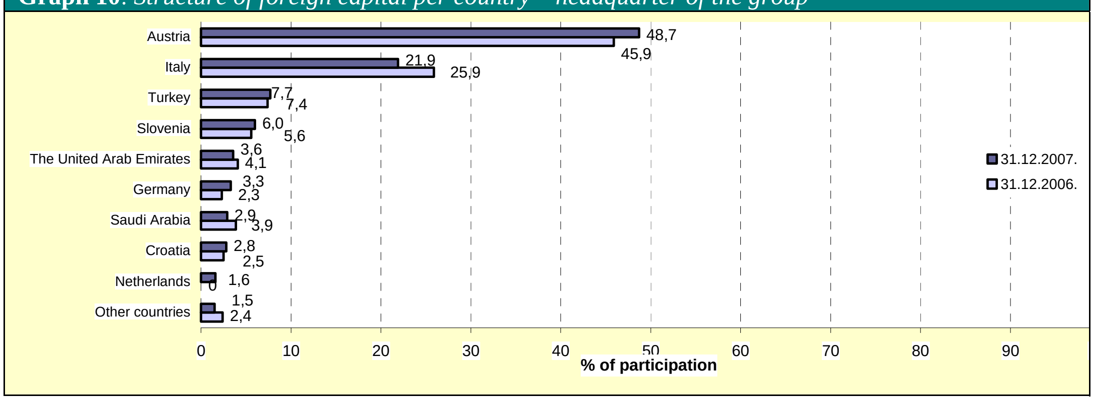
If we only analyze foreign capital according to the criteria of the shareholder's home country, 54% of foreign capital was owned by the shareholders from Austria, followed by 13,8% of shareholders from Croatia, while other countries participated below 10% as of 31.12.2007.

Graph 9: *Structure of foreign capital per country*



If we, however, take into account the capital correlation, we could take the criteria of headquarter of the parent institution or the group that have majority ownership (direct or indirect through the group members) over banks in the Federation of BiH. According to this criteria as of the end of 2007, there was also majority participation of banking groups and banks from Austria (48,7%), followed by the Italian banks with participation of 21,9%. Other countries recorded participation below 10%.

Graph 10: *Structure of foreign capital per country – headquarter of the group*[10]



The ownership structure could be viewed from the aspect of financial indicators, which is based on the value of total capital [11].

[10] Apart from the country of the headquarter of the parent-group whose members are the banks from the F BiH, the countries of all other foreign shareholders of the banks from the FBiH are also included.

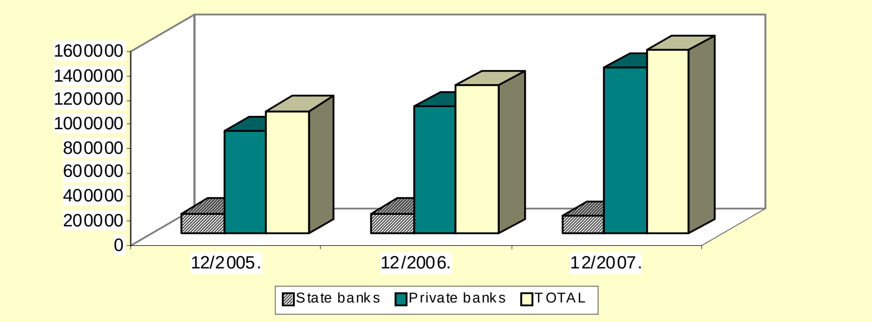
[11] Information from balance sheet - FBA schedule: shareholders capital, premium issue, undistributed profit and reserves, and other capital (financial results of current period).

-in 000 KM-

Table 2: *Ownership structure by total capital*

BANKS	31.12.2005.		31.12.2006.		31.12.2007.		RATIO	
							3/2	4/3
1	2		3		4		5	6
State banks	166.494	16%	170.680	14%	147.022	10%	103	86
Private banks	850.223	84%	1.055.905	86%	1.370.996	90%	124	130
TOTAL	1.016.717	100%	1.226.585	100%	1.518.018	100%	121	124

Graph 11: *Preview of ownership structure (total capital)*



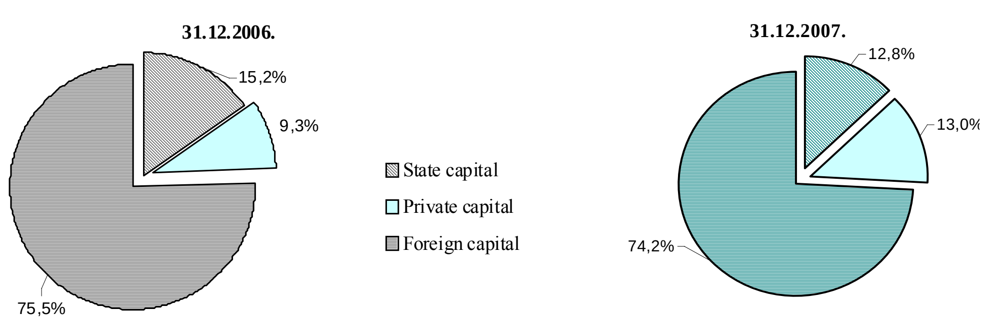
Analyzing participation of state, private and foreign capital in the share capital of banks, we get more precise picture of the capital ownership structure in banks of the Federation of BiH.

- in 000 KM-

Table 3: *Ownership structure by participation of state, private and foreign capital*

SHARE CAPITAL	31.12.2005.		31.12.2006.		31.12.2007.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	5/3	7/5
1	3	4	5	6	7	8	9	10
State capital	135.344	16,9	135.019	15,2	133.582	12,8	100	99
Private capital (residents)	103.026	12,9	83.077	9,3	135.728	13,0	81	163
Foreign capital (nonresidents)	561.117	70,2	670.695	75,5	775.912	74,2	120	116
TOTAL	799.487	100,0	888.791	100,0	1.045.222	100,0	111	118

Graph 12: *Ownership structure (share capital)*



Share capital of banks in the Federation of BiH during the year 2007 has increased by 18% or KM 156 million, which is higher by 7% if compared to 2006. The highest increase of KM 158,8[12] million comes from additional capitalization and inflow of green money in eight banks, internally from the reserves (dividend issue of shares in three banks), the increase amounted to KM 11,4 million, while in three banks the share capital decreased by KM 13,8 million (loss coverage, transfer to the reserves in the process of status change of integration of two banks and repurchase of own shares).

Analysis of the banks' ownership structure from the aspect of share capital shows in the most explicit way the changes and trends in the banking system of the FBiH, and especially the changes of the ownership structure.
Participation of state capital in total share capital, as of 31.12.2007., was 12,8 %, representing decrease of 2,4%, if compared to the end of 2006., due to loss coverage in one bank against state capital.

If compared to the end of 2006, participation of private capital (residents) in total share capital of the banking sector has increased from 9,3% to 13%, that is, by KM 52,7 million, as a result of the following: share trading between residents and nonresidents (with nine banks) has caused increase of five million KM as net effect, purchase of shares through additional capitalization in seven banks of KM 49 million by domestic buyers (of which two banks had „technical issue“ that is increase of share capital of KM 0,8 million from their provisions), upon which the ownership structure in three banks was changed two with majority state capital and one with majority foreign capital into banks with majority private domestic capital), as well as decrease by KM 1,4 million during integration of two banks in the process of determining ratio for share exchange (provisions increased).

Participation of foreign capital decreased from 75,5% to 74,2%, although its nominal increase was KM 105,2 million as a result of additional capitalization performed in the amount of KM 121 million in 10 banks (five foreign owned banks and five majority resident owned), above mentioned share trading between residents and non-residents in nine banks (net effect to the foreign capital was decrease of KM five million), and decrease of KM 7,2 million from the integration process of two banks and KM 3,4 million based on withdrawal of the owned shares purchased (in one bank).

Changes in the ownership structure reflected on participation, that is, market share and position of banks grouped by majority ownership in share capital as criteria. Market share of banks with majority foreign ownership decreased by 0,6%, but still representing the high position of 92,4% as of 31.12.2007. Market share of banks with majority domestic private capital was 4,9%, which is higher by 2% if compared to the end of 2006. Participation of state capital decreased from 4,1% to 2,7.

[12] In two issues, the paid exchange premium was KM 23,6 million, so the inflow of green money from additional capitalization of eight banks in 2007 was KM 182,4 million (in 2006, KM 137,4 million in seven banks – a newly established bank included).

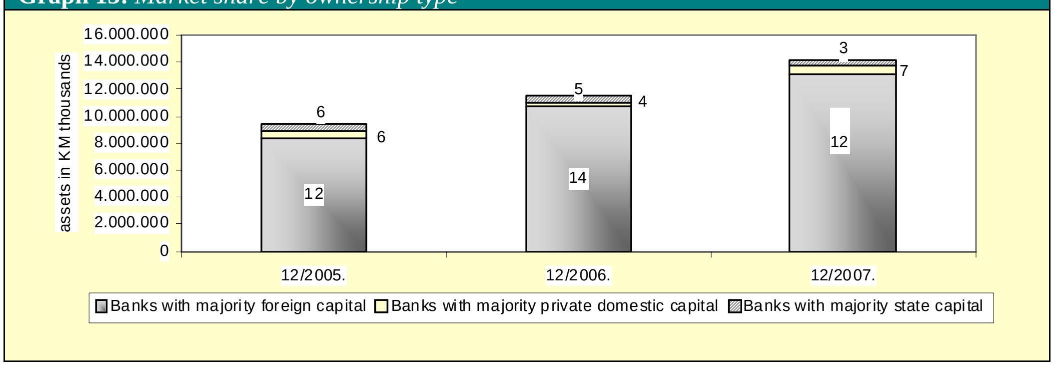
Integration processes from the past period were performed with purpose of stronger market positioning, resulting by concentrations in the banking sector by largest banks becoming larger, decreased number of banks, and intensified competition. Over the observed period, one integration process has been finalized (status change of integration) as of 31.07.2007., and the other one, planned for the fourth quarter of 2007., was moved to the next year. Such processes should result by decreased number of banks, strengthening of the resulting bank and further concentrations in the banking sector of the Federation of BiH.

- in %-

Table 4: *Market share of banks by ownership type (majority capital)*

BANKS	31.12.2005.			31.12.2006.			31.12.2007.		
	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	2	3	7	5	6	10	8	9
Banks with majority state capital	6	16,4	4,5	5	13,9	4,1	3	9,7	2,7
Banks with majority private domestic capital	6	8,0	6,5	4	3,7	2,9	7	10,9	4,9
Banks with majority foreign capital	12	75,6	89,0	14	82,4	93,0	12	79,4	92,4
TOTAL	24	100,0	100,0	23	100,0	100,0	22	100,0	100,0

Graph 13: *Market share by ownership type*



1.3. Staff

As of 31.12.2007., there were total of 7.361 employees employed by banks in the Federation of BiH, of which 5% by banks with majority state capital and 95% by private banks.

Table 5: *Bank employees in the FBiH*

BANKS	NUMBER OF EMPLOYEES						RATIO	
	31.12.2005.		31.12.2006.		31.12.2007.		3:2	4:3
1	2		3		4		5	6
State banks	475	8%	423	6%	342	5%	89	81
Private banks	5.540	92%	6.183	94%	7.019	95%	112	114
TOTAL	6.015	100%	6.606	100%	7.361	100%	110	111
Number of banks	24		23		22			

The trend of further increase of the employees' number of banks in the Federation of BiH continues in 2007, with almost the same growth rate (11%) as prior year, representing an increase of 755 employees in absolute number. This is the result of expansion of business network of banks in the territory of the entire BiH, followed by development and increase of performance volume through classic banking products and services and initiation of the variety of new products and services. The four largest banks in the system employ 46% of total number of employees in the banking sector, representing decrease of 2% if compared to the end of 2006.

Table 6: *Qualification structure of employees*

EDUCATION	NUMBER OF EMPLOYEES						RATIO	
	31.12.2005.		31.12.2006.		31.12.2007.		4:2	6:4
1	2	3	4	5	6	7	8	9
University qualifications	2.165	36,0%	2.408	36,5%	2.725	37,0%	111	113
Two-year post secondary school qualifications	642	10,7%	714	10,8%	799	10,8%	111	112
Secondary school qualifications	3.102	51,6%	3.391	51,3%	3.759	51,1%	109	111
Other	106	1,7%	93	1,4%	78	1,1%	88	84
TOTAL	6.015	100%	6.606	100,0%	7.361	100,0%	110	111

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

Table 7: *Assets per an employee*

BANKS	31.12.2005.			31.12.2006.			31.12.2007.		
	No. of empl.	Assets (000 KM)	Assets per an empl.	No. of empl.	Assets (000 KM)	Assets per an empl.	No. of empl.	Assets (000 KM)	Assets per an empl.
State	475	422.680	890	423	474.793	1.122	342	381.036	1.114
Private	5.540	8.956.027	1.617	6.183	11.023.562	1.783	7.019	13.822..471	1.969
TOTAL	6.015	9.378.707	1.559	6.606	11.498.355	1.741	7.361	14.203.507	1.930

At the end of 2007, there was KM 1,93 million of assets per an employee at the level of the banking system. This indicator is much better with the private bank sector, which is expected, having in mind stagnation or decreased volume of business activities of state banks, and, consequently, excessive number of employees.

Table 8: *Assets per an employee by groups*

Assets (000 KM)	31.12.2005.	31.12.2006.	31.12.2007.
	Number of banks	Number of banks	Number of banks
Up to 500	5	5	2
500 to 1.000	7	7	7
1.000 to 2.000	6	4	7
2.000 to 3.000	5	6	4
Over 3.000	1	1	2
TOTAL	24	23	22

Analytical indicators of respective banks range from KM 310 thousand to KM 3,8 million of assets per an employee. The indicator of eight banks is better than the one for the whole banking sector, and the indicator for four largest banks in the system exceeds KM 2,5 million.

And finally, we could say that conditions under which banks service their customers, both legal entities and citizens, as well as conditions under which banks offer their services and finance their customers, have significantly improved in terms of quality.

2. FINANCIAL INDICATORS OF BANKS' PERFORMANCE

Examination of banks based on reports is performed in the way to use the reports prescribed by the FBA and the reports of other institutions, representing database of three groups 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, based on the reports prescribed by the FBA (quarterly),
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 get 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[13].

2.1. Balance sheet

Aggregate balance sheet of banks in the Federation of BiH, according to the balance sheets submitted as of 31.12.2007. amounted to KM 14,2 billion, which is higher by 24% or KM 2,7 billion than at the end of 2006, that is, by 1% higher than the rate realized in 2006. This is an indicator of a continuous, stable and moderate growth of the banking sector for the past several years.

[13] 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 31.12.2007., these items amounted to KM 607 million.

Table 9: *Balance sheet*

DESCRIPTION	AMOUNT (in 000 KM) 31.12.2005.	31.12.2006.	31.12.2007.	RATIO 3/2	4/3
1	2	3	4	5	6
ASSETS:					
Cash funds	3.533.700	4.286.202	4.895.107	121	114
Securities[14]	20.010	45.922	48.565	229	106
Placements to other banks	68.811	105.390	69.314	153	66
Loans	5.545.077	6.820.154	8.875.003	123	130
Loan loss provisions (LLP)	260.155	288.433	329.128	111	114
Loans – net value (loans minus LLP)	5.284.922	6.531.721	8.545.163	124	131
Business premises and other fixed assets	306.637	341.671	406.567	111	119
Other assets	164.628	187.449	238.826	114	127
TOTAL ASSETS	**9.378.708**	**11.498.355**	**14.203.507**	**123**	**124**
LIABILITIES:					
LIABILITIES					
Deposits	6.864.048	8.379.322	10.190.977	122	122
Borrowings from other banks	2.912	2.890	3.289	99	114
Loan Commitments	1.152.910	1.420.944	1.856.471	123	131
Other liabilities	342.121	468.614	634.752	134	135
CAPITAL					
Capital	1.016.717	1.226.585	1.518.018	121	124
TOTAL LIABILITIES (LIABILITIES AND CAPITAL)	**9.378.708**	**11.498.355**	**14.203.507**	**123**	**124**

Table 10: *Assets of banks based on the ownership structure*

BANKS	31.12.2005. Number of banks	Assets (000 KM)		31.12.2006. Number of banks	Assets (000 KM)		31.12.2007. Number of banks	Assets (000 KM)		RATIO 5/3	7/5
1	2	3		4	5		6	7		8	9
State	6	422.680	5%	5	474.793	4%	3	381.036	3%	112	80
Private	18	8.956.027	95%	18	11.023.562	96%	19	13.822.471	97%	123	125
TOTAL	24	9.378.707	100%	23	11.498.355	100%	22	14.203.507	100%	123	124

During the year of 2007, the ownership structure of state banks changed, that is, two banks, upon additional capitalization being finalized, moved to the group of banks with majority private capital. This has led to a decrease of the state banks' assets by 20% or KM 94 million, so their participation (three banks) in the aggregate assets of the banking sector are down to only 3%.

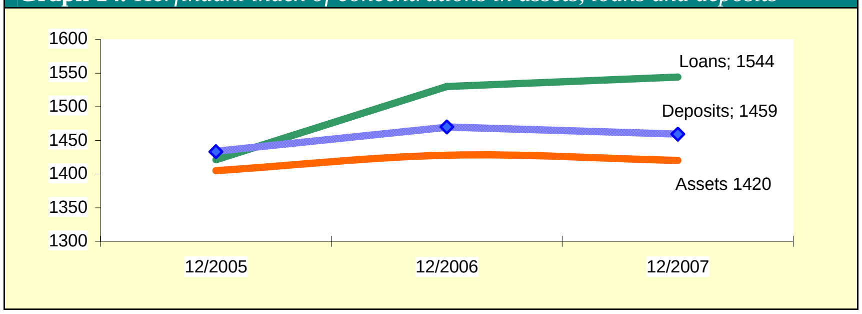
Growth rate of individual banks ranged from 9% to the high 93%. It should be pointed out that 10 banks realized assets growth of more than 30%, and several smaller banks recorded extremely high growth rates (40% and more), which is reasonable since the increase accrual basis is rather low. Only three banks increased their assets between 20% and 30%, and six banks recorded growth rate below 20%. Three banks (two state owned and one private under provisional administration) recorded assets at the same level as last year.

[14] Trading securities and securities held to maturity.

Assets growth of the four largest banks in the system ranged between 10% and 31%, and the largest bank in the system realized assets growth of 23,3%. Four largest banks in the system make 62% or KM 1,7 billion of total aggregate balance sheet growth of the banking sector.

However, the true indicator of concentrations in the three most significant segments of banking performance in assets, loans, and deposits, is the value of the Herfindahl index[15].

Graph 14: *Herfindahl index of concentrations in assets, loans and deposits*

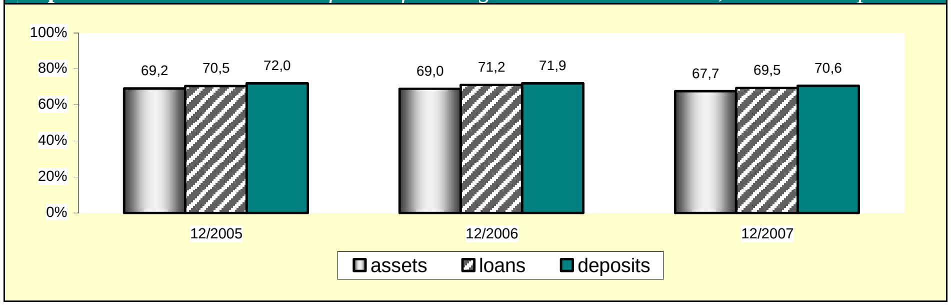


Over the last three years, the Herfindahl indexes for concentration of assets and deposits have recorded smaller oscillations, that is, a slight fall in 2007: eight units, that is, 11 units, and their value at the end of 2007 was 1.420 units and 1.459 units. However, contrary to the two mentioned indicators, the indicator of concentrations of the originated loans increased by 14 units, amounting to 1.544 units at the end of 2007.

If the concentrations in the banking system are analyzed upon other criteria, that is, Concentration Rate (CR), the most relevant for the banking system of the F BiH is the CR4 and analysis of changes in participation of the four largest banks in the system. The largest bank and the leader is Raiffeisen bank d.d. Sarajevo that for the last several years holds the majority of market share, which, along with smaller oscillations for the last three years, amounted to 26,9% at the end of 2007 that has not changed if compared to 2006. Second bank, if compared to the size, is the Group Unicredit Zagrebačka bank d.d. Mostar and HVB Central profit bank d.d. Sarajevo[16] with market share of 25,1%, and the next one is Hypo Alpe Adria Bank d.d. Mostar with participation of 15,7%. The CR4, according to the assets size and at the end of 2007, was 67,7%, for loans 69,5% and for deposits 70,6%. If we analyze changes in the last three years, we see a smaller downfall of all three indicators in 2007, based on which we could make conclusion that there has been certain reallocation of market shares and decreased domination of the four largest banks, suggesting an intensified competition in the entire banking system.

[15] 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%. Hypotetically, if there is only one bank in the system, the HHI would be maximum at 10000.
[16] Since HVB Central Profit bank d.d. Sarajevo is in process of integration with UniCredit Zagrebačka bank d.d. Mostar, the indicator is calculated based on the aggregated data.

Graph 15: *Concentration rates for the four largest banks -CR4: assets, loans and deposits*



We can also analyze the banking sector from the aspect of several groups, as formed upon the assets size[17]. Individual groups recorded smaller changes as for the number of banks and their participation, as a result of assets growth in majority of banks and completion of the integration process of two banks.

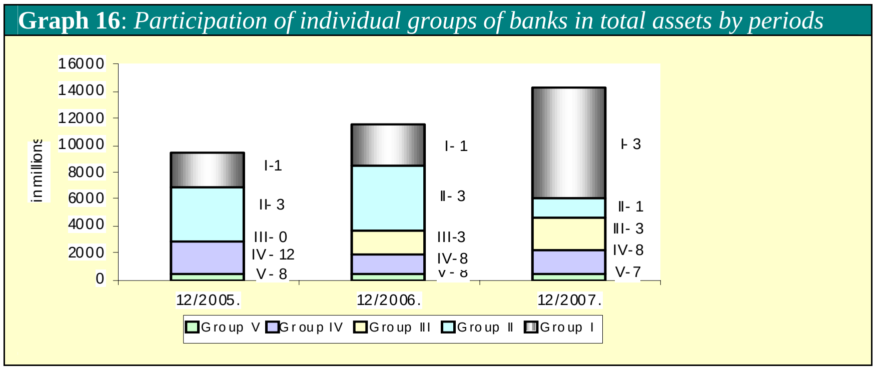
As mentioned, the four largest banks, classified under Groups I and II, still hold dominant participation of 67,7%, which has decreased by 1,3% if compared to the end of 2006. Three banks from Group III increased their participation from 15% to 16,8%, as a result of transfer of one bank from Group IV, after integration to other bank, to the Group III and increase of the balance sheet sum of individual banks from this Group, while participation of the largest group IV (eight banks), with the assets between KM 100 and 500 million, increased by only 0,3% (from 12% to 12,3%). Decrease in participation of the last group of seven banks has continued, amounting to only 3,2% at the end of 2007.

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

Table 11: *Participation of individual groups of banks in total assets through periods*

ASSETS	31.12.2005.			31.12.2006.			31.12.2007.		
	Amount	Particip %	No. of banks	Amount	Particip %	No. of banks	Amount	Particip %	No. of banks
I- Over 2.000	2.495	26,6	1	3.098	26,9	1	8.207	57,8	3
II- 1000 to 2000	3.996	42,6	3	4.836	42,1	3	1.409	9,9	1
III- 500 to 1000	0	0,0	0	1.723	15,0	3	2.393	16,8	3
IV- 100 to 500	2.504	26,7	12	1.382	12,0	8	1.742	12,3	8
V- Below 100	384	4,1	8	459	4,0	8	453	3,2	7
TOTAL	9.379	100,0	24	11.498	100,0	23	14.204	100,0	22

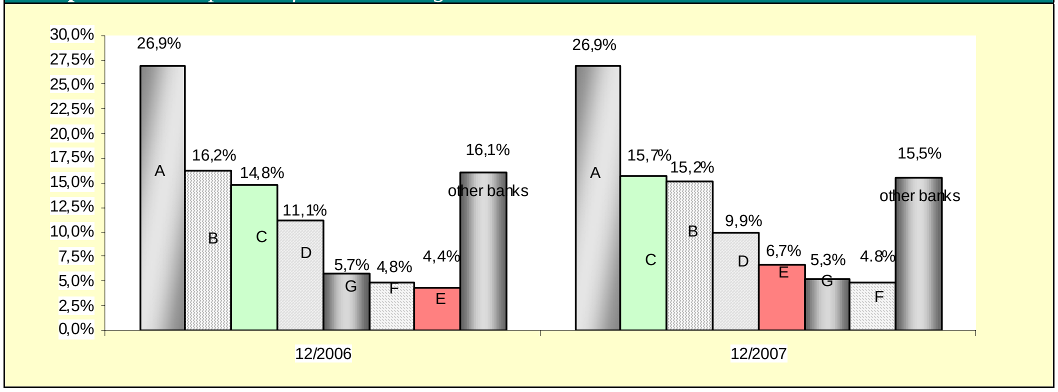
Graph 16: *Participation of individual groups of banks in total assets by periods*



[17] Banks ae divided into five groups, depending on the assets size.

The following graph presents the structure and participation trend of the seven largest banks[18] in the banking system of the Federation of BiH :

Graph 17: *Participation of the seven largest banks in total assets*



Based on the mentioned, we could draw a conclusion that the concentrations in the banking system, as measured by the HHI index in the three most significant segments: market share, loans and deposits, is acceptable and with slight decreasing trend of the index for assets and deposits. If we take into account that the index concentration value is under influence of degree of the economic development (the correlation is negative: the higher degree of development, the lower concentration) and country size (also, the correlation is negative: in smaller countries, concentration is higher), it is obvious that the concentration in the banking system of the F BiH is lower than the expected values for similar countries based on the two mentioned elements. However, according to some other concentration indicators, that is, according to the concentrations rates expressed as the CR4, we could say that the concentration is relatively high, with a slight decreasing trend, primarily due to increasing participation of several larger banks, so the seven largest banks in the system „hold“ approximately 85% of the market. Positive changes related to decreasing concentrations have direct influence on increasing competition, which adds to the quality of services and accelerates introduction of new products and services, all together in order to meet the requirements and need of bank customers.

Growth of the balance sheet sum in the sources has been primarily financed through deposit growth (by 22% or KM 1,8 billion), then borrowings (by 31% or KM 435 million) and capital (by 24% or KM 291 million).

The highest relative and nominal growth (30% or KM 2,05 billion) of the assets was recorded in loans that has directly reflected on lower growth rate of cash funds, which have increased by 14% or KM 609 million.

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

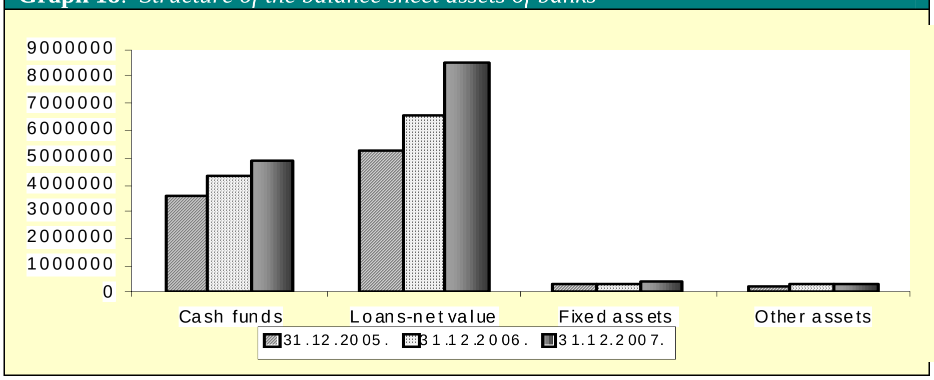
[18] Banks are market with letters A to G.

- in % -

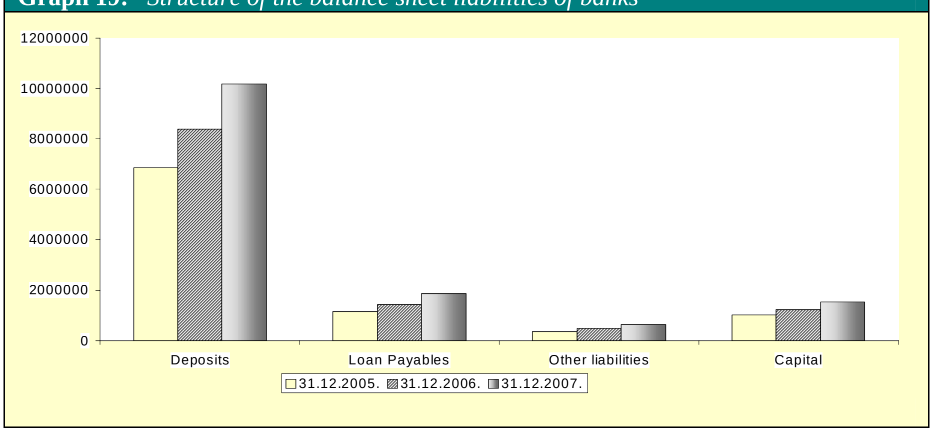
Table 12: *Balance sheet structure of banks*

DESCRIPTION	PARTICIPATION		
	31.12.2005.	31.12.2006.	31.12.2007.
ASSETS:			
Cash funds	37,7	37,3	34,5
Securities	0,2	0,4	0,3
Placements to other banks	0,7	0,9	0,5
Loans	59,1	59,3	62,5
Loan loss reserves (LLR)	2,8	2,5	2,3
Loans- net value (loans minus LLR)	56,3	56,8	60,2
Business premises and other fixed assets	3,3	3,0	2,8
Other assets	1,8	1,6	1,7
TOTAL ASSETS	100,0	100,0	100,0
LIABILITIES:			
LIABILITIES			
Deposits	73,2	72,9	71,7
Borrowings from other banks	0,0	0,0	0,0
Loan commitments	12,3	12,3	13,1
Other liabilities	3,7	4,1	4,5
CAPITAL			
Capital	10,8	10,7	10,7
TOTAL LIABILITIES (LIABILITIES AND CAPITAL)	100,0	100,0	100,0

Graph 18: *Structure of the balance sheet assets of banks*



Graph 19: *Structure of the balance sheet liabilities of banks*



The most significant changes in the liabilities structure are the following: continuing slow decrease in participation of deposits and increase of loan payables. Deposits of KM 10,2 billion and participation of 71,7% are still dominant source of financing for banks in the Federation of BiH, while loan payables have reached the amount of KM 1,86 billion and participation of 13,1%. Capital participation of 10,7% remained the same as last year.

Major changes have been recorded in the assets structure, in the two essential assets categories of banks' balance sheet: cash funds and originated loans. High growth rate of loans of 30% resulted from increase of their participation from 59,3% to 62,5%, while participation of cash funds, with 50% lower growth rate (14%), decreased from 37,3% to 34,5%.

Table 13: *Cash funds of banks*

CASH FUNDS	31.12.2005.		31.12.2006.		31.12.2007.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Cash	231.874	6,6	241.561	5,6	311.436	6,4	104	129
Reserve accounts with CBBiH	1.679.194	47,5	2.258.035	52,7	2.805.634	57,3	134	124
Accounts with deposit institutions in BiH	24.241	0,7	21.354	0,5	12.304	0,3	88	58
Accounts with deposit institutions abroad	1.596.932	45,2	1.764.210	41,2	1.764.825	36,0	111	100
Cash funds in collection process	1.459	0,0	1.042	0,0	908	0,0	71	87
TOTAL	3.533.700	100,0	4.286.202	100,0	4.895.107	100,0	121	114

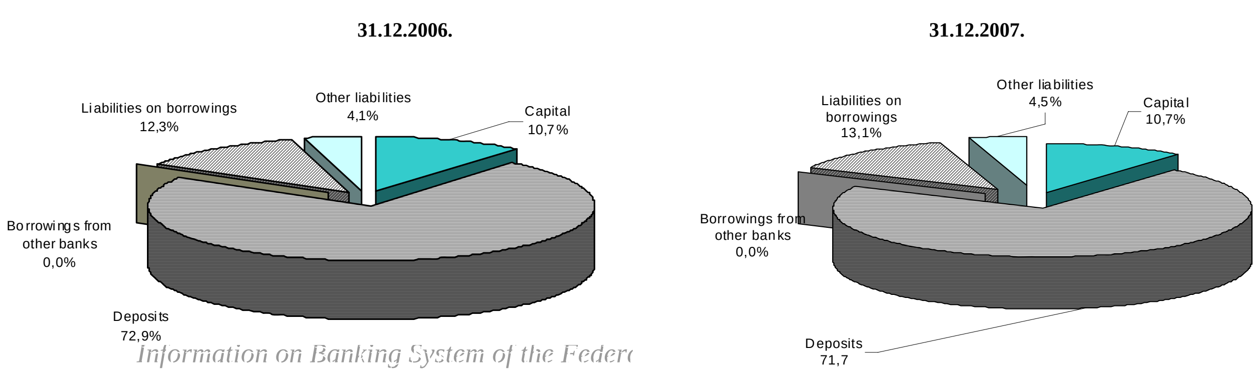
Over the year 2007, cash funds of banks in the Federation of BiH on the reserve accounts with the Central Bank of BiH increased by 24%, amounting to KM 2,8 billion or 57,3% of total cash funds as of 31.12.2007., which is higher by 4,6% if compared to the end of 2006. Required reserve rate in 2007 remained the same as in 2006 (15%). Banks held on the accounts with depository institutions abroad almost the same amount as at the end of 2006 (KM 1.765 million, most of it in EUR) or 36% of total cash funds (41,2% at the end of 2006). Banks' funds held as cash in vaults and tellers amounted to KM 311 million as of 31.12.2007., representing 6,4% of total cash funds, which is increase of 0,8% if compared to the end of 2006.

Currency structure changes in regard to further growth of domestic currency participation has continued in the observed period, that is, participation of domestic currency has increased from 56% to 61,4%, resulting by decrease in participation of funds in foreign currency.

2. 1. 1. Liabilities

Structure of liabilities (liabilities and capital) in the balance sheet of banks as of 31.12.2007. is presented in the following graph:

Graph 20: *Liabilities structure of banks*



In 2007, banks' deposits have increased by 22% or KM 1,8 billion, so at the end of 2007 they exceeded the amount of KM 10 billion, that is, they amounted to KM 10,2 billion with participation of 71,7%, remaining the most significant source of financing for banks in the Federation of BiH. Credit funds represent the second most significant source of financing, while credit indebtness of banks in 2007 has increased by KM 435 million or 31%. These liabilities, amounting to KM 1,9 billion, have reached participation of 13,1% (0,7% higher than at the end of 2006). If, to these liabilities, we add subordinated loans of KM 192 million, that banks have borrowed to strengthen their capital base and capital adequacy, then total credit funds in the sources would have participation of 14,5%. Capital has increased by 291 million or 24%, reaching the amount of KM 1,5 billion and participation of 10,7% as of 31.12.2007.

At the end of 2007, the highest bank commitments came from following creditors (seven of total 57), representing 71% of total credit commitments: Raiffeisen Zentralbank Osterreich A.G. (RZB), OEWAG Wien, ComercBank AG Frankfurt, European Investment Bank (EIB), European fund for Southeast Europe (EFSE), Bank Polska OPIEKI and International Finance Corporation (IFC).

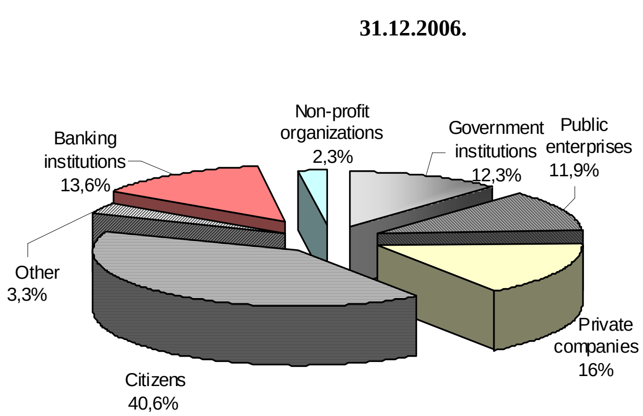
According to the data submitted by banks, out of total deposits only 4,4% were deposits collected by organizational units of banks from the Federation of BiH operating in Republic Srpska and Brčko District as of 31.12.2007.

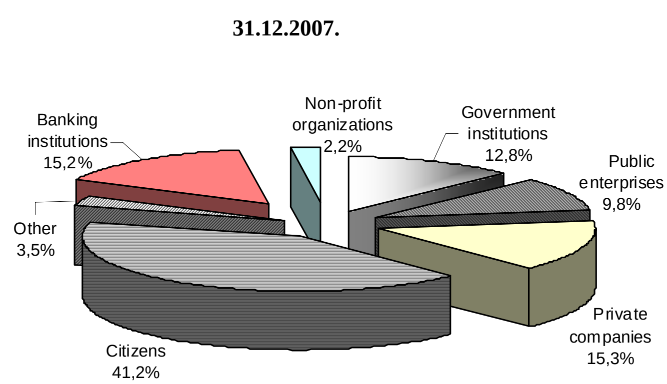
- in 000 KM-

Table 14: *Deposit structure by sectors*[19]

SECTORS	31.12.2005.		31.12.2006.		31.12.2007.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Governmental institutions	733.881	10,7	1.033.902	12,3	1.300.485	12,8	141	126
Public enterprises	806.321	11,7	996.110	11,9	997.448	9,8	124	100
Private enterprises and assoc.	1.066.022	15,5	1.342.538	16,0	1.554.693	15,3	126	116
Non-profit. organizations	169.005	2,5	193.009	2,3	225.866	2,2	114	117
Banking institutions	1.102.161	16,1	1.136.450	13,6	1.548.619	15,2	103	136
Citizens	2.717.081	39,6	3.403.443	40,6	4.202.161	41,2	125	123
Other	269.577	3,9	273.870	3,3	361.705	3,5	102	132
TOTAL	6.864.048	100,0	8.379.322	100,0	10.190.977	100,0	122	122

Graph 21: *Deposit structure by sectors*





Analysis by sectors shows that citizen deposits with the growth rate of 23% recorded the highest nominal growth of KM 799 million, reaching the amount of KM 4,2 billion and participation of 41,2%, higher by 0,6% than at the end of 2006. The highest growth rate of 36%, representing nominal growth of KM 413 million, was recorded by deposits of banking institutions with participation of 15,2%, which made them equal to the deposits of private companies sector that recorded decreased participation by 0,7% due to lower growth rate realized (16% or KM 212 million). Deposits of government institutions increased their participation form 12,3% to 12,8% as a result of increase of 26% or KM 266 million. The highest participation decrease (from 11,9% to 9,8%) was recorded by public enterprise deposits, since they remained at almost the same level (KM 977 million) as last year.

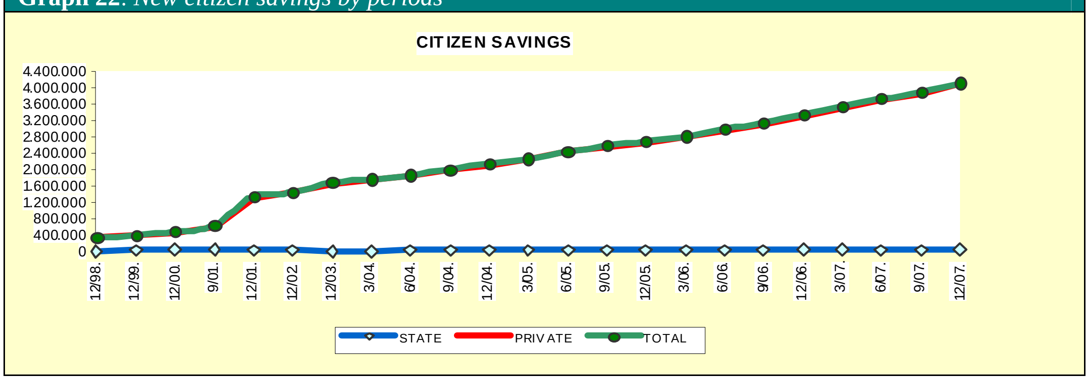
Currency structure of deposits has slightly changed in favor of domestic currency, that is, deposits in foreign currency (dominant participation of EUR) of KM 5,6 billion participated with 55% (55,8% at the end of 2006), while deposits in domestic currency arrived at KM 4,6 billion and participation of 45% (44,2% at the end of 2006).

Savings deposits, as the most significant deposit and financial potential of banks, continued with moderate and stable growth in 2007, that is, their increase was 23,3% or KM 777 million, arriving at KM 4,1 billion. Of the overall increase generated, four largest banks in the system make 71% or KM 552 million.

Table 15: *New citizen savings by periods*

BANKS	AMOUNT (in 000 KM)			RATIO	
	31.12.2005.	**31.12.2006.**	**31.12.2007.**	**3/2**	**4/3**
1	3	3	4	5	6
State	26.886	31.723	30.469	118	96
Private	2.638.391	3.308.413	4.086.820	125	124
TOTAL	2.665.277	3.340.136	4.117.289	125	123

Graph 22: *New citizen savings by periods*



Four largest banks in the system hold 74,8% of savings, while 10 banks show participation bellow 1%, representing only 4,1% of total savings in the system.

Savings deposits in domestic currency represent 34%, while in foreign currency 66% of total savings.

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

Table 16: *Maturity structure of citizen saving deposits by periods*								
BANKS	AMOUNT (in 000 KM)						RATIO	
	31.12.2005.		31.12.2006.		31.12.2007.		3/2	4/3
1	3		3		4		5	6
Short term savings deposits	1.567.617	58,8%	1.851.173	55,4%	2.174.863	52,8%	118	117
Long term savings deposits	1.097.660	41,2%	1.488.963	44,6%	1.942.426	47,2%	136	130
TOTAL	2.665.277	100,0%	3.340.136	100,0%	4.117.289	100,0 %	125	123

Maturity structure of savings deposits, as well as of the overall deposits, continues with positive trend of changes, which is the result of permanent improvement of the banking sector's condition and strengthening of its safety and stability. This is especially reflected through the improvement of maturity structure of both savings and total deposits, and the emphasis should be on continuity and high level of growth rate of long term savings deposits, as a result their participation in total savings deposits is closer to 50%.

Significant growth and positive trends in the segment of savings in banks of the FBiH are primarily the result of, on one side, 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 side, deposit insurance system with the main purpose to increase stability of the banking, that is, financial sector and protection of savers. There is total 14 banks from the Federation of BiH that were accepted to the deposit insurance program, and according to the submitted data, there is total 96% of total deposits and 98% of total savings deposited in these banks. As for remaining banks, six of them cannot apply to be accepted since they do not qualify with the criteria prescribed by the Deposit Insurance Agency: three state owned banks due to their ownership structure, one private bank with participation of state capital exceeding 10%, and two private banks under provisional administration, while two banks (a new bank that started operating as of October 2006 and one in which, after additional capitalization, provisional administration was terminated in July 2007) are currently in process of acceptance to the insurance program.

2.1.2. Capital - strength and adequacy

Capital[20] of banks in the FBiH, as of 31.12.2007., amounted to KM 1,9 billion.

-in 000 KM-

Table 17: *Regulatory capital*									
	DESCRIPTION	31.12.2005.		31.12.2006.		31.12.2007.		RATIO	
								3/2	4/3
	1	2		3		4		5	6
STATE BANKS									
1.	Core capital before reduction	166.737		169.829		145.802		102	86
2.	Offsetting items	4.200		5.034		2.018		120	40
a)	Core capital (1-2)	162.537	96%	164.795	95%	143.784	96%	101	87
b)	Supplementary capital	7.107	4%	9.370	5%	6.017	4%	132	64
c)	**Capital (a + b)**	169.644	100%	174.165	100%	149.801	100%	103	86
PRIVATE BANKS									
1.	Core capital before reduction	828.196		1.029.002		1.318.778		124	128
2.	Offsetting items	98.341		104.704		125.212		106	120
a)	Core capital (1-2)	729.855	72%	924.298	71%	1.193.566	69%	127	129
b)	Supplementary capital	290.758	28%	374.448	29%	536.007	31%	129	143
c)	**Capital (a + b)**	1.020.613	100%	1.298.746	100%	1.729.573	100%	127	133
Total									
1.	Core capital before reduction	994.933		1.198.831		1.464.580		120	122
2.	Offsetting items	102.541		109.738		127.230		107	116
a)	Core capital (1-2)	892.392	75%	1.089.093	74%	1.337.350	71%	122	123
b)	Supplementary capital	297.865	25%	383.818	26%	542.024	29%	129	141
c)	**Capital (a + b)**	1.190.257	100%	1.472.911	100%	1.879.374	100%	124	128

[20] Regulatory capital as defined by Article 8 and 9 of Decision on Minimum Standards for Capital Management in Banks.

Over the year 2007, capital[21] increased by 28% or KM 406 million, of which core capital increased by 23% or KM 248 million, and supplementary capital increased by 41% or KM 158 million.

Growth of core capital primarily comes from the inflow of new, green capital – additional capitalization in eight banks. Based on the mentioned, share capital increased by KM 159 million, and in two additional capitalizations the exchange premium was realized in the amount of KM 24 million. If compared to previous year, the inflow of green capital has increased by 33% or KM 45 million. In addition, three banks have increased share capital through technical issue (from their reserves) in total amount of KM 11,4 million. At the same time, the share capital of one bank decreased by KM 8,6 million in process of status change of integration with other bank, while the capital reserves of the resulting bank increased by the same amount, and one bank decreased its share capital by 3,4 million by withdrawal of its own shares.

Increase of the core capital, apart from the above mentioned has been significantly influenced by the increase of reserves and retained not distributed profit of KM 95 million. Upon implementation of legal procedure for adoption of decision on allocation of the audited profit by the assemblies, the profit generated in 2006 (17 banks) was distributed 85% in core capital (in reserves or retained – not distributed profit). Five banks have made decision to pay out dividends in total amount of KM 14 million that represents approximately 15% of the profit generated at the level of the banking system.

Aside from the mentioned, the reserves and retained profit of two banks have increased by KM 18 million (based on the assessment of fair value of fixed assets in one bank, and implementation of the IAS 8 – Accounting Policy, Changes to the Accounting Appraisal and Errors, in the other one).

Offsetting items (causing decrease of core capital) have increased by KM 17 million (five banks covered their losses in total amount of KM 4,5 million, current loss was KM 8,2 million, and intangible assets increased by KM 13,3 million).

Supplementary capital increased by KM 158 million, along with some more significant changes in the structure: profit from 2006 of KM 85,7 million was transferred to core capital, and 14 banks included their current audited profit of KM 98,8 million in the supplementary capital, while the following supplementary capital items have increased: subordinated debts by KM 52,3 million (four banks), liabilities of permanent nature in one bank of KM 45 million, and general loan loss provisions by KM 47,7 million.

The mentioned changes have influenced the structure of regulatory capital, so participation of core capital decreased from 74% to 71%, and supplementary capital increased from 26% to 29%.

Increase of regulatory capital of 28% has positively reflected on net capital, which in the year 2007 has also increased by 28% or KM 408 million, amounting to KM 1,9 million as of 31.12.2007.

Capitalization rate of banks, expressed as ratio between capital and assets as of 31.12.2007., was 12,9%, representing improvement of 0,4% of compared to the end of 2006.

One of the most significant indicators of capital strength and adequacy[22] of banks is capital adequacy ratio calculated as ratio between net capital and risk weighted assets. As of 31.12.2007., this ratio at the system level was 17,3%, which is lower by 0,3% than at the end of 2006. The cause of this downfall is primarily higher growth rate realized in the risk weighted assets (30%) than in the net capital (28%).

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[21] Data source is quarterly Report on Capital Positions of Banks (Form 1-Schedule A) regulated by the Decision on Minimum Standards for Managing Capital in Banks.
[22] The Law prescribes minimum capital adequacy rate of 12%.

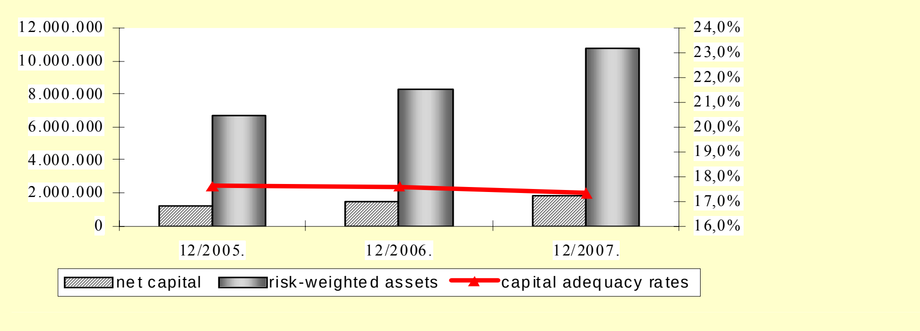
While conducting supervision of operations and financial positions of banks in the FBiH as regulated by the Law, the FBA has been issuing orders to banks to undertake actions for strengthening of capital base and provision of adequate capital in order to strengthen safety in banks individually and in the entire banking system, according to the level and profile of existing and potential exposure to all risks relevant to the banking operation.

- 000 KM -

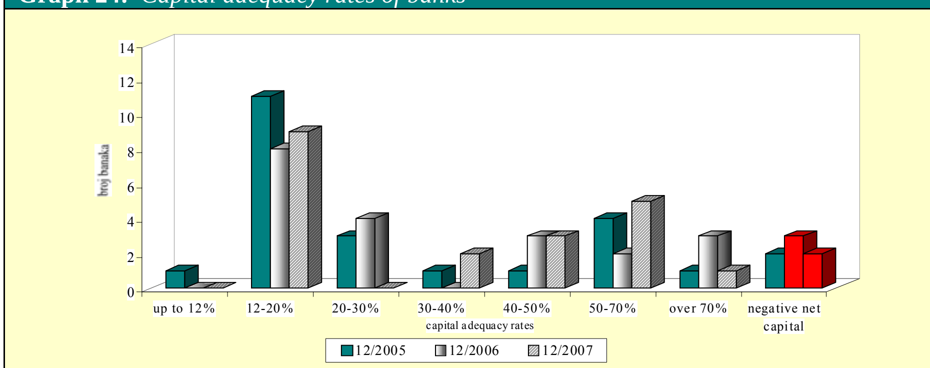
Table 18: *Net capital, risk-weighted assets and capital adequacy rate*

DESCRIPTION	31.12.2005.	31.12.2006.	31.12.2007.	RATIO	
				3/2	4/3
1	2	3	4	5	6
NET CAPITAL	1.173.022	1.455.675	1.863.338	124	128
RISK WEIGTHED ASSETS AND CREDIT EQUIVALENTS	6.681.510	8.282.086	10.747.145	124	130
NET CAPITAL RATE (CAPITAL ADEQUACY)	17,6%	17,6%	17,3%	100	98

Graph 23: *Net capital, risk-weighted assets and capital adequacy rate*



Graph 24: *Capital adequacy rates of banks*



Of total 22 banks in the FBiH as of 31.12.2007., capital adequacy rate of 20 banks was higher than minimum prescribed by the law of 12%, while two banks, under provisional administration, recorded capital adequacy rate bellow 12%, that is, negative adequacy rate. The rate of individual banks was moving in both ways: capital adequacy of 10 banks was better than at the end of 2006, of which in seven banks this was the result of additional capitalization performed during 2007, while twelve banks recorded downfall in capital adequacy.

Preview of capital adequacy rates of 20 banks in comparison to the minimum prescribed by the law of 12% is the following:

- Nine banks had the rate between 12,5% and 20%, and four largest banks from 12,5% to 16,8%,
- Five banks had the rate between 21% and 50%,
- Five banks had the rate between 51% and 70%,
- One bank had the rate higher than 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. 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 undertaken and potential risk, then intensified supervision and monitoring of bank, request to supply additional capital in order to strengthen capital base, limitation and decrease of credit risk exposure with some concentrations, monitoring of capital plan implementation, especially for additional capital supplied from external resources, supervision of compliance and implementation of the ordered measures, etc.

All the mentioned has contributed to the improvement of this segment, which is an assurance of stability and safety of the banking and overall financial system.

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)[23] of banks in the FBiH, as of 31.12.2007., amounted to KM 17 billion, which is higher by 25% than at the end of 2006.

Gross assets[24] of the balance sheet amounted to KM 14,5 billion, which is higher by 23% or KM 2,7 billion than at the end of 2006. Off-balance sheet risk items amounted to KM 2,5 billion, representing an increase of 34% or KM 627 million.

[23] Assets defined by Article 2 of Decision on Minimum Standards for Loan Risk Management and Assets Classification of Banks.

[24] Data source: Report on classification of balance sheet assets and off-balance sheet items of banks.

-in 000 KM-

Table 19: *Assets, off-balance sheet items and potential loan losses*

DESCRIPTION	AMOUNT (in 000 KM)						RATIO	
	31.12.2005.	Struct. %	31.12.2006.	Struct. %	31.12.2007.	Struct. %	4:2	6:4
1.	2	3	4	5	6	7	8	9
Loans	5.326.900	55,2	6.609.302	56,0	8.660.769	59,6	124	131
Interests	37.531	0,4	36.210	0,3	53.522	0,4	96	148
Past due claims	214.045	2,2	206.720	1,8	210.596	1,4	97	102
Claims for paid guarantees	4.132	0,0	4.132	0,0	3.638	0,0	100	88
Other placements	23.950	0,2	47.739	0,4	61.907	0,4	199	130
Other assets	4.050.650	42,0	4.893.407	41,5	5.556.224	38,2	121	114
TOTAL ASSETS	9.657.208	100,0	11.797.510	100,0	14.546.656	100,0	122	123
OFF-BALANCE SHEET	1.391.183		1.826.980		2.453.626		131	134
ASSETS WITH OFF-BALANCE SHEET	11.048.391		13.624.490		17.000.282		123	125
RISK ASSETS WITH OFF-BALANCE SHEET	7.091.338		8.871.314		11.628.220		125	131
General loan risk and Potential loan losses	313.873		343.737		405.717		110	118
General and Special loan loss reserves already established	314.175		345.067		405.691		110	118

Non-risk items amount to KM 5,4 billion or 32% of total assets with off-balance sheet, and they increased by 13% if compared to the end of 2006, which is primarily the result of the cash funds increase. On the other hand, risk assets with off-balance sheet items amount to KM 11,6 billion and they increased by 31% or KM 2,8 billion over the year of 2007.

Credit placements[25] over the year of 2007 recorded significant increase of KM 2,1 billion or 30%, which, if compared to 2006, has increased by 7%, arriving at KM 8,9 billion and participation of 62,5%. Past-due claims increased by 2%, and their participation in the assets structure decreased from 1,8% to 1,5%.

Analytical data by banks show that two banks (both under provisional administration) recorded slight decrease of credit placements (total of KM 2,8 million), while nine banks recorded growth rate of credit placements between 2% and 30%, six banks increased their placements between 30% and 50%, while remaining five banks recorded the growth of credit placements over 50%.

Four largest banks in the FBiH increased their credit placements by KM 1,3 billion, representing 64% of the overall increase at the banking system level, amounting to KM 6,2 billion at the end of 2007, and their participation in total loans decreased from 71,2% to 69,5%.

Over the year 2007, banks have originated majority of their loans to private companies and citizens that are at the same time two sectors with dominant participation of 95,3%. Placements originated to citizens recorded the highest absolute growth of KM 990 million, or 29% in relative amount, but their participation decreased from 50,9% to 50,3%. Loans to private companies increased by KM 968 million or 32%, reflecting positively to their participation that has increased from 44,4% to 45,1%. If compared to 2006, growth rates of credit placements in both sectors are higher by four, that is, eight percentage points, while it is encouraging that in 2007 banks have significantly increased their loans originated to private companies. Although participation of the non-banking financial institutions sector is down to only 1,3%, if compared to 2006, placements to this sector have increased by 118% or KM 62 million, as were primarily originated by micro-credit organizations.

[25] Short term and long term loans, past due claims and claims based on paid-called for payment guarantees.

According to the data submitted by banks, as of 31.12.2007., from the aspect of citizen loan structure by purpose, the highest participation of approximately 70% had loans originated to finance consumer goods[26], 24% had housing loans, and remaining 6% had loans for SMEs and agriculture.

Four largest banks in the system financed 69% of total loans originated to citizens, which is lower by 3% if compared to the end of 2006, while the same indicator for the private company sector is 70%, which is lower by 2% if compared to the end of 2006.

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

-in 000 KM-

Table 20: *Structure of loans by sectors*

SECTORS	31.12.2005.		31.12.2006.		31.12.2007.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Government institutions	35.513	0,6	27.084	0,4	32.556	0,4	76	120
Public enterprises	188.143	3,4	192.394	2,8	211.465	2,4	102	110
Private enterprises and assoc.	2.446.358	44.1	3.029.964	44,4	3.998.141	45,0	124	132
Non-profit organizations	33.123	0,5	28.445	0,4	26.768	0,3	86	94
Banking institutions	48.566	0,9	52.279	0,8	114.084	1,3	108	218
Citizens	2.784.053	50,2	3.471.829	50,9	4.461.984	50,3	125	129
Other	9.321	0,2	18.159	0,3	30.005	0,3	195	165
TOTAL	5.545.077	100,0	6.820.154	100,0	8.875.003	100,0	123	130

Currency structure of loans has also been unchanged for longer period: loans financed with currency clause had the highest participation of 73% or KM 6,5 billion, and then loans in domestic currency of 25% or KM 2,2 billion, and loans in foreign currency had the smallest participation of only 2% or KM 210 million.

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[27] and off-balance sheet items are presented in the following table:

[26] Including card based operations.
[27] 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 21: *Asset classification, general loan risk (GLR),potential loan losses (PLL) and off-balance sheet items (charged off assets and suspended interest)*

Classification categories	AMOUNT (in 000 KM) AND PARTICIPATION (in%)									RATIO	
	31.12.2005.			31.12.2006.			31.12.2007.				
	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	5.943.367	83,8	118.864	7.513.553	84,7	150.390	9.886.443	85,0	197.924	126	132
B	831.403	11,7	62.512	1.073.906	12,1	79.451	1.476.856	12,7	105.268	129	138
C	157.310	2,2	41.915	147.718	1,7	36.574	143.068	1,2	35.602	94	97
D	159.224	2,3	90.551	135.980	1,5	77.181	121.815	1,1	66.885	85	90
E	34	0,0	31	157	0,0	141	38	0,0	38	462	24
Risk assets (A-E)	7.091.338	100,0	313.873	8.871.314	100,0	343.737	11.628.220	100,0	405.717	125	131
Nonrisk assets[28]	3.957.053			4.753.176			5.372.062			120	113
TOTAL	11.048.391			13.624.490			17.000.282			123	125
OFF-BALANCE SHEET ITEMS											
	385.601	87,6		409.108	89,7		430.048	90,1		106	105
Susp. Interest	54.426	12,4		46.546	10,3		46.919	9,9		86	101
TOTAL	440.027	100,0		455.654	100,0		476.967	100,0		104	105

Risk assets with off-balance sheet items (A-E) amount to KM 11,6 billion. They increased by 31% or KM 2,8 billion. Non-risk items amount to KM 5,4 billion. They increased by 13%, if compared to the end of 2006, which is primarily the result of the cash funds increase.

If quality of risk assets is analyzed, we can see there is still increase of classified assets (B-E) by 28% or KM 384 million, exclusively due to the growth of special mentioned placements (category B) by 38% or KM 403 million, therefore, as of 31.12.2007., category B reached KM 1,5 billion, and classified assets KM 1,7 billion. Only poor quality assets (C-E) were lower by 7% or KM 19 million, amounting to KM 265 million at the end of 2007. However, we have to mention that in the same period the assets were charged off (write off to the off-balance sheet) in the amount of KM 103 million. The assets quality indicators expressed as ratio, that is, participation of individual categories in risk assets have insignificantly changed to slightly better, as a result of the above mentioned. The ratio of classified assets and risk assets, if compared to the end of 2006, was lower by 0,3%, amounting to 15,0%, due to slightly faster growth of risk assets (31%) than classified assets (28%).

Second important indicator of assets quality expressed as ratio of poor quality assets and risk assets, as of 31.12.2007., was 2,3%, which is relatively low ratio, but it has improved by 0,9% if compared to the end of 2006. However, if we take into account increase of the special mentioned assets (category B) of 38% and its participation of 13% in the risk assets, expressing doubt that portion of placements reported under this category have worst quality and should be placed under the category of poor quality assets, that is, some banks practice not to timely establish adequate loan loss provisioning (as confirmed through on-site examinations, resulting by insufficient loan loss reserves), we could make conclusion there is a slight trend of deterioration in the assets quality. That is why it is of key importance that banks more realistically evaluate quality of placements and establish adequate loan loss reserves, especially for the fact that these are new loans with long maturity (especially citizen loans), so the issues related to the assets quality have not been timely detected, that is, they are in some way hidden through the highest increase of category B.

[28] 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%.

The analysis of data by sectors is based on the indicators of loan quality granted to the two most significant sectors: private companies 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 22: *Classification of loans originated to citizens and legal entities*

Classification categories	AMOUNT (in 000 KM) AND PARTICIPATION (in %)										RATIO
	31.12.2006.					31.12.2007.					
	Citizens	Partic. %	Legal entities	Partic. %	TOTAL	Citizens	Partic. %	Legal entities	Partic. %	TOTAL	11/6
1	2	3	4	5	6 (2+4)	7	8	9	10	11 (7+9)	12
A	3.293.646	94,87	2.397.988	71,62	5.691.634	4.176.207	93,60	3.276.108	74,24	7.452.315	131
B	109.338	3,15	744.616	22,24	853.954	199.186	4,46	968.764	21,95	1.167.950	137
C	44.074	1,27	96.719	2,89	140.793	56.213	1,26	81.672	1,85	137.885	98
D	24.766	0,71	108.886	3,25	133.652	30.360	0,68	86.475	1,96	116.835	87
E	5	0,0	116	0,00	121	18	0,00	0	0,00	18	15
TOTAL	3.471.829	100,00	3.348.325	100,00	6.820.154	4.461.984	100,00	4.413.019	100,00	8.875.003	130
Classified assets (B-E)	178.183	5,13	950.337	28,38	1.128.520	285.777	6,40	1.136.911	25,76	1.422.688	126
Poor quality assets (C-E)	68.845	1,98	205.721	6,14	274.566	86.591	1,94	168.147	3,81	254.738	93
Loan structure		50,91		49,09	100,00		50,28		49,72	100,00	
Participation by sectors in classified assets, poor quality assets and category B:											
Classification B-E		15,79		84,21	100,00		20,09		79,91	100,00	
Poor quality C-E		25,07		74,93	100,00		33,99		66,01	100,00	
Category B		12,80		87,20	100,00		17,05		82,95	100,00	

As of 31.12.2007., of total loans originated to legal entities in the amount of KM 4,4 billion, KM 1,1 billion or 25,8% was classified in categories B to E (KM 950 million or 28,4% at the end of 2006), and of total loans originated to citizens in the amount of KM 4,5 billion, KM 286 million or 6,4% was classified in categories B to E (KM 178 million or 5,1% at the end of 2006).

Poor quality assets represent KM 168 million or 3,8% of all the loans originated to legal entities (as of 31.12.2006., they amounted to KM 206 million or 6,1%). As for the sector of citizens, loans classified as poor quality represent KM 87 million or 2% of total loans originated to this sector (as of 31.12.2006., they amounted to KM 69 million or 2%).

Although there is the trend of improvement of the two observed indicators of quality of loans originated to legal entities, while the indicator of loans originated to citizens has slightly deteriorated, in order to make more realistic assessment we should take into account the amount of loans that banks have in the meantime charged off to the off-balance sheet, which is presented in the following table.

-000 KM-

Table 23: *Off-balance sheet records: charged off assets and suspended interest*

OPIS	CITIZENS		LEGAL ENTITIES		TOTAL	
	Charged off assets	Suspended interest	Charged off assets	Suspended interest	Charged off assets	Suspended interest
1	2	3	4	5	6	7
Opening balance as of 31.12.2006.	58.711	6.698	341.297	38.374	400.008	45.072
Changes in 2007:						
- new charge offs (current year)	23.767	4.642	68.622	6.094	92.389	10.736
- payments made in the current year	15.817	4.004	28.768	3.314	44.585	7.318
- *permanent charge off*	593	171	17.171	1.400	17.764	1.571
Balance as of 31.12.2007.	66.068	7.165	363.980	39.754	430.048	46.919

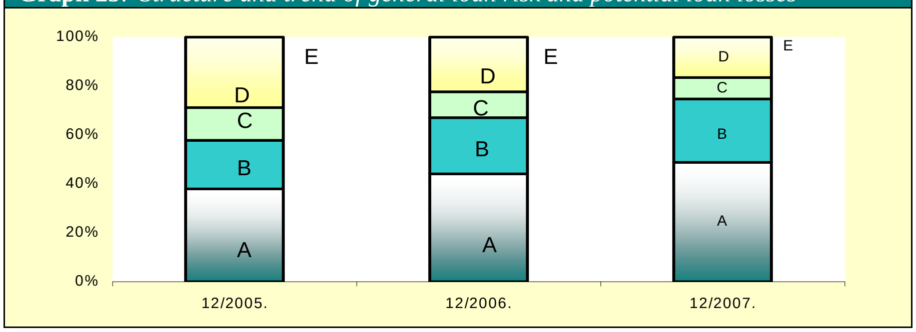
Balance of the charged off assets as of 31.12.2007. was KM 430 million, which was higher by 5% if compared to the end of 2006, while balance of suspended interest was KM 47 million, which was at the same level as in 2006.

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 24: *Structure and trend of general loan risk and potential loan losses*

Classification categories	AMOUNT (in 000 KM) AND STRUCTURE (in %)						RATIO	
	31.12.2005.		31.12.2006.		31.12.2007.		4/2	6/4
1	2	3	4	5	6	7	8	9
A	118.884	37,9	150.390	43,8	197.924	48,8	127	132
B	62.517	19,9	79.451	23,1	105.268	25,9	127	132
C	41.954	13,4	36.574	10,6	35.602	8,8	87	97
D	90.465	28,8	77.181	22,5	66.885	16,5	85	87
E	31	0,0	141	0,0	38	0,0	455	27
TOTAL	313.851	100,0	343.737	100,0	405.717	100,0	110	118

Graph 25: *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 the analysis of the established provisions, in total amount and by classification categories, if compared to the end of 2006, general loan risk and potential loan loss provisions are higher by 18%, amounting to KM 406 million, that is 3,5% of risk assets with off-balance sheet, which is lower by 0,4% if compared to the end of 2006. As of 31.12.2007., banks in average allocated for category B 7,1%, for category C 24,9%, category D 54,9% and E 100%.

Analysis of assets quality, that is, loan portfolio of individual banks, as well as on-site examinations at banks, indicate loan risk as still dominant risk with majority of banks, and 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, the problem is not essentially resolving.

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 poor quality assets issue and prevention of their further deterioration. Implementation of the FBA's orders is continuously monitored in the follow-up procedure based on reports and other documentation submitted by banks, which are checked through targeted on-site examinations.

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 25: *Transactions with related entities*

Description	ORIGINATED LOANS			RATIO	
	31.12.2005.	31.12.2006.	31.12.2007.	3/2	4/3
1	2	3	4	5	6
Shareholders over 5% of voting rights, subsidiaries and other related enterprises	28.520	21.333	26.083	75	122
Supervisory Board and Audit Board members	101	38	145	39	384
Bank Management	2.663	1.962	2.355	74	120
TOTAL	31.284	23.333	28.583	75	123
Potential and undertaken off-balance sheet liabilities	911	1.072	1.936	118	180

Based on reporting data we can conclude this would be a small amount of loans granted to the mentioned categories of legal entities, so, in general, level of risk is low. The FBA pays special attention (in on-site examinations) to banks' operations with related entities. The FBA on-site examiners issue orders for elimination of determined weaknesses within certain deadlines and initiate violation procedures, and part of the 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 has improved, level of transactions with related entities has decreased, causing decrease in risk exposure to these entities.

2.2. Profitability

According to the final non-audited data from the financial statements, showing the achievement of banks' performance, that is, income statement for 2007, banks in the Federation of BiH have realized positive financial result – profit in the amount of KM 115,2 million, representing a significant increase at the system level of 30,5% or KM 27 million if compared to the year 2006. Continuing trend of improvement in the achievement of total system, as measured by the level of realized profit, is the result of the overall trend of improvement and stabilization of the banking sector.

Positive financial result of KM 123,4 million was generated by 18 banks, which is higher by 29,5% or KM 28 million than in the same period in 2006 (the same number of banks), while four banks reported loss of KM 8,3 million, which is higher by 17,5% than prior year.

More detailed information is presented in the following table:

-000 KM-

Table 26: *Financial result reported: profit/loss*

Date/Description	At the system level		State banks		Private banks	
	Amount	No. of banks	Amount	No. of banks	Amount	No. of banks
31.12.2005.						
Loss	-26.398	5	-1.896	3	-24.502	2
Profit	87.129	19	4.236	3	82.893	16
Total	60.731	24	2.340	6	58.391	18
31.12.2006.						
Loss	-7.030	5	-2.603	3	-4.427	2
Profit	95.287	18	3.134	2	92.153	16
Total	88.257	23	531	5	87.726	18
31.12.2007.						
Loss	-8.261	4	-420	1	-7.841	3
Profit	123.425	18	3.182	2	120.243	16
Total	115.164	22	2.762	3	112.402	19

Based on analytical data, as well as parameters for evaluation of achievement and profitability (level of realized financial result – profit/loss and ratios used for evaluation of profitability, productivity and effectiveness of performance, and other parameters related to evaluation of performance), we can conclude that improvement of the general profitability of the system comes from the overall increasing trend and stabilization of the banking sector, although the highest influence to this high level of realized profit comes from the financial result of several large private banks with majority foreign ownership. The state banks sector does not have any significant influence to the realized financial result and total profitability of the banking sector.

Similar to other segments, the four largest banks have dominant participation in the realized profit. These banks (assets amounting to 68% of the banking system assets) have realized profit of KM 92,3 million, representing 74,8% of total profit realized by 18 banks (KM 123,4 million). From the aspect of the financial result realized in 2006, 16 banks have reported better financial result than in 2006.

Total profit reported of KM 8,3 million refers to one state and three private banks (two banks under provisional administration).

Total income realized on the system level was KM 807 million with the growth rate of 18% or KM 124 million. If compared to 2006, the growth rate is higher by 3%. Total noninterest bearing expenses amount to KM 681 million with growth rate of 16% or KM 93 million. If compared to prior year, this growth rate is higher by 5%.

Structure of total income of banks has improved in sense of quality, through nominal and percentage based faster growth and increased participation of interest income, if compared to 2006, which has primarily influenced the growth of total income.

Total interest income at the end of 2007 amounted to KM 834 million. They were higher by 32% or KM 204 million if compared to prior year, and the growth rate realized was higher by 10% or KM 65 million than in 2006.

Interest income from loans have increased by 23% and their participation in total income of 79,2% in comparison to prior year has increased to 82,5%. Within this category, the highest participation of 55,8% have interest income from citizen credit placements, although in the loan portfolio loans originated to citizens record participation of 50,3%, based on which, we may conclude that citizen loan portfolio is still less risky than loans originated to legal entities. Interest income and similar income from loans originated to citizens also have high participation of 47,1% in total interest income, followed by income from interest and similar income on loans originated to private companies with participation of 35,5%.

Interest expenses still have faster growth than interest income. At the end of 2007, they amounted to KM 324 million, that is, the realized growth rate is 38% or KM 89 million. If compared to 2006, the growth rate is higher by 6%. Participation of interest expenses in the structure of total income has increased from 34% to 40%, and in the interest income from 37,2% to 38,8%.

Growth of interest expenses based on deposits of 30% is the result of faster growth of term and interest-bearing deposits (24%) than total deposits (22%). Increase of long term credit indebtness of banks, primarily from foreign financial institutions („mother“ banks or related banks from the group and in the financial market from other creditors) of 31%, funds of the subordinated debt of 67%, as well as increase of the benchmark interest rates, Euribor and Libor have caused the increase of interest expenses for borrowings of 58,5%. The sources of foreign financial institutions (deposits, loans, subordinated debts) are the most expensive sources for banks, since in the structure of interest-bearing sources they participate with approximately 32%, while interest expenses on the same basis represent approximately 47% of total interest-bearing expenses.

Apart from faster increase of interest expenses, if compared to the last year, interest income increased by 29% or KM 115 million, and the realized growth rate is higher by 12% or KM 48 million than last year. With the amount of KM 510 million at the end of 2007, net interest income participated in total income of 63,2%, which is significantly better than at the end of 2006, when the participation was 57,9%.

Growth of participation of interest income in total income of banks is a positive indicator of the increasing trend of quality and stability of earnings, since banks now realize more profit from their core activity, that is, their lending activity, which is at the same time demonstrating that banks in the Federation of BiH are still typical commercial banks of traditional type, more oriented on lending as their primary and dominant activity, while they are at the same time introducing and developing new banking products, such as investment banking, custody activities, etc., which are in relatively low level and it is expected in near future to see them growing.

Operating income, as second most important component of total income, has recorded slower increase than net interest income, that is, they are higher by only 3% or KM nine million at the end of 2007, amounting to KM 297 million. That is why participation of operating income in the structure of total income has decreased from 42,1% to 36,8% in comparison to 2006.

The growth rate of operating income was significantly influenced by decrease of fee income, as a result of changes in the accounting policies in the segment of treatment and recognition methodology for fee income related to loans[29].

Non-interest bearing expenses of KM 680 million increased by 16% or KM 93 million, if compared to prior year, and the realized growth rate was higher by 5%. Non-interest bearing expenses, with slight trend of decrease in participation, if compared to last year (85,9%), represent 84,3% of total income.

Within noninterest bearing expenses, salary and contribution expenses represent the highest increase of 18% or KM 34 million, which are at the same time the highest item in the structure of non-interest bearing expenses with participation of 32,3%. General loan risk and potential loan loss provisions have increased by 20% or KM 28 million with participation of 25,3% in the structure of non-interest bearing expenses.

Analysis of non-interest bearing expenses in 2007, we notice a significant increase of „head office" expenses of banks owned by foreign banking groups, which are related to mother-banks and/or members of the group. These expenses amount approximately KM 29 million and have significantly influenced the financial result of some banks.

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

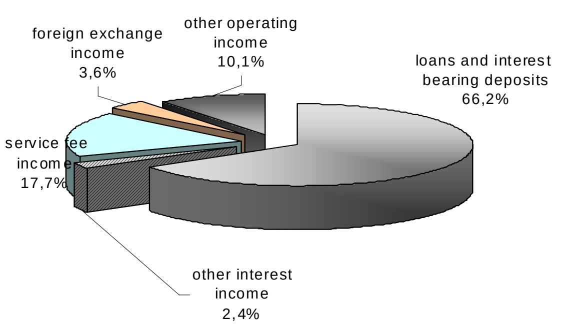
- in 000 KM-

Table 27: *Structure of total income*

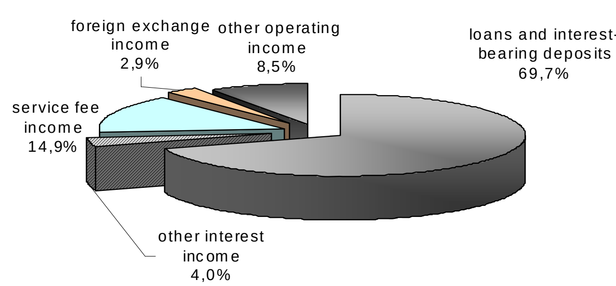
Structure of total income	31.12.2005.		31.12.2006.		31.12.2007.		RATIO	
	Amount	%	Amount	%	Amount	%	4/2	6/4
1	2	3	4	5	6	7	8	9
I Interest income and similar type of income								
Interest bearing deposit accounts with depository institutions	44.408	5,8	66.234	7,2	121.966	10,8	149	184
Loans and leasing	457.840	59,4	541.538	59,0	666.417	58,9	118	123
Other interest income	14.751	1,9	22.402	2,4	46.150	4,0	152	206
TOTAL	516.999	67,1	630.174	68,6	834.533	73,7	122	132
II Operating income								
Service fees	150.351	19,5	162.502	17,7	168.353	14,9	108	104
Foreign exchange income	30.266	3,9	32.578	3,6	33.054	2,9	108	101
Other operating income	73.397	9,5	93.030	10,1	95.577	8,5	127	103
TOTAL	254.014	32,9	288.110	31,4	296.984	26,3	113	103
TOTAL INCOME (I + II)	771.013	100,0	918.284	100,0	1.131.517	100,0	119	123

Graph 26: *Structure of total income*

31.12.2006.



31.12.2007.



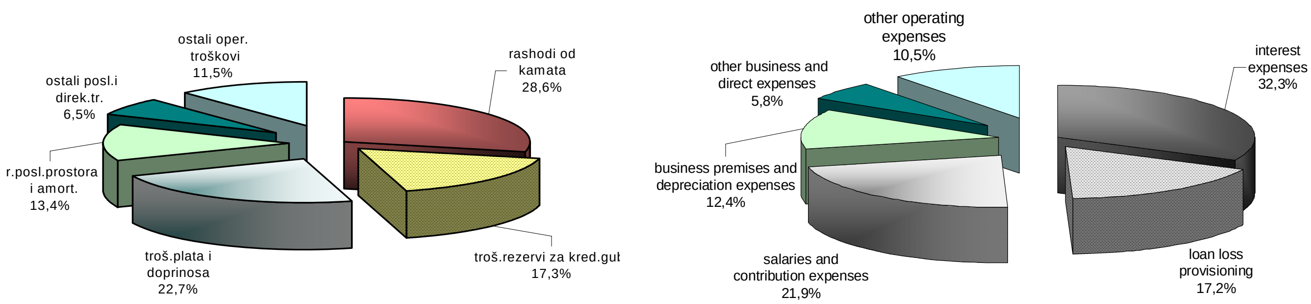
- in 000 KM-

Table 28: *Structure of total expenses*

Structure of total expenses	31.12.2005.		31.12.2006.		31.12.2007.		RATIO	
	Amount	%	Amount	%	Amount	%	4/2	6/4
1	2	3	4	5	6	7	8	9
I Interest expenses and similar expenses								
Deposits	131.063	18,6	173.231	21,1	225.465	22,5	132	130
Liabilities for borrowings	40.345	5,7	53.987	6,6	83.192	8,3	134	154
Other interest expenses	6.162	0,9	7.412	0,9	15.114	1,4	120	204
TOTAL	177.570	25,2	234.630	28,6	323.771	32,2	132	138
II Total non-interest bearing expenses								
General loan risk and potential loan losses Provisioning	130.214	18,5	143.059	17,3	172.548	17,2	109	121
Salary expenses	166.621	23,6	185.907	22,7	219.730	21,9	112	118
Business premises and depreciation expenses	97.232	13,8	110.239	13,4	124.633	12,4	113	113
Other business and direct expenses	38.684	5,5	53.615	6,5	58.260	5,8	138	109
Other operating expenses	94.836	13,5	94.451	11,5	105.553	10,5	99	112
TOTAL	527.587	74,8	587.271	71,4	680.724	67,8	111	116
TOTAL EXPENSES (I + II)	705.157	100,0	821.901	100,0	1.004.495	100,0	116	122

Graph 27: *Structure of total expenses*

31.12.2006. **31.12.2007**



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

- in %-

Table 29: *Ratios of profitability, productivity and effectiveness by periods*

RATIOS	31.12.2005.	31.12.2006.	31.12.2007.
Return on Average Assets	0,72	0,86	0,90
Return on Average Total Capital	6,31	7,95	8,45
Return on Average Equity	7,81	10,64	12,19
Net Interest Income/Average Assets	4,05	3,86	3,97
Fee Income/Average Assets	3,03	2,80	2,31
Total Income/Average Assets	7,08	6,65	6,28
Operating and Direct Expanses30/Average Assets	2,01	1,91	1,79
Operating Expenses/Average Assets	4,28	3,80	3,50
Total Non-interest Expanses/Average Assets	6,29	5,71	5,29

30 Expenses include provisions for potential loan losses.

-in %-

Table 30: *Ratios of profitability, productivity and effectiveness as of 31.12. 2007.*

RATIOS	31.12. 2007.		
	STATE BANKS	PRIVATE BANKS	AVERAGE IN THE FBiH
Return on Average Assets	0,73	0,90	0,90
Return on Average Total Capital	1,87	9,25	8,45
Return on Average Equity	2,27	13,65	12,19
Net Interest Income/Average Assets	4,35	3,96	3,97
Fee Income/Average Assets	4,48	2,24	2,31
Total Income/Average Assets	8,83	6,20	6,28
Operating and Direct Expanses/Average Assets	3,01	1,76	1,79
Operating Expenses/Average Assets	4,66	3,46	3,50
Total Non-interest Expanses/Average Assets	7,66	5,22	5,29

Analysis of some general parameters for assessment of banks' profitability indicates that the two essential indicators of profitability: ROAA (Return on Average Assets) of 0,90% and ROAE (Return on Average Equity) of 12,19 are better than in 2006.

However, productivity of banks, measured as ratio between total income and average assets (6,28%), as well as, the realized net interest-bearing and operating income per unit of average assets are still worst due to faster growth of average assets rate (25%) in relation to the growth of net interest income and operating income (18%), and decreasing trend of active interest rates and faster interest-bearing expenses.

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.

Profitability of banks in the upcoming period will depend on several factors, and as the main ones we could specify the following: assets quality, that is, banks' exposure to credit risk and related loan loss provisioning, followed by effective management and control of operating expenses, along with level and trend of off-balance sheet operations-activities carrying significant profit for banks in form of fees and commissions, while in the income structure of banking balance sheets they have almost the same participation as net interest income. That is why, the key factor of effectiveness and profitability of each bank is management quality and business policy the management is following and bank development and growth strategy, since that is the most direct way to influence its performance. Apart from the mentioned, which are specified as internal factors, we have to point out that profitability rate of the entire banking system is strongly influenced by the environment, such as macro-economic factor, that is, condition and degree of the overall economic development, especially of the real sector.

In addition, under the new market conditions, banks more adopt new concept of business policy aimed to market oriented banking in order to gain more profit, providing for bank stability and adequate management and control of all risks a bank is exposed to, and primarily credit risk. However, by entering international financial operations and market, banks in future will be more exposed to market risks: interest rate risk, foreign exchange and price risk, as well as indebtness risk, which will require further strengthening of capital base, not only from internal sources through increase of retained income from profit, but from external sources, which is at the same time a precondition for further expansion and growth of banks.

2.3. Liquidity

Liquidity risk management, along with credit risk, is one of the most compound and most important segments of banking operation. 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 trust in banking system of any country.

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' profitability.

In the structure of financing sources of banks in the Federation of BiH as of 31.12.2007., deposits and borrowings still have the highest participation of 71,7% (including subordinated debts[31]) of 14,8% with longer maturity, representing quality sources for long term placements, and have made a significant contribution to maturity adjustment between assets and liabilities. On the other hand, majority structure of deposits is considerably unfavorable, although it has been some time of improving trend.

- in 000 KM-

Table 31: *Maturity structure of deposits*

DEPOSITS	31.12.2005.		31.12.2006.		31.12.2007.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Savings and demand deposits	3.264.937	47,5	4.079.002	48,7	4.747.689	46,6	125	116
Up to 3 months	408.679	6,0	293.735	3,5	430.784	4,2	72	147
Up to 1 year	541.832	7,9	745.994	8,9	1.045.768	10,3	137	140
1. Total S-T	4.215.448	61,4	5.115.731	61,1	6.224.241	61,1	121	122
Up to 3 years	1.709.665	24,9	2.212.076	26,4	2.722.927	26,7	129	123
Over 3 years	938.935	13,7	1.051.515	12,5	1.243.809	12,2	112	118
2. Total L-T	2.648.600	38,6	3.263.591	38,9	3.966.736	38,9	123	122
TOTAL (1 + 2)	6.864.048	100,0	8.379.322	100,0	10.190.977	100,0	122	122

Analysis of maturity structure of deposits in two main groups, if compared to 2006, shows that sort term and long term deposits had the same relative increase of 22%, while nominal increase of short term deposits was KM 1,1 billion, and of long term KM 0,7 million.

Within short term deposits, if compared to 2006, the highest nominal growth of KM 669 million (growth rate of 16%) was realized by demand deposits that at he same time had the highest participation of 46,6% in total deposits, while term deposits up to 3 months had the highest growth rate (47% or KM 137 million). The highest participation in total demand deposits is still maintained by citizen deposits (36,8%) that have increased by 24% or KM 334 million in comparison to 2006.

[31] Subordinated debts: borrowings and permanent liabilities

We should emphasize that in long term deposits, there are two sectors with dominant participation: citizens of 49,2% and banking institutions of 25,6%, with moderate trend of decrease of their participation (from 28,7% to 25,6%). Citizen deposits represent the highest participation of 62% of term deposits up to 3 years (58,4% at the end of 2006), while banking institutions deposits have the highest participation of 64,4% over three years (62,9% at the end of 2006).

In the function of planning of 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 32: *Maturity structure of loans*

LOANS	31.12.2005.		31.12.2006.		31.12.2007.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Pastdue claims and paid off-balance sheet liabilities	218.177	3,9	210.852	3,1	214.234	2,4	97	102
Short term loans	1.134.850	20,5	1.360.381	19,9	1.719.297	19,4	120	126
Long term loans	4.192.050	75,6	5.248.921	77,0	6.941.472	78,2	125	132
TOTAL LOANS	5.545.077	100,0	6.820.154	100,0	8.875.003	100,0	123	130

Over the year 2007, as already mentioned, banks have significantly increased credit placements, and the realized growth rate of 30% is higher by 7% than in 2006. Long term deposits increased by 32% or KM 1.693 million (loans originated to citizens represent 56% or KM 942 million of the generated growth), and short term loans increased by 26% or KM 359 million (private companies represent 84% or KM 301 million).

Sectorial analysis by maturity indicates that long term loans represent 91,5% of total loans originated to citizens and 64,5% of loans originated to private companies, with increasing trend (62,7% at the end of 2006).

In the assets structure, as the most significant category, loans still have the highest participation of 62,5%, with constant increasing trend, which has been supported by the growth of deposits (22%) and borrowings (31%).

In 2007, banks were regularly meeting required reserves with the Central Bank of BiH.[32] Through the required reserve, as the most significant instrument of monetary policy in BiH under the Currency Board and relatively financially underdeveloped market, required reserve as the most significant instrument of monetary policy is used to meet a primary monetary purpose, that is, monetary control, in sense of stopping fast credit growth from the past years and decrease multiplications. 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 keep 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 review of the most significant ones is presented in the following table:

[32] Since 01.01.2008. the required reserve has increased to 18% (it was 15% from 01.12.2005. to 31.12.2005.).

- in % -

Table 33: *Liquidity ratios*

Ratios	31.12.2005.	31.12.2006.	31.12.2007.
1	2	3	4
Liquid assets[33] / Total assets	37,8	37,4	34,5
Liquid assets / Short term financial liabilities	63,9	62,2	58,1
Short term financial liabilities / Total financial liabilities	66,9	68,0	67,3
Loans / Deposits and borrowings[34]	69,2	69,6	73,7
Loans / Deposits, borrowings and subordinated debts[35]	68,0	68,5	72,2

In 2007, a trend of slight deterioration of general liquidity indicators quality has continued, primarily due to faster growth of credit placements. However, if compared to the year 2006, when slight changes were recorded (up to 1,5%), in the year 2007 almost all observed indicators have had negative changes between 3 and 4%. Still, we could say that liquidity position of the banking system of the Federation of BiH is good, with satisfactory participation of liquid assets in total assets and coverage of short-term liabilities by liquid assets, while structural indicator of participation of short term liabilities in total financial liabilities has slightly improved if compared to the end of 2006. The last two indicators, expressed as ratio between loans and financing sources (deposits and borrowings), are also very good and they are in accordance with feasible standard.

Regulatory requirements set towards banks are quite restrictive, which resulted by good liquidity of banks individually and the entire banking system. All banks continuously meet prescribed minimum over the average, requirement of ten-day average of 20% in relation to short-term sources, and daily minimum of 10% according to the same basis, which is presented in the following table.

- in 000 KM-

Table 34: *Liquidity position – ten-day average and daily minimum*

	31.12.2005.	31.12.2006.	31.12.2007.	RATIO	
	Amount	Amount	Amount	3/2	4/3
1	2	3	4	5	6
1. Average daily balance of cash assets	2.687.043	3.478.292	3.974.722	129	114
2. Minimum total daily balance of cash assets	2.371.336	3.201.670	3.686.972	135	115
3. Short term sources (accrual basis)	4.165.268	5.135.086	6.094.193	123	119
4.Liabilities:					
4.1. ten-day average 20% of Item 3	833.054	1.027.017	1.218.839	123	119
4.2. daily minimum 10% of Item 3	416.527	513.509	609.419	123	119
5.Meeting requirement :ten-day average					
Surplus = Item 1 – Item 4.1.	1.853.989	2.451.275	2.755.883	132	112
6. Meeting requirement :daily minimum					
Surplus = Item.2 – Item 4.2.	1.954.809	2.688.161	3.077.553	138	114

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.

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[33] Liquidity assets in the narrow sense: cash and deposits and other financial assets with maturity below three months, except inter-banking deposits.
[34] Empiric standards: below 70%-very solid, 71%-75%-satisfactory, 76%-80%-marginal to satisfactory, 81%-85%-insufficient, over 85%-critical.
[35] Prior ratio has been modified. Subordinated debts are included in the sources, which gives more realistic indicator.

- in 000 KM -

Table 35: *Maturity adjustment of financial assets and liabilities up to 180 days*

Description	31.12.2005. Amount	31.12.2006. Amount	31.12.2007. Amount	RATIO 3/2	RATIO 4/3
1	2	3	4	5	6
I. 1- 30 days					
1. Financial assets	4.051.257	5.111.643	5.685.911	126	111
2. Financial liabilities	3.668.868	4.626.466	5.291.774	126	114
3. Difference (+ or -) = 1-2	382.389	485.177	394.137	127	81
Accrual of requirement in %					
a) Performed %= Item 1 / Item 2	110,4%	110,5%	107,4 %		
b) Required minimum %	100,0%	100,0%	100,0%		
Surplus (+) or shortage (-) = a – b	10,4%	10,5%	7,4%		
II. 1-90 days					
1. Financial assets	4.559.015	5.622.709	6.291.403	123	112
2. Financial liabilities	4.150.956	5.107.109	5.957.300	123	117
3. Difference (+ or -) = 1-2	408.059	515.600	334.103	126	65
Accrual of requirement in %					
a) Performed %= Item 1 / Item.2	109,8%	110,1%	105,6%		
b) Required minimum %	100,0%	100,0%	100,0%		
Surplus (+) or shortage (-) = a – b	9,8%	10,1%	5,6%		
II. 1-180 days					
1. Financial assets	5.091.381	6.245.949	7.039.638	123	113
2. Financial liabilities	4.598.836	5.662.698	6.861.962	123	121
3. Difference (+ or -) = 1-2	492.545	583.251	177.676	118	30
Accrual of requirement in %					
a) Performed %= Item 1 / Item.2	110,7%	110,3%	102,6%		
b) Required minimum %	95,0%	95,0%	95,0%		
Surplus (+) or shortage (-) = a – b	15,7%	15,3%	7,6%		

Based on the above presented, we may conclude that as of 31.12.2007., banks were compliant with the prescribed limits, and have realized better maturity adjustment between financial assets and liabilities in relation to the prescribed limits, but still slightly deteriorated if compared to the end of 2006. The main reason is stronger growth of credit placements (long term primarily) in 2007.

Liquidity of the banking system of the Federation of BiH, based on the presented indicators, is satisfactory, which is a result of existing restrictive regulation. Since this segment of performance and level of liquidity risk exposure is in correlation with credit risk, while having in mind increasing trend and level of credit risk, banks will in future have to pay more attention to liquidity risk management through establishment and implementation of 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 examination in banks, monitor how banks manage this risk and if they acted in accordance with the adopted policies and programs.

2.4. Foreign exchange risk – foreign currency adjustment of balance sheet assets and liabilities and off-balance sheet

While operating 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 these risks is foreign exchange risk (FX) created as a result of changes of exchange rates and/or 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 – total 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 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.[36]

Banks daily report to the FBA as part of the monitoring of prescribed limits. 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 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 31.12.2007., currency structure of banks' assets on the level of banking system recorded participation of items in foreign currencies of 15,6% or KM 2,2 billion (20,8% or KM 2,4 billion at the end of 2006). On the other hand, currency structure of liabilities is essentially different, since participation of liabilities in foreign currency is significantly higher of 53,9% or KM 7,6 billion (53,5% or KM 6,2 billion at the end of 2006).
The following table presents structure and trend of financial assets and liabilities and foreign currency position for EUR as the most significant currency[37] and total: -in KM millions-

Table 36: *Foreign currency adjustment of financial assets and liabilities (EUR and total)*

Description	31.12.2006.				31.12.2007.				RATIO	
	EUR		TOTAL		EUR		TOTAL		EUR	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	1.335	21,5	1.876	27,2	1.330	17,7	1.882	22,3	100	100
2. Loans	325	5,2	376	5,5	157	2,1	205	2,4	48	55
3.Loans with currency clause	4.434	71,4	4.507	65,3	5.910	78,9	6.233	73,8	133	138
4. Other	117	1,9	138	2,0	98	1,3	130	1,5	84	94
Total (1+2+3+4)	6.211	100,0	6.897	100,0	7.495	100,00	8.450	100,00	121	123
II. Financial liabilities										
1. Deposits	3.951	68,5	4.576	71,1	4.632	65,8	5.518	69,0	117	121
2. Borrowings	1.327	23,0	1.362	21,1	1.752	24,9	1.806	22,6	132	133
3.Deposits and loans with currency clause	284	4,9	284	4,4	341	4,8	341	4,3	120	120
4.Other	208	3,6	218	3,4	315	4,5	325	4,1	151	149
Total (1+2+3+4)	5.770	100,0	6.440	100,0	7.040	100,00	7.990	100,00	122	124
III. Off-balance sheet										
1.Assets	16		20		38		41			
2.Liabilities	377		380		429		431			
IV.Position										
Long (amount)	79		97		64		70			
%	7,3%		8,9%		4,8%		5,2%			
Short										
%										
Limit	30%		30%		30%		30%			
Below limit	22,7%		21,1%		25,2%		24,8%			

[36] 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 bank up to 30%.
[37] Source: Form 5-Foreign currency position.

If we analyze the structure of foreign currencies, we see a dominant participation of EUR in the financial assets[38], which in 2007 was increased by 2,9 index points (from 74,4% to 71,5%), along with decrease of nominal amount from 1,8 billion to 1,6 billion. Participation of EUR in the liabilities has also decreased from 89,1% to 87,6%, even there has been increase of nominal amount from KM 5,5 billion to KM 6,7 billion.

However, calculation of the FX risk exposure also includes the amount of indexed assets items (loans) and liabilities[39], which is especially important in the assets (73,8% or KM 6,2 billion) with continuous increasing trend, which is partially the result of the increase of foreign borrowings as financing source in bank's liabilities structure that is becoming more important. Other foreign currency assets items represent 26,2% or KM 2,2 billion, of which EUR items make 18,7% or KM 1,6 billion, and other currencies 7,5% or KM 0,6 billion (at the end of 2006, loans contracted with currency clause amounted to KM 4,5 billion with participation of 65,3%, and other items in EUR of 25,8% or KM 1,8 billion). Of total net loans (KM 8,5 billion), 73% were contracted with currency clause (69% at the end of 2006), primarily tied to EUR (95%).

On the other hand, the structure of financial liabilities stipulates and determines the structure of financial assets, for each currency respectively. Items in EUR (primarily deposits) had the highest participation in foreign currency liabilities (KM 8 billion) of 83,8% or KM 6,7 billion, while participation and amount of indexed liabilities was at minimum, amounting to 4,3% or KM 0,3 billion (at the end of 2006, participation of liabilities in EUR was 85,2% or KM 5,5 billion, and indexed liabilities were 4,4% or KM 0,3 billion).

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 in 2007 ranged within the prescribed limits. However, if compared to 2006, it has improved due to increase of core capital of 24%.

As of 31.12.2007., there were 15 banks with long foreign currency position, and 7 with short position, so on the system level long foreign currency position represented 5,2% of banks' core capital, which is lower by 24,8% than the limit. Individual foreign currency position for EUR was 4,8% where financial assets items were higher than financial liabilities (long position), which is lower by 25,2% 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.

[38] 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).
[39] 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).

IV. CONCLUSION

Consolidation and stabilization of banking sector of the Federation of BiH has reached an enviable level and upcoming activities should provide for further progress and development of the system. This implies a continuous engagement of all parts of the system, legislative and executive authorities in order to provide for the most favorable environment in economy, which would be stimulating to both banks and the economy.

In other to meet such goals, it is necessary to have further involvement of authorized institutions and bodies of Bosnia and Herzegovina and the Federation of BiH in order to:

- Realize the conclusion made by the Federation of BiH Parliament to establish banking supervision on state level;
- Finalize privatization process of two state banks;
- Initiate acceleration of the appointment process for the FBA Managing Board and management members;
- Define and build on regulation for financial sector related to the activity, status and performance of micro-credit organizations, leasing companies, insurance companies, transition of Investment Bank of the Federation of BiH d.d. Sarajevo into Development Bank, etc.;
- Accelerate implementation of economic reform in the real sector in order to reach the level of monetary and banking sector;
- Based on a documented material, specialized and professionally processed in the Banks Association of BiH, and through the Ministry of Finance of the Federation of BiH, it is necessary to accelerate the activities in order to:
    - Continuously build on legal regulation for banking sector and financial system based on Basle Principles and 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.

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

- Continue, as so far, implementing activities, from the scope of its authority, related to consolidation of supervision on state level,
- Proceed with a continues supervision of banks through on-site and off-site examinations, emphasizing targeted examination of dominant risk segments of banking operations, which will make supervision more effective and in that regard to:
    - Continue systematic monitoring of banks' activities in prevention of money laundering and terrorism financing and improve cooperation with other supervisory and examination institutions,
    - Persist on capital strengthening of banks, especially those recording outstanding assets growth,
    - Continue permanent monitoring of banks with the highest concentration of savings and other deposits in order to protect depositors,
    - Continue working on development of regulation based on the Basle Principles and European Directives as part of preparation to join the European Union,
    - Maintain continuity in payment system examinations,

  - 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, etc.,
- Continuous operational development of the new IT system for early warning and prevention in elimination of weaknesses in banks,
- Work on continuous education and training of staff,
- Finalize remaining provisional administrations and liquidations based on the conclusion made by the Management Board as of 29. 03. 2006.

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

- Further capital strengthening, proportional to the growth of assets and risk, higher profitability, solvency, 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 establish internal audits, which will be fully independent in their work,
- Constant improvement of cooperation with the Banks Association in the area of professional development, change all laws and regulations which have become a limiting factor in bank development, introduction of new products, collection of claims and active involvement in the establishment of unified registry of irregular debtors – legal entities and individuals;
- Regular and updated submission of data to the Central Loan Registry and Unified Central Account Registry with the Central Bank of BiH.

ATTACHMENTS

ATTACHMENT 1

Banks in the Federation of BiH as of 31.12.2007.

Ord .No.	BANK	Address		Telephone	Director
1	ABS BANKA dd - SARAJEVO	Sarajevo	Trampina 12/VI	033/277-060, fax:667-674	ZUKIĆ ADNAN
2	BOSNA BANK INTERNATIONAL dd - SARAJEVO	Sarajevo	Trg djece Sarajeva bb	033/275-100, fax:472-159	AMER BUKVIĆ
3	BOR BANKA dd - SARAJEVO	Sarajevo	Obala Kulina bana 18	033/663-500, fax:278-550	HAMID PRŠEŠ
4	FIMA BANKA dd - SARAJEVO	Sarajevo	Kolodvorska br. 5.	033/720-070, fax:720-100	EDIN MUFTIĆ
5	HERCEGOVAČKA BANKA dd MOSTAR	Mostar	Kneza Domagoja bb.	036/332-901, fax:332-908	Prov.Admin. - Nikola Fabijanić - 16.04.2007.
6	HVB CENTRAL PROFIT BANKA d.d. - SARAJEVO	Sarajevo	Zelenih beretki 24	033/533-688, fax:532-319	ZVONIMIR JURJEVIĆ
7	HYPO ALPE-ADRIA-BANK dd - MOSTAR	Mostar	Kneza Branimira 2b	036/444-200, fax:444-235	PETAR JURČIĆ
8	INVESTICIJSKA BANKA FEDERACIJE BIH	Sarajevo	Paromlinska bb	033/277-900, fax:668-952	RAMIZ DŽAFEROVIĆ
9	INVESTICIONO-KOMERCIJALNA BANKA dd - ZENICA	Zenica	Trg B&H 1	032/401-804, fax:246-187	Acting Director - SUVAD IBRANOVIĆ
10	KOMERCIJALNO-INVESTICIONA BANKA DD V.KLADUŠA	V.Kladuša	Ibrahima Mržljaka 3.	037/771-253, fax:772-416	HASAN PORČIĆ
11	NLB TUZLANSKA BANKA dd - TUZLA	Tuzla	Maršala Tita 34	035/259-259, fax:250-596	ALMIR ŠAHINPAŠIĆ
12	POŠTANSKA BANKA BiH - SARAJEVO	Sarajevo	Branilaca Sarajeva 20/XI	033/212-993, fax:210-007	DŽENAMIR ABAZA
13	PRIVREDNA BANKA SARAJEVO dd - SARAJEVO	Sarajevo	Alipašina 6	033/277-700, fax:277-798	Prov. Admin. – Maruf Burnazović - 17.07.2006.
14	PROCREDIT BANK dd - SARAJEVO	Sarajevo	Emerika Bluma 8.	033/250-950, fax:250-971	PETER MÖLDERS
15	RAIFFEISEN BANK dd BiH - SARAJEVO	Sarajevo	Danijela Ozme 3	033/287-100, fax: 213-851	MICHAEL MÜLLER
16	TURKISH ZIRAAT BANK BOSNIA dd - SARAJEVO	Sarajevo	Ferhadija 29	033/254-050, fax: 254-051	KENAN BOZKURT
17	UNA BANKA dd - BIHAĆ	Bihać	Bosanska 25	037/322-400, fax: 322-331	Prov. Admin. - Stjepan Blagović - 01.05.2005.
18	UNICREDIT ZAGREBAČKA BANKA dd – MOSTAR	Mostar	Kardinala Stepinca bb	036/312-121, fax:312-123	BERISLAV KUTLE
19	UNION BANKA dd - SARAJEVO	Sarajevo	Dubrovačka 6	033/561-000, fax: 201-567	ESAD BEKTEŠEVIĆ
20	UPI BANKA dd – SARAJEVO	Sarajevo	Obala Kulina bana 9a.	033/497-555, fax:497-589	ALMIR KRKALIĆ
21	VAKUFSKA BANKA dd - SARAJEVO	Sarajevo	M. Tita 13.	033/280-100, fax: 663-399	AMIR RIZVANOVIĆ
22	VOLKSBANK BH dd - SARAJEVO	Sarajevo	Fra Anđela Zvizdovića 1	033/295-601, fax:295-603	REINHOLD KOLLAND

ATTACHMENT 2

CORE (BASLE) PRINCIPLES OF EFFECTIVE BANK SUPERVISION AND THEIR IMPLEMENTATION IN THE FEDERATION OF BiH

Preconditions for Effective Supervision

Principle 1: *An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.*

Implementation: Regulation in the FBiH has been complied with and applied in sense of this Principle. Supervision has its clear role and duty. Legal framework has enabled existence of an independent and self-financing Agency. Full compliance with the Basle Principles was reached in 2002 when the High Representative had passed Law on Changes and Amendments to the Law on Banking Agency of the FBiH that regulated "limited immunity" of the FBA, its Management Board and its employees. Implementation of the Changes and Amendments to the Law on Banks started at the beginning of 2003 (adopted in August of 2002), including the entire sub-legislation that was prepared and adopted by the Agency with a full respect of the Basle Principles and European Directive.

Licensing and Ownership Structures

Principle 2: *The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.*

Implementation: Activities of banks and limited use of the word "bank" are defined by the Law on Banks. The regulation is fully complied with this Principle.

Principle 3: *The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.*

Implementation: Pursuant to the Law on Banks, the FBA has right to set criteria and reject applications for establishment of banks. The FBA has adopted Guidelines on Licensing and Other Approvals issued by the Banking Agency of the Federation of Bosnia and Herzegovina. The Guidelines is fully complied with this Principle and is consistently applied.

Principle 4: *Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other (new) parties.*

Implementation: In the banking sector of the FBiH, there is full compliance with this Principle and its implementation. According to the Law, no significant ownership right in a bank over the thresholds of 10, 33, 50 and 66,7 % may be acquired or increased without prior approval issued by the FBA that has a sufficient authority and it has determined the procedure necessary for implementation of the Law and the Principle, which has been standardized in a special Guidelines that is strictly applied.

Principle 5: *Banking supervisors must have the authority to establish the criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.*

Implementation: This Principle has been covered by the Law on Banks and Decisions of the FBA, and regulation and practice have been complied with it.

Prudential and Safety Regulations and Requirements

Principle 6: *Banking Supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these requirements must not be less than those established in the Basle Capital Accord and its amendments.*

Implementation: The Law and the FBA's Decision on Minimum Standards for Capital Management in Banks define capital components and the way of its management. The requirements are consistent with the Basle Principles and corresponding European Directive. However, interest rate risk and price risk as part of the market risks have to be developed further more. Within the market risks, special attention was dedicated to the regulation of foreign exchange risk. The activities are underway to develop the regulation in order to reach a full compliance with this Principle.

Principle 7: *As essential part of any supervisory system is the independent evaluation of a bank's policies, practices, and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolio.*

Implementation: Starting with collateral as the key element, Decision on Minimum Standards for Credit Risk Management and Assets Classification and Decision on Minimum Standards for Internal and External Audit, as adopted by the FBA, represent the most compound regulations, specifying assets classification in details. Based on these decisions, banks are required to perform audit of all risk areas. However, we have noted in some banks that internal auditors are not independent in their work (under influence of the supervisory board members and management of banks), so in some cases banks have good policies, but are not acting upon them. In some cases external audit firms do not perform their job correctly. Although there are good regulatory frameworks for evaluation of credit and investment risks, there are still occasional problems with their compliance. We could say that the practice is largely compliant with Principle 7. The FBA will continue monitoring the work of internal controls and external auditors, and, if necessary, take adequate measures.

Principle 8: *Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices, and procedures for evaluating the quality of assets and the adequacy of loan loss provisions and reserves.*

Implementation: Regulatory framework for adequate policies, practices and procedures are in compliance with this Principle. In the implementation, banks do not always fully adhere with the laws and regulations. The FBA has been determined in exercising its authority and it has sanctioned the omissions which have resulted by a significant improvement in these areas. The activities will be continued to full compliance with this Principle.

Principle 9: *Banking supervisors must be satisfied that banks have a management information system that enables management to identify concentrations within the portfolio and supervisors must set prudential limits to restrict bank exposures to single borrowers or groups of related borrowers.*

Implementation: The FBA's Decision on Minimum Standards for Risk Concentration Management sets in details the limits of credit risk exposures and defines related entities of banks, starting with the standards as determined by the Law. Respective the framework set by the Law, the FBA has accepted the initiative of banks and it developed in details the criteria to specify related entities of banks as entities with at least 5% of total number of bank's shares. By doing so, we have precisely set the limits as established by this Principle. The FBA was persistent in implementing this Decision. As a result, we have decreased number of lending to the entities related with a bank and the entities related to bank's shareholders, that is, decreased risk on this basis.

Principle 10: *In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arm's-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.*

Implementation: Implementation of the existing provisions of the Law and regulations of the FBA is sufficient to prevent abuses arising from connected lending. In general, similar situations would end up as provisional administrations, liquidations or bankruptcies of banks. In order to enable a full compliance, we have intensified examinations of banks with these issues.

Principle 11: *Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.*

Implementation: While the Law on Banks does not specify in details country risk, the FBA's Decision on Minimum Standards for Foreign Exchange Risk Management sets adequate limits. There is no regular process for evaluation of country risk. Although, for now, there are no banks in the Federation that considerably originate loans or investments outside the country, the FBA is gradually preparing corresponding regulation for future reference.

Principle 12: *Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor and adequately control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.*

Implementation: Changes and Amendments to the Law on Banks and corresponding Decision of the FBA create opportunity for introduction of specific limits and more severe capital requirements when assessed that level of risk exposures requires so. It should be taken into account that our financial market is still emerging, so there are no explicit requirements that banks create policies and procedures for securities and financial derivatives trading. The FBA is working on additional regulation, including necessary education of staff to be ready for challenges that development of the financial market will bring.

Principle 13: *Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure and control all other material risks and where appropriate, to hold capital against these risks.*

Implementation: Our banking system is reflecting dominance of traditional risks, so the FBA has been primarily occupied with credit risk. However, losses may arise in the non-traditional areas, which is more present through development of banking (market risks, money laundering, etc.). The FBA has adopted corresponding regulation for prevention of money laundering and terrorism financing in accordance with the Basle and FATF Recommendations. The emphasis will be aimed at risk management in all areas of the activities of supervisory institutions, while the FBA will continue building on the regulation in accordance with the European Directives. Apart from already regulated, core and supplementary capital, the third category of capital will be added to cover market risks.

Principle 14: *Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets; and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.*

Implementation: Internal control and audit function in all banks. However, this function is still not at optimum level. Pursuant to the Law, the FBA has passed Decision on Minimum Standards for Internal Control in Banks and Decision on Minimum Standards for Internal and External Audit in Banks. The FBA is monitoring implementation of these decisions and is taking appropriate measures.

Principle 15*: *Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict "know-your-customer" rules that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.

Implementation: Through the Decision on Minimum Standards for Banks' Activities in Prevention of Money Laundering and Terrorism Financing the FBA has introduced the rule "know-your-customer". Banks apply this Decision, and the FBA examiners are part of permanent education aimed to eliminate financial crime. Cooperation with other institutions is improved; some concrete achievements are made; penalty measures are sentenced; preventive actions are improved; changes to appropriate laws specify money laundering as criminal act. Preparation of changes to the law is underway, which will regulate this area better and be fully complied with the European Directive.

Methods of Continued Bank Supervision

Principle 16: *An effective banking supervisory system should consist of some form of both on-site and off-site supervision.*

Implementation: Since its establishment, both forms of supervision have been present in the FBA (on – site and off – site) with good coordination. The FBA has developed procedure for evaluation of risk in banks that are fully compliant with this Principle. Special manual, „guide"for on-site examination has been prepared in accordance with the international standards.

Principle 17: *Banking supervisors must have regular contact with bank management and a thorough understanding of the institutions' operations.*

Implementation: The FBA maintains contacts with banks. Foundation of Bankers Association has created opportunity for effective and quality communication. Unfortunately, the FBA has been preoccupied with the inherited problems, such as implementation of provisional administrations, follow-up procedures, liquidation processes, etc. Decreased number of banks, that is, „elimination" from the system of problem institutions, create en essential precondition for full implementation of this Principle.

Principle 18*: *Banking supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.

Implementation: Except for the area of examination of the consolidated balance sheets, the information prepared by the FBA is sufficient and complete.

Principle 19: *Banking supervisors must have a means of independent validation of supervisory information either through on-site examinations or use of external auditors.*

Implementation: There are no obstacles for full implementation of this Principle. The FBA is able to perform full validation and this represents a significant part of its activities. It is necessary to continue promoting international accounting and audit standards in order to eliminate deviations and inaccuracies in the banks' statements, to unify the statements and require from audit firms to act upon them.

Principle 20: *An essential element of banking supervision is the ability of supervisors to supervise the banking group on a consolidated basis.*

Implementation: This issue is becoming more pressing in our banking system. Preparations for adoption of corresponding regulation are underway and this Principle will be adequately applied.

Necessary Information

Principle 21: *Banking supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.*

Implementation: Pursuant to the applicable legislative provisions, banks are obliged to publish in media an abbreviated version of external audit report about annual financial statements and non-audited semiannual financial statements. Banks fulfill this commitment, which is essentially improving transparency of the banking sector, while as a result we have further strengthening of financial discipline and a consolidate trust in banks.

Official Supervisory Authorities

Principle 22: *Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.*

Implementation: The Law specifies necessary authority of the FBA. Emphasis of the activities should be moved to "proactive" approach in order to prevent crisis situations that, according to the worldwide experience, could not be avoided, regardless of frequency and quality of supervision.

Cross-Border Banking

Principle 23: *Banking supervisors must practice global consolidated supervision over their internationally active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.*

Principle 24: *A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.*

Principle 25: *Banking supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required of domestic institutions and must have powers to share information needed by the home country supervisors of those banks for the purpose of carrying out consolidated supervision.*

Implementation: There are no real "internationally active" banking institutions in the Federation of BiH, but we could expect in the upcoming period expansion of some banks in the neighboring market. The Principles are, for now, not applicable. Activities that have been undertaken are underway: Memorandums of Understanding have been signed with Bank of Slovenia and National Bank of Croatia, while preparation of similar documents with supervisory authorities of Austria, Turkey and Italy is in process.
Information exchange has been agreed with Bank of Slovenia and National Bank of Croatia, and similar arrangements exist with other countries whose investors have entered the banking sector in the Federation of BiH.

ATTACHMENT 3

LEGAL FRAMEWORK OF THE BANKING AGENCY OF THE FBiH AND BANKS AND MICROCREDIT ORGANIZATIONS IN THE FEDERATION OF BIH

Laws of BiH

1. Law on Central Bank of BiH ("Official Gazette of BiH", number 1/97, 29/02, 13/03, 14/03, 9/05, 76/06),
2. Law on Administrative Procedure ("Official Gazette of BiH", number 29/02 and 12/04),
3. Law on Court of Bosnia and Herzegovina («Official Gazette of BiH», number 29/00, 16/02, 24/02, 3/02, 37/03, 4/04 and 9/04),
4. Law on Conflict of Interests in Government Institutions of Bosnia and Herzegovina («Official Gazette of BiH», number 16/02 and 12/04),
5. Law on Violations of Bosnia and Herzegovina («Official Gazette of BiH», number 20/04),
6. Conclusion on Authentic Interpretation of Laws, Regulations and General Enactment («Official Gazette of BiH», number 24/04),
7. Law on Criminal Proceeding of Bosnia and Herzegovina («Official Gazette of BiH», 36/03, 26/04 and 76/06),
8. Roof Law on Pledges («Official Gazette of BiH», number 27/04 and 54/04),
9. Law on Prevention of Money Laundering («Official Gazette of BiH», number 29/04),
10. Law on Prosecution of Bosnia and Herzegovina («Official Gazette of BiH», number 42/03, 9/04 and 35/04),
11. Law on Civil Proceeding in front of the Court of Bosnia and Herzegovina («Official Gazette of BiH», number 36/04),
12. Law on Civil Proceeding («Official Gazette of BiH», number 53/03),
13. Law on Mediation Proceeding («Official Gazette of BiH», number 37/04),
14. Law on Accounting and Audit of Bosnia and Herzegovina («Official Gazette of BiH», number 42/04),
15. Law on Deposit Insurance in BiH («Official Gazette of BiH», number 20/02 and 18/05),
16. Law on Temporary Suspension of Realization of Claims based on Executive Decisions against Budget of the Institutions of Bosnia and Herzegovina and International Liabilities of Bosnia and Herzegovina («Official Gazette of BiH», number 43/03 and 43/04),
17. Law on Treasury of the Institutions of BiH («Official Gazette of BiH», number 27/00),
18. Law on Public Supplies of BiH («Official Gazette of BiH», number: 49/04, 19/05, 52/05, 24/06 and 70/06);
19. Law on Consumer Protection in BiH («Official Gazette of BiH», number: 25/06);
20. Law on Repayment of Liabilities based on Old Foreign Currency Savings («Official Gazette of BiH», number: 28/06 and 76/06);

Laws of the F BiH

1. Law on Banking Agency of the Federation of BiH ("Official Gazette of the FBiH", number 9/96, 27/98, 20/00, 45/00, 58/02, 13/03, 19/03, 47/06, 59/06)
2. Law on Banks ("Official Gazette of the FBiH", number 39/98,32/00, 48/01, 27/02, 41/02 and 58/02, 13/03, 19/03 and 28/03),
3. Law on Financial Operations ("Official Gazette of the FBiH", number 2/95, 13/00 and 29/00),
4. Law on Foreign Exchange Operations ("Official Gazette of the FBiH", number 35/98),
5. Law on Securities ("Official Gazette of the FBiH", number 39/98 and 36/99),
6. Law on Securities Registry ("Official Gazette of the FBiH", number 39/98 and 36/99),
7. Law on Securities Commission ("Official Gazette of the FBiH", number 39/98 and 36/99),
8. Law on Bill of Exchange ("Official Gazette of the FBiH", number 32/00 and 28/03),
9. Law on Check ("Official Gazette of the FBiH", number 32/00),
10. Law on Payment Transactions ("Official Gazette of the FBiH", number 32/00 and 28/03),
11. Law on Obligations ("Official Gazette of the FBiH", number 29/03),
12. Law on Enterprises ("Official Gazette of the FBiH", number 23/99, 45/00, 2/02, 6/02-correction and 29/03 and 68/05),
13. Law on Bankruptcy ("Official Gazette of the FBiH", number 29/03, 32/04, 42/06),

14. Law on Liquidation Process ("Official Gazette of the FBiH", number 29/03),
15. Labor Law ("Official Gazette of the FBiH", number 43/99, 32/00 and 29/03),
16. Law on Executive Procedure ("Official Gazette of the FBiH", number 32/03, 33/06, 39/06),
17. Law on Civil Proceeding ("Official Gazette of the F BiH", number: 53/03 and 19/06),
18. Law on Opening Balance Sheet of Enterprises and Banks ("Official Gazette of the F BiH", number: 12/98, 40/99, 47/06),
19. Law on Registration of Legal Entities into Court Registry ("Official Gazette of the FBiH", number 4/00, 19/00, 49/00, 32/02, 58/01, 13/03, 19/03 and 50/03),
20. Law on Administrative Procedure («Official Gazette of the FBiH», number 2/98 and 48/99),
21. Law on Violations subject to the FBiH ("Official Gazette of the FBiH", number 31/06),
22. Law on Treasury of the FBiH ("Official Gazette of the FBiH", number 19/03),
23. Law on Accounting and Audit of the FBiH ("Official Gazette of the FBiH", number 32/05),
24. Law on Competition ("Official Gazette of the FBiH", number 48/05),
25. Law on Assumption of Shareholder Companies («Official Gazette of the FBiH», number 7/06).
26. Law on Microcredit Organizations ("Official Gazette of the F BiH", number 59/06)

DECISION OF THE BANKING AGENCY OF THE FEDERATION OF BIH REGULATING WORK OF BANKS

1. Decision on Bank Supervision and Actions of the Banking Agency of the Federation of BiH ("Official Gazette of the F BiH", number 3/03);
2. Decision on Minimum Standards for Capital Management in Banks ("Official Gazette of the F BiH", number 3/03, 18/03, 53/06, 55/07, 81/07, 6/08);
3. Decision on Minimum Standards for Loan Risk and Assets Classification Management in Banks ("Official Gazette of the FBiH", number 3/03, 54/04, 68/05);
4. Decision on Minimum Standards for Risk Concentration Management in Banks ("Official Gazette of the F BiH", number 3/03, 6/03 correct., 18/03, 64/03, 1/06);
5. Decision on Minimum Standards for Liquidity Risk Management in Banks ("Official Gazette of the F BiH", number 3/03, 12/04, 88/07, 6/08);
6. Decision on Minimum Standards for Foreign Exchange Risk Management in Banks ("Official Gazette of the F BiH", number 3/03, 31/03, 64/03, 54/04);
7. Decision on Minimum Standards for Activities of Banks in Prevention of Money Laundering and Terrorism Financing ("Official Gazette of the F BiH", number 3/03, 18/04, 5/05, 13/05);
8. Decision on Financial Disclaimer ("Official Gazette of the F BiH", number 3/03);
9. Decision on Minimum Standards for Operations with Related Entities in Banks ("Official Gazette of the F BiH", number 3/03);
10. Decision on Minimum Standards for Documenting Loan Activities in Banks ("Official Gazette of the F BiH", number 3/03);
11. Decision on Minimum Standards for Internal Control System in Banks ("Official Gazette of the F BiH", number 3/03);
12. Decision on Minimum Standards for Internal and External Audit in Banks ("Official Gazette of the F BiH", number 3/03);
13. Decision on Conditions when Bank is Considered Insolvent ("Official Gazette of the F BiH", number 3/03);
14. Decision on Procedure for Determination of Claims and Distribution of Assets and Liabilities in Liquidation of Banks ("Official Gazette of the F BiH", number 3/03);
15. Decision on Reporting Forms Submitted by Banks to the Banking Agency of the Federation of BiH ("Official Gazette of the F BiH", number 3/03, 18/03, 52/03, 64/03 correct., 6/04, 14/04, 54/04, 5/05, 43/07, 55/07, 81/07, 88/07, 6/08);
16. Decision on Reporting about Non-performing Customers Considered a Special Loan Risk ("Official Gazette of the F BiH", number 3/03);
17. Decision on Minimum Scope in Form and Content of Program and Reporting about Economic-Financial Audit in Banks ("Official Gazette of the F BiH", number 3/03, 64/03);
18. Internal Rating Criteria of Banks performed by the Banking Agency of the Federation of BiH ("Official Gazette of the F BiH", number 3/03, 6/03 correct.);
19. Decision on Interest and Fee Accrual for Dormant Accounts ("Official Gazette of the F BiH", number 7/03);

20. Decision on Amount and Conditions for Origination of Loans to Bank Employees ("Official Gazette of the F BiH", number 7/03);
21. Guidelines for Licensing and Other Approvals Issued by the Banking Agency of the Federation of the F BiH ", number 46/02, 18/03, 27/04, 6/08 changes and cleaned text);
22. Decision on Minimum Standards for Market Risks Management in Banks (**"**Official Gazette of the Federation of BiH", number: 55/07, 81/07);
23. Decision on Unified Accrual and Declaration of Effective Interest Rate on Loans and Deposits (**"**Official Gazette of the Federation of BiH", number 27/07);
24. Decision on Minimum Standards for Operating Risk Management in Banks („Official Gazette of the FBiH", number: 6/08).

DECISIONS OF THE BANKING AGENCY OF THE FEDERATION OF BIH REGULATING WORK OF MICROCREDIT ORGANIZATIONS

1. Decision on Requirements and Procedure for Issuance of License to Microcredit Foundations Created as a Result of Changed Form of Microcredit Organizations („Official Gazette of the Federation of Bah", number: 27/07);
2. Decision on Requirements and Procedure for Issuance and Revoking of License and Other Approvals to Microcredit Organizations („Official Gazette of the Federation of BiH", number: 27/07);
3. Decision on Requirements and Procedure for Issuance of License and Consent to Acquire Ownership Share by Investing and Transferring Property of Microcredit Foundation („Official Gazette of the Federation of BiH", number: 27/07);
4. Decision on Supervision of Microcredit Organizations („Official Gazette of the Federation of BiH", number: 27/07);
5. Decision on Form and Content of Reports Microcredit Organizations Submit to the Banking Agency of the Federation of BiH and Reporting Deadlines („Official Gazette of the Federation of BiH", number: 27/07);
6. Decision on Level and Method of Establishing and Maintaining Loan Loss Reserves of Microcredit Organizations („Official Gazette of the Federation of BiH", number: 27/07);
7. Decision on Other General Requirements for Microcredit Organizations („Official Gazette of the Federation of BiH", number: 27/07);
8. Decision on Fees Microcredit Organizations Pay to the Banking Agency of the Federation of BiH („Official Gazette of the Federation of BiH", number: 27/07);
9. Decision on Unified Method of Accrual and Declaration of Effective Interest rate on Loans and Deposits („Official Gazette of the Federation of BiH", number: 27/07).

ATTACHMENT 4

BALANCE SHEET OF BANKS IN THE FBiH - FBA SCHEDULE

ACTIVE SUB-BALANCE SHEET

in 000 KM

Ord. No.	DESCRIPTION	31.12.2005.	31.12.2006.	31.12.2007.
	ASSETS			
1.	Cash funds and deposit accounts at depository institutions	3.533.700	4.286.202	4.895.107
1a	Cash and non-interest deposit accounts	1.167.310	1.514.758	349.375
1b	Interest deposit accounts	2.366.390	2.771.444	4.545.732
2.	Trading securities	13.625	41.121	44.361
3.	Placements in other banks	68.811	105.390	69.314
4.	Loans, receivables in leasing and past due receivables	5.545.077	6.820.154	8.875.003
4a	Loans	5.326.708	6.609.122	8.660.601
4b	Receivables on leasing	192	180	168
4c	Past due receivables - loans and leasing	218.177	210.852	214.234
5.	Securities held until maturity	6.385	4.801	4.204
6.	Premises and other fixed assets	275.276	314.012	364.721
7.	Other real estate	31.361	27.659	41.846
8.	Investments in non-consolidated related enterprises	28.750	27.679	34.387
9.	Other assets	154.222	170.492	217.712
10.	MINUS: Reserves for potential losses	278.499	299.155	343.148
10a	Reserves on item 4 in Assets	260.155	288.433	329.875
10b	Reserves on Assets except item 4	18.344	10.722	13.273
11.	**TOTAL ASSETS**	**9.378.708**	**11.498.355**	**14.203.507**
	LIABILITIES			
12.	Deposits	6.864.048	8.379.322	10.190.977
12a	Interest deposits	6.114.978	7.529.517	9.368.276
12b	Non-interest deposits	749.070	849.805	822.701
13.	Loans - past due	8.308	7.802	7.376
13a	Balance of payable loans, unpaid	0	0	0
13b	Unpaid - called for payment off-balance sheet items	8.308	7.802	7.376
14.	Loans from other banks	2.912	2.890	3.289
15.	Payables to Government	0	0	0
16.	Payables on loans and other borrowings	1.152.910	1.420.944	1.856.471
16a	payable within one year	241.955	196.381	357.425
16b	payable longer than one year	910.955	1.224.563	1.499.046
17.	Subordinated debts and subordinated bonds	132.429	145.079	242.791
18.	Other liabilities	201.384	315.733	384.585
19.	**TOTAL LIABILITIES**	**8.361.991**	**10.271.770**	**12.685.489**
	CAPITAL			
20.	Permanent priority shares	26.280	30.180	26.224
21.	Common shares	773.205	858.610	1.018.997
22.	Shares issued	29.975	71.130	94.739
22a	Permanent priority shares	532	8.332	28.123
22b	Common shares	29.443	62.798	66.616
23.	Undistributed income and capital reserves	130.440	172.581	262.894
24.	Currency rate difference	0	0	0
25.	Other capital	56.817	94.084	115.164
26.	**TOTAL CAPITAL (20. TO 25.)**	**1.016.717**	**1.226.585**	**1.518.018**
27.	**TOTAL LIABILITIES AND CAPITAL (19+26)**	**9.378.708**	**11.498.355**	**14.203.507**
	PASSIVE AND NEUTRAL SUBBALANCE	**680.040**	**641.164**	**606.752**
	TOTAL BALANCE SHEET IN BANKS	**10.058.748**	**12.139.519**	**14.810.259**

ATTACHMENT 5

NEW CITIZEN SAVINGS BY PERIODS

in 000 KM

	31.12.2005.	31.12.2006.	31.12.2007.
State banks	26.886	31.723	30.469
Private banks	2.638.391	3.308.413	4.086.820
TOTAL	**2.665.277**	**3.340.136**	**4.117.289**

ATTACHMENT 6

CLASSIFICATION OF ASSETS AND OFF-BALANCE SHEET RISK ITEMS
as of **31.12.2007.**

- ACTIVE BALANCE SHEET -

in 000 KM

Ord. No.	BALANCE SHEET ASSETS AND OFF-BALANCE SHEET ITEMS	CLASSIFICATION					TOTAL
		A	B	C	D	E	
1.	Short-term loans	1.427.063	283.694	6.167	2.373	0	1.719.297
2.	Long-term loans	5.931.219	830.661	112.202	67.374	16	6.941.472
3.	Other placements	59.533	1.551	817	6	0	61.907
4.	Interest accrued	40.122	13.400	0	0	0	53.522
5.	Past due receivables	93.695	53.580	19.510	43.809	2	210.596
6.	Receivables on guarantees paid	338	15	6	3.279	0	3.638
7.	Other assets	5.544.902	7.306	1.542	2.454	20	5.556.224
8.	**TOTAL ACTIVE BALANCE SHEET**	**13.096.872**	**1.190.207**	**140.244**	**119.295**	**38**	**14.546.656**
	a) Guarantees payable	285.525	63.570	371	1.577	0	351.043
9.	b) Performing guarantees	434.778	119.160	1.185	172	0	555.295
10.	Unsecured LoC	55.198	16.325	0	299	0	71.822
11.	Irrevocable loans	1.382.442	87.594	1.268	472	0	1.471.776
12.	Other potential liabilities	3.690	0	0	0	0	3.690
13.	TOTAL OFF-BALANCE SHEET	2.161.633	286.649	2.824	2.520	0	2.453.626
14.	TOTAL BALANCE AND OFF-BALANCE SHEET (8+13)	15.258.505	1.476.856	143.068	121.815	38	17.000.282
15.	General credit risk and potential loan losses (#14 x % of loss)	197.924	105.268	35.602	66.885	38	405.717
16.	Allocated general reserves (A) and special reserves (B, C, D, E)	197.899	105.268	35.601	66.885	38	405.691
17.	**MORE (LESS) of the allocated reserves (#16 - 15) +or -**	**-25**	**0**	**-1**	**0**	**0**	**-26**

ATTACHMENT 7

INCOME STATEMENT

in 000 KM

ELEMENTS	PERFORMED 31.12. 2006.		PERFORMED 31.12.2007.		RATIO 4 : 2
	Amount	Partic.in total income	Amount	Partic.in total income	
INCOME					
Interest income	630.174	92%	834.533	103%	132
Interest expenses	234.630	34%	323.771	40%	138
Net interest income	395.544	58%	510.762	63%	129
Fee income and other operating income	288.110	42%	296.984	37%	103
TOTAL INCOME	**683.654**	**100%**	**807.746**	**100%**	**118**
EXPENSES					
Reserves for potential losses	143.059	21%	172.548	21%	121
Salaries and contribution expenses	185.907	27%	219.730	27%	118
Fixed assets and overhead expenses	110.239	16%	124.633	16%	113
Other expenses	148.066	22%	163.813	20%	111
TOTAL EXPENSES (without interests)	587.271	86%	680.724	84%	116
NET INCOME BEFORE TAX	96.383	14%	127.022	16%	132
Income Tax	8.126	1%	11.858	1%	146
NET INCOME	**88.257**	**13%**	**115.164**	**15%**	**130**

ATTACHMENT 8

COMPARATIVE SCHEDULE OF CAPITAL BALANCE AND ADEQUACY

ACTIVE SUB-BALANCE SHEET

in 000 KM

Ord. No.	DESCRIPTION	31.12.2005.	31.12.2006.	31.12.2007.
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	784.085	873.390	1.029.756
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	29.975	71.130	94.739
1.4.	General regulatory reserves (reserves as regulated by the Law)	41.801	61.228	65.942
1.5.	Other reserves not related to assets quality assessment	49.583	86.990	128.882
1.6.	Retained - undistributed income from previous years	76.939	93.543	132.711
1.a.	**TOTAL (from 1.1. to 1.6.)**	**994.933**	**1.198.831**	**1.464.580**
1.b.	Offsetting items from 1.a.			
1.7.	Uncovered losses transferred from previous years	34.741	62.603	65.514
1.8.	Losses from current year	26.376	7.030	8.261
1.9.	Book value of treasury shares owned by the bank			2
1.10.	Amount of intangible assets	41.424	40.105	53.453
1.b.	**TOTAL (from 1.7.to 1.10.)**	**102.541**	**109.738**	**127.230**
1.	**AMOUNT OF CORE CAPITAL: (1.a.-1.b.)**	**892.392**	**1.089.093**	**1.337.350**
2	**BANK'S SUPLEMENTARY CAPITAL**			
2.1.	Share capital - common and perm. priority non-cumulat. shares - cash payments	2.850	2.850	2.917
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	119.163	150.200	197.899
2.4.	Accrued income for current year audited and confirmed by external auditor	43.423	85.689	98.778
2.5.	Income under FBA's temporary restriction on distribution	0	0	0
2.6.	Subordinated debts, the most 50% of core capital	126.632	139.251	191.575
2.7.	Hybrid convertible items - the most 50% of core capital	0	0	0
2.8.	Items-permanent liabilities without repayment duty	5.797	5.828	50.855
2.	**AMOUNT OF SUPPLEMENTARY CAPITAL: (from 2.1. to 2.8.)**	**297.865**	**383.818**	**542.024**
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	17.235	17.236	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	0	0	0
3.	**AMOUNT OF OFFSETTING ITEMS FROM BANK'S CAPITAL (3.1. to 3.4.)**	**17.235**	**17.236**	**16.036**
A	**AMOUNT OF BANK'S NET CAPITAL (1.+2.-3.)**	**1.173.022**	**1.455.675**	**1.863.338**

B.	**RISK FROM RISK-WEIGHTED ASSETS AND LOAN EQUIVALENTS**	**6.681.510**	**8.282.086**	**10.747.145**

C.	**NET CAPITAL RATE (CAPITAL ADEQUACY) (A.:B.) X 100**	**17,6%**	**17,6%**	**17,3%**

ATTACHMENT 9

NUMBER OF EMPLOYEES BY BANKS

Ord. No.	BANK	31.12.2005.	31.12.2006.	31.12.2007.
1	ABS BANKA dd SARAJEVO	290	297	326
2	BOSNA BANK INTERNATIONAL dd Sarajevo	85	104	145
3	BOR BANKA dd SARAJEVO	37	40	42
4	CBS BANK dd SARAJEVO	130		
5	FIMA BANKA dd SARAJEVO		58	101
6	HVB CENTRAL PROFIT BANKA dd SARAJEVO	451	476	465
7	HERCEGOVACKA BANKA dd MOSTAR	99	98	93
8	HYPO ALPE ADRIA BANK dd MOSTAR	431	492	550
9	INVESTICIJSKA BANKA FBiH SARAJEVO	75	84	104
10	INVESTICIONO KOMERCIJALNA BANKA dd ZENICA	165	163	154
11	KOMERCIJALNO INVESTICIONA BANKA dd V. KLADUŠA	63	66	65
12	LT GOSPODARSKA BANKA BANKA dd SARAJEVO	186	196	
13	LJUBLJANSKA BANKA dd SARAJEVO	62		
14	NLB TUZLANSKA BANKA dd TUZLA		479	472
15	TUZLANSKA BANKA dd TUZLA	332		
16	PROCREDIT BANK dd SARAJEVO	430	595	831
17	POŠTANSKA BANKA dd SARAJEVO	63	63	97
18	PRIVREDNA BANKA dd SARAJEVO	190	170	163
19	RAIFFEISEN BANK BH dd SARAJEVO	1.195	1.348	1.543
20	TURKISH ZIRAAT BANK dd SARAJEVO	95	108	129
21	UNA BANKA dd BIHAĆ	58	61	59
22	UNION BANKA dd SARAJEVO	180	175	179
23	UPI BANKA dd SARAJEVO	208	233	479
24	UNI CREDIT ZAGREBACKA BANKA BH dd MOSTAR	790	840	840
25	VAKUFSKA BANKA dd SARAJEVO	167	175	184
26	VOLKSBANK BH dd SARAJEVO	233	285	340
	TOTAL	**6.015**	**6.606**	**7.361**