

Official Gazette of the FBiH, number 3/03

On the basis of provisions from article 4, 9, and 25 of the Law on the Banking Agency of the Federation of Bosnia and Herzegovina ("Official Gazette of the Federation of Bosnia and Herzegovina", No 9/96, 27/98, 20/00, 45/00 and 58/02) and articles 20 and 41 in relation to provisions from Article 69 of the Law on Banks ("Official Gazette of the Federation of Bosnia and Herzegovina", No. 39/98, 32/00, 48/01, 27/02, 41/02 and 58/02), the Managing Board of the Banking Agency of the Federation of Bosnia and Herzegovina declares

DECISION ON MINIMUM STANDARDS FOR MANAGING THE CAPITAL OF BANKS

Article 1

This decision more closely defines the minimum standards of capital and minimum standards for creating and implementing the Program for managing capital, which a bank is obliged to provide and to continually maintain and implement.

The minimum amount of equity capital in cash, amount and ratio of net capital out of total risk weighted assets, in accordance with the provisions of the Law on Banks, represent the minimum standards which provide for full access and intermediation within the financial market, that is standards which provide for full capability for the bank to absorb possible losses which occur from various different risks which the bank, in completing its activities, is exposed to.

Payments in equity capital must be in accordance with Article 20 of the Law on Banks (hereinafter: the Law).

Bank is not allowed to lend, guarantee or in any other way finance purchase of its shares.

Article 2

Bank's Assembly and its Supervisory Board, depending on their authorization given by the Law and the bank's charter, are responsible for the quantitative and qualitative supply and maintenance of the bank's capital at least at the level of all minimum standards from this Decision and other regulations adopted by the Federation of Bosnia and Herzegovina Banking Agency (hereinafter: FBA).

According to Article 2 of this Decision, the bank's Supervisory Board is responsible, as a minimum to:

- 1) Implement the authorizations and responsibilities from the Law, other regulations, and by-laws of the bank and to adopt the Program for Managing and Developing Bank's Capital (hereinafter: Program) with policies in regards to the quantity and quality of the capital which the

- bank is obligated to provide and maintain, and determine the procedure for creating and developing methods for monitoring the current and plan the future requirements for the capital of the bank;
- 2) Management of the bank must regularly and timely submit proposals for adoption of decisions in regards to item 1) of this paragraph;
 - 3) Define to the management of the bank the contents and timelines of reporting on the adequacy of capital, at least every 3 months, and to ensure compliance of reporting policies with provisions of this Decision;
 - 4) Provide all required funds for implementing the Program and bank policies in regards to the issue of capital of the bank in accordance with its general decisions and this Decision;
 - 5) Decide based on proposals and looks over reports from the management of the bank;
 - 6) Monitors and considers the periodical plan of the bank's capital, at least once per year; and
 - 7) Considers and makes decisions based on reports, proposals, and requests that is regulations issued by the FBA.

Article 3

The management of the bank is responsible to maintain adequate capital of the bank in accordance with its by-laws, the Program, policies, and procedures adopted by the Board and with provisions of this Decision.

The management of the bank, as a minimum, is responsible to:

- 1) Implement authorizations from the Law and from other regulations and charter of the bank, create and submit to the Supervisory Board for adoption suggestions for the Program, policies, and procedures in regards to the management of the bank's capital;
- 2) Implement the Program, policies, and procedures in regards to managing the bank's capital;
- 3) Continual monitoring of whether the condition and structure of the bank's capital satisfies the minimum standards from the Law and this Decision;
- 4) Report to the Supervisory Board on bank's capital adequacy in details and within the given timelines, and at least in accordance with reporting requirements determined by this Decision; and
- 5) For the Supervisory Board at least twice a year prepare a proposed periodical plan of bank's capital for evaluation and adoption.

Article 4

Managing bank's capital has to represent a continual process of determining and maintaining the quantity and quality (that is the structure) of the bank's capital at least on a regulated, which is on an appropriate level, as well as a clear understanding of the real needs of the bank for capital. Because the capital represents rare economic and strategic resource, managing bank's capital has to be one of the most important components of prudential, effective, and strategic planning and management of the bank. As the elements of prudential program of managing capital differ from one bank to another, which is based on the nature and complexity of individual activities and undertaken risk of those banks, each bank must adopt its own specific and appropriate Program expressed in written form.

The bank's Program must especially include the following:

1. Prudential policies for providing and maintaining the quantity and quality of capital at least at the level of minimum standards as according to this Decision; and
2. Defined clear and effective procedures for the continual monitoring of the current condition and needs of the bank for capital at the level of the standards included in this Decision and satisfying its future needs depending on the complexity and risk of its current and planned future activities.

Article 5

Capital has to offer the bank the required resources for: regular banking activities, covering undertaken and potential risk, fulfilling all operations, expanding the scope of the bank, and funding non-interest bearing assets.

Capital, is a separate financial resource, which the Supervisory Board and management of the bank have to carefully manage, and in doing so, to ensure a successful access to necessary additional capital.

The Supervisory Board is responsible to adopt and ensure the implementation of policies to satisfy the quantity and quality requirements of the bank for capital at each moment and with that allow for its undisturbed operation and activities. Bank's policies (in written form) have to develop the complete and detailed functions for managing the capital sources, depending on the complexity of each of its operations, including at least the following issues:

- 1) The list and profiles of the bank's shareholders;
- 2) The type of capital instruments, rights and distribution of rights through different forms of co-ownership in order to improve the management of the bank and to decrease the excessive concentration of power, of one or a group of entities who act together, which could have an unfavorable effect on the bank;
- 3) Limiting additional forms of capital in accordance with the Law, this Decision, and other regulations of the FBA;
- 4) Dividend policy considered in regards to realized and expected profits of the bank, adopted rates of payment and their capitalization;
- 5) The nature of expected or determined resources for new additional capital requirements;
- 6) Forms of initiatives and premiums through shares or parts of the profits as rewards to management of the bank for effective management of the bank in the past, current, and necessary future success;
- 7) Internal system of insurance and allocation of capital in regard to the risk within the activities of commercial units of the bank; and
- 8) Possible minimum rates of capital in regard to estimated undertaken risk, and which could be over the minimum rates regulated by this Decision.

Article 6

Management of the bank is obliged to create and develop appropriate

procedures for managing the condition and structure of the bank's capital. Those procedures as a minimum have to include the following:

- 1) procedures for the permanent monitoring of agreed upon capital condition with standards from this Decision or from reporting; and
- 2) the process of planning the capital which has to provide for predicting and for fulfilling the future requirements of the bank for capital, and if needed, achieving a special level of adequate capital which in certain cases the FBA can demand, as well as contacting and informing the Board in regards to these issues.

The plan for maintaining adequate capital of the bank (hereinafter: the Plan), taking into consideration the current condition and expected effect of foreseen changes in operations and the environment, and the operational and financial condition of the bank has to, as a minimum include the following:

- 1) Forecast the needs of the bank for capital and its expected condition during at least the next 3 years with special and detailed regard to the next year;
- 2) Identify and give basis for assumptions upon which the expectations are established;
- 3) Identify the quantity and quality, and also analyzes the possibility of having internal resources for required additional capital;
- 4) Estimate the approachability and availability of required external resources of additional capital;
- 5) Estimate the possible approachability and rapid approach to different resources of capital; and
- 6) Estimate the cost of growth of additional capital.

The factors which could cause additional capital and which have to be clearly considered, that is presented and analyzed in the Plan include: already realized or possible changes in regulations, eventual special requests of the FBA, the increase in assets and liabilities in the balance sheet and off-balance sheet records, acquisitions, expansion of branches, basic costs of capital and investment, and operational and investment losses, as well as bank's policies in the issue of payment of dividends.

Article 7

According to the Law, and in regards to this Decision, the Capital of the Bank represents the amount of Core capital defined under Article 8 and Additional capital defined in Article 9 of this Decision, and net capital amount decreased for off-set items in Article 10 of this Decision.

Article 8

Core capital of the bank is made of:

- 1) Equity capital based on nominal amounts of ordinary and permanent, priority non-cumulative shares;
- 2) Equity capital based on nominal amounts of permanent, priority cumulative shares issued on the basis of invested goods and rights in the equity of the bank;
- 3) Issue premiums realized during payment of bank's shares;
- 4) Bank's general reserves required by the law;

- 5) Other reserves which do not relate to evaluation of bank's assets; and
- 6) Retained, that is undistributed profit of the bank from previous years.

Article 9

Additional capital of the bank consists of:

- 1) Equity capital based on nominal amount of permanent, priority cumulative shares issued on the basis of cash payments in the equity of the bank;
- 2) Equity capital based on nominal amounts of permanent, priority cumulative shares issued on the basis of invested goods and rights in the equity of the bank;
- 3) Bank's general reserves for covering loan losses for assets classified as "A" - Good assets in compliance with articles 10. and 11. of the Decision of the FBA on Minimum Standards for Managing Credit Risk and Classification of Bank Assets ("Official Gazette of the Federation of Bosnia and Herzegovina", No. 3/03)(hereinafter: Decision on Classification of Assets);
- 4) Accrued income for the current year and exchange rate differences;
- 5) The amount of income for which the FBA has decided to temporarily stop from its further distribution;
- 6) Subordinated debts (loans, bonds) up to 50% of the Core capital of the bank, if the following conditions are satisfied:
 - a) that the bank provided a written agreement from the FBA of including the taken subordinated debt in the calculation of the Additional capital of the bank;
 - b) that the bank's funds are completely used;
 - c) that the bank did not give the creditor instruments for insuring the collection of payments based on the above and that it does not have a status of an insured debt;
 - d) that the bank does not have a signed agreement with the creditor determining the same operation but in opposite direction;
 - e) that in the loan agreement, the maturity date is determined for at least 5 years, and it can not be repaid after the maturity date has passed if that operation will decrease bank's capital below the required level, and that the debt in case of bank's liquidation is in subordinate position in relation to other liabilities of the bank;
 - f) that in order for the bank to accrue the Additional capital, the amount of subordinate debt of the bank has to be regularly decreased in accordance with agreed terms, in the case that such agreed repayment is contracted; and
 - g) that the debt can not be repaid or amortized before the maturity date and without the previous approval made by the FBA in the written form;
- 7) hybrid items, that is convertible items-instruments of capital up to 50% of the amount of Core capital of the bank with previous written agreement of the FBA for the inclusion of those items-instruments in the accrual of the Additional capital of the bank. In the goal of this Decision, convertible items-instruments of capital are understood as being items-obligation in capital or with clearly defined possibilities that they can be converted into instruments of (permanent) capital in the period no longer then contracted maturity date for convertible items-instruments; and

- 8) items-obligations with a permanent character (without the repayment obligation of the bank) and if engaged in active operations of the bank they are subject to policies and procedures of the bank but only under the condition that there is a previous written approval of the FBA in this regard.

In the goal of calculating the adequacy of capital, the amount of additional capital cannot go over the amount of Core capital of the bank.

Article 10

During the calculation of Net capital (adjusted capital) of the bank, that is the amount that serves for accrual of the capital adequacy ratio of the bank, is represented by the amount of capital mentioned in Article 7, paragraph 1 of this Decision and the off-set items which include:

- 1) part of the general credit risk and potential loan losses for which the bank has not formed general, that is special reserves for loan losses in compliance with provisions in Article 15 of the Decision on the Classification of Assets;
- 2) uncovered losses transferred from previous years;
- 3) losses from the current year;
- 4) book value of their own (treasury) shares under the possession of the bank regardless of the type of possession;
- 5) what ever part of invested equity which according to FBA assessments represents a difference between actually received and booked over estimated assets;
- 6) the amount of intangible assets - patents, licenses, franchise, investments in market research, trade name, trade mark, goodwill, etc.
- 7) the bank's investments into the capital of other legal entities, which are over 5% of the level of the Core capital of the bank;
- 8) all claims by shareholders who possess a significant ownership interest in the bank (over 10% of shares with a right to vote), approved by the bank which is not in compliance with provisions of the Law, regulations of the FBA, and the operational policy of the bank;
- 9) all big credit risk exposures of the bank (over 15% of the Core capital of the bank) for the shareholders with a significant interest in the bank, completed without written approval from the FBA. In the process of issuing approval (in relation to these provisions), the FBA will not perform a quality evaluation of loan request, instead it will ensure that the bank has followed regulations and its internal acts related to procedures of granting such loans.

Provision within paragraph 1, clause 7 of this Article does not apply to:

- 1) Acquired share in capital on the basis of collecting claims or restructuring of bad claims in accordance with the Decision on the Classification of Assets, if prior to such acquirement written authorization from FBA was received, but only up to one year after acquiring that share or in the period which, in extreme cases, the FBA can especially determine; and
- 2) Equity which the bank holds as an agent

The bank is obliged to assess the value of received equity in accordance with guidelines for restructuring bad/problem debts, and after the expiration of one

year from the date of acquirement of the share they must apply a quick write off of 1/4 of the book value quarterly or in special cases determined by the FBA.

Article 11

Risk assets of the bank represent items within assets of the balance sheets and off-balance sheet records of the bank which have been exposed to risk and which have been multiplied by the appropriate rate of the standard risk which is adequate for the exposure of individual forms of assets to the level of natural risk (in accordance with Article 15 of this Decision).

Article 12

In regard to this Article, the assets of the balance sheet and off-balance sheet records of the bank are represented by total book net value of balance sheet assets and credit equivalents of their off-balance sheet obligations, which represent their potential balance sheets assets.

The book net value of assets represents the book value of assets decreased by whatever subtractions or whatever offset items.

Credit equivalent of off-balance sheet obligations represents the amount, which is received after multiplying the book/nominal value of off-balance sheet obligations and appropriate conversion rates mentioned in Article 14 of this Decision.

Article 13

The conversion rate of off-balance sheet obligations of the bank for calculation of credit equivalents is in the amounts presented in the table below:

| TYPES OF OFF-BALANCE SHEET LIABILITIES | | Conversion rate | Entity-potential debtors |
|---|---|------------------------|---------------------------------|
| 1. | Irrevocable payable guaranties issued by the bank | 1.0 | Beneficiary |
| 2. | Irrevocable guarantees (except for payables) issued by the bank | 0.5 | Beneficiary |
| 3. | Irrevocable credit obligations with maturity to 1 year | 0.5 | Beneficiary |
| 4. | Documentary letters of credit opened or confirmed by the bank | 0.5 | Beneficiary |
| 5. | Obligations which the bank has accepted, and which are the result of Purchase agreement which includes a repurchase clause | 1.0 | Beneficiary, Opening bank |
| 6. | Foreign currency and KM bought under contract about foreign currency futures, swaps, currency options, etc. and customers obligations which the bank has accepted and which result from exchange rates found in agreements on one currency swaps, exchange rates forward contracts, and | 0.1 | Other contracted side |

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|--|------------------------------|--|--|
| | bought currency rate options | | |
|--|------------------------------|--|--|

In other cases of off-balance sheet obligations of the bank, the FBA can individually determine their conversion rate depending on their specific nature.

Article 14

The total risk of bank's assets represents the sum of multiples of appropriate risk rates and assets items, that is credit equivalents of off-balance sheet items exposed to the risk in accordance with the following table:

| ASSETS AND OFF-BALANCE SHEET CREDIT EQUIVALENTS | | RATE OF RISK |
|--|---|---------------------|
| 1. | <ul style="list-style-type: none"> • cash funds • claims by the Government of Federation of BIH, the Government of BIH and Central Government countries in the A Zone • claims by the CB of BIH and central banks of other countries in the A Zone | 0% |
| 2. | <ul style="list-style-type: none"> • claims from countries in the A zone, apart from on the basis of subordinated debts • claims from banks with head offices in countries in the B zone with current maturity to 1 year, apart from those on the basis of subordinated debts • claims from the international banks for development • claims from Governments from countries in the A zone • claims from institutions which finance the budget of the FBIH and BIH and central governments of countries in the A zone financial instruments in the process of collection | 20% |
| 3. | <ul style="list-style-type: none"> • claims from banks within the F BIH | 50% |
| 4. | <ul style="list-style-type: none"> • all other Assets and credit equivalents of off- balance sheet liabilities from article 13 of this Decision | 100% |

Zone "A" includes following countries: Austria, Australia, Belgium, Canada, Denmark, Finland, France, Germany, Iceland, Ireland, Italy, Japan, Luxembourg, New Zealand, Norway, Netherlands, Portugal, Spain, Switzerland, Turkey, Great Britain, and USA

Article 15

The adequacy of capital (capital adequacy ratio) of the bank represents the relationship between the Net capital defined in the provision from Article 7, paragraph 2, and the total level of risk of assets, defined in Article 14 of this Decision.

The Agency can prescribe to the bank some special requirements in regard to its capital that could be higher than those prescribed by the Law. It all depends on the assessment of existing performance risks, as well as the assessment of bank's risk management.

Article 16

The bank is obliged to report to the FBA (in a written form) on the quarterly basis regarding all information on the condition and structure of its capital no later than 1 month after the previous reporting cycle.

Apart from the obligation from paragraph 1 of this Article, important changes in capital and potential negative changes for the calculation of the adequacy of their capital, the bank must compile a report as of the last day of the month in which the important change occurred and give it to the FBA, at the latest 15 calendar days from that day.

The report for the last quarter of the previous calendar year, prepared on the basis of the preliminary data, the bank must give to the FBA at the latest one month after the last day of the reporting year.

The report mentioned in Paragraph 3 of this Article which is prepared on the basis of final data, the bank must give to the FBA at the latest by the 5th of March of the current year.

Two authorized persons who represent the bank sign the bank's report.

The prescribed report of the bank has to be adopted by its Supervisory Board and submitted to FBA in accordance with the Decision on Reporting Forms that Banks Submit to the Federation of BiH Banking Agency (the FBiH Official Gazette, No, 3/03).

Article 17

The report from Article 16, paragraph 4 is a subject to a review and can be assessed by external auditors of the bank and their report has to give information on the following;

- 1) whether the reporting system of the bank offers correct information about the adequacy of the bank's capital; and
- 2) whether information on the adequacy, contained in the bank's report as of the 31st of December of the reporting year is correct and real, taking into consideration the quality of the loan portfolio of the bank and other relative risk categories.

Article 18

By the day when this Decision comes into effect, the Decision on Minimum Standards for Capital Management ("Official Gazette of the Federation of BiH" No. 47/98, 46/99, 25/00 and 43/00) will cease to exist.

Article 19

This Decision comes into force on the date of its issuance, and it will be published in the "Official Gazette of the Federation of BiH".

No. 01-1-1190-3/02
Sarajevo, 19th of December 2002

CHAIRMAN OF
THE MANAGEMENT BOARD
M.A. Eldar Arnautovic