



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

I N F O R M A T I O N
ON THE BANKING SYSTEM OF
THE FEDERATION OF BOSNIA AND HERZEGOVINA
AS OF 31.12.2010.

Sarajevo, March 2011

Information on banking system of the Federation of BiH (as of 31.12.2010., based on final, unaudited 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.

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I INTRODUCTION

The performance of the banking sector in 2010, as in the previous year, was under the strong impact of the global economic crises and recession. The crises consequences and the adverse effects in the banking sector of FBiH, are mostly reflected in its stagnations, decline of profitability, increase of the non-performing assets and loans, past due receivables, loan loss provisions and deterioration of other key indicators of banks' performance. During the 2010, the banks kept the enhanced focus on the credit risk and restructuring of their credit portfolios with more restrictive and rigorous policies of credit risk management, especially in the loan approval process. Although, in 2010 recorded are first signs of slight recovery of economic activities, it is evident that the condition of the real sector is still not satisfactory and that the economic recovery will be slow and lengthy.

At the end of 2010, there were 19 banks with banking license issued in the Federation of BiH (18 banks with majority private ownership, and one bank in majority state owned). The number of banks declined in comparison to 31.12.2009, since the license of UNA bank d.d. Bihać was revoked on 20.12.2010. As of 31.12.2009. two banks were under provisional administration - Hercegovačka bank d.d. Mostar and Postanska bank BH d.d. Sarajevo. In 2010, the trend of decrease of the number of employees in banks continued, which is another negative effect of the economic crises on the banking system in FBiH. As of 31.12.2010., the number of employees in banks was 7.388.

The aggregate balance sheet of the banking sector, as of 31.12.2010., amounted to 15,1 billion KM, representing a decrease by 1% or 161 million KM compared to the previous year. The loans, as the largest item in the banks' balance sheet, recorded a minor increase by 2%, and at the end of the year amounted to 9,98 billion KM or 66,2% of the banks' balance sheet in FBiH. The slight credit growth, especially in the fourth quarter, can be assessed as a positive sign, as it indicates that the banks' credit activities in 2010 intensified.

In the assets structure the cash funds present 4,4 billion KM (or 29,5 %) and they declined by 7% or 339 million KM in comparison to the end of 2009, mostly due to repayment of the past due credit liabilities. The banks used the limited opportunity for granting new loans and the surplus liquidity for increasing their investments in securities, with an effort to realize higher income and reduce the decline of the interest income.

The trend in the change of participation of the two most significant financing sources of banks, the deposit growth and the decline of the credit liabilities (mostly towards abroad) continued in 2010. The deposits with a participation of 74,5% and amount of 11,2 billion KM, are the most significant source of financing for banks in the F BiH and they increased by 2% or 187 million KM in relation to the end of 2009. In the same period the credit liabilities declined by 21% or 369 million KM. The listed changes in the banks' balance sheet can be a limiting factor for the future credit growth, taking into account the maturity profile of the sources and lending needs with longer maturity dates.

Positive trends in the saving deposits segment continued in 2010, and the savings as of 31.12.2010., reached the amount of 4,97 billion KM, which is the highest amount up to date and is by 444 million KM or 10% higher than the savings level as of 30.09.2008., which just before the crises was the highest amount to that date.

Net capital of banks in the FBiH, as well as regulatory capital, remained at almost the same level as the previous year and as of 31.12.2010., amounted to two billion KM. Capital adequacy ratio, as one of the most important indicators of strength and adequacy of banks' capital, was 16,2% on the level of the banking sector, which is higher by 0,1% than at the end of 2009.

At the level of the banking system of F BiH in 2010, recorded was a loss in the amount of 103 million KM. Positive financial result was realized by 14 banks in the total amount of 55 million KM, while five banks realized loss in the amount of 157,9 million KM. The core reason for such a poor financial result is primarily the impact of a extremely high loss at one bank, as well as deterioration of the profitability of almost all banks due to increase of provisioning expenses for loan losses, as well as decline of the interest and similar income.

And finally, we could conclude that 2010 was marked by stagnation of the banking sector, slight decrease of assets and insignificant growth of credit activities, with a deterioration of the asset quality indicators that had a significant negative impact on the profitability of the entire system.

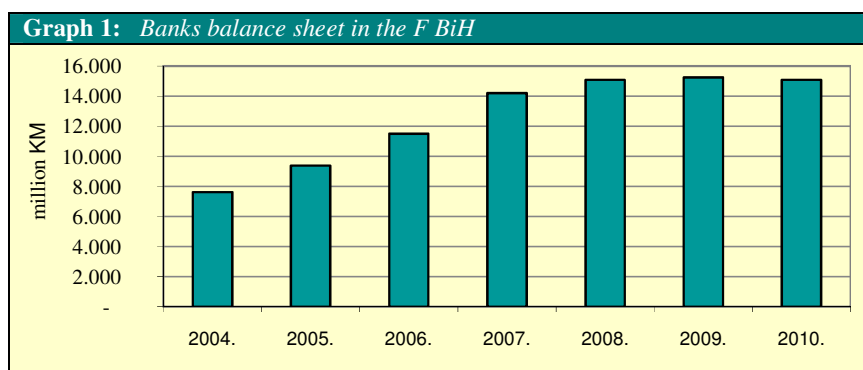
• **Growth and development of the banking sector and the ownership structure:** The following table gives a review of the changes in number and ownership structure of banks in the last five years.

Table 1: Review of changes in number and ownership structure of banks			
	State banks	Private banks	TOTAL
31.12. 2005.	6	18	24
Changes in 2006:			
-revoked license	-1		-1
- new license		+1	+1
-merger/acquisition		-1	-1
31.12.2006.	5	18	23
Changes in 2007:			
-merger/acquisition		-1	-1
- changes in the owner. struct.	-2	+2	
31.12.2007.	3	19	22
Changes in 2008.			
-merger/acquisition		-1	-1
- revoked licenses ¹	-1		-1
31.12.2008.	2	18	20
In 2009, there were no changes			
31.12.2009.	2	18	20
Changes in 2010.			
-revoked licenses	-1	18	19
31.12.2010.	1	18	19

Balance sheet

As affected by the global economic and financial crisis and adverse effects to the overall economy, the banking sector in 2010 was characterized by stagnation, that is, minimum decline of the aggregate balance sheet and slight growth of credit activities. The assets of banks recorded an insignificant decline of 1% or 161 million KM, reaching the amount of 15,1 billion KM. Over the past five years or in the period since the beginning of 2005 to the end of 2010, the aggregate balance sheet of the system increased by 2 times.

¹ Development Bank of the F BiH, as of 01.07.2008., became a legal successor of the Investment Bank of the F BiH d.d. Sarajevo.



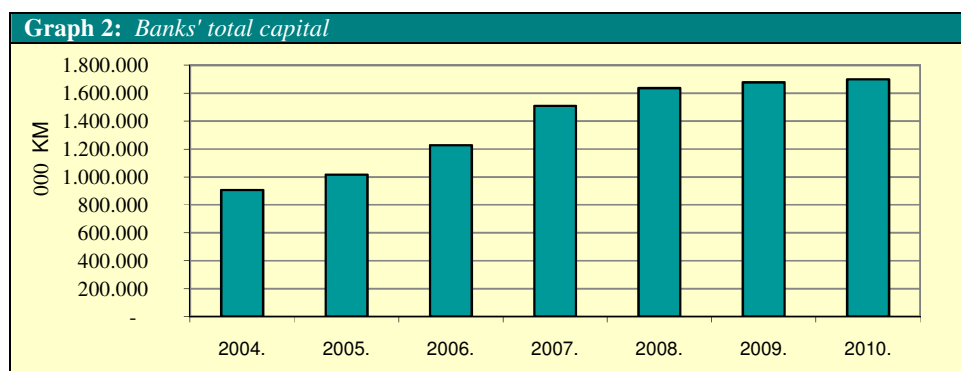
The minimum growth of the aggregate balance sheet of only 1%, in comparison to 2010, is a result of decrease in the sources of loans taken by 21% or 369 million KM, while the deposits increased by 187 million KM or 2% and capital by 19 million KM or 1%.

In the assets of banks, the most significant item were credit placements with participation of 66,2% that in 2010 were increased by 185 million KM or 2%, amounting to 10 billion KM. The largest changes refer to two dominant sources. The loans to private enterprises increased by 3% or 119 million KM, amounting to 4,82 billion KM with a participation of 48,2%, while the loans to citizens decreased by 1% or 32 million KM amounting to 4,73 billion and a participation of 47,4%.

Cash funds decreased by 7% or 339 million KM, mostly due to servicing past due loan liabilities, and partially due to continued investment in securities and slight growth of the credit portfolio, and they amounted to 4,4 billion KM, representing participation of 29,5% in the assets.

Deposits, with participation of 74,5%, amounting to 11,2 billion KM, still represent the most significant source of funding for banks in the FBiH.

Total capital of banks amounted to 1,7 billion KM (shareholders' capital was 1,17 billion KM), representing an increase of 1%. The mentioned capital increase was primarily caused by the inflow of new, green capital – additional capitalization in three banks of KM 122 million, which in good part amortized the loss realized in banks' performance in 2010.



Income statement

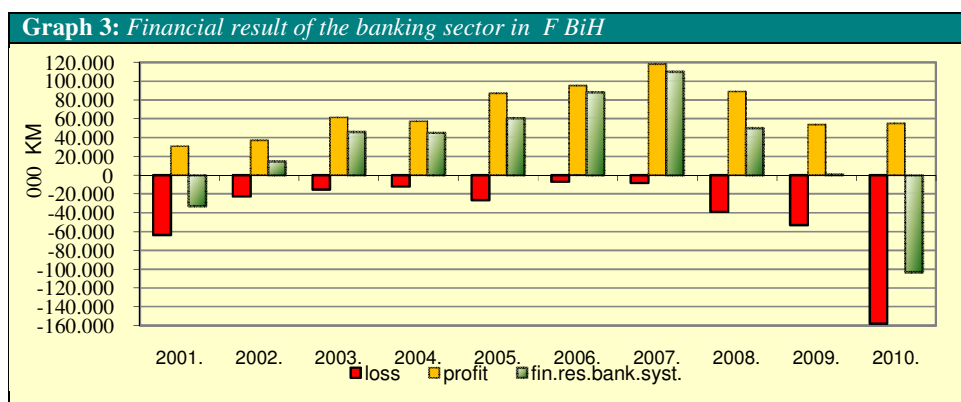
Since 2001, when the banking system reported loss of KM 33 million, a positive trend of the successful performance had begun that due to the global economic and financial crisis spreading

was stopped in 2008, so there was the significant deterioration of profitability recorded in the entire banking system of the Federation of BiH. In 2010, as affected by an adverse influence of the crisis, profitability decline was even more present.

According to the final non-audited data for 2010, the banks in the Federation of BiH reported negative financial result-profit in the amount of 103 million KM, which is the largest loss realized to date in the banking sector in the Federation of BiH.

Positive financial result was reported by 14 banks in total amount of 55 million KM, representing a decline of 2% or 1,2 million KM in comparison to 2009 (13 banks), while five banks reported loss in the amount of 157,9 million KM, three times more or 105 million KM in comparison to prior years.

Reason for deterioration of the entire sector's profitability in 2010, is, on one hand, the high growth of provisioning expenses for loan losses due to deterioration of asset quality, and on the other, low credit growth which generated modest increase of total income, which was insufficient in several banks to cover the high non-interest expenses, and with remaining banks, after covering all the expenses, the realized profit was not on a satisfactory level.



Total income in 2010 amounted to 859 million KM, which was higher by 5% or 43 million in comparison to 2009. Net interest income was 531 million KM, with a low growth rate of 2% or 9 million KM, as result of higher decline in interest expenses (by 18% or 71 million KM) than in interest income (by 7% or 62 million KM), so there was a slight decline of net interest income in the structure of total income from 64% to 62%. Operating income, as a second component of the total income, had a moderate growth of 12% or 35 million KM and an increase of participation from 36% to 38%. On the expenses side, the provisioning expenses for the loan losses increased by 63% or 148 million KM and amounted to a high 386 million KM (a high 44,9% of total income), for which reason the total noninterest expenses had a significant growth of 18% or 144 million KM, that is they were realized in the amount of 954 million KM.

• **Ownership structure:** At the end of 2010, ownership structure of banks in the Federation of BiH was the following: one bank with majority state ownership, and of 18 banks with majority private ownership, seven banks were majority owned by domestic legal entities and individuals (residents), and 11 banks were majority foreign owned. Based on the criteria of the owner-shareholder's home country, that is the criteria of direct or indirect majority ownership through the group members, at the end of 2010, the largest participation was recorded of banking groups and banks from Austria (57,3%), followed by Italian banks (16,7%), while other countries participated below 6,6%.

In 2010, participation of state, foreign and private domestic (resident) capital in total share

capital had slight changes which as of 31.12.2010., was 1,173 million KM. The participation of state capital remained the same 3,6%. Foreign capital nominally decreased by 7,6 million KM, that is 968 million KM, and participation from 83,3% to 82,5%. Private capital (residents) increased by 9,7 million KM, and was 163 million KM, and participation in total share capital increased from 13,1% to 13,9%.

• **Concentration and competition:** As for opportunities in the banking market of the Federation of BiH, where in order to compete for customers and greater market share banks enter into acquisitions and integration processes through mergers, upon finalization of such processes in the system, as estimated by some financial experts, will remain 15. However, six to seven large foreign owned banks will control 90% of the market, in which they already sovereignty rule, while smaller banks will profile as local character banks.

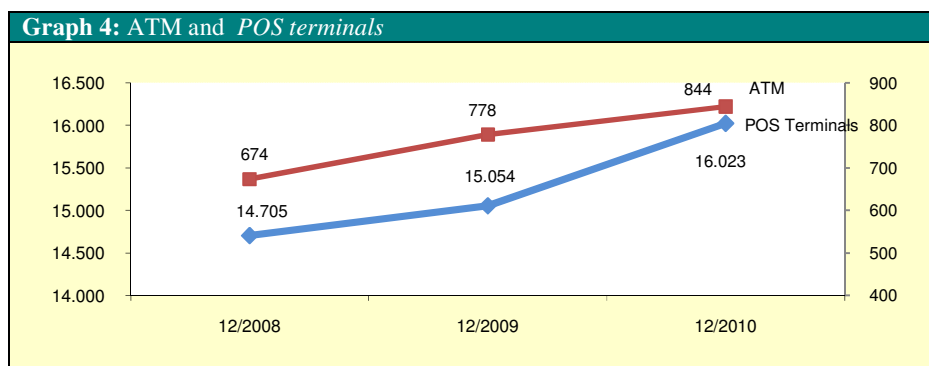
Four banks that still have dominant participation of 69,7% (at the end of 2009 it was 72,7%) hold the assets in the range of 1,3 billion KM to 3,7 billion KM. Majority of banks (12) hold the assets bellow 500 million KM, with market participation of 13,6%, of which three banks have the assets bellow 100 million KM. Three banks hold the assets between 500 million KM and one billion KM, and participation of 16,7%.

One of the indicators of concentration in banking system is the ratio of market concentration, that is, the concentration rate² (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 2010 in the banking system of the Federation of BiH amounted to 75,8% (78% in 2009), but there is still dominant participation of the two largest banks in the system that „hold“ 49% of the market.

In the market „game“, banks use various instruments, from interest rate policy, organization improvement, personnel strengthening, to strong marketing approach and business network expansion, financial support by "parent" bank or group member banks.

Card-based operations of majority of banks in the Federation of BiH represent a significant business activity, primarily of credit character, which is reflected through more massive use of credit and debit cards and increased volume of non-cash payments.

During 2010, 66 new ATMs were installed, and, at the end of the same year, their number was 844. Number of POS terminals has also increased by 969, so there was total of 16.023 POS terminals at the end of 2010 with possibility to pay commodities by cards.



² Engl.: Concentration Ratio (CR), assigned according to the number of institutions included in the calculation.

II. SUPERVISION OF BANKING SYSTEM

1. BANKING AGENCY

Banking Agency of the FBiH (FBA) has given its full contribution to the banking sector reform, although there have often been lack of understanding for the measures that were taken. As an independent and sovereign authority for bank supervision and licensing, the Agency was established in the second half of 1996 and its work, since the very beginning, has been directed towards a strong and stable banking system, as market-oriented and based on the international standards of performance and supervision of banks.

Law on Banking Agency sets out the main tasks of the Agency, such as issuance of banking license, adoption of regulations, supervision of banks, microcredit organizations and leasing companies and measures to be taken in accordance with the Law, including initiation of provisional administration and liquidation in banks, that is, initiation of bankruptcy procedure over banks.

Based on the assessments conducted by domestic and international officials, the FBA has, over the past 14 years, achieved the high professional level, and its staff has obtained expertise and skills in the area of supervision through various educations in country and overseas.

The FBA has, over the past year, successfully acted towards banks in the Federation of BiH to better manage especially credit risk, and banks have been doing so in compliance with the prescribed minimum prudential criteria, taking into account the interests of all „stakeholders“, including their financial „soundness“.

The FBA, with the main purpose being protection of funds and interests of depositors, has introduced measures in 27 banks (provisional administrations, liquidations or bankruptcies), since its initiation to the end of 2010, while provisional administration in one bank was introduced pursuant to the order of the High Representative of BiH. Provisional administration was introduced in 25 banks.

Of 27 banks in which the measures were taken, the procedure was finalized in 14 banks. As of 31.12.2010., there were 13 banks under the measures.

Of 27 banks with the measures initiated:

- Bankruptcy process at the authorized courts was initiated in eight banks,
- Liquidation process was initiated in ten banks. Liquidation process was finalized in six banks (four banks paid out all liabilities towards their creditors and shareholders, and two banks were sold out),
- Four banks were integrated into other banks,
- Three banks were rehabilitated and continued operating. First banks was additionally capitalized and privatized, second bank one was additionally capitalized, and third bank was resolved, the bank management bodies were elected and the bank continued operating,
- Provisional administration process in two banks is still pending.

2. 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 met in order for any supervisory system in banking to be efficient. The same principles were revised and published in the new form in 2006. By this revision, the Basle Committee has brought the core principles up to date, made them more clear and concise, additionally developed some already existing and added some new ones, and generally made them closer to the new international capital framework for banks – Basel II.

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

Generally acceptable international principles, standards and practices for banking supervision that are being more broadly and consistently applied by the Agency, alongside with permanently intensified attention to striking and easily contagious causes of crisis situations, were major concern of the Agency for preparation and initiation of the available defense activities and measures as result of its own experiences, as well as “lessons learned” by many more developed and stronger, especially hit by the crisis, banking systems.

Regulations, their upgrading and extensibility, and operating decisions within the scope of its work, the Agency has been making, following all steps that were prescribed with main purpose that banks to maximum extent enable rule of law in their work, full implementation of the Agency's regulations and of all generally acceptable principles and practices for their prudent and successful work, especially under the circumstances of more present recession. Apart from the mentioned, the main focus of all of the Agency's efforts have been directed towards capital strengthening of banks, improvement of their credit policies and their consistent implementation in practice, raising prudency at maximum possible level in terms of credit risk management that is still very dominant in our environment, as well as liquidity risk, as well as to strengthen capacities for potential crisis management. Along with the mentioned, the Agency has been continuously giving incentives to banks, especially those that are dominant in the system to strengthen their financial potentials and through additional special support by their foreign parent-banks.

Bank supervision - on site and off site bank examinations was conducted upon the plan and program for 2010. Upon preparation of the examination reports, all banks subject to examination received orders to execute and eliminate determined deficiencies. The examinations determined that all banks were regularly and generally 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 the mutual interest.

In 2010, the Agency continued and intensified its work with the International Monetary Fund and the Central Bank of BiH, along with initiation of concrete analytical activities, aimed at developing the skills for collection and analysis of „Financial Soundness Indicators“, as one of preconditions for strengthening and higher effectiveness of supervision over the entire financial, and not just banking sector. Also, continued is the development of the methodology and application of the “stress tests” for credit risk and impact on capital, based on the macroeconomic assumptions, as well as informing the banks about the results of the stress tests.

During 2010, the Agency implemented changes and additions to the regulations with an aim to comply with the Law on accounting and the relevant regulations and banks' obligations to develop the financial reports in compliance with the International accounting standards (IAS) and International financial reporting standards (IFRS).

The USAID's Project of technical assistance to the financial sector of Bosnia and Herzegovina was initiated in 2008 under the name „Partnership for Advancing Reforms in Economy – „PARE“. In 2010, according to the Strategy developed by the Agency for introduction of „International Convergence of Capital Measurement and Capital Standards“– Basel II and action plans, the Agency has implemented the activities for the most part of Phase 1 of the mentioned Strategy; certain number of working drafts of the future regulations has been prepared in order to regulate the management of three core banking risks (credit risk, market risk and operating risk), as well as the preliminary steps for preparation of supervisory approach preparation to include wide range of prudential instruments as essential improvements to the successful management of the mentioned risks.

As equal counterpart, the Agency participated in all activities implemented by the Group of Banking Supervisors for Central and Eastern Europe – „BSCEE“ that comprises supervisory institutions from 20 transition countries and Austria that receives special support from the Basel Committee for Banking Supervision.

In compliance with the requirements of Principle 25 from the list of „Core principles for effective bank supervision“ issued by the Basle Committee, the Agency, by the end of 2010, together with the Central Bank of BiH and Banking Agency of RS signed multilateral agreements with the supervisory bodies of the south east Europe: Albania, Greece, Macedonia, Romania, Bulgaria, Serbia, Montenegro and Cyprus and Memorandums of understanding with authorized supervisory bodies in Republic of Slovenia, Republic of Croatia, Republic of Serbia, Montenegro and Republic of Turkey. The Memorandum of understanding more closely defines: the share of information, on-site examination, requests for information and examinations, information safety, continuous cooperation and other provisions.

In 2010, the Agency realized cooperation not only with the regulatory authorities of the countries-signatories of the memorandums of understanding, but with all other supervisory authorities of the countries in the closer and wider region. In addition, special forms of concrete work cooperation were realized through so called „colleges“ and information exchange regarding performance and condition of parent-banks and their „daughters“, that is, subsidiaries.

During 2010, the Agency actively participated in the realization of the program “Strengthening of the macro and micro prudential supervision in the countries candidates for EU members and countries that are potential candidates for membership in EU”. The program is created by the European Central Bank and 13 national central banks of the Eurosystem. The program includes joint activities of the Central bank of BiH, Banking Agency of RS and Banking Agency of FBiH in cooperation with regulatory institutions of 7 countries candidates for EU membership and potential candidates for membership in EU (apart from BiH, the following countries also participate in the project: Albania, Montenegro, Croatia, Kosovo, Macedonia, Serbia, Turkey).

Based on the decision of the Parliament of the Federation of BiH in 2006, and later on „CARDS Program“ that was prepared by the European Central Bank experts and group of the European central banks, in 2010 the Agency was, in all occasions, supportive of the idea to consolidate banking supervision at state level, since it has recognized, with many pragmatic reasons, such organization of supervision over the main segment of the financial system, on the path to the European Union, would not be viable. The European experts also confirmed that: „banking supervision is actually organized at state level in the European countries under the roof of the central bank or outside of it“ and that: „... membership to the European Union implies the

establishment of a single banking market that leads to a single (consolidated) supervision“.

Growing aggressive globalization and banking industry development, the enhancement and evolution of supervisory principles, rules and standards, as well as more recent painful reflection of the global financial and economic crisis that „taught“ many lessons to everything and everyone it had influenced, has demonstrated that especially banking supervisors have to be constantly updated and should keep developing their knowledge, skills and instruments for more effective action when realizing their mission. For the same reasons, and in order to hire new, especially young people, in 2010 the Agency was taking care of such needs, and on its own and with assistance of many international and highly qualified and specialized institutions, it applied necessary education of its employees, that was conducted in the country and overseas. At the same time, the Agency offered assistance, through specialized education, to other authorities and institutions in the Federation of BiH.

3. COMBAT AGAINST MONEY LAUNDERING AND TERRORISM FINANCING

The banking system assessment for 2010 was based on the assessment of banks as result of supervisory examinations conducted in terms of banks' compliance to the standards for prevention of money laundering and terrorism financing, follow-up examinations of orders being met, and analysis of banks' reports submitted to the Agency.

1. The banks' condition

In full-scope and targeted examinations, and based on the banks' reports submitted to the Agency, it was determined no reasons for supervisory concern in terms of the management of risk from money laundering and terrorism financing. Risk management quality that in banks' performance could arise as result of money laundering and terrorism financing (reputation risk, operating risk, legal risk, assets and deposits concentrations risk), in the banking sector of the Federation of Bosnia and Herzegovina, is satisfactory although it has started a declining trend. Namely, in 10 examination of the compliance of the performance of banks with the standards for prevention of money laundering and terrorism financing activities, the risk management quality was satisfactory in 5 banks, marginal satisfactory in 3 banks and poor in 2 banks. Of 41 issued orders that were subject to examination in the examination of the order implementations the banks implemented 16 orders. In the remaining cases they took measures to implement the orders and partially implemented them in 20 issued orders. However, although measures were taken 5 orders were not implemented. Risk quantity has maintained within the limits of moderate. Additional reason for such supervisory rating is the rating of compliance of the legislation of Bosnia and Herzegovina to the standards on prevention of money laundering and terrorism financing performed by the European Council's MONEYVAL Committee in December 2010. Namely, in the Report of this Committee, it was stated that, based on the report from Bosnia and Herzegovina, it was not possible to evaluate the progress in relation to the last compliance evaluation, and that is why Bosnia and Herzegovina will have to submit a new progress report which will be reviewed in April of 2011.

1.1 Customer Acceptance Policy: Banks have established special registries of their customer profiles. Certain issue in regard to functioning of such registries appeared in terms of updating the data of customers that banks classify in different categories. However, it is especially important that banks have established and are applying the approach towards customers that is based on risk analysis that customers have for the bank, that is, that they define what type of customers are acceptable for the bank.

1.2 Customer Identification Policy: Banks have adopted customers' identification as core element of the «know your customer» standard. The customer identification policy is applied by banks when establishing business relationship with customers. However, there is still this

problem of records updating that is used to document the establishment of such relationships with already established business relationships.

Apart from the updating the documentation problem, there is a problem with the identification of sources of funding which the clients use for performing the transactions for paying the annuities for given loans and documenting the performance of this identification.

1.3 Account and Transaction Permanent Monitoring Policy: This policy is applied and there is fewer formal monitoring of the customers' accounts and transactions. In order to achieve the essential monitoring of the customers' accounts and transactions, and based on implementation of the «know your customer» policy, banks have defined the transaction limits per certain types of accounts and transactions; developed information systems to apply limits set in monitoring of accounts and transactions. However, in the cases where there is a suspicion of money laundering and terrorism financing, the defined limits, served less in the preventive steps and more in the follow up monitoring of the accounts. There are problems in monitoring of transactions that are used to pay loan annuity and are a direct consequence of not performing the identification of sources of funds that are used with an aim to pay the annuities.

1.4 Money Laundering and Terrorism Financing Risk Management Policy: The elements of the mentioned policy are defined in the banks' programs. Reporting lines, both external and internal, are also defined.

Reporting: In 2010, banks reported of 303.542 transactions, representing 0,42% of total transactions realized in the banking system of the Federation of Bosnia and Herzegovina (70.938.797 transactions realized, according to the banks' data) with the value of 11.364.176 h/KM, representing 8,50% of total value of the transactions realized in the banking system of the Federation of Bosnia and Herzegovina (133.426.795 h/KM according to the banks' data). Number of reported transactions in 2010 decreased by 0,10%, in comparison to the prior year, while their value increased by 2,68%.

The following table presents the comparative schedule of number and value of reported transactions based on the transfer reporting method (prior to conducting, within deadline prescribed and after deadline prescribed):

Transfer value in 000 KM

Table 2: Comparative schedule of number and values of reported transfers							
No.	Description (of transfer)	Transfers in 2009		Transfers in 2010		%	
		Number	Value	Number	Number	Value	Number
1	2	3	4	5	6	7 (5/3)	8 (6/4)
1.	Total reported transfers (2+3+4)	303.822	11.067.457	303.542	11.364.176	99,90	102,68
2.	Transfers reported prior to conducting	32	28.646	11	7.360	34,37	25,70
3.	Transfers reported within deadline of 3 days	303.637	11.030.046	303.352	11.341.940	99,90	102,82
4.	Transfers reported following deadline of 3 days	153	8.765	179	14.876	117,00	169,72

In the structure of reported transactions, there is a notable decrease of the number (34,37%), in comparison to the prior year, and the value (25,70%) of reported transactions prior to their conducting. This leads to the conclusion that banks' actions related to prevention of money laundering and terrorism financing have started to decline in quality, since the number (117%) and the value (169,72%) of the transfers reported in the prescribed deadline for reporting increased in comparison to the previous year. The number and value of transfers reported following the deadline prescribed indicates an existence of corrective measures (follow up transactions and business performance of clients). The number and value of reported transfers within the deadline prescribed has the same trend as the number and value of the total reported transfers.

Suspicious transactions: In their reports, banks marked 49 transfers as suspicious and they all refer to money laundering. There were no reported transfers related to suspicion of terrorism financing activities. The number of suspicious transfers declined by 43% in comparison to the previous year. The value of those transfers is 16.494 h/KM, representing 55,30% less in comparison to prior year.

The following table presents the comparative schedule of the number and value of reported suspicions transactions based on the transfer reporting method (prior to conducting, within deadline prescribed and after deadline prescribed):

Transfer value in 000 KM

Table 3: Comparative schedule of number and value of suspicious transfers reported							
No.	Suspicious transfers	Transfers in 2009.		Transfers in 2010.		%	
		No.	Value	No.	Value	No.	Value
1.	2	3	4	5	6	7 (5/3)	8(6/4)
1.	Total reported transfers	86	36.895	49	16.494	57,00	44,70
2.	Transfers reported prior to conducting	32	28.646	9	7.144	28,00	25,00
3.	Transfers reported within deadline of 3 days	42	6.287	20	2.232	47,60	35,50
4.	Transfers reported following deadline of 3 days	12	1.960	20	7.118	166,60	363,00

The structure of reported suspicious transfers, as well as the structure of total reported transfers, supports above mentioned conclusions. Namely, significant decrease of the number (28%) and value (25%) of suspicious transactions reported prior to conducting was noted. This further indicates that there was a lack of preventive actions by the bank on prevention of money laundering and terrorism financing activities and that the „know your customer“ principle and defined transaction limits as one of core instruments to identify some transaction being related to money laundering and terrorism financing were not applied. Increased number (166,60%), in comparison to prior year, and value (363,00%) of transfers reported following deadline for reporting indicates that banks have practiced more follow up monitoring of the transactions and clients. The decrease in the number (47,60%) and value (35,50%) of the transfers reported within three days, further deteriorates this fact, since the follow up is even less performed in the period of three days, and more upon a longer period of time from the moment the transaction was performed.

III BUSINESS PERFORMANCES OF BANKS IN THE FEDERATION OF BIH

1. STRUCTURE OF THE BANKING SECTOR

1.1. Status, number and business network

As of 31.12.2010., there were 19 banks with the banking license issued in the Federation of BiH. Number of banks is smaller than as of 31.12.2009. due to revoking of a license from UNA Bank d.d. Bihac on 20.12.2010. There is a special law regulating establishment and work of the Development Bank of the Federation of BiH, Sarajevo which is a legal successor of the Investment Bank of the Federation of BiH d.d., Sarajevo, as of 01.07.2008.

As of 31.12.2010., there were two banks under provisional administration (Hercegovačka banka d.d. Mostar and Postanska banka BH d.d. Sarajevo).

In 2010, the banks continued expanding the network of their organizational units, but at a significantly lower level. At the same time, some banks had to close their organizational units, that is, they reorganized and merged their organizational units for purpose of cost cutting. Consequently, as of 31.12.2010., the banks from the Federation of BiH had a total of 600 organizational units. This represents a downfall of 5,5% when compared to 31.12.2009., as of which date the banks had 635 organizational units.

As of 31.12.2010., seven banks from the Federation of BiH had 54 organizational units in the Republic Srpska and nine banks had 12 organizational units in District Brcko. Five banks from the Republic Srpska had 23 organizational units in the Federation of BiH, and an increase of 10 organizational units or 76,9% happened after UNA bank d.d. Bihac was acquired by Balkan Investment Bank a.d. Banja Luka.

As of 31.12.2010., all the banks had the license for inter-bank transactions in the internal payment system and 15 banks were under the deposit insurance program.

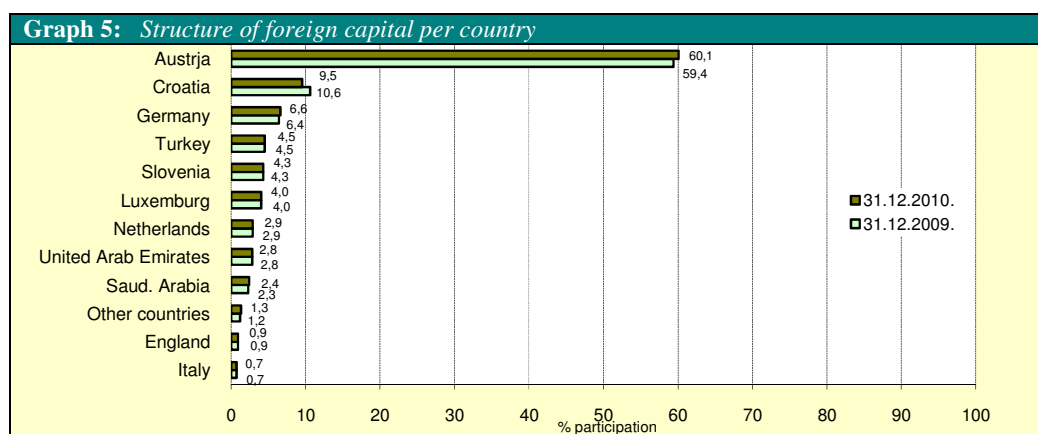
1.2. Ownership structure

As of 31.12.2010., ownership structure in banks³ based on the available information and on-site visits to banks⁴ is the following:

- Private and majority private ownership 18 banks (94,7%)
- State and majority state ownership⁵ 1 banks (5,3%)

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

If only foreign capital is analyzed based on the criteria of the shareholders' home country, as of 31.12.2010., the condition is almost the same as at the end of 2009: shareholders from Austria owned 60,1% of foreign capital, the shareholders from Croatia owned 9,5% of foreign capital, while other countries participated less than 7%.

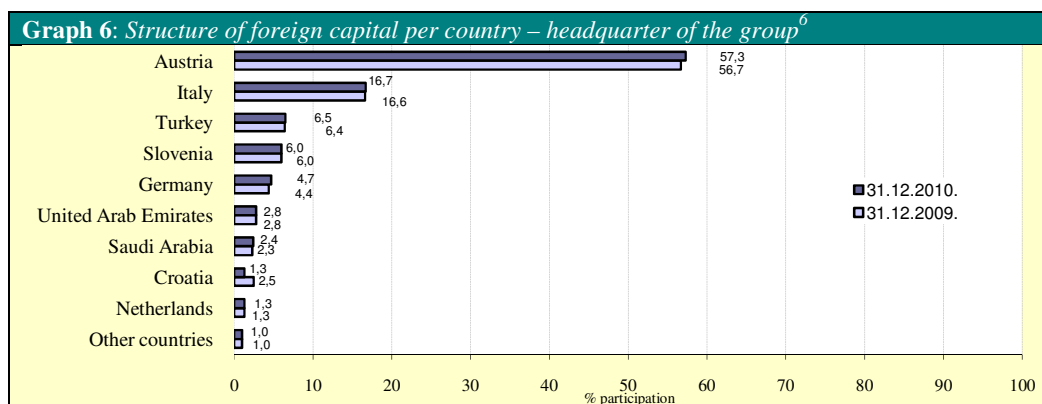


³ Bank classification criteria is ownership over banks' share capital.

⁴ The ownership structure of banks in the FBiH, as of 31.12.2010., resulted from received documentation and registrations at authorized courts (changes in capital and shareholders structure).

⁵ State ownership refers to domestic state capital of BiH.

However, if capital correlations are taken into account the structure for foreign capital could be viewed according to the criteria of the parent-bank or the group's headquarter that has majority ownership (directly or indirectly over the group members) of the bank in the Federation of BiH. According to these criteria, situation as of 31.12.2010. has insignificantly changed in relation to the end of 2009: banking groups and banks from Austria with participation of 57,3%, banks from Italy with participation of 16,7%, while other countries participate below 6,5%.

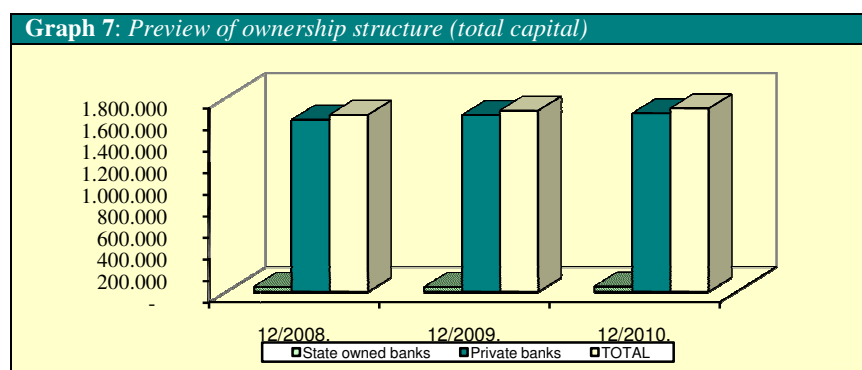


The ownership structure could be viewed from the aspect of financial indicators, which is based on the value of total capital⁷.

- in 000 KM-

Table 4: Ownership structure by total capital

BANKS	31.12.2008.		31.12.2009.		31.12.2010.		RATIO	
	1	2	3	4	5	6	3/2	4/3
State banks		42.593 3%	41.736 2%	46.586 3%			98	112
Private banks		1.594.261 97%	1.635.962 98%	1.650.039 97%			103	101
TOTAL		1.636.854 100%	1.677.698 100%	1.696.625 100%			102	101



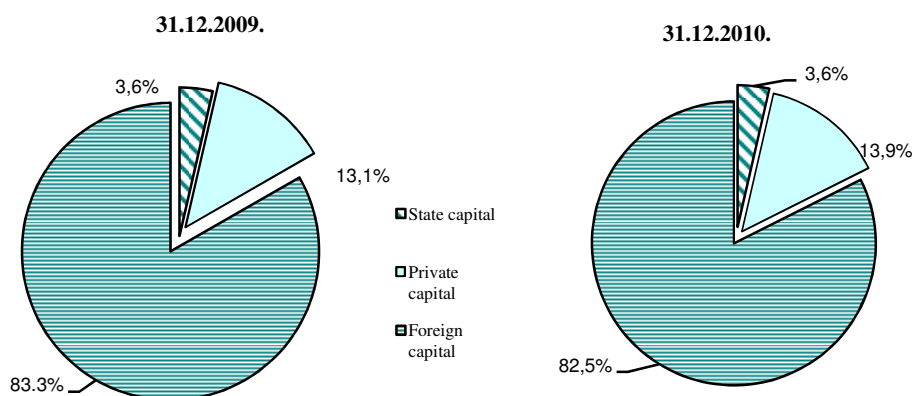
Analysis of participation by state, private and foreign capital in the share capital of banks shows more precise picture of the capital ownership structure in banks of the Federation of BiH.

⁶ Apart from the country of the headquarters of the parent-group whose members are the banks from the F BiH, the countries of all other shareholders of the banks from the F BiH are also included.

⁷ Information from balance sheet – FBA schedule: shareholder's capital, premium issue, undistributed profit and reserves, and other capital (financial results of current period).

- in 000 KM-

Table 5: Ownership structure by participation of state private and foreign capital								
SHARE CAPITAL	31.12.2008.		31.12.2009.		31.12.2010.		RATIO	
	Amount	Participation %	Amount	Participation %	Amount	Participation %	5/3	7/5
1	2	3	4	5	6	7	8	9
State capital	46.100	4,1	41.860	3,6	41.860	3,6	91	100
Private capital (residents)	142.469	12,8	153.365	13,1	163.074	13,9	108	106
Foreign capital (nonresident)	929.447	83,1	975.943	83,3	968.363	82,5	105	99
TOTAL	1.118.016	100,0	1.171.168	100,0	1.173.297	100,0	105	100

Graph 8: Ownership structure (share capital)

The share capital of banks in the Federation of BiH, in 2010, increased by 2,1 million KM in relation to 2009. The structure of the shareholder's capital slightly changed: private capital (resident) increased by 9,7 million KM, and private (nonresident) capital decreased by 7,6 million KM.

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

Participation of the state capital in total share capital, as of 31.12.2010., was 3,6%, and it is the same as of 31.12.2009.

Participation of private capital (residents) in total share capital of 13,9% is representing a 0,8 per cent increase in comparison to the end of 2009. Nominal increase of 9,7 million KM was based on the increase in one bank in the net amount of 12,4 million KM (additional capitalization of 15,2 million KM and decrease of 2,8 million KM, due to covering of losses from previous periods), decrease due to trading with nonresidents in four banks in the net amount of 2,2 million KM and a decrease due to withdrawal of own funds in one bank in the amount of 0,5 million KM.

Participation of foreign capital (nonresidents) in total share capital has decreased by 0,8 per cent in comparison to 31.12.2009. In absolute amount, the decrease was by 7,6 million KM.

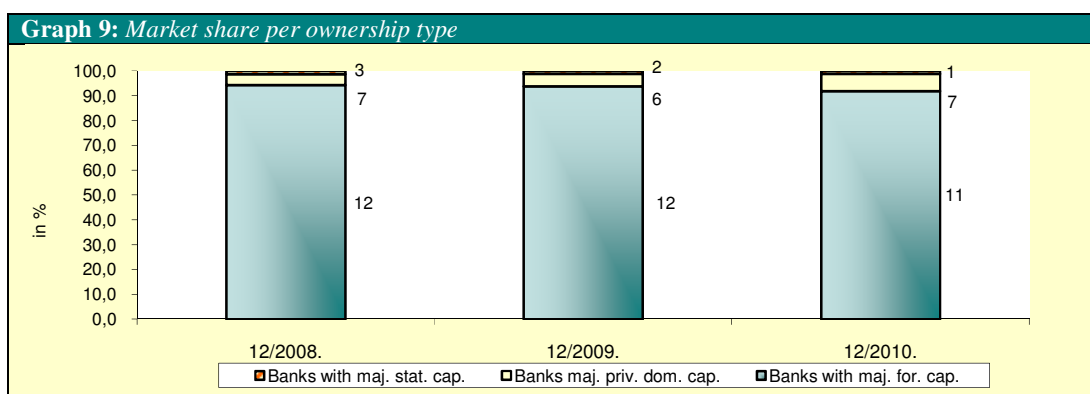
As of 31.12.2009., the market share of banks with majority foreign ownership was a high 93,9%, of banks with majority domestic private capital was 5,0%, and the share of banks with majority state capital was 1,1%.

This reduction refers to: a decrease in the amount of 11,8 million KM due to a 50% reduction of the nominal value shares of one bank because of covering the losses from previous periods, an increase in the trading with the resident in four banks in the amount of 2,2 million KM, as well as on additional capitalization in one bank in the amount of two million KM.

As of 31.12.2010., the market share of banks with majority foreign ownership was a high 91,9%, of banks with majority domestic private capital of 7%, and the share of banks with majority state capital was 1,1%.

- in %-

Table 6: Market share of banks per ownership type (majority owned capital)									
BANKS	31.12.2008.			31.12.2009.			31.12.2010.		
	No. of banks	Partic. in total capital	Partic. in total assets	No. of banks	Partic. in total capital	Partic. in total assets	No. of banks	Partic. in total capital	Partic. in total assets
1	2	3	4	5	6	7	8	9	10
Banks with majority state capital	2	2,6	1,3	2	2,5	1,1	1	2,7	1,1
Banks with majority private domestic capital	6	10,5	4,4	6	10,7	5,0	7	12,2	7,0
Banks with majority foreign capital	12	86,9	94,3	12	86,8	93,9	11	85,1	91,9
TOTAL	20	100,0	100,0	20	100,0	100,0	19	100,0	100,0



1.3. Employees

As of 31.12.2010., there was a total of 7.388 employees in the banks of the Federation of BiH, of that number 2% is in the banks with a majority state capital and 98% in private banks.

Table 7: Bank employees in the FBiH								
BANKS	NUMBER OF EMPLOYEES						RATIO	
	31.12.2008.		31.12.2009.		31.12.2010.		3:2	4:3
1	2	3	4	5	6	7	8	9
State banks	234	3%	231	3%	180	2%	99	78
Private banks	7.763	97%	7.425	97%	7.208	98%	96	97
TOTAL	7.997	100%	7.656	100%	7.388	100%	96	97
Number of banks	20		20		19		100	95

The decreasing trend from the previous year continued in 2010, which is one of the consequences of the adverse effects of the economic crisis on the banking sector of the Federation of BiH. However, it should be emphasized that the number of employees decreased by 3,5% or 268, which is by 0,8 per cent or 73 employees less than the previous year.

The decline, as in 2009, primarily refers to one bank where the number of employees decreased by 161 or 24%, and due to revoking the license from one bank the number of employees further reduced by 56.

Table 8: Qualification structure of employees								
EDUCATION	NUMBER OF EMPLOYEES						RATIO	
	31.12.2008.		31.12.2009.		31.12.2010.		4:2	6:4
1	2	3	4	5	6	7	8	9
University qualifications	3.007	37,6%	3.104	40,5%	3.234	43,8%	103	104
Two-year post secondary school qualifications	861	10,8%	774	10,1%	696	9,4%	90	89
Secondary school qualifications	4.054	50,7%	3.719	48,6%	3.406	46,1%	92	92
Other	75	0,9%	59	0,8%	52	0,7%	79	88
TOTAL	7.997	100,0%	7.656	100,0%	7.388	100,0%	96	97

Although, over a longer period of time the employees' qualification structure has recorded a trend of improvement through an increase of the number of employees with university qualifications, the negative trends of decrease of employees in the previous period, mostly of those with secondary school qualifications, have also had a positive effect on the qualification structure.

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

Table 9: Assets per employee									
BANKS	31.12.2008.			31.12.2009.			31.12.2010.		
	No. of empl.	Assets (000 KM)	Assets per empl.	No. of empl.	Assets (000 KM)	Assets per empl.	No. of empl.	Assets (000 KM)	Assets per empl.
State	234	187.157	800	231	161.619	700	180	167.263	929
Private	7.763	14.882.747	1.917	7.425	15.074.741	2.030	7.208	14.908.434	2.068
TOTAL	7.997	15.069.904	1.884	7.656	15.236.360	1.990	7.388	15.075.697	2.041

At the end of 2010, there was a two million KM assets per employee on the level of the banking system. The increase of the indicators for the majority state capital is a consequence of the decrease of the number of banks that is the revoking of the license from one state bank, so at the end of 2010, there remained only one bank with a majority state capital in the system.

Table 10: Assets per employee by groups			
Assets (000 KM)	31.12.2008.	31.12.2009.	31.12.2010.
	Number of banks	Number of banks	Number of banks
Up to 500	2	1	0
500 to 1.000	9	8	7
1.000 to 2.000	3	5	6
2.000 to 3.000	5	5	5
Over 3.000	1	1	1
TOTAL	20	20	19

Analytical indicators of respective banks range from 599 thousand KM to 3,3 million KM of assets per an employee. Six banks have a better indicator than the one for the whole banking sector, and three largest banks in the system have one that exceeds 2,2 million KM.

2. FINANCIAL INDICATORS OF BANKS' PERFORMANCES

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

1. Information on balance sheet for all banks submitted monthly, including quarterly attachments, containing more detailed information on funds, loans, deposits and off-balance sheet items, and some general statistic information,
2. Information on bank solvency, data on capital and capital adequacy, asset classification, concentrations of certain types of risks, liquidity position, foreign exchange exposure, 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 obtain realistic indicators of banks' performance in the Federation of BiH, all further analysis of the banking system will be based on the indicators from the active sub-balance sheet of banks with majority state owned capital⁸.

2.1. Balance sheet

The performance of the banking sector of the Federation of BiH in 2010, as in the previous year, was under the impact of the global economic crisis and recession. Although, there were recorded some signs of slight economic recovery, the situation and the condition in the economy, that is the real sector is still not satisfactory, and coming out of the crises will be slow and related to numerous external and internal factors and risks. The banking sector remains stable and safe, well capitalized, with a satisfactory liquidity. However, the growth and the development is still stagnating, a slight credit growth has been realized, which is still a positive change in relation to the relatively significant decline of the credit activities in 2009. The key problem is still the increase of the credit risk, that is the downfall of the asset quality (increase of poor performing assets), which resulted in a deterioration of profitability, the profits are significantly lower, and in some banks the losses are increasing. The banks kept the enhanced focus on the credit risk, more restrictive and rigorous policies in managing the credit risk, especially in the credit approval process. The structure of the financing sources is determined by the needs of the banks and their availability, which is resulting in an increased participation of local deposits and decreased foreign credits. That can be a limiting factor and a problem for the future credit growth, taken the maturity profile of the sources and the needs for lending with longer maturity dates. The limitations of the new lending possibilities and the surplus of the liquidity the banks used to invest in the securities. All of that resulted in changes in the banks' balance sheet structure.

⁸ 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 31.12.2010., these items amounted to KM 659 million.

Aggregate balance sheet of the banking sector, as of 31.12.2010., amounted to 15,1 billion KM, 1% or 161 million KM higher than at the end of 2009. After slight increase in the first quarter of 1% or 176 million KM, primarily due to the funds received from the payment of proceeds from the agreement IMF (second and third payment in the amount of 180,4 million KM), in the following three quarters there happened a decline of 2,2% or 337 million KM, with a note that in the fourth quarter the Federation of BiH received the funds in the amount of 49,5 million KM as the fourth payment from the stand by agreement. In comparison to the previous year, when the increase was 1% or 166 million KM, the decline of the balance sheet of 1% in 2010 was expected and is realistic taken into account the continued strong impact of the financial and economic crises on the banking sector in the Federation of BiH.

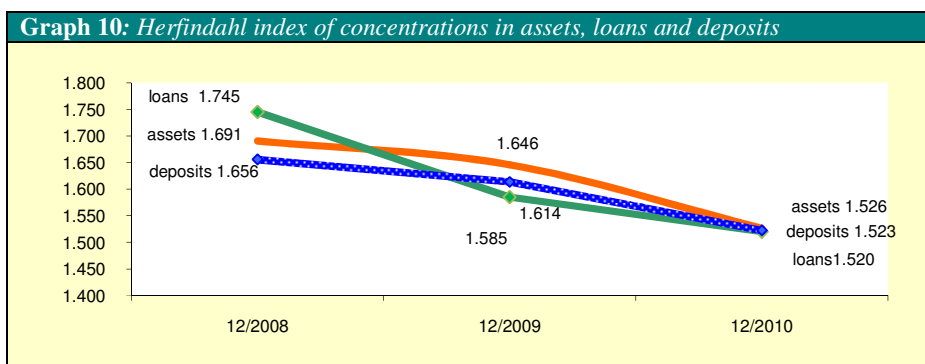
Table 11: Balance sheet								
DESCRIPTION	AMOUNT (IN 000 KM)							
	31.12.2008.		31.12.2009.		31.12.2010.		RATIO	
	AMOUNT	Partic. %	AMOUNT	Partic. %	AMOUNT	Partic. %	3/2	4/3
1	2		3		4		5	6
ASSETS:								
Cash funds	4.207.559	27,9	4.782.301	31,4	4.443.614	29,5	114	93
Securities ⁹	18.814	0,1	119.157	0,8	375.252	2,4	633	315
Placements to other banks	90.415	0,6	111.019	0,7	145.007	1,0	123	131
Loans	10.434.377	69,2	9.796.800	64,3	9.981.911	66,2	94	102
Loan loss provisions (LLP)	381.215	2,5	458.803	3,0	635.792	4,2	120	139
Loans – net value (loans minus LLP)	10.053.162	66,7	9.337.997	61,3	9.346.119	62,0	93	100
Business premises and other fixed assets	467.507	3,1	528.910	3,5	552.764	3,7	113	105
Other assets	232.447	1,6	356.976	2,3	212.941	1,4	154	60
TOTAL ASSETS	15.069.904	100,00	15.236.360	100,00	15.075.697	100,00	101	99
LIABILITIES:								
LIABILITIES								
Deposits	10.461.850	69,4	11.045.868	72,5	11.232.830	74,5	106	102
Borrowings from other banks	3.089	0,0	3.089	0,0	7.000	0,0	100	227
Loan Commitments	2.176.594	14,4	1.771.978	11,6	1.403.451	9,3	81	79
Other liabilities	791.517	5,3	737.727	4,9	735.791	4,9	93	100
CAPITAL								
Capital	1.636.854	10,9	1.677.698	11,0	1.696.625	11,3	102	101
TOTAL LIABILITIES (LIABILITIES AND CAPITAL)	15.069.904	100,0	15.236.360	100,00	15.075.697	100,00	101	99

Table 12: Assets of banks based on the ownership structure										
BANKS	31.12.2008.			31.12.2009.			31.12.2010.			RATIO
	No. banks	Assets (000 KM)		No. banks	Assets (000 KM)		No. banks	Assets (000 KM)		
	1	2	3	4	5	6	7	8	9	
State	2	187.157	1%	2	161.619	1%	1	167.263	1%	86 103
Private	18	14.882.747	99%	18	15.074.741	99%	18	14.908.434	99%	101 99
TOTAL	20	15.069.904	100%	20	15.236.360	100%	19	15.075.697	100%	101 99

The assets of majority of banks (14) were higher than at the end of 2009, ranging from 1% to 35%. The remaining five banks recorded the aggregate balance sheet decline from 0,4% to 17%. Of the three largest banks in the system two recorded the decline of 17,1% and 11,2% with total nominal amount of 855 million KM, while the third listed bank recorded a growth of 4,3% or 150 million KM.

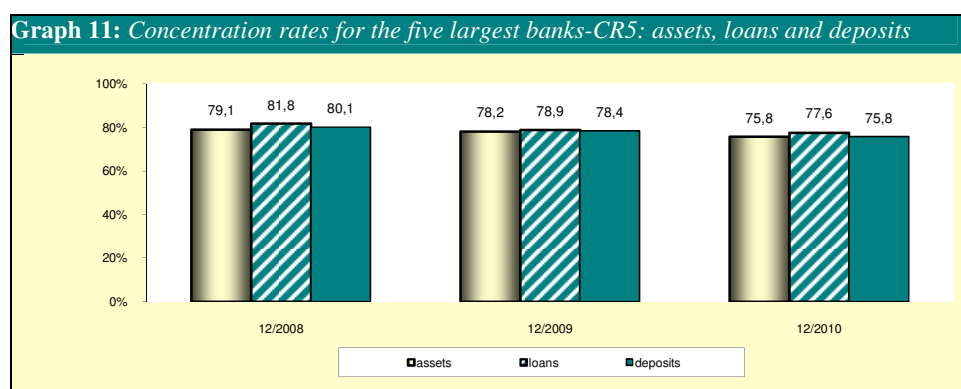
⁹ Trading securities and securities held to maturity.

Indicator of concentrations in the three most significant segments of banking performance, in assets, loans and deposits is the value of the Herffindahl index¹⁰.



At the end of 2010, the Herfindahl index in all three relevant categories (loans, deposits and assets) recorded almost the same value: assets 1.526 units, loans 1.520 deposits 1.523, indicating a moderate concentration¹¹. In comparison to the end of 2009, the largest decline was recorded by the assets indicators (120 units), 65 for loans and 91 for deposits.

Another indicator of concentration in the banking system is the ratio of market concentration, that is the concentration rate¹² (hereinafter: CR), which indicates the total market participation of the largest institutions in the system per relevant chosen categories: assets, loans and deposits. The CR5 for market participation and deposits of the five largest banks in the system, at the end of 2010, was the same (75,8%), and for loans 77,6% which is respectfully a decline of 2,4 per cent, 2,6 per cent and 1,3 per cent in comparison to the end of 2009. In the past two years the CR value has slightly declined in all three categories, but there is still an evident dominance of five largest banks in the system that “hold” approximately 76% of the market, loans and deposits



¹⁰ It is also called the Hirschmann-Herfindahl index or HHI as calculated in the formula $HI = \sum_{j=1}^n (S_j)^2$,

representing the sum of square of percentage shares of concrete values (e.g. assets, deposits, loans,...) of all market participants in the system. We should mention that the index is not linearly increasing, and the value of e.g. 3000 does not mean the concentration in the system is 30%. Hypothetically, if there is only one bank in the system, the HHI would be maximum at 10000.

¹¹ 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.

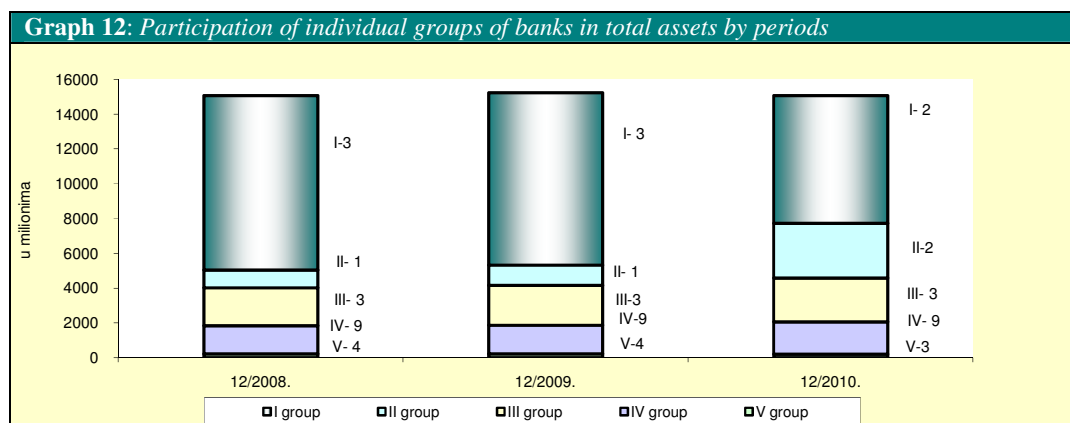
¹² Engl.: concentration ratio (CR), assigned to the number of institutions included in the calculation.

The banking sector could be analyzed from the aspect of several groups established according to the asset size¹³. The minor changes in relation to the end of 2009 refer to the number of banks and participation of certain groups which is a result of changes of assets in a larger number of banks.

The number of banks in Group I (assets higher than two billion KM), that includes the largest banks in the system, decreased from three to two, after the assets of one of the banks at the end of 2010 decreased under two billion KM, and consequently the participation of the Group I with 65,1% to 48,8%. The number of banks in Group II increased from one to two, and the participation from 7,6% to 20,9%. The participations of Group III (three banks assets between 500 million KM and one billion KM) and Group IV (the largest group with nine banks, assets between 100 and 500 million KM) increased by 1,6 per cent and 1,5 per cent and as of 31.12.2010 they were: Group III 16,7% and Group IV 12,3%. The participation of the Group V (three banks with assets lower than 100 million KM), due to the decrease of the number of banks to one, changed from 1,4% to 1,3%.

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

Table 13: Participation of individual groups of banks in total assets through periods										
ASSETS	31.12.2008.			31.12.2009.			31.12.2010.			
	Amount	Partic. %	No. of banks	Amount	Partic. %	No. of banks	Amount	Partic. %	No. of banks	
I- Over 2.000	10.036	66,6	3	9.912	65,1	3	7.348	48,8	2	
II- 1000 to 2000	1.017	6,7	1	1.165	7,6	1	3.146	20,9	2	
III- 500 to 1000	2.180	14,5	3	2.293	15,1	3	2.521	16,7	3	
IV- 100 to 500	1.627	10,8	9	1.648	10,8	9	1.862	12,3	9	
V- Bellow 100	210	1,4	4	218	1,4	4	199	1,3	3	
TOTAL	15.070	100,0	20	15.236	100,0	20	15.076	100,0	19	



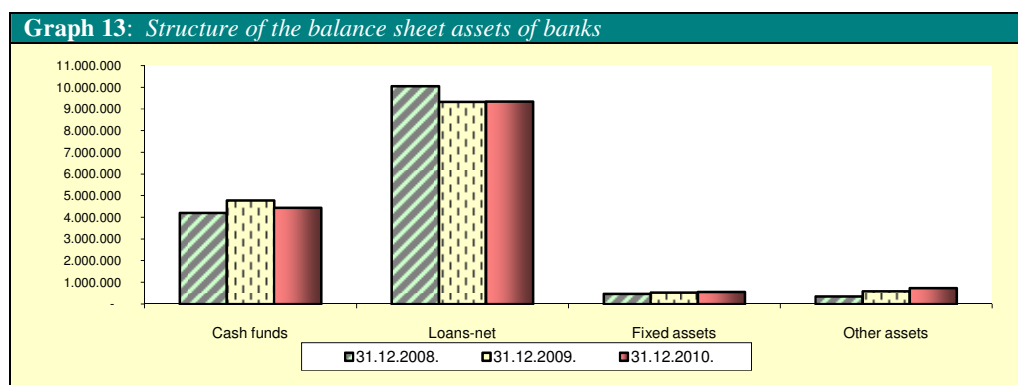
The slight decrease of the aggregate balance sheet in 2010 of 1% or 161 million KM is a result of changes in two largest items in banks' liabilities: collection of the liabilities from loans, that decreased by 21% or 369 million KM (they were 1,4 billion KM as of 31.10.2010.) and the growth of deposits of 2% or 187 million KM, which partly alleviated the decline of the aggregate balance sheet. At the end of 2010, the deposits were 11,2 billion KM. However, it has to be emphasized that this growth of deposit funds is primarily the result of the funds received through the standby agreement with IMF of 230 million KM (180 million KM in the first quarter and 50 million KM in the fourth quarter of 2010.).

¹³ Banks are divided into five groups depending on the assets size.

In the assets, cash funds (4,4 billion KM) are lower by 7% or 339 million than in comparison to the end of 2009, mostly due to collection of matured loans liabilities. Also, banks increased the time deposits on the accounts in the foreign banks by 31% or 34 million KM (as of 31.12.2010., they were 145 million KM), and placed approximately 120 million KM in securities¹⁴, mostly EU countries state bonds. At the end of 2010, the securities portfolio was 375 million KM. Significant funds were placed in the IV quarter of 2009 with the same purpose, purchase of securities (around 180 million KM, of which trading securities are 120 KM¹⁵). Due to too high liquidity and minimal return on funds over the obliged reserves on the reserve account in Central Bank of BiH, the banks, mostly the large ones, through placements in the securities and time deposits in foreign banks, are trying to realize higher income and by doing that mitigate the decline of the interest income due to decrease in loan placement

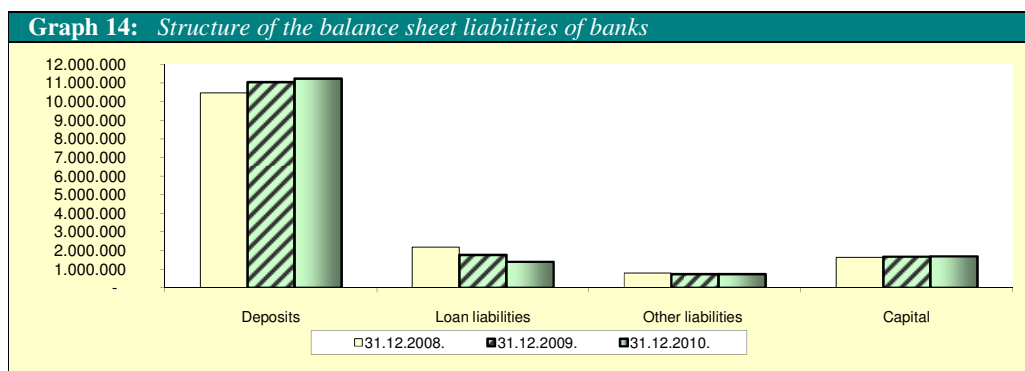
In the second and third quarter of 2010, the loans had a slight increase of 77 million KM and 22 million KM realizing a cumulative growth rate of 2% or 185 million KM in 2010, for the first time after five consecutive quarterly rates of decline of loans (all quarters in 2009 and the first in 2010), which was primarily the consequence and the result of restrictive lending policies of banks and decreased level of lending activities of banks in the conditions of economic crises and recession. It should be noted that the banks, in 2010, after classifying them in category E-loss, transferred to off balance sheet the loans in the amount of 184 million KM, which is by 35% or 48 million KM higher than in 2009. Such slight credit growth, especially in the fourth quarter, can be considered as a positive sign since they indicate that the banks' activities had, after several months of decrease, intensified in 2010., but that simultaneously the negative trends in the deterioration of the credit portfolio quality continued, which resulted in higher write offs. At the end of 2010, loans were 9,98 billion KM.

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



¹⁴ In the Balance sheet position 2 – Trading Securities also includes the financial instruments (debit and equity securities) available for sale.

¹⁵ In the II quarter of 2010, these funds were repositioned from other assets to the position 2 - Trading securities.



In the structure of banks' balance sheet liabilities from the aspect of the most significant balance sheet categories, deposits in the amount of 11,2 billion KM and participation of 74,5% are still the dominant source of financing for banks in the Federation of BiH. Participation of credit liabilities has decreased from 11,6% to 9,3%, and participation of capital increased from 11,0% to 11,3%.

The structure of assets, as well as the structure of sources, had relatively significant changes related to two key assets items: increased participation of loans from 64,3% to 66,2% and a decrease of cash funds from 31,4% to 29,5%

- in 000 KM-

Table 14: Cash funds of bank

CASH FUNDS	31.12.2008.		31.12.2009.		31.12.2010.		INDEX	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Cash	344.618	8,2	355.419	7,4	370.414	8,3	103	104
Reserve accounts with CBBiH	2.228.687	53,0	2.455.505	51,4	2.592.920	58,4	110	106
Accounts with deposit institutions in BiH	12.341	0,3	441	0,0	670	0,0	4	152
Accounts with deposit institutions abroad	1.621.449	38,5	1.970.473	41,2	1.479.322	33,3	122	75
Cash funds in collection process	464	0,0	463	0,0	288	0,0	100	62
TOTAL	4.207.559	100,0	4.782.301	100,0	4.443.614	100,0	114	93

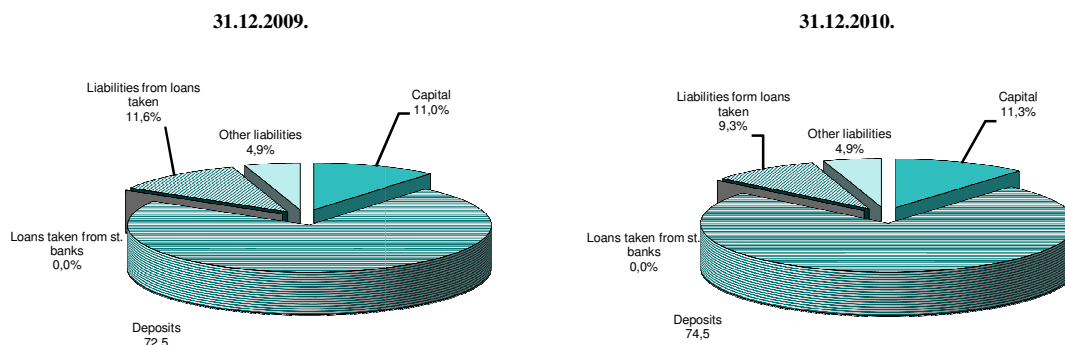
Cash funds of the banks on the reserve accounts of CBBiH, in 2010, increased by 6% or 137 million KM, amounting to 2,59 billion KM or 58,4% of total cash funds as of 31.12.2010., representing the participation decrease of seven per cent in relation to the end of 2009. Banks' funds on the accounts with the depository institutions abroad have decreased by a significant 25% or 491 million KM, amounting to 1,48 billion KM or 33,3% of total cash funds at the end of 2010, (41,2% at the end of 2009). The banks have increased their cash on hand and in vaults by 4% or 15 million KM. At the end of 2010, those funds amounted to 370 million KM, representing 8,3% of total cash funds (7,4 at the end of 2009.).

The listed fluctuations had a significant impact on the change of the currency structure of the cash funds: the domestic currency participation in the reviewed period increased from 55,8% to 63,7%, and for the same, while the participation of funds in foreign currency has increased by the same amount of change.

2. 1. 1. Liabilities

Structure of liabilities (liabilities and capital) in the balance sheet of banks, as of 31.12.2010. is presented in the following graph:

Graph 15: Liabilities structure of banks



The changing trend of the participation of the two most significant funding sources of banks (deposits and credit liabilities), continued in 2010. On one hand, through the growth of deposits, mostly based on the funds from the agreement with IMF, and on the other hand due to decrease of loan liabilities, due to payment of the due obligations, the deposit participation increased from 72,5% to 74,5%, and the credit liabilities have decreased from 11,6% to 9,3.

Deposits participating with 74,5% or 11,2 billion KM still represent the most significant funding source of banks in the Federation of BiH. In comparison to the end of 2009, these items increased by 2% or 187 million KM. Second source, per its size are credit funds obtained by banks through the debt with foreign financial institutions. During 2009, the banks had far less lending from abroad, and with the payment of the past due liabilities the net effect was the decrease of the credit liabilities by 19% or 405 million KM. The same trend continued in 2010, credit funds decreased by 21% or 369 million KM. If subordinate debts of 160 million KM, which were withdrawn by banks to strengthen capital base and capital adequacy, are added to credit liabilities then the participation of total credit funds in the sources would be 10,4% (12,8% at the end of 2009.).

Capital, at the end of 2010, was 1,7 billion KM, which is by 1% or 19 million KM higher than at the end of 2009. Although at the end of 2010 there was a significant loss in performance realized at the level of the banking system, the performed capitalizations in three banks in the third and fourth quarter neutralized the negative effects on the total capital of banks in the Federation of BiH.

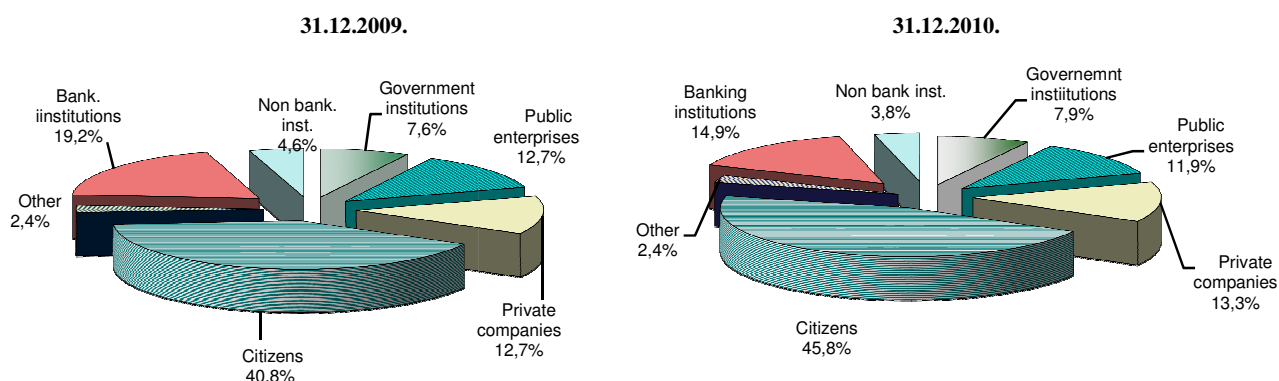
As of 31.12.2010., the highest bank commitments were towards the following creditors (eight of total 42), representing 72% of total credit commitments: European Investment Bank (EIB), Central Eastern European Finance Agency (CEEFA), EBRD, European fund for Southeast Europe (EFSE), Council of Europe Development Bank, ComercBank AG Frankfurt, Raiffeisen Zentralbank Osterreich A.G. (RZB) and Steirmarkische Sparkasse.

According to the data submitted by banks, out of total deposits as of 31.12.2010., only 6% were deposits collected by organizational units of banks from the Federation of BiH operating in Republic Srpska and Brcko District.

- in 000 KM-

Table 15: Deposit structure by sectors¹⁶

SECTORS	31.12.2008.		31.12.2009.		31.12.2010.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Governmental institutions	701.520	6,7	839.926	7,6	891.638	7,9	120	106
Public enterprises	1.245.793	11,9	1.400.839	12,7	1.332.695	11,9	112	95
Private enterprises and assoc.	1.490.139	14,2	1.403.465	12,7	1.491.562	13,3	94	106
Non-profit. organizations	2.172.860	20,8	2.120.143	19,2	1.674.576	14,9	98	79
Banking institutions	403.295	3,9	509.769	4,6	428.045	3,8	126	84
Citizens	4.181.882	40,0	4.506.881	40,8	5.144.607	45,8	108	114
Other	266.361	2,5	264.845	2,4	269.707	2,4	99	102
TOTAL	10.461.850	100,0	11.045.868	100,0	11.232.830	100,0	106	102

Graph 16: Deposit structure by sectors

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

Namely, the positive movements in the segment of citizen deposit continued through the fourth quarter of 2010 with growth of 5% or 224 million KM, which is the largest quarterly increase in 2010, that is the total deposit growth in 2010, was 14% or 638 million KM, and 5 percentage points of participation. In comparison to 2009, the growth rate is by 6 percentage points higher, which nominally is 313 million KM. Such trend is evaluated as positive, however, on the other hand, under the conditions when the economic crises is still strong, it indicates to a problem in decrease of spending, and decline in spending potential of majority of citizens, which has a negative effect on the economic movements and productive activities of the enterprises. The citizen deposits amounting to 5,14 billion KM and participation of 45,8% in total deposits, still represent the largest funding source of banks in the Federation of BiH.

While the citizens deposits had a significant growth in 2010, the largest change is recorded by the banking institutions deposits, second largest sector source of funds in the banks' deposits potential. Up to the beginning of the financial crises, a few banks had a significant financial

¹⁶ Information from the attached form BS-D, each quarter submitted by banks with balance sheet - FBA format.

support through deposit funds from the “parent” or “group”. However in 2009, the banking institution deposits decreased by 2%. In 2010, the same still decreased by a significant 21% or 446 million KM. At the end of 2010, they amounted to 1,67 billion KM, which is 14,9% of total deposits. As of 31.12.2010. the deposits of the banking institutions are by 271 million KM higher than the loan liabilities (at the end of 2009, the difference was 348 million KM), which are, after the deposits, the second most significant source of funding for bank in the FBiH. From the listed data it can be concluded that the lending of the banks in FBiH from abroad significantly decreased, in the foreign credit institutions but also from parent groups, which was expected taken the impact of the financial and economic crises and the condition of the economy and related decrease of banks’ credit activities and high liquidity.

It should be emphasized that 96% or 1,82 billion KM of banking institutions’ deposits refers to deposits of banks-members of groups (primarily shareholders). Financial support of the groups is present in nine banks in the Federation of BiH, with a concentration on three large banks (75%), with only one bank representing 37% of total deposits received from the group. In this manner, the domestic banks-members of the groups receive financial support and have secured inflow of new funding sources by the group whose members they are. This is especially important in times of crisis and more difficult access to money market and new funds, as well as the increase of liquidity risk as result of deterioration in collection of loans and increase of nonperforming claims. If credit liabilities and subordinate debts (loans and deposits in supplementary capital) are added to these funds, the financial support the banks receive from their groups becomes higher (in ten banks), amounting to 2,28 billion KM or 15% of total liabilities of the banking sector as of 31.12.2010. In comparison to the end of 2009, these funds were reduced by 764 million KM or 25% (deposits by 483 million KM or 23%, credit liabilities by 258 million KM or 35% and subordinated loans by 23 million or 11%).

Under the support of IMF and other financial institutions, the FBA has been involved in activities related to signing of the Memorandum of Understanding with parent-banks from the European Union countries whose daughter-banks operate in the territory of BiH, the so-called “Vienna Initiative”, by which the parent banks have taken the obligation to maintain the exposure in Bosnia and Herzegovina at the level from 31.12.2008., during the IMF program (2009 -2012), taken into account the availability of adequate credit possibilities in BiH within the defined good practices for managing the credit risk, capital and liquidity. Since, due to the economic crises, the banks’ credit activities have significantly decreased, which resulted with high liquidity, as well as the good capitalization of almost all banks in FBiH which parent banks signed the “Vienna Initiative”, in 2010 the risk exposure decreased in collection of past due credit liabilities, as well as the return of portions of deposit funds, in most part before the maturity. Although that had a positive impact on the profitability of those banks, through decrease of the interest expenses, once again emphasized should be the importance of the continuing financial support of the group, primarily the “parent”, especially in the banks which core sources were deposits and credit funds from the “parent” bank or the group.

Deposits of other sectors had minor changes: growth of the private enterprises' deposits that realized (after a decline of 6% or 87 million KM in 2009) an increase of 6% 88 million KM in 2010, so that as of 31.12.2010 they amounted to 1,49 billion KM, reaching the level from the end of 2008. However, the participation of 13,3% in the total deposits is by 0,9 per cent lower, while in comparison to 2009, it increased by 0,6 per cent. The public enterprises' deposits, after a decline of 5% or 68 million KM, at the end of 2010 amounted to 1,3 billion KM, while the participation decreased from 12,7% to 11,9%. Deposits of government institutions, with a growth rate of 6% or 52 million KM, as of 31.12.2010., amounted to 891 million KM, which is 7,9% of total deposits.

Currency structure of deposits, at the end of 2010, was the following: deposits in foreign currencies (with the dominant participation of EURO) in the amount of 6,4 billion KM participated with 57,5% (59,6% at the end of 2009) and deposits in domestic currency in the amount of 4,8 billion KM participated with 42,5% (40,4% at the end of 2009).

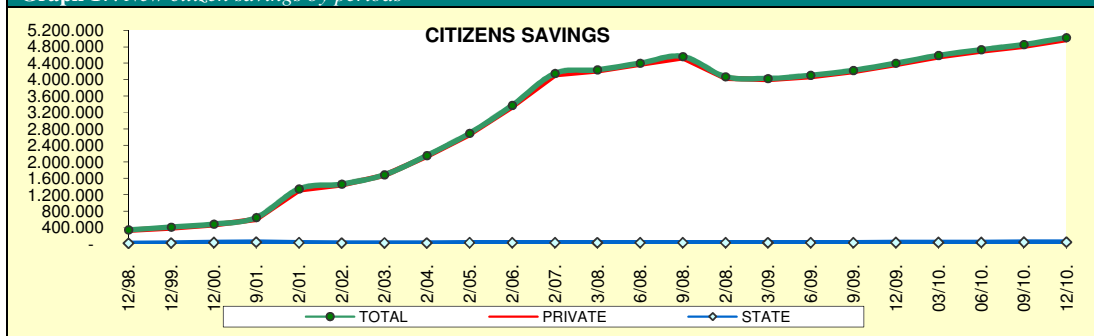
Saving deposits, as the most significant segment of deposits and financial potential of banks, following many years of a stable and continuous growth, with the first signs of the economic and financial crisis in the fourth quarter of 2008, decreased by 11% or 494 million KM. The most critical withdrawal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

Positive trends continued in 2010. As of 31.12.2010., savings reached the amount of 4,97 billion KM, which is the highest amount until now, and by 444 million KM or 10% higher than the level of savings as of 30.09.2008. that right before the crisis was the highest amount until that time. In 2010, the savings increased by 14% or 612 million KM. Those changes were primarily the result decreased spending due to the effect of the crises, difficult situation in the economy in general and citizens' fear due to uncertainty whether the situation will get better, and when will the positive signs for the coming out of crises and economic recovery start appearing.

Table 16: New citizen savings by periods

BANKS	AMOUNT (in 000 KM)			RATIO	
	31.12.2008.	31.12.2009.	31.12.2010.	3/2	4/3
1	2	3	4	5	6
State	32.481	35.275	47.148	109	134
Private	4.003.184	4.325.928	4.926.361	108	114
TOTAL	4.035.665	4.361.203	4.973.509	108	114

Graph 17: New citizen savings by periods



The largest three banks hold 71% of savings, while participation of seven banks has an individual participation of less than 1%, representing only 3,5% of total savings in the system.

Savings deposits in local currency represent 30% and in foreign currency 70% of total savings amount.

Table 17: : Maturity structure citizen saving deposits by periods

BANKS	AMOUNT (in 000 KM)						RATIO	
	31.12.2008.		31.12.2009.		31.12.2010.		3/2	4/3
	1	2	3	4	5	6		
Short term saving deposits	2.119.669	52,5%	2.054.197	47,1%	2.581.767	51,9%	97	126
Long term saving deposits	1.915.996	47,5%	2.307.006	52,9%	2.391.742	48,1%	120	104
TOTAL	4.035.665	100,0 %	4.361.203	100,0 %	4.973.509	100,0 %	108	114

After positive changes and improvement of the savings deposit structure in the last several years, in 2010, we saw a slight deterioration. The participation of the long term savings deposits decreased from 52,9% to 48,1%, and short term increased from 47,1% to 51,9%. The short term had a high rate of 26% or 528 million KM, and long term only 4% or 85 million KM, which impacted the changes of the maturity structure.

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

As of 31.12.2010., there are 15 banks included in the deposit insurance program in the Federation of BiH (they have a license by the Deposit Insurance Agency in BiH), and according to the submitted data 96,8% of total deposits and 98,5% of total savings are in these banks.

Upon the change of the Law on the deposit insurance in the banks in BiH¹⁷ and elimination of the ownership criteria (participation of private and state capital), in the first quarter of 2010, one state owned bank was accepted in the insurance program. The remaining four banks can not apply to be admitted since they do not qualify with the criteria prescribed by the Deposit Insurance Agency: two banks due to the existing composite rating, two because they are under provisional administration.

¹⁷ „Official Gazette of BiH“ No.75/09.

2.1.2. Capital – strength and adequacy

Capital¹⁸ of banks in the Federation of BiH, as of 31.12.2010., amounted to two billion KM.

-in 000 KM-

Table 18: Regulatory capital							
DESCRIPTION	31.12.2008.		31.12.2009.		31.12.2010.		RATIO
1	2		3		4		5
							6
STATE BANKS							
1. Core capital before reduction	44.852		44.906		45.431		100
2. Offsetting items	2.752		3.796		97		138
a) Core capital (1-2)	42.100	97%	41.110	97%	45.334	98%	98
b) Supplementary capital	1.335	3%	1.294	3%	1.046	2%	97
c) Capital (a + b)	43.435	100%	42.404	100%	46.380	100%	98
PRIVATE BANKS							
1. Core capital before reduction	1.610.692		1.708.796		1.839.728		106
2. Offsetting items	170.042		195.208		313.224		115
a) Core capital (1-2)	1.440.650	72%	1.513.588	75%	1.526.504	76%	105
b) Supplementary capital	574.370	28%	506.458	25%	488.940	24%	88
c) Capital (a + b)	2.015.020	100%	2.020.046	100%	2.015.444	100%	100
Total							
1. Core capital before reduction	1.655.544		1.753.702		1.885.159		106
2. Offsetting items	172.794		199.004		313.321		115
a) Core capital (1-2)	1.482.750	72%	1.554.698	75%	1.571.838	76%	105
b) Supplementary capital	575.705	28%	507.752	25%	489.986	24%	88
c) Capital (a + b)	2.058.455	100%	2.062.450	100%	2.061.824	100%	100

In 2010, capital¹⁹ remained on almost the same level, it decreased by only 0,6 million KM in comparison to 2009, while the changes in core and supplementary capital influenced the changes in the structure of regulatory capital. The core capital increased by 1% or 17 million KM, and supplementary capital decreased by 3% or 18 million KM.

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

The second important event is the completion of the additional capitalization of three banks in the fourth quarter of 2010, that were undercapitalized: one bank implemented capitalization of 105 million KM with payment into the reserve fund, and the other two with a new emission of shares of 17,3 million KM (two million KM and 15.3 million KM, with a note that this bank had previously covered losses from previous years against the shareholders capital in the amount of

¹⁸ Regulatory capital as defined by Article 8 and 9 of Decision on Minimum Standards for Capital Management in Banks (Official Gazette of the Federation of BiH, 3/03, 18/03, 53/06, 55/07, 81/07, 6/08).

¹⁷ Data source is the quarterly Report on Capital Positions of Banks (Form 1-Schedule A) regulated by the Decision on Minimum Standards for Managing Capital in Banks.

14,6 million KM). In addition, the revoking of license from one bank (that was under provisional administration) with a negative amount of core capital (about four million KM) also had a positive effect on its growth.

The core capital decline is a result of increase of offsetting items (that reduce the core capital) by a high 57% or 114 million KM, mostly based on the increase of the current loss (158 million KM, by 105 million higher than in 2009), with a simultaneous decrease based on partial covering of uncovered losses from previous years in the amount of 39 million KM and based on the cease of operations of one bank that had cumulated losses in the amount of 3,7 million KM.

Supplementary capital decreased by 3% or 18 million KM, with major changes in the structure: the 2009 profit of 49 million KM moved to the core capital, current audited profit is 52 million KM, based on the regular payments of the due liabilities the subordinate debts decreased by 25 million KM, while items of general loan loss provisions increased by 4,3 million KM.

The mentioned changes slightly influenced the structure of the regulatory capital, so participation of core capital has increased from 75% to 76%, while the supplementary capital has decreased from 25% to 24%.

Net capital, as well as regulatory capital decreased by only 0,5 million KM, amounting to two billion KM as of 31.12.2010.

The banks capital level rate is expressed as a ratio of capital and assets and as of 30. 12. 2010 it was 13,1%, at the same level as at the end of 2009.

One of the most significant indicators of capital strength and adequacy²⁰ of banks is capital adequacy ratio calculated as a ratio of net capital and risk weighted assets. As of 31.12.2010., this ratio at the banking system level was 16,2% which is lower by 0,1% than at the end of 2009. The reason was the decrease of total risk weighted items by 17 million KM while net capital remained on almost the same level. Analysis of the risk weighted items structure leads to conclude that the risk decline of the risk weighted assets and credit equivalents of 77 million KM (from 11,79 billion KM to 11,71 billion KM) has been neutralized through an increase of risk weighted operating risk by 60 million KM (amounting to 943 million KM), which resulted with the mentioned decrease of the overall risk weighted risk.

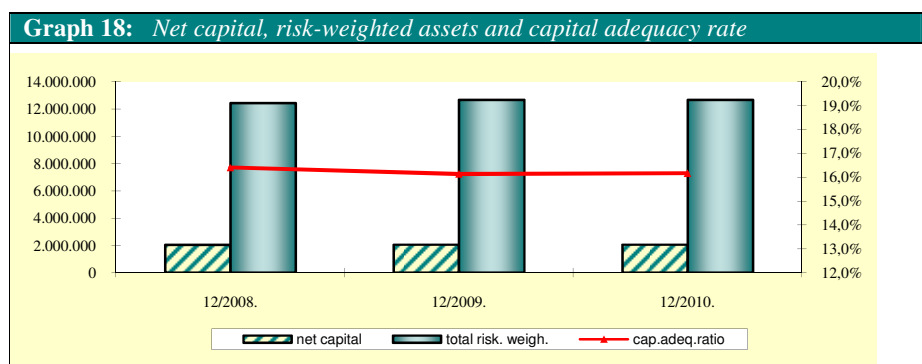
At the end of 2010, the participation of risk-weighted assets exposed to credit risk was 93%, and to operating risk 7%, the same as in 2009.

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

²⁰ The Law prescribes minimum capital adequacy rate of 12%.

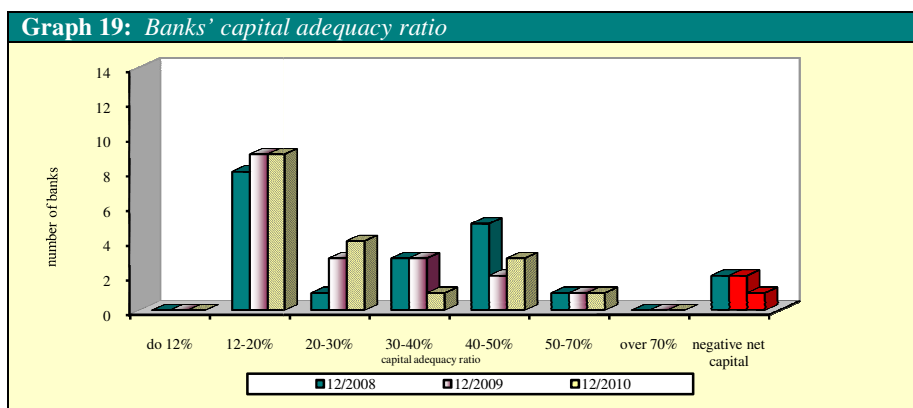
- 000 KM-

Table 19: Net capital, risk-weighted assets and capital adequacy rate					
DESCRIPTION	31.12.2008.	31.12.2009.	31.12.2010.	RATIO	
				3/2	4/3
1	2	3	4	5	6
1. NET CAPITAL	2.038.997	2.046.414	2.045.886	100	100
2. RISK WEIGHTED ASSETS AND CREDIT EQUIVALENTS	12.301.441	11.790.234	11.713.173	96	99
3. POR (RISK WEIGHTED OPERATING RISK)	130.975	882.928	942.707	674	107
4. TOTAL RISK WEIGHTED RISKS (2+3)	12.432.416	12.673.162	12.655.880	102	100
5. NET CAPITAL RATE (CAPITAL ADEQUACY) (1/ 4)	16,4%	16,1%	16,2%	98	101



Although the financial crises had a strong impact on the profitability of the banks, that is the growth of the losses in performance and decrease of the profit, mostly due to the high growth of the loan loss reserves, which had a negative impact on banks' capital, net capital and total risk weighted risk remained at approximately the same level, and the capital adequacy rate is higher by an insignificant 0,1% in comparison to 2009. Capital's strength and adequacy is preserved, on one hand, due to relatively high level of capitalization of banks before the crises, and on the other hand, due to the minimum decline during the crises in the last two years. The erosion of the capital base had been blocked, and the capital adequacy retained on a satisfactory level thanks to the additional inflow of the capital from external sources (additional capitalization) in three banks in the amount of 122,3 million KM (in these banks the capital base was jeopardized and/or there was a violation of the legally prescribed minimal standard of capital adequacy, therefore additional capital was provided in compliance with the FBA's request) and retaining profit from 2009 in capital reserves (in compliance with the FBA's request).

Capital adequacy rate of the banking system, as of 31.12.2010., was 16,2%, which is still much more than the minimum prescribed by the law (12%), representing satisfactory capitalization of the entire system and very strong basis and foundation to preserve its safety and stability.



Of total 19 banks in the FBiH, as of 31.12.2010., capital adequacy rate of 18 banks was higher than minimum prescribed by the law of 12%, one bank under provisional administration recorded capital adequacy rate below 12% that is a negative adequacy rate. According to analytical data at the end of 2010, 11 banks recorded the capital adequacy rate lower than prior year, five banks recorded better rate.

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

- nine banks had the rate between 13% and 18,2%, and three largest banks from 13% to 15,8%,
- eight banks had the rate between 20,4% and 45,0%,
- One bank had the rate between of 60%.

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

2.1.3. Assets and asset quality

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

Total assets with off-balance sheet items (assets)²¹ of banks in the FBiH as of 31.12.2010., amounted to 18,1 billion KM, representing an increase of 1% or 100 million KM in comparison to the end of 2009. Gross assets²² in the amount of 15,7 billion KM are lower by 20 million KM.

-in 000 KM-

Table 20: Assets off-balance sheet items and potential loan losses								
DESCRIPTION	AMOUNT (in 000 KM)						RATIO	
	31.12.2008.	Struct. %	31.12.2009.	Struct. %	31.12.2010.	Struct. %	4:2	6:4
1.	2	3	4	5	6	7	8	9
Loans	10.200.134	66,0	9.442.600	60,1	9.414.729	59,8	93	100
Interests	59.564	0,4	61.797	0,4	51.348	0,3	104	83
Past due claims	231.890	1,5	352.580	2,2	566.629	3,7	152	161
Claims for paid guarantees	2.353	0,0	1.620	0,0	553	0,0	69	34
Other placements	39.393	0,2	276.693	1,8	410.797	2,6	702	148
Other assets	4.937.976	31,9	5.581.877	35,5	5.292.854	33,6	113	95
TOTAL ASSETS	15.471.310	100,0	15.717.167	100,0	15.736.910	100,0	102	100
OFF-BALANCE SHEET	2.582.093		2.271.512		2.352.092		88	104
ASSETS WITH OFF-BALANCE SHEET	18.053.403		17.988.679		18.089.002		100	101
RISK ASSETS WITH OFF-BALANCE SHEET	13.304.610		12.583.315		13.053.738		95	104
General loan risk and Potential loan losses	461.839		534.721		717.713		116	134
General and Special loan loss reserves already established	461.687		534.749		717.768		116	134

Non-risk items amount to five billion KM or 28% of total assets with off-balance sheet, and they are by 7% less than as of the end of 2009. On the other hand, risk assets with off-balance sheet items amount to 13 billion KM, and they increased by 4% or 470 million KM. Off-balance sheet risk items amounted to 2,4 billion KM and are by 4% higher or 81 million KM.

The impact and negative consequences of the global financial and economic crisis in BiH are still apparent in banks' operations in 2010, as result of the transfer of crisis from real to the banking sector, with the largest impact on banks' key operation and that is the segment of lending and credit portfolio. While the decline of the credit portfolio quality continued in 2010, it can be concluded that there was a slight recovery in the lending segment, which is evident in a minimal growth of the loans. Following significant downfall of credit placements of 6% or 638 million KM in 2009, in 2010 there was a minor growth of 2% or 185 million KM that could be assessed positive, since banks have increased their volume of new placements based on which the negative trend from the previous periods came to an end. It should be noted that during 2010, and approximately the same amount of loans was written off (transferred into the off-balance), which resulted in a decreased loans growth rate. As of 31.12.2010., loans amounted to 9,9 billion KM with participation in the assets of 66,2%, which is lower by 1,9 per cent than at the end of 2009. However, although the consequences of the crises will be present in 2011, the macroeconomic projections indicate that a significant acceleration of the economic activities and export is expected in 2011, which should lead to recovery of the economic activities, which is further in correlation with the increase of the banks' credit activities.

In 2010, a total of 4,9 billion KM was generated in new loans, which is by 20% or 815 million KM higher than in comparison to 2009, but still by 17% or one billion KM in decline in comparison to the amount of the newly granted loans in 2008. In the last two years, there were positive changes in the sector structure of new lending, while in 2008, 61,4% of new loans were

²¹ Assets defined by Article 2 of Decision on Minimum Standards for Loan Risk Management and Assets Classification of Banks („Official Gazzette of FBiH“, number 3/03, 54/04, 68/05).

²² Data source: Report on classification of balance sheet assets and off-balance sheet items of banks.

placed to economy (private and public companies), and 34,7% to citizens, in 2009, the relation improved on the benefit of the economy (72,8%, and citizens 20,5%). In 2010, the participation of newly granted loans to economy remained almost unchanged (71,7%), and the citizens increased by 25,7%, mostly since, unlike the situation in 2009, the lending to government institutions in 2010 was on a much smaller scale. Significant oscillations were noted in relation to the maturity of the newly granted loans. While in 2008, the participation of the new short term loans in the total newly granted loans was 42,7%, and long term 57,3%, in 2009, the participations were 61,6% and 38,4%. Another change happened again in 2010, when the participations were the same (50% respectively).

The most significant limiting factor to the credit growth is adverse impact of the crisis to the entire economy in BiH and deterioration of condition in the real sector, then decreased citizen's spending, as well as more restrictive and prudent lending policies of banks. Based on that, as well as on the basis of the expected faster economic recovery in 2011, it is projected that the loan growth will be somewhat higher than in 2010. However, the quality performance of the existing loan portfolio will not significantly improve, but it is expected that the deterioration trend will be blocked, the level of the poor performing loans is still significantly high and with that the individual loan losses, which will have a negative effect on the banks' financial results. In 2010 the banks significantly increased the provisioning for loan losses, "cleaning" the credit portfolio, therefore the reserves for loan losses will be a good amortization for potential loan losses in the following period.

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

Three largest banks in the FBiH with credit amount of 6,2 billion KM have participation of 62,3% in total loans at the system level.

As already listed, from the aspect of sectors to which banks originate their loans, the movements in 2010, can be evaluated as positive due to increase of loans originated to private companies decreased, while loans originated to citizens have decreased slightly. Namely, in comparison to the end of 2009, the loans to private companies are higher by 3% or 119 million KM, and they amount to 4,8 billion KM or 48,2% of total loans (47,9% at the end of 2009). Loans to citizens decreased by 1% or 32 million KM, and they amount to 4,73 billion KM, with a participation of 47,4% (48,6% at the end of 2009). This is the first time since 2001, that the loans generated to private companies are higher than the loans to citizens by 82 million KM (at the end of 2009 they were lower by 69 million KM, and 2008, by 266 million KM). Due to overcoming of the existing financial crises the government institutions made a credit debt at several banks in the FBiH, therefore the loans to this sector increased by 69% or 52 million KM, and they amounted to 126 million KM which is an insignificant participation of only 1,3% in total loans (2009, 77 million KM, participation of 0,8%). The data submitted by banks, as of 31.12.2010., in the aspect of loan structure originated to citizens (based on the purpose), do not record any change over a longer period of time, that is, the highest participation of approx. 72% have loans originated to finance consumer goods²³, 25% have housing loans, and remaining 3% have loans for SMEs and agriculture.

²³ Short- term operation included.

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

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

-in 000 KM-

Table 21 : Structure of loans per sectors								
SECTORS	31.12.2008.		31.12.2009.		31.12.2010.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Government institutions	76.964	0,7	74.609	0,8	126.328	1,3	97	169
Public enterprises	175.424	1,7	184.005	1,9	238.105	2,4	105	129
Private enterprises and assoc.	4.881.526	46,8	4.696.276	47,9	4.815.426	48,2	96	103
Banking institutions	5.805	0,1	6.755	0,1	10.975	0,1	116	162
Non-banking financial instit.	105.352	1,0	51.255	0,5	37.235	0,4	49	73
Citizens	5.146.963	49,3	4.765.656	48,6	4.733.198	47,4	93	99
Other	42.343	0,4	18.244	0,2	20.644	0,2	43	113
TOTAL	10.434.377	100,0	9.796.800	100,0	9.981.911	100,0	94	102

Currency structure of loans has also been unchanged for longer period: loans financed with currency clause had the highest participation of 74% or 7,4 billion KM, loans in domestic currency of 25% or 2,5 billion KM, while loans in foreign currency had the lowest participation of only 1% or 112 million KM.

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

Quality of assets and off-balance sheet risk items, general loan risk, potential loan losses by classification categories²⁴ and off-balance sheet items are presented in the following table:

Table 22: Asset classification, general loan risk (GLR), potential loan losses (PLL) and off-balance sheet items (charged off assets and suspended interest)											
Classification category	AMOUNT (in 000 KM) and PARTICIPATION (in%)									RATIO	
	31.12.2008.			31.12.2009.			31.12.2010.				
	Assets classif.	Partic. %	GLR PLL	Assets classif.	Partic. %	GLR PLL	Assets classif.	Partic. %	GLR PLL	5/2	8/5
1	2	3	4	5	6	7	8	9	10	11	12
A	11.534.783	86,7	230.749	10.260.601	81,5	205.228	10.477.329	80,3	209.588	89	102
B	1.446.503	10,9	103.385	1.804.767	14,4	136.973	1.645.750	12,6	131.933	125	91
C	165.309	1,2	40.558	307.892	2,5	72.970	471.505	3,6	113.085	186	153
D	154.168	1,2	83.300	206.201	1,6	115.703	455.303	3,5	257.915	134	221
E	3.847	0,0	3.847	3.854	0,0	3.847	3.851	0,0	3.851	100	100
Risk assets (A-E)	13.304.610	100,0	461.839	12.583.315	100,0	534.721	13.053.738	100,0	716.372	95	104
Classified (B-E)	1.769.827	13,3	231.090	2.322.714	18,5	349.493	2.576.409	19,7	506.784	131	111
Nonperform. (C-E)	323.324	2,4	127.705	517.947	4,1	119.550	930.659	7,1	374.851	160	180
Nonrisk assets²⁵	4.748.793			5.405.364			5.035.264			114	93
TOTAL (risk and non-risk)	18.053.403			17.988.679			18.089.002			100	101
OFF BALANCE SHEET											
Written Off	429.419	89,0		505.632	89,7		622.990	89,6		118	123
Susp. Interests	54.479	11,0		57.957	10,3		72.251	10,4		106	125
TOTAL:	483.898	100,0		563.589	100,0		695.241	100,0		117	123

²⁴ 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%.

²⁵ 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%.

Risk assets with off-balance sheet items (A-E) amounted to 13 billion KM, and, as of 31.12.2010., these items decreased by 4% or 470 million KM. Non-risk items amounted to five billion KM, decreasing by 7% or 370 million KM in comparison to the end of 2009.

If an analysis of the risk assets quality is performed, it could be concluded, that in 2010, there was a continued downfall of asset quality and its deterioration as an impact of the economic crisis and an increase of non-payable claims, that is, delinquency of customers to pay past due loan liabilities. However, it must be noted that the highest impact on the significant deterioration of the indicators of the overall system had one bank, which in 2009, started and in 2010, intensified “cleaning” of its credit portfolio, which as a result had a significantly more poor asset quality indicators of this bank and the overall banking system. While the credit portfolio participation of that bank as of 12.31.2010., was 16,5%, the participation of its classified and non performing assets was 33% and 55%, and of the realized increase of the non-performing loans (409 million KM) the largest part refers to the bank (304 million KM or 75%). In the other banks the indicators has slight oscillations (deterioration or improvement), that is: four banks have indicators of the classified in relation to the risk assets more poor than the banking sector, and two banks have participation of non-performing in relation to risk asses also more poor than the banking sector.

Classified assets (B – E), in the observed period recorded growth of 11% or 254 million KM, the category B was decreased by 9% or 159 million KM, and nonperforming assets (C-E) increased by a high 80% or 413 million KM. In the same period performed was the write off of the assets and interest (transferred to off balance sheet) in the amount of 218 million KM. The noted indicators are of concern and that is underlined by the fact that in 2009 the total increase of the classified assets was 31% or 553 million, from which the B category was increased by 25% or 358 million KM, nonperforming by 60% or 195 million KM, the written off assets and interest were 157 million KM. In 2010 due to poor collection and increase of due days of the past due receivables, the banks had to perform a reclassification and a significant amount of loans were moved from B category to nonperforming category resulting in the increase of the loan loss provisioning expenses and having a significant negative impact on the financial results of the banks in 2010.

The classified assets as of 31.12.2010 were 2,6 billion KM, and nonperforming 931 million KM (31.12.2009: 2,3 billion KM and 518 million KM).

As result of the mentioned, the indicators of asset quality expressed as ratio, that is, participation of individual categories in risky assets have deteriorated in comparison to the end of 2009 and it is expected that the negative trends in 2011, will be slower and of smaller intensity. The classified assets to risky assets ratio has deteriorated by 1,2 per cent due to an increase of classified assets (11%) and downfall of risky assets (4%) in comparison to the end of 2009, which is representing 19,7%.

If an analysis is performed of only the ratio and trend of nonperforming assets and risk assets, as of 31.12.2010., this ratio was 7,1%, which is still relatively low ratio, and, if compared to the end of 2009, it is higher by three per cent. However, if we take into account that participation of category B in the risk assets is 12,6%, and the increasing doubt that portion of placements reported under this category deteriorated in quality and should be categorized as nonperforming assets, in other words that some banks still practice not to timely establish adequate loan loss provisioning (as confirmed through on-site examinations, resulting by insufficient loan loss reserves), it could be concluded that the assets quality still has a decreasing trend. That is why it is of key importance that banks more realistically evaluate quality of their placements and establish adequate loan loss reserves, especially due to the fact that under an impact of the crisis

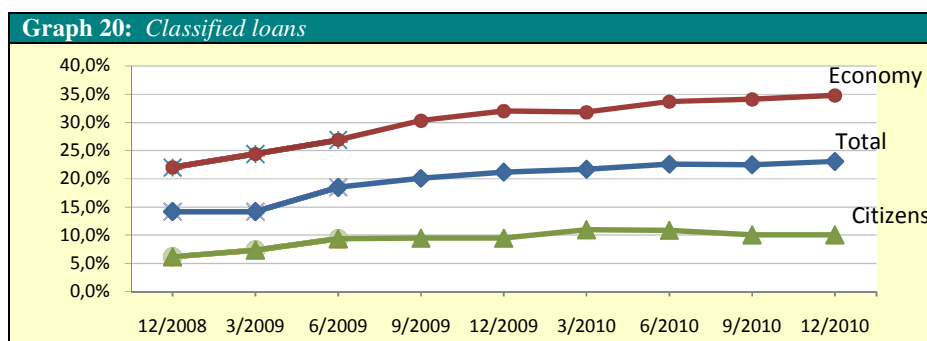
delinquency concerning payment of past due claims increase, provisioning increases, and the earnings of banks decrease.

The analysis of data by sectors is based on the indicators of the quality of loans granted to the two most significant sectors: 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 23: Classification of loans originated to citizens and legal entities

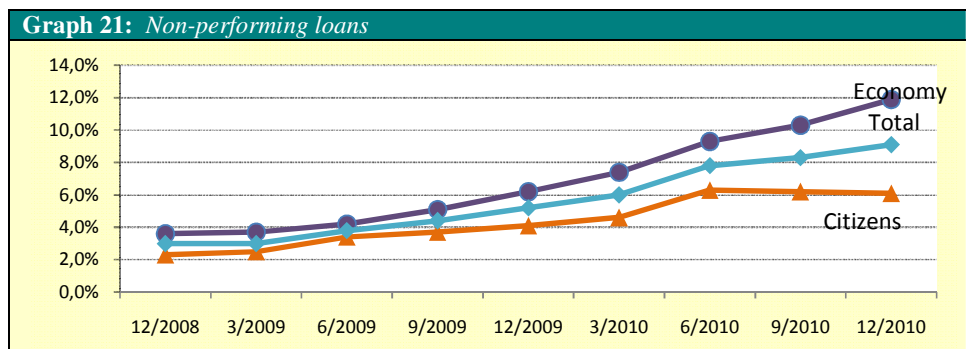
Classification category	AMOUNT (in 000 KM) and PARTICIPATION (in %)												RATIO
	31.12.2009.						31.12.2010.						
	Citizens	Partic. %	Legal entities	Partic. %	TOTAL Amount	Partic	Citizens	Partic %	Legal entities	Partic %	TOTAL Amount	Partic	
1	2	3	4	5	6 (2+4)	7	8	9	10	11	12 (8+10)	13	14
A	4.311.231	90,46	3.421.255	68,00	7.732.486	78,93	4.257.408	89,95	3.422.650	65,21	7.680.058	76,94	99
B	260.509	5,47	1.298.642	25,81	1.559.151	15,91	185.851	3,93	1.201.981	22,94	1.387.832	13,90	89
C	108.969	2,29	193.570	3,85	302.539	3,09	125.114	2,65	336.038	6,36	461.152	4,62	152
D	84.947	1,78	117.677	2,34	202.624	2,07	164.826	3,47	288.042	5,49	452.868	4,54	223
E	0	0,00	0	0,00	0	0,00	1	0,00	0	0,00	1	0,00	100
TOTAL	4.765.656	100,0	5.031.144	100,0	9.796.800	100,00	4.733.200	100,0	5.248.711	100,0	9.981.911	100,00	102
Class.loans B-E	454.425	9,53	1.609.889	32,00	2.064.314	21,07	475.792	10,05	1.826.061	34,79	2.301.853	23,06	111
NPL C-E	193.916	4,07	311.247	6,19	505.163	5,16	289.941	6,13	624.080	11,89	914.021	9,16	181
	48,64		51,36		100,00		47,42		52,58		100,00		
Participation by sectors in classified loans, nonperforming loans and category B:													
Classification B-E	22,02		77,98		100,00		20,67		79,33		100,00		
NPL C-E	38,39		61,61		100,00		31,72		68,28		100,00		
Category B	16,71		83,29		100,00		13,39		86,61		100,00		

The indicators of the quality of loans originated to legal entities and citizens, as well as already stated indicators of the quality of total risky assets, show a deteriorating trend in 2010, which is primarily a result of growth in the poor quality categories by a high 81% or 409 million KM (citizens 49% or 96 million KM, and legal entities 100% or 313 million KM), which lead to increase of the participation of non-performing loans from 5,16% to 9,16%, and also had a negative impact on other indicators for these two sectors and total loan portfolio. However, again should be noted the impact of the indicators of one bank on the total banking system, especially on the growth indicator and participation of the non-performing loans, since if that bank is excluded, it can be concluded that the indicators deteriorated, but in a significantly lower volume. In other words, without this bank the participation of the non-performing loans at the end of 2009 would be 3,8% increasing to 4,9% in 2010 that is by 1,1 per cent, while at the level of the system the growth of the participation would be four per cent.



As of 31.12.2010., of total loans originated to legal entities in the amount of 5,2 billion KM, 1,8 billion KM or 34,79% was classified in categories B to E (1,6 billion KM or 32% at the end of 2009), while of total loans originated to citizens in the amount of 4,7 billion KM, classification

categories B to E represent 476 million KM or 10,05% (454 million KM or 9,53% at the end of 2009).



Of loans finance to legal entities, 624 million KM was classified as nonperforming loans or 11,89% of total loans originated to this sector (as of 31.12.2009., these items amounted to 311 million KM or 6,19%). Nonperforming loans, in the sector of citizens, amounted to 290 million KM or 6,13% of total loans originated to this sector (as of 31.12.2009., these items amounted to 194 million KM or 4,07. If we exclude the data related to one bank, that was already mentioned, the deterioration of this indicator for both sectors is significantly lower: for legal entities increased from 4,68% to 6,46%, and citizens from 2,89% to 3,23%).

Due to poor performing receivables trend that is the delays in collecting the past due loan liabilities from clients, there were activated some guarantees in a number of delinquent loans that had this type of insurance, so the burden of payment of such loans fell on the guarantors. As of 31.12.2009., the FBA requires a report about the loans being repaid by the guarantor, in order to collect, monitor and analyze the data on loans that are being repaid by the guarantors. According to the banks' reports in F BiH as of 31. 12. 2010., 3.767 guarantors in total repaid 15 million KM of the total granted amount of loans of 101 million KM (3.192 credit party), which is almost twice higher than the amount repaid by the guarantors as of 31. 12. 2009. (7,5 million KM rapid by 3.327 guarantors, while the amount of the total granted loans was 54 million KM-2.704 credit party). The amount of the remaining debt at the end of 2010, was 63 million KM (31. 12. 2009.: 31,5 million KM). From the listed data it can be concluded that in 2010, the amount of loans paid by guarantors significantly increased, as well as the amount of payment on the burden of guarantors. While at the end of 2009, of the total amount paid 33% referred to the amount by guarantors, as of 31.12.2010., the participation by guarantors increased to 40%. The participation of loans and the number of credit parties being repaid by the guarantors in relation to the data for the entire system is low and amounts to only 0,63% and 0,29%.

With an aim to defer the negative effects of the global financial and economic crises, and taking care of maintaining the stability of the banking sector, the FBA at the end 2009, issued a Decision on temporary measures for reconstruction of loan liabilities of individuals and legal entities²⁶.

The main goal for issuing these temporary measures was to stimulate the banks to „revive“ credit activities, and restructuring the existing receivables, without increasing the price of the loan and expenses for the existing creditors, to help both the individuals and the legal entities to overcome the situation in which they are because of the effects of the economic crises (decrease in the repayment capability, for individuals due to the loss of jobs, late salaries, decrease in income etc., and for legal entities due to increased lack of liquidity, significant decrease of business activities, very difficult conditions in the real sector in general etc.).

²⁶ “Official Gazette F BiH”, No.2/10.

Acting in accordance with the mentioned Decision, the banks in the Federation of BiH in 2010, of total received 247 requests for reconstruction of credit liabilities granted 182 requests in the total amount of 128 million KM or 74%. Of the total amount of granted reconstructed liabilities 123 million KM refers to legal entities, and four million to individuals. Restructuring loans for legal entities had an increasing trend in the first three quarters, while in the fourth quarter there were less restructured loans granted in relation to the second and third quarter. The banks had far less restructured loans to individuals, noting that there is a decreasing trend in 2010.

Net effect on the loan loss reserves (in further reading LLR), based on the performed reprogramming in 2010, is an increase of 349 thousand KM. It should be noted that there were opposite movements that is increases and declines of the LLR on these basis, which at the end resulted in the noted net effect. The banks were performing very prudently, mostly maintaining the LLR on the same level, with which they were able to avoid short term and long term increases of the income, which in reality presents a true and responsible banks' attitude in implementing the provisions of the Decision that relate to this segment.

As of 31.12.2010., the reconstructed loans in the total loans have a participation of only 1,28% (for the sector of legal entities in the portfolio of legal entities this per cent is 2,35%, while the citizens sector is 0,09%).

-000 KM-

Table 24: Reconstructed loan liabilities of legal entities and individuals					
DESCRIPTION	31.03.2010. (I quarter)	30.06.2010. (II quarter)	30.09.2010. (III quarter)	31.12.2010. (IV quarter)	TOTAL
1	2	3	4	5	6 (2+3+4+5)
Legal entities	20.125	40.011	40.268	22.930	123.335
Individuals	2.390	850	470	735	4.444
TOTAL	22.515	40.861	40.738	23.665	127.779
Amount of decrease/increase of reserves	191	-15	-211	384	349

Based on the listed data, it can be concluded that, comparing the number and the amounts of the reconstructed loan liabilities) the result is relatively modest, if it is compared with the total credit portfolio and through sectors (for legal entities and individuals).

Although the results and the effects of implementation of the Decision are not significant, it is estimated that development of such a regulation was very important, such measures of temporary character under the conditions of extreme financial and economic crises were necessary for the financial and real in FBiH, and had a positive effect on debtors (individuals and legal entities), facilitating debt servicing in compliance with their repayment ability. That is why the prolonging of the amendments of the Decision to the end of 2011 is justifiable, especially due to the fact that the impact of the crises is still evident, and that the positive movements and economic recovery are to be expected next year.

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

Table 25: *Off-balance sheet records: charged off assets and suspended interest*

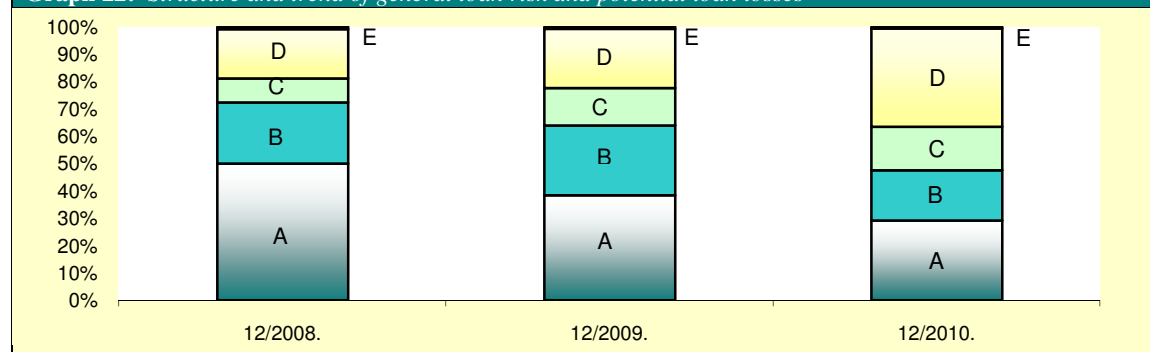
DESCRIPTION	CITIZENS		LEGAL ENTITIES		TOTAL	
	Charged off assets	Suspended interest	Charged off assets	Charged off assets	Suspended interest	Charged off assets
1	2	3	4	5	6	7
Opening balance as of 31.12.2008.	146.611	12.560	350.577	43.129	497.188	55.689
Changes in 2009:						
- new charge offs (current year)	90.966	10.700	93.403	22.769	184.369	33.469
- payments made in the current year	20.409	6.192	19.064	6.262	39.473	12.454
- permanent charge off	447	309	18.647	4.144	19.094	4.453
Balance as of 31.12.2010.	216.721	16.759	406.269	55.492	622.990	72.251

Balance of the charged off assets, as of 31.12.2010., (623 million KM), and the suspended interest (72 million KM) generated an increase of 25% that is 30% in comparison to 2009.

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

Table 26: *Structure and trend of general loan risk and potential loan losses*

Classification category	AMOUNT (in 000 KM) and STRUCTURE (in%)						RATIO	
	31.12.2008.	31.12.2009.	31.12.2010.	4/2	6/4			
1	2	3	4	5	6	7	8	9
A	230.749	50,0	205.228	38,4	209.555	29,2	89	102
B	103.385	22,4	136.973	25,6	132.048	18,4	132	96
C	40.558	8,8	72.970	13,7	113.962	15,9	180	156
D	83.300	18,0	115.703	21,6	258.297	36,0	139	223
E	3.847	0,8	3.847	0,7	3.851	0,5	100	100
TOTAL	461.839	100	534.721	100	717.713	100	116	134

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

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

Based on an analysis of the established provisions, in total amount and by classification categories, if compared to the end of 2009, general loan risk (for category A) and potential loan loss provisions have increased by 34%, or 183 million KM amounting to 718 million KM (only in the second quarter of 2010 they increased by 80 million KM, and in the fourth by 63 million KM). Due to an increase of the poor performing assets in 2010, the banks had to significantly

increase the reserves for these poorest quality loans, and the outcome was the increase from 192 million KM to 376 million KM, that is 95,4% or 184 million KM. The reserves for general credit risk (A category) increased by an insignificant 2% or four million KM, while for category B, due to its decrease, mostly generated by the reclassification into more poor categories, the reserves decreased by 4% or five million KM. One of the most significant indicators of the asset quality is the relation of the potential loan losses and the risk assets with the off-balance sheet, which increased from 2,6% to 3,9%. As of 31.12.2010., banks in average allocated for category B 8%, for category C 24,2%, category D 56,7% and E 100% (at the end of 2009: B 7,6%, C 23,7%, D 56,1% and E 100%).

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

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

Transactions with related entities

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

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

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

The set of prescribed reports include data on loans originated to the following categories of related entities:

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

-000 KM-

Table 27: Transactions with related entities					
Description	ORIGINATED LOANS ²⁷			RATIO	
	31.12.2008.	31.12.2009.	31.12.2010.	3/2	4/3
1	2	3	4	5	6
Shareholders over 5% of voting rights, subsidiaries and other related enterprises	26.823	29.191	84.600	109	290
Supervisory Board and Audit Board members	304	470	375	155	80
Bank Management	2.315	2.193	2.239	95	102
TOTAL	29.442	31.854	87.214	108	274
Potential and undertaken off-balance sheet liabilities	10.304	5.137	22.653	50	441

In the observed period, credit exposures to persons related to banks increased by 174, and potential liabilities by 341% % (the increase mainly relates to one large bank in the system). Based on the presented data, we could conclude that it is a question of a small amount of loans-guarantees operations with related entities, and the level of risk is low. The FBA pays special attention (in on-site examinations) to banks' operations with related entities, especially in assessing identification system and monitoring of risk exposure to related entities operations. The FBA on-site examiners issue orders for elimination of determined weaknesses within certain deadlines and initiate violation procedures. Part of these activities is also to monitor and supervise implementation of the issued orders in the follow up procedure. This has had a positive influence on this segment of operations, since the risk management quality in this segment has improved.

2.2. Profitability

According to the financial reports data that indicate the success of bank's performance, that is from the income statements for 2010, at the banking system level of the Federation of BiH, there was realized a negative financial result – loss in the amount of 103 million KM, while in 2009, there was profit generated at the banking system level in the amount of 807 thousand KM. Main reason to realizing this negative financial result is primarily the impact of high loss with one bank, which is by 36 million KM higher than the loss on the level of the system. In the same period last year this bank had a significantly lower, but still the largest loss in the system, in the amount of 19 million KM. In comparison with 2009, it is evident that of 14 banks that had positive performance in 2010, seven have a more poor profitability (effect 7,4 million KM), while at the same time six banks had higher profit (effect 6,4 million KM), and the highest positive effect of 9,8 million KM is realized in two banks that operated with losses in the last year but realized profit in 2010. . On the other hand, although the total loss on the level of the system is high, as it is stated mostly due to one bank, the number of banks that operate with losses has decreased from seven to five, of which one bank had a significantly lower loss (by 8,2 million KM) than the previous year. However, after further analyzing the quarters in 2010, it can be concluded that there were positive movements, the realized profit in the fourth quarter is significantly higher, as well as the number of banks that operated with positive financial results. In this quarter, if we exclude the bank with the high loss that influenced the high systemic loss, the number of banks that operated with losses and the loss is lower than in the previous quarter.

²⁷ Apart from loans, it includes other claims, deposited funds and the placements to shareholders (financial institutions) exceeding 5% of voting rights.

The biggest influence on deterioration of profitability of almost all banks in 2010 is the increase of loan loss provisions, as result of considerable decline in quality of loan repayments, that is, increased loan delinquency, as well as downfall in interest income and similar income.

Positive financial result of 55 million KM was generated by 14 banks, which is higher by 2% or 1,2 million KM than in 2009. At the same time five banks reported loss of 158 million KM, this is higher by three times or 105 million KM in comparison to the previous year.

High oscillations in the reported financial result at the sector level, if compared to the periods over the past three years, were mainly under influence of the events in stock exchanges related to price changes in securities trading, such as high income in 2007, that is, high expenses in 2008, while in 2009, their influence was at minimum, almost insignificant. The main reason for poor financial results is, as already noted, the decline of the credit portfolio and consequently the growth of the expenses for loan loss provisioning.

Detailed data is shown in the following table:

-000 KM-

Table 28: Financial result reported: profit/loss						
Date/Description	At the system level		State banks		Private banks	
	Amount	No. of banks	Amount		Amount	No. of banks
31.12.2008.						
Loss	-38.938	5	-761	1	-38.177	4
Profit	88.977	15	464	1	88.513	14
Total	50.039	20	-297	2	50.336	18
31.12.2009.						
Loss	-52.966	7	-965	1	-52.001	6
Profit	53.773	13	518	1	53.255	12
Total	807	20	-447	2	1.254	18
31.12.2010.						
Loss	-157.933	5	-	-	-157.933	5
Profit	54.957	14	1.155	1	53.802	13
Total	-102.976	19	1.155	1	-104.131	18

Similar to other segments, this segment has also encountered concentrations: of total profit generated (55 million KM), 79,3% or 44 million was generated by three banks in the system, whose participation in the banking system assets was 57,3% (two largest banks and one on the fourth place in the market participation). In the total loss of 158 million KM, 139 million KM or 87,8% refers to only one large bank which is in the foreign ownership, with asset participation of 12,3% on the third place in the system. Analytical data indicate that a total of eleven banks reported significantly deteriorated financial result (for a high 129 million KM), and eight banks have better results (by 24 million KM).

Based on the analytical data and the indicators for the quality evaluation of the profitability (the amount of the generated financial result – profit/loss and ratios used for evaluation of profitability productivity and efficiency of operation as well as other parameters related to evaluation of operation) it can be concluded that profitability had declined under the impact of the economic crises from the beginning of 2009. However, although a high loss was realized in 2010, there should be emphasized the influence of one bank with an enormous loss, even if majority of other banks had poor profitability. Indeed, after 2001 (when loss of 33 million was reported on the system level), initiated was the trend of successful performance that was stopped due to expansion of global and financial crisis, so in 2010 loss was being reported on the banking system level again, as a result of the fact that generally in the system, and especially in large banks that generate profitability, there was recorded a decline of total income, primarily as a result of downfall of the interest income through the decline of lending, as well as on the other side due to an extreme increase of loan loss provisions, as a consequence of deterioration of loan

quality in all banks, which was to be expected under the circumstances of growing impact of the economic crises.

At the system level, total income was realized in the amount of 859 million KM with decreasing rate of 43% or 43 million KM in comparison to 2009. Total noninterest bearing expenses were 953 million KM, and growth rate was 18% or 144 million KM which had negative reflection to the overall financial result of the sector.

Stagnation and the subsequent downfall of lending activities in 2009 (6%) and the slight increase in 2010 (2%) had negative reflection to the level of interest income. Indeed, in 2010 total interest income amounts to 856 million KM and it decreased by 7% or 62 million KM in comparison to 2009, and their participation in total income decreased from 112,6% to 99,7%. Major participation have interest income on loans that decreased by 8% or 66 million KM, and participation decreased from 103,5% to 90,6%. In the structure of interest income, highest participation (49,1%) was realized by interest income on loans total loan portfolio have a participation of 47,4%. Next is the interest income on loans given to private enterprises with participation of 39,2% and loan portfolio participation of 48,2%. Based on this it can be concluded that the credit portfolio to citizens is still more profitable for banks and less risky due to the lower level of poor quality loans in the lending structure, but also due to the higher interest rates on loans to citizens, which in 2010, in average were higher by about 30% than the interest rates for loans to enterprises. Significant downfall of 40% or 10 million KM was recorded by income on interest-bearing accounts with depository institutions, and their participation decreased from 2,9% to 1,7%. Opposite trend and changes were recorded in securities held to maturity that amount to 4,3 million KM and that in comparison to the same period last year increased by more than 3 times or three million KM, which under the circumstances of decline in lending activities is result of placing surplus of liquid assets to the securities in order to realize better return on the invested assets as well as the effect to profitability.

Positive changes were recorded in interest expenses that in comparison to the last year declined by 18% or 71 million KM and in 2010 they were 326 million KM, and their participation in the total income structure declined from 48,6% to 37,9. Interest expenses on deposits, as the largest item, and in relative participation and nominal amount in total interest expenses, decreased by 12% or 35 million KM, which apart from the growth of the interest bearing deposits of 4%, mostly a consequence of the decrease of interest rates, especially on long term deposits of legal entities and citizens, while the interest rates on short term deposits recorded a slight increase. Their participation in the structure of total income decreased from 37,1% to 31,1%. Decrease in long term credit indebtedness of banks, primarily with foreign financial institutions ("parent" banks or related banks from the group and in the financial markets with other creditors) of around 20% due to regular payments, and less significantly due to premature payments that the banks practice in order to decrease the expenses due to high liquidity lead to decrease of interest expenses on loans of 41% or 30 million KM. Their participation in total income decreased from 9% to 5,1%.

As a result of the faster decline of the interest expenses (18% or 71 million KM) than the interest income (7% or 62 million KM), net interest income increased by 2% or nine million KM and amounts to 531 million KM, with decreased participation in total income from 64% to 61,8%.

Operating income amounts to 328 million KM, and, if compared to the prior year, it records an increase of 12 or 35 million KM, and the increase in structure of total income from 36% to 38,2%. Within the operating income the largest participation have the service fees that recorded a growth of 8% or 15 million KM. The increase of the operating income is in part related to the increase of other operating income (21%).

The result of the above is an increase of the total income in 2010, by 5% or 43 million KM that

is it is realized in the amount of 859 million KM.

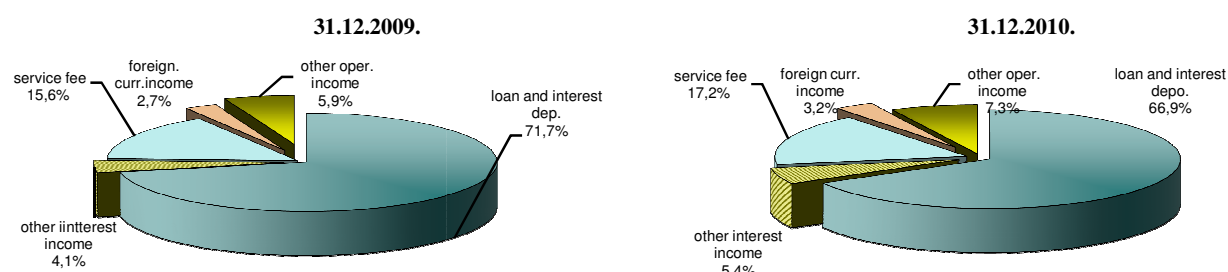
Total noninterest expenses had a faster growth (18%) than the net interest income (5%) and as of 31.12.2010., amount to 954 million KM and in comparison to the same period last year they increased by 144 million KM, primarily based on the increase of loan loss provisions. At the same time, their participation in the structure of total income increased from 99,2% to 111%.

Within the noninterest expenses, both nominally and relatively significant increase of 63% or 149 million KM was recorded by loan loss provisions of 386 million KM, and their participation in the structure of total income increased from 29,1% to 44,9%. On the other hand, the banks tried to set restrictions in the operating expenses, through reducing the number of employees, rationalization of the business network and generally decrease of material expenses, which is visible in the decline of the salary and contributions expenses by 2% or six million KM (average number of employees in 2010 decreased by 4,7% in comparison to the previous year) and fixed assets expenses with decreasing rate of 4% or six million KM.

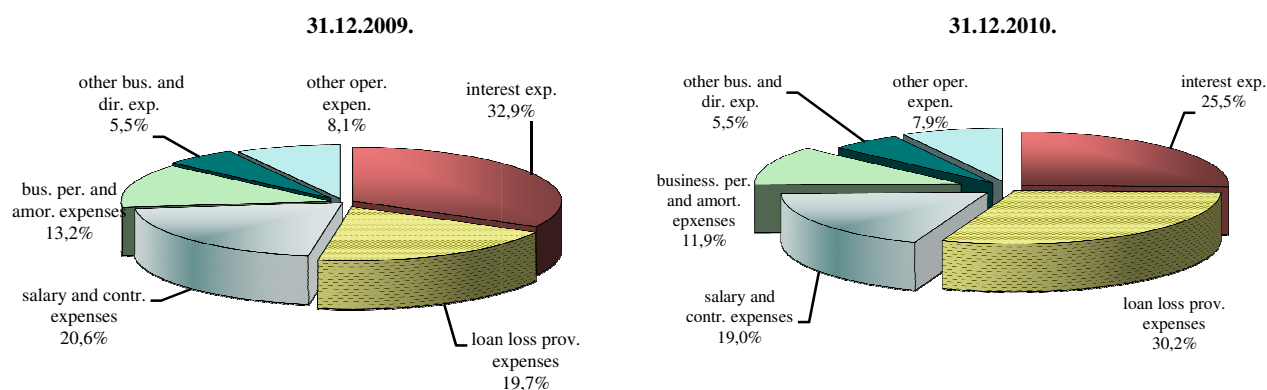
Trend and structure of total income and expenses is presented in the following tables and graphs:

- in 000 KM-

Table 29: Structure of total income								
Structure of total income	31.12.2008.		31.12.2009.		31.12.2010.		RATIO	
	Amount	%	%	%	Amount	%	4/2	6/4
1	2	3	4	5	6	7	8	9
I Interest income and similar income								
Interest bearing deposit accounts with depository institutions	84.585	6,7	23.848	2,0	14.388	1,2	28	60
Loans and leasing	816.338	64,6	844.681	69,7	778.690	65,7	103	92
Other interest income	45.254	3,6	50.163	4,1	63.450	5,4	111	126
TOTAL	946.177	74,9	918.692	75,8	856.528	72,3	97	93
II Operating income								
Service fees	186.477	14,8	188.891	15,6	204.173	17,2	101	108
Foreign exchange income	35.063	2,7	33.129	2,7	37.784	3,2	94	114
Other operating income	95.970	7,6	72.005	5,9	86.616	7,3	75	120
TOTAL	317.510	25,1	294.025	24,2	328.573	27,7	93	112
TOTAL INCOME (I + II)	1.263.687	100,0	1.212.717	100,0	1.185.101	100,0	96	98

Graph 23: Structure of total income**Table 30: Structure of total expenses**

Structure of total expenses	31.12.2008.		31.12.2009.		31.12.2010.		RATIO	
	Amount	%	Amount	%	Amount	%	4/2	6/4
1	2	3	4	5	6	7	8	9
I Interest expenses and similar expenses								
Deposits	291.575	24,5	302.305	25,1	266.893	20,9	104	88
Liabilities for borrowings	112.074	9,4	73.593	6,1	43.536	3,4	66	59
Other interest expenses	23.664	2,0	20.804	1,7	15.344	1,2	88	74
TOTAL	427.313	35,9	396.702	32,9	325.773	25,5	93	82
II Total non-interest bearing expenses								
General loan risk and potential loan losses	157.552	13,2	237.596	19,7	386.102	30,2	151	163
Provisioning	243.089	20,4	248.716	20,6	242.690	19,0	102	98
Salary expenses	151.159	12,7	158.884	13,2	152.737	11,9	105	96
Business premises and depreciation expenses	64.247	5,4	66.944	5,5	70.185	5,5	104	105
Other business and direct expenses	147.415	12,4	97.479	8,1	101.833	7,9	66	104
Other operating expenses	763.462	64,1	809.619	67,1	953.547	74,5	106	118
TOTAL	763.462	64,1	809.619	67,1	953.547	74,5	106	118
TOTAL EXPENSES (I + II)	1.190.775	100,0	1.206.321	100,0	1.279.320	100,0	101	106

Graph 24: Structure of total expenses

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

- in %-

Table 31: Ratios of profitability, productivity and effectiveness by periods			
RATIOS	31.12.2008.	31.12.2009.	31.12.2010.
Return on Average Assets	0,35	0,01	-0,68
Return on Average Total Capital	3,33	0,05	-6,15
Return on Average Equity	5,02	0,07	-8,53
Net Interest Income/Average Assets	3,61	3,44	3,49
Fee Income/Average Assets	2,21	1,94	2,16
Total Income/Average Assets	5,82	5,38	5,65
Operating and Direct Expenses/Average Assets	1,54	2,01	3,00
Operating Expenses/Average Assets	3,77	3,33	3,27
Total Non-interest Expenses/Average Assets	5,31	5,34	6,27

-in %-

Table 32: Ratios of profitability, productivity and effectiveness as of 31.12. 2010.			
RATIOS	31.12. 2010.		
	STATE BANKS	PRIVATE BANKS	AVERAGE IN THE FBiH
Return on Average Assets	0,68	-0,69	-0,68
Return on Average Total Capital	2,51	-6,4	-6,15
Return on Average Equity	3,39	-8,87	-8,53
Net Interest Income/Average Assets	2,23	3,50	3,49
Fee Income/Average Assets	8,24	2,09	2,16
Total Income/Average Assets	10,48	5,59	5,65
Operating and Direct Expenses/Average Assets	3,47	2,99	3,00
Operating Expenses/Average Assets	6,21	3,24	3,27
Total Non-interest Expenses/Average Assets	9,68	6,23	6,27

Reported loss at the banking system level resulted by negative key profitability indicators: ROAA (Return on Average Assets) and ROAE (Return on Average Equity). Productivity of banks, measured as ratio of total income and average assets was slightly better than in 2009 (increased from 5,38% to 5,65%) due to faster growth of the total income (5%) than the average total assets (0,3%). It should be emphasized a high increase of business and direct expenses per average assets (from 2,01% to 3%), which is related to the high increase of loan loss provisions expenses.

Under a more deteriorated performance conditions of banks, and due to adverse effects of the economic and financial crisis to the banking sector in the FBiH, profitability of banks, in the forthcoming period, will mostly depend on deterioration of asset quality, that is, permanent increase of loan losses and loan risk, and will depend on effective management and operating income and expenses control, although the banks reached the maximum on the side of the expenses, and further reductions might have negative effects on efficiency and overall business performance. Banks will have to increase the level of lending activities, not only to ensure increase of interest income, but to utilize their social core function of the collected financial assets allocation to the economic flows and the economy in compliance with the standards of prudent performance and sound practices of risk management, primarily of credit risk.

In addition, profit of banks, that is, financial result will mostly depend on price and interest rate risk, both in the sources and price changes in funding sources of banks, and possibility to realize interest rate margin sufficient to cover all non-interest bearing expenses, and, eventually, to provide for satisfactory profit on the invested capital for bank owners. That is why the key factor

28 Expenses include provisions for potential loan losses.

is effectiveness and profitability of each bank's management quality and its business policy since this is the most direct way to affect its performance.

2.3. Risk-weighted nominal and effective interest rates

In order to increase transparency, and to make easy a comparability of conditions of banks in process of originating loans and accepting deposits and protection of customers through a transparent disclosure of loan expenses versus deposit income, and, in accordance with the international standards, criteria and practices in other countries, the FBA, as of 01.07.2007., prescribed unified method of computation and disclosure of effective interest rate²⁹ for all banks that have their seat in the Federation of BiH, and their organizational units, regardless of the territory in which they operate, including organizational units of the banks operating in the Federation of BiH. Effective interest rate represents a real relative price of a loan, that is, an income generated from a deposit, expressed as per cent at the annual level.

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

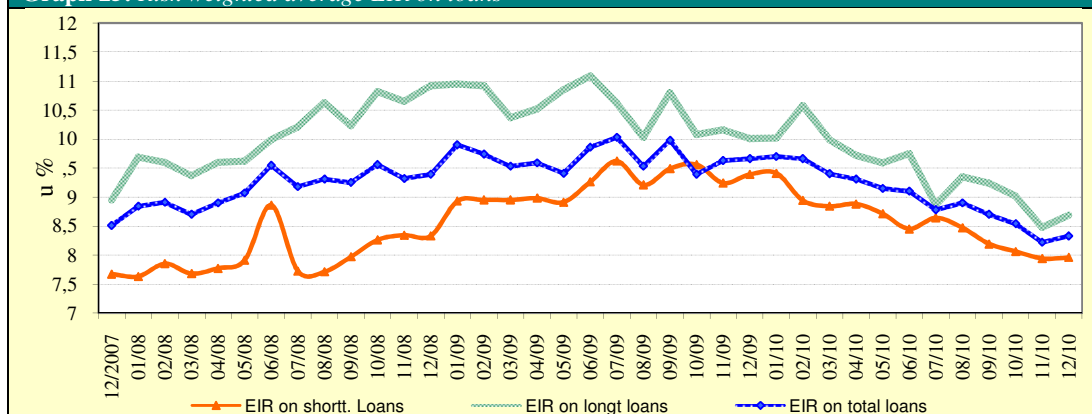
Banks are obliged to monthly report to the FBA of risk-weighted nominal and effective interest rates on loans and deposits originated or accepted within the reporting month, in accordance with the methodology prescribed³⁰.

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

Table 33 Risk-weighted average NIR and EIR on loans										
DESCRIPTION	31.12.2008.		30.6.2009.		31.12.2009.		30.06.2010.		31.12.2010	
	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR
1	2	3	4	5	6	7	8	9	10	11
1. Risk-weighted interest rates for short-term loans	7,82	8,33	8,41	9,26	8,55	9,39	7,9	8,45	7,51	7,96
1.1. Economy	7,74	8,19	8,40	9,10	8,51	9,27	7,86	8,34	7,47	7,82
1.2. Citizens	10,25	13,04	10,03	13,94	9,51	12,9	8,97	12,28	8,67	12,65
2. Risk-weighted interest rates for long-term loans	9,95	10,92	9,92	11,09	9,16	10,00	8,89	9,75	7,91	8,69
2.1. Economy	8,33	8,92	8,70	9,62	8,46	9,15	8,4	8,9	7,34	7,82
2.2. Citizens	11,16	12,54	10,82	12,20	10,21	11,32	9,35	10,56	8,79	10,05
3. Total risk-weighted interest rates for loans	8,69	9,39	8,91	9,86	8,82	9,66	8,4	9,1	7,72	8,33
3.1. Economy	7,88	8,37	8,45	9,19	8,50	9,23	8,04	8,53	7,42	7,82
3.2. Citizens	11,09	12,58	10,75	12,34	10,17	11,42	9,34	10,64	8,78	10,18

²⁹ Decision on unified method of computation and disclosure of effective interest rates on loans and deposits ("Official Gazette of the FBiH", number 27/07).

³⁰ Guidelines for implementation of Decision on unified method of computation and disclosure of effective interest rates on loans and deposits and Guidelines for computation of risk-weighted nominal and effective interest rate.

Graph 25: Risk weighted average EIR on loans

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

The risk-weighted EIR for loans, during 2010, had a decreasing trend. In comparison to the level of 9,66% in December 2009, following minor increase of 0,04 per cent in January 2010, 0,12% in August, and 0,11% in December, it records a continuous decrease and in December of 2010 is 8,33%, presenting a decline of risk weighted EIR by 1,33 per cent.

During the 2010, higher oscillations are recorded by the EIR for long-term loans, within 2,1%, than the short term that oscillated within 1,45%.

The risk-weighted EIR for short-term loans, in December 2010, was 7,96%, which was lower by 1,43 per cent in comparison to December 2009.

The risk-weighted EIR for long-term loans, in December 2010, was 8,69%, which was lower by 1,32 per cent in comparison to December 2009.

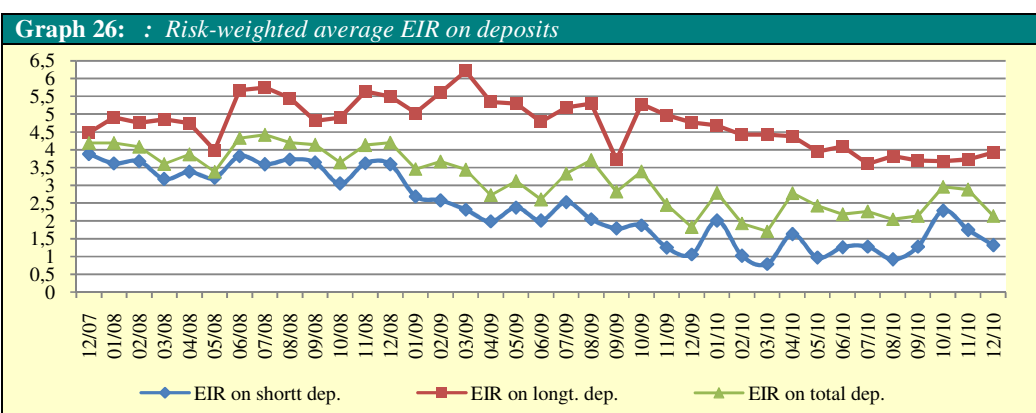
Interest rates for loans originated in the two most significant sectors: economy and citizens³¹, over the observing period of 2010, had the decreasing trend. The risk weighted EIR for loans originated in the economy, although still much lower than the EIR for loans to citizens, decreased from 9,23% in December 2009 to the level of 7,82% in December 2010 (by 1,41 per cent). As for long term loans, downfall was 1,33 per cent (from 9,15% to 7,82%), while EIR for short-term loans recorded a downfall of 1,45 per cent (from 9,27% to 7,82%). During 2010, there were recorded frequent oscillations in the EIR movements on short term and long term loans to economy, so their relation changed several times. In January, May, July, October and November the average EIR on short term loans was higher than EIR on long term, in the other months it was the opposite, and finally in December 2010., it reached the level of 7,82%.

During 2010 the overall EIR on loans financed to citizens had a slight declining trend, more with long term than the short term. The changes oscillated within 1,85 per cent, with the lowest rate in April (10,03%) and highest recorded in February (11,88%). EIR for long term loans to the same sector, from the 2009 December level of 11,32%, decreased to 10,05% in December 2010. EIR for short term loans in December 2010 was 12,65%, which was lower by 0,26 per cent than in December 2009.

³¹ Based on the methodology of classification in sectors: entrepreneurs are included in the sector of citizens.

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

Table 34: Risk-weighted average NIR and EIR on deposits										
DESCRIPTION	31.12.2008.		30.06.2009.		31.12.2009.		30.06.2010.		31.12.2010.	
	NIR	EIR	NIR	EIR	NIR	NIR	EIR	NIR	EIR	NIR
1	2	3	4	5	6	7	8	9	10	11
1. Risk-weighted interest rates on short term deposits	3,59	3,59	1,99	2,01	1,06	1,06	1,26	1,26	1,31	1,32
1.1. up to 3 months	3,48	3,49	1,74	1,74	0,72	0,72	0,39	0,39	0,97	0,97
1.2. up to 1 year	4,13	4,14	3,80	3,95	2,90	2,91	3,25	3,26	2,61	2,63
2. Risk-weighted interest rates on long term deposits	5,48	5,49	4,72	4,78	4,75	4,77	4,08	4,09	3,89	3,92
2.1. up to 3 years	5,41	5,42	4,58	4,66	4,72	4,74	3,86	3,87	3,78	3,80
2.2. over 3 years	6,34	6,33	6,14	6,11	5,12	5,13	5,45	5,47	4,48	4,57
3. Total risk-weighted interest rates on deposits	4,2	4,2	2,57	2,60	1,82	1,83	2,19	2,19	2,13	2,14



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

If compared to December 2009, risk-weighted EIR for total term deposits, in December 2010, increased by 0,31 per cent (from 1,83% to 2,14%) mostly due to slight increase of EIR on short term deposits. Risk-weighted EIR on short term deposits shows fluctuations within 1,5 per cent, with the highest in October when it was 2,29 per cent, the lowest in March 0,79%, and in December of 2010 it was 1,32% (2009: 1,06). Risk-weighted EIR on long term deposits recorded a downfall of 0,85 per cent in comparison to December 2009, and it was 3,92% in December of 2010.

The short term deposits have an increase of EIR for time deposits up to three months by 0,25 per cent in comparison to the level from December of 2009, and it is 0,97%. The average EIR on time deposits up to one year is 2,63%, which is by 0,28 per cent less than in comparison to December of 2009.

Risk weighted EIR on long term time deposits for up to three years decreased in relation to the level from December by 0,94 per cent and in December it was 3,80%. EIR on time deposits of over three years was 4,57% in December, which is by 0,56 per cent less than as of December of 2009, when it was 5,13%

Average EIR on deposits to citizens was 2,94% in December, and it declined by 0,81% in comparison to December of 2009. In the last quarter of 2010., EIR on time deposits to economy increased from the level in September of 1,59% to 2,66% in October, and in December it was slightly lower and amounted to 2,55% (December 2009: 1,1%), which resulted in a decrease of the difference in EIR on deposits to citizens and economy.

The difference in EIR for economy and citizens derives from the structure of the time deposits. Namely, the deposits to economy are mostly for short terms up to three months (a small portion up to one year), and these deposits carry significantly lower interest rates. On the other hand, in the deposit structure of deposits over one year (the longest deposit is up to three years) dominating are the deposits to citizens. In the fourth quarter of 2010, the amount of the short-term deposits of legal entities significantly decreased, which as a consequence had an increase of their interest rates with an aim to attract these deposits by banks.

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

Table 35: Risk-weighted average NIR and EIR on loans-overdrafts and demand deposits										
DESCRIPTION	31.12.2008.		30.06.2009.		31.12.2009.		30.06.2010.		31.12.2010.	
	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR	NIR	EIR
1	2	3	4	5	6	7	8	9	12	13
1. Risk-weighted interest rates for loans-overdrafts	8,62	8,81	8,56	9,00	8,96	8,96	8,83	8,84	8,29	8,29
2. Risk-weighted interest rates for demand deposits	0,40	0,40	0,40	0,40	0,41	0,41	0,23	0,23	0,22	0,22

The EIR for the above items of assets and liabilities, in general, should be equal to the nominal interest rate. The risk-weighted EIR for total loans in overdrafts for the banking sector, in December of 2010, was 8,29% (an increase of 0,67 per cent in comparison to December 2009), and 0,22% for demand deposits, which was lower by 0,19 per cent in comparison to December 2009.

2.4. Liquidity

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

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

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

In the last quarter of 2008 the liquidity risk increased after the expansion of the global crises and its adverse impact on the financial and economic system in BiH. Although a part of the savings was withdrawn and the trust in banks was impaired, it was evaluated that the banking system

liquidity was not in danger in any given moment, since the banks in FBiH, due to regulatory requirements and proscribed limits, based on a conservative approach, had significant liquid funds and a good liquidity position.

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

In addition, we should have in mind the fact that impact of the crisis is still present in the real sector in 2010, adverse consequences are being reflected to the entire economy environment under which banks operate in BiH, causing delinquency of debtors and increase of nonperforming claims, which is causing decrease in inflow of liquid assets of banks.

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

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

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

In the structure of financing sources of banks in the Federation of BiH, as of 31.12.2010., deposits still have the highest participation of 74,5%, followed by loans taken (including the subordinated debt³²) with participation of 10,8% with longer maturity, representing quality source for long term placements, and have made a significant contribution to maturity match between assets and liabilities.

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

³² Subordinated debt – loans taken and permanent liabilities.

- in 000 KM-

Table 36: Maturity structure of deposits								
DEPOZITI	31.12.2008.		31.12.2009.		31.12.2010.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Savings and demand deposits	4.186.773	40,0	4.490.845	40,7	5.054.335	45,0	107	113
Up to 3 months	460.100	4,4	322.763	2,9	344.926	3,1	70	107
Up to 1 year	979.516	9,4	833.089	7,5	1.085.115	9,6	85	130
1. Total short term	5.626.389	53,8	5.646.697	51,1	6.484.376	57,7	100	115
Up to 3 years	3.018.766	28,9	3.292.619	29,8	2.832.507	25,2	109	86
Over 3 years	1.816.695	17,4	2.106.552	19,1	1.915.947	17,1	116	91
2. Total long term	4.835.461	46,2	5.399.171	48,9	4.748.454	42,3	112	88
TOTAL (1 + 2)	10.461.850	100,0	11.045.868	100,0	11.232.830	100,0	106	102

Analysis of maturity structure of deposits in two main groups, if compared to 2009, shows a deterioration in the maturity, due to an increase in participation of short term deposits by 6,6 per cent, and by the same percentage a decrease of long term deposits, so their participation, as of 31.12.2010., was 57,7% and 42,3% respectively.

The listed changes in the maturity structure are a result of the growth of the short term deposits in 2010 by 15% or 838 million KM and a simultaneous decrease of the long term deposits by 12% or 651 million KM.

The increase of short term deposits was realized from increased demand deposits of 13% or 564 million KM, and participation from 40,7% to 45%, while deposits up to three months increased by 7% or 22 million KM, along with an insignificant increase in participation from 2,9% to 3,1%. The deposits up to one year increased by 30% or 252 million KM, which is why their participation in total deposits increased from 7,5% to 9,6%. Demand deposits still have the highest participation of 45% in total deposits, while deposits up to three months have the lowest participation (3,1%). In total demand deposits, the highest participation is still recorded by citizen deposits (39,9%), which, in comparison to 2009, have increased by 24% or 394 million KM.

Total long term deposits in 2010 have declined by a significant 12% or 651 million KM mostly on the basis of the decrease of long term deposits of the banking institutions in the amount of 571 million KM, of which amount 348 million KM refers to only one bank. It should be emphasized that of long term deposits, two sectors show dominant participation: citizens with an increased participation from 43,8% to 51,6% and banking institutions with a decrease in participation from 34,6 to 27,4%. Citizen deposits in term deposits up to three years show the highest participation of 67,1% (58,2% at the end of 2009), while banking institutions' deposits over three years show the highest participation of 60,9% (72% at the end of 2009).

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

- in 000 KM-

Table 37: Maturity structure of loans								
LOANS	31.12.2008.		31.12.2009.		31.12.2010.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Past due claims and paid off-balance sheet liabilities	234.178	2,2	354.200	3,6	567.182	5,7	151	160
Short term loans	2.337.251	22,4	2.159.008	22,0	2.129.184	21,3	92	99
Long term loans	7.862.948	75,4	7.283.592	74,4	7.285.545	73,0	93	100
TOTAL LOANS	10.434.377	100,0	9.796.800	100,0	9.981.911	100,0	94	102

In 2010, long term loans remained at approximately the same level (increased by two million), short term loans recorded a decrease of 1% or 30 million KM, while past due claims increased by a steep 60% or 213 million KM, of which the largest amount, 184 million KM, refers to private companies. In the structure of past due claims, 77% are private companies, 19% are citizens, and 4% are other sectors.

Sector analysis by maturity, in two most significant sectors, indicates that loans to citizens represent 89% of long term loans, and loans to private companies, of total originated loans, represent 56,7% of long term loans.

In the assets structure, as the most significant category, loans still have the highest participation of 66,2%, which has increased by 1,9 per cent in comparison to the end of 2009 due to a slight growth of loans of 2% or 185 million KM and decrease of assets of 161 million KM or 1%. Cash funds decreased by 7% or 339 million KM and their participation, in comparison to the end of 2009., decreased from 31,4% to 29,5%.

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

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

- in % -

Table 38: Liquidity ratios			
Ratios	31.12.2008.	31.12.2009.	31.12.2010.
1	2	3	4
Liquid assets ³³ / Total assets	28,3	31,9	30,2
Liquid assets / Short term financial liabilities	51,2	54,2	50,8
Short term financial liabilities / Total financial liabilities	62,9	66,9	68,1
Loans / Deposits and Borrowings ³⁴	82,6	76,4	79,0
Loans / Deposits, borrowings and subordinate debts ³⁵	80,9	75,0	77,6

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

- in 000 KM-

Table 39: Liquidity position – ten-day average and daily minimum					
Description	31.12.2008.	31.12.2009.	31.12.2010.	RATIO	
	Amount	Amount	Amount	3/2	4/3
1	2	3	4	5	6
1. Average daily balance of cash assets	3.687.406	3.789.107	3.887.490	103	103
2. Minimum total daily balance of cash assets	3.310.173	3.341.965	3.585.319	101	107
3. Short term sources (accrual basis)	5.821.848	5.431.143	6.128.941	93	113
4. Liabilities:					
4.1. ten-day average 20% of Item 3	1.164.370	1.086.229	1.225.788	93	113
4.2. daily minimum 10% of Item 3	582.185	543.114	612.894	93	113
5. Meeting requirement :ten-day average					
Surplus = Item 1 – Item 4.1.	2.523.036	2.702.878	2.661.702	107	98
6. Meeting requirement :daily minimum					
Surplus = Item.2 – Item 4.2.	2.727.988	2.798.851	2.972.425	103	106

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.³⁶

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.

³⁶ Decision on Changes and Amendments to Decision on Minimum Standards for Liquidity Risk Management in Banks (Official Gazette of the FBiH, number 88/07) dated of 01.01.2008. sets new percentages for maturity matching between financial assets and liabilities: minimum 85% of funding sources (used to be 100%) with maturity up to 30 days must be engaged in placements with maturity up to 30 days; minimum 80% of funding sources (used to be 100%) with maturity up to 90 days in placements with maturity up to 90 days and minimum 75% of funding sources (used to be 95%) with maturity up to 180 days in placements with maturity up to 180 days.

- in 000 KM -

Table 40: Maturity of financial assets and liabilities up to 180 days					
Description	31.12.2008.	31.12.2009.	31.12.2010.	RATIO	
	Amount	Amount	Amount	3/2	4/3
1	2	3	4	5	6
I. 1- 30 days					
1. Financial assets	5.126.920	5.719.878	5.674.836	112	99
2. Financial liabilities	4.763.530	5.070.291	5.816.147	106	115
3. Difference (+ or -) = 1-2	363.390	649.587	- 141.311	179	N/a
Accrual of requirement in %					
a) Performed %= Item 1 / Item 2	107,6%	112,8%	97,6%		
b) Required minimum %	85,0 %	85,0 %	85,0%		
Surplus (+) or shortage (-) = a – b	22,6 %	27,8 %	12,6%		
II. 1-90 days					
1. Financial assets	5.892.107	6.479.395	6.408.275	110	99
2. Financial liabilities	5.441.072	5.745.023	6.450.887	106	112
3. Difference (+ or -) = 1-2	451.035	734.372	- 42.612	163	N/a
Accrual of requirement in %					
a) Performed %= Item 1 / Item.2	108,3%	112,8 %	99,3%		
b) Required minimum %	80,0%	80,0%	80,0%		
Surplus (+) or shortage (-) = a – b	28,3%	32,8%	19,3%		
III. 1-180 days					
1. Financial assets	6.999.103	7.469.752	7.343.882	107	98
2. Financial liabilities	6.477.230	6.956.965	7.509.597	107	108
3. Difference (+ or -) = 1-2	521.873	512.787	- 165.715	99	N/a
Accrual of requirement in %					
a) Performed %= Item 1 / Item.2	108,1 %	107,4%	97,8%		
b) Required minimum %	75,0 %	75,0 %	75,0%		
Surplus (+) or shortage (-) = a – b	33,1%	32,4%	22,8%		

Based on the presented data, we may conclude that banks, as of 31.12.2010., were able to meet the required limits, and have managed to realize better maturity match between financial assets and financial liabilities in relation to the limits prescribed. However, of concern is the fact that the maturity match reflect deterioration taken the significantly lower percentages of the surplus over the prescribed minimum, that is, as of 31.12.2010, for the first time in the last two years the amount of the financial liabilities is higher than the amount of the financial assets, in all three time intervals up to 180 days, which was significantly impacted by the return of the long term deposits to the parent bank before the maturity (just in the fourth quarter of 2010, about 219 million KM. Also, from the aspect of the remaining maturity there is a negative trend of increase of the participation of deposits with maturity up to seven days, which growth is (about 17%), in comparison to the end of 2009, ten times faster than the increase of the total deposits of 1,7%, which resulted in an increase of their participation with about 42% to 48% in total deposits, and in compliance with the proscribed limits for the maturity match. In part, these funds finance the placements with longer maturities.

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

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

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

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

In order to enable application and implementation of prudential principles in foreign exchange activities of banks and to decrease influence of foreign exchange risk to their profitability, liquidity and capital, the FBA has issued Decision on Minimum Standards for Foreign Exchange Risk Management in Banks³⁷ 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.³⁸

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

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

According to the balance as of 31.12.2010., currency structure of banks' assets on the level of banking system recorded participation of items in foreign currencies of 14,8% or 2,2 billion KM (17,1% or 2,6 billion KM at the end of 2009). On the other hand, currency structure of liabilities is essentially different, since participation of liabilities in foreign currency is significantly higher of 53,6% or 8,1 billion KM (56,7% or 8,6 billion KM at the end of 2009).

The following table presents structure and trend of financial assets and liabilities and foreign currency position for EUR as the most significant currency³⁹ and total.

³⁷ “Official Gazette of F BiH”, Number. 3/03, 31/03, 64/03, 54/04.

³⁸ Article 8 of Decision on Minimum Standards for Capital Management of Banks determines limits for individual foreign currency position in EUR up to 30% of core capital, for other currencies up to 20% and foreign currency of a bank up to 30%.

³⁹ Source: Form 5-Foreign currency position.

Table 41: Foreign currency adjustment of financial assets and liabilities (EUR and total)										
Description	31.12.2009.				31.12.2010.				RATIO	
	EURO		TOTAL		EURO		TOTAL		EURO	TOTAL
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	6/2	8/4
1	2	3	4	5	6	7	8	9	10	11
<i>I. Financial assets</i>										
1. Cash assets	1.697	19,4	2.150	22,2	1.195	14,6	1.637	18,0	70	76
2. Loans	90	1,0	124	1,3	72	0,9	104	1,1	80	84
3. Loans with currency clause	6.713	76,6	7.095	73,1	6.508	79,6	6.868	75,5	97	97
4. Other	269	3,0	336	3,4	401	4,9	489	5,4	149	146
Total (1+2+3+4)	8.769	100,0	9.705	100,0	8.176	100,0	9.098	100,0	93	94
<i>II. Financial liabilities</i>										
1. Deposits	5.704	68,9	6.585	71,5	5.552	71,6	6.424	74,1	97	98
2. Borrowings	1.689	20,4	1.727	18,7	1.328	17,1	1.363	15,7	79	79
3. Deposits and loans with currency clause	577	6,9	577	6,3	584	7,5	584	6,8	101	101
4. Other	313	3,8	322	3,5	288	3,8	296	3,4	92	92
Total (1+2+3+4)	8.283	100,0	9.211	100,0	7.752	100,0	8.667	100,0	94	94
<i>III. Off-balance sheet</i>										
1. Assets	50		57		26		28			
2. Liabilities	500		505		435		438			
<i>IV. Position</i>										
Long (amount)	36		46		16		21			
%	2,3%		3,0%		1,0%		1,3%			
Short										
%										
Limit	30%		30%		30%		30%			
Below limit	27,7%		27,0%		29,0%		28,7%			

If we analyze the structure of foreign currencies in the financial assets⁴⁰ we see a dominant participation of EUR of 74,8, which decreased somewhat in comparison to the participation as of 31.12.2009. (78,8%) with slight decline in nominal amount from 2,1 billion KM to 1,7 billion KM. Participation of EUR in the liabilities has slightly decreased from 89,3% to 88,7%, with decline in nominal amount from 7,7 billion KM to 7,2 billion KM.

However, calculation of the FX risk exposure also includes the amount of indexed items of assets (loans) and liabilities⁴¹, which are especially significant in the assets (75,5% or 6,9 billion KM) this is slightly lower in relation to 31.12.2009. (73,1% or 7,1 billion KM). Other foreign currency assets items represent 24,5% or 2,2 billion KM, of which EUR items make 18,3% or 1,7 billion KM, and other currencies 6,2% or 0,5 billion KM (at the end of 2009, loans contracted with currency clause amounted to KM 7,1 billion with participation of 73,1%, and other items in EUR of 21,2% or 2,1 billion KM). Of total net loans (9,3 billion KM), 73,5% were contracted with currency clause, primarily tied to EUR (94,8%).

On the other hand, the structure of financial liabilities stipulates and determines the structure of financial assets, for each currency individually. In foreign currency liabilities (8,7 billion KM) items in EUR (primarily deposits) had the highest participation of 82,7% or 7,2 billion KM, while participation and amount of indexed liabilities was at minimum, amounting to 6,8% or 0,6

⁴⁰ Source: Form 5-Foreign currency position: portion of financial assets (in foreign currencies denominated in KM). According to the methodology, financial assets are expressed based on net principle (reduced by loan loss reserves).

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

billion KM (at the end of 2009, participation of liabilities in EUR was 83,7% or 7,7 billion KM, while indexed liabilities were 6,3% or 0,6 billion KM).

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

As of 31.12.2010., there were 10 banks with long foreign currency position, and nine banks with short position. At the system level, long foreign currency position represented 1,3% of banks' core capital, which is lower by 28,7% than the limit. Individual foreign currency position for EURO was almost at balance at 1%, with financial assets items being slightly higher than financial liabilities (long position), representing a decline of 29% 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.

IV CONCLUSION AND RECOMMENDATIONS

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

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

- Take measures and activities within its powers to overcome and mitigate adverse effects to the banking sector of the FBiH caused by the global financial crisis,
- Continue implementing activities, from the scope of its authority, to consolidate supervision on state level,
- Proceed with a continues supervision of banks through on-site and off-site examinations, focusing on targeted examination of dominant risk segments of banking operations, which will make supervision more effective, in regard to:
 - Persist on capital strengthening of banks, especially those recording outstanding assets growth,
 - Continue permanent monitoring of banks, primarily those with systemic importance to development of credit activities with the highest concentration of savings and other deposits in order to protect depositors,
 - Continue a systematic monitoring of banks' activities in prevention of money laundering and terrorism financing and improve cooperation with other supervisory and examination institutions,
 - Maintain continuity in payment system examinations,
- Continue working on further development of regulation based on the Basle Principles, the Basle Capital Accord, and the European Banking Directives, as part of BiH's preparation to join the European Union,
- Establish and expand cooperation with home country supervisors of the investors present in the banking sector of the FBiH, and other countries in order to have more effective supervision,
- Improve cooperation with the Banks Association in all banking performance segments, organization of counseling and professional assistance in the area of implementation of banking laws and regulations, advancement of cooperation in regard to professional development, proposed changes of all legislative regulations that have become a limiting factor to banks' development, introduction of new products, collection of claims and fully involve in building up and functioning of the unified registry of irregular debtors – legal entities and citizens, with daily data update.
- Continuous operational development of the IT system for early warning and prevention in elimination of weaknesses in banks;
- Work on continuous education and training of staff;
- Make effort to accelerate finalization of the remaining provisional administrations and liquidations based on the conclusion made by the Management Board;

- Particularly, accelerate resolution of unsettled issues with the Government of BiH in relation to the Provisional Administration of Hercegovačka Bank d.d. Mostar related to terminal Dretelj.

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

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

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

- Full dedication to good quality and prudent performance, and actions to cope with the crisis impact that presently represents the greatest danger for banks and the real sector of the economy and citizens;
- Further capital strengthening and level of solvency proportional to the growth of assets and risk, higher profitability, more consistent implementation of adopted policies and procedures in the area of prevention of money laundering and terrorism financing, and safety and protection of money in banks and in transportation, in accordance with laws and regulations;
- Strengthen internal control systems and internal audit functions as fully independent in performing their duties and roles;
- Regular, updated and accurate submission of data to the Central Loan Registry and Unified Central Account Registry with the Central Bank of BiH.

Number: U.O. – 28 – 3-1/11
Sarajevo, 31.03.2011.

ATTACHMENTS

ATTACHMENT 1.....	General data about banks in the F BiH
ATTACHMENT 2.....	Legal framework for the performance of the Banking Agency and banks in F BiH
ATTACHMENT 3.....	Balance sheet of banks, FBA Schedule
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ATTACHMENT 1

Banks in the Federation of Bosnia and Herzegovina - 31.12.2010.

No.	BANK	Address		Telephone	Director
1	BOSNA BANK INTERNATIONAL dd - SARAJEVO	Sarajevo	Trg djece Sarajeva bb	033/275-100, fax:203-122	AMER BUKVIĆ
2	BOR BANKA dd - SARAJEVO	Sarajevo	Obala Kulina bana 18	033/663-500, fax:278-550	HAMID PRŠEŠ
3	HERCEGOVAČKA BANKA dd - MOSTAR	Mostar	Nadbiskupa Čule bb	036/332-901, fax:332-903	Privr.upravitelj - Nikola Fabijanić - 16.04.2007.
4	HYPO ALPE-ADRIA-BANK dd - MOSTAR	Mostar	Kneza Branimira 2b	036/444-444, fax:444-235	MICHAEL VOGT
5	INVESTICIONO-KOMERCIJALNA BANKA dd - ZENICA	Zenica	Trg B&H 1	032/448-400, fax:448-501	SUVAD IBRANOVIĆ
6	INTESA SANPAOLO BANKA D.D. BOSNA I HERCEGOVINA	Sarajevo	Obala Kulina bana 9a.	033/497-555, fax:497-589	ALMIR KRKALIĆ
7	KOMERCIJALNO-INVESTICIONA BANKA DD V.KLADUŠA	V.Kladuša	Ibrahima Mržljaka 3	037/771-253, fax:772-416	HASAN PORČIĆ
8	MOJA BANKA dd - SARAJEVO	Sarajevo	Kolodvorska br. 5.	033/720-070, fax:720-100	EDIN MUFTIĆ
9	NLB TUZLANSKA BANKA dd - TUZLA	Tuzla	Maršala Tita 34	035/259-259, fax:250-596	ALMIR ŠAHINPAŠIĆ
10	POŠTANSKA BANKA BiH dd - SARAJEVO	Sarajevo	Put zivota 2.	033/564-000, fax: 564-050	Privr.upravitelj - Stjepan Jovičić - 05.10.2010.
11	PRIVREDNA BANKA SARAJEVO dd - SARAJEVO	Sarajevo	Alipašina 6	033/277-700, fax:664-175	AZRA ČOLIĆ
12	PROCREDIT BANK dd - SARAJEVO	Sarajevo	Emerika Bluma 8.	033/250-950, fax:250-971	FRIEDER WOEHRMANN
13	RAIFFEISEN BANK dd BiH - SARAJEVO	Sarajevo	Zmaja od Bosne bb.	033/755-010, fax: 213-851	MICHAEL MÜLLER
14	RAZVOJNA BANKA FEDERACIJE BIH	Sarajevo	Igmanska 1	033/277-900, fax: 668-952	RAMIZ DŽAFEROVIĆ
15	SPARKASSE BANK dd - SARAJEVO	Sarajevo	Zmaja od Bosne br. 7.	033/280-300, fax:280-230	SANEL KUSTURICA
16	TURKISH ZIRAAT BANK BOSNIA dd - SARAJEVO	Sarajevo	Dženetića Čikma br. 2.	033/252-230, fax: 252-245	KENAN BOZKURT
17	UNICREDIT BANK dd - MOSTAR	Mostar	Kardinala Stepinca bb	036/312-112, fax:312-121	BERISLAV KUTLE
18	UNION BANKA dd - SARAJEVO	Sarajevo	Dubrovačka 6	033/561-000, fax: 201-567	ESAD BEKTEŠEVIĆ
19	VAKUFСКА BANKA dd - SARAJEVO	Sarajevo	M. Tita 13.	033/280-100, fax: 663-399	AMIR RIZVANOVIĆ
20	VOLKSBANK BH dd - SARAJEVO	Sarajevo	Fra Andela Zvizdovića 1	033/295-601, fax:295-603	REINHOLD KOLLAND

LEGAL FRAMEWORK OF THE BANKING AGENCY OF THE FBiH, BANKS, MICROCREDIT ORGANIZATIONS AND LEASING COMPANIES IN THE FEDERATION OF BiH

Laws of the FBiH

Basic laws regulating work of the Banking Agency of the FBiH, banking, microcredit and leasing sectors

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, 48/08)
2. Law on Banks ("Official Gazette of the FBiH", number 39/98, 32/00, 48/01, 27/02, 41/02, 58/02, 13/03, 19/03 and 28/03)
3. Law on Microcredit organizations ("Official Gazette of the FBiH", number: 59/06)
4. Law on Leasing („Official Gazette of the Federation of BiH number: 85/08 and 39/09)
5. Law on Development Bank of the Federation of BiH ("Official Gazette of the FBiH", number: 37/08)
6. Decree on Criteria and Supervision Method of Development Bank of the FBiH, ("Official Gazette of the FBiH", number: 57/08)

Other Laws

1. Law on Enterprises ("Official Gazette of the FBiH" number 23/99, 45/00, 2/02, 6/02, 29/03 and 68/05, 91/07 and 84/08)
2. Law on Taking Over Public Limited Companies („Official Gazette of the FBiH“, number: 7/06)
3. Law on Financial Operations ("Official Gazette of the F BiH", number 2/95, 14/97, 13/00 and 29/00)
4. Law on Foreign Exchange Operations ("Official Gazette of the F BiH", number: 35/98)
5. Law on Bill of Exchange ("Official Gazette of the F BiH", number 32/00, 28/03)
6. Law on Check ("Official Gazette of the F BiH", number: 32/00)
7. Law on Obligations ("Official Gazette of RBiH" number 2/92, 13/93, Official Gazette of the FBiH number: 29/03)
8. Law on Opening Balance Sheet of Enterprises and Banks ("Official Gazette of the FBiH", number 12/98, 40/99, 47/06, 38/08 and 65/09)
9. Law on Securities Market ("Official Gazette of the FBiH", number: 85/08)
10. Law on Investment Funds ("Official Gazette of the FBiH", number: 85/08)
11. Law on Securities Market ("Official Gazette of the FBiH", number: 85/08)
12. Law on Securities Register ("Official Gazette of the FBiH", number 39/98 and 36/99),
13. Law on Securities Commission ("Official Gazette of the FBiH" number 39/98 and 36/99)
14. Law on Payment Transactions ("Official Gazette of the FBiH", number 32/00, 28/03)
15. Law on Termination of Law on Internal Payment System („Official Gazette of the FBiH“, number: 56/04)
16. Law on Accounting and Audit in the FBiH ("Official Gazette of the F BiH", number: 83/09)
17. Law on Determination and Fulfillment Method of Internal Liabilities of the F BiH ("Official Gazette of the F BiH", number 66/04, 49/05, 35/06, 31/08, 32/09 and 65/09)
18. Law on Determination and Fulfillment of Citizen Claims from Privatization Process

- (“Official Gazette of the F BiH”, number 27/97, 8/99, 45/00, 54/00, 7/01, 32/01, 27/02, 57/03, 44/04, 79/07 and 65/09)
19. Law on Debt, Indebtedness and Guarantees in the FBiH („Official Gazette of the FBiH“, number: 86/07)
 20. Law on Treasury of the FBiH (“Official Gazette of the FBiH”, number: 19/03)
 21. Law on Registration of Legal Entities in the FBiH (“Official Gazette of the FBiH”, number 27/05 and 68/05)
 22. Law on Classification of Activities in the FBiH (“Official Gazette of the FBiH”, number: 64/07)
 23. Law on Foreign Exchange Operations (“Official Gazette of the FBiH”, number: 35/98)
 24. Law on Audit (“Official Gazette of the F BiH”, number: 32/05)
 25. Law on Property-Legal Relationships (“Official Gazette of the FBiH”, number 06/9 and 29/03)
 26. Law on Land Books in the F BiH (“Official Gazette of the F BiH”, number 19/03 and 54/04)
 27. Law on Profit Tax (“Official Gazette of the F BiH”, number: 97/07)
 28. Law on Salary Tax (“Official Gazette of the F BiH”, number: 10/08)
 29. Law on Contributions (“Official Gazette of the F BiH”, number 35/98, 54/00, 16/01, 37/01, 1/02 and 17/06 and 14/08)
 30. Law on Foreign Investments (“Official Gazette of the F BiH”, number 61/01 and 50/03)
 31. Labor Law (“Official Gazette of the F BiH”, number 43/99, 32/00 and 29/03)
 32. Law on Conflict of Interest in the Government Bodies in the F BiH (“Official Gazette of the F BiH”, number: 70/08)
 33. Law on Violations of the FBiH (“Official Gazette of the F BiH”, number: 31/06)
 34. Law on Courts in the F BiH (“Official Gazette of the F BiH”, number 38/95 and 22/06)
 35. Law on Appraisers (“Official Gazette of the F BiH”, number 49/05 and 38/08)
 36. Law on Free Access to Information in the FBiH („Official Gazette of the FBiH“, number: 32/01)
 37. Law on Expropriation (“Official Gazette of the FBiH”, number: 70/07)
 38. Law on Administrative Disputes („Official Gazette of the FBiH“, number: 9/05)
 39. Law on Government of the F BiH („Official Gazette of the FBiH“, number 1/94, 8/95, 58/02, 19/03, 2/06 and 8/06)
 40. Law on Bankruptcy Proceeding (“Official Gazette of the F BiH”, number 29/03, 32/04, 42/06),
 41. Law on Liquidation Proceeding (“Official Gazette of the FBiH”, number: 29/03),
 42. Law on Executive Proceeding (“Official Gazette of the F BiH”, number 32/03 and 33/06, 39/06-correction and 39/09),
 43. Law on Civil Proceeding (“Official Gazette of the FBiH”, number 53/03, 73/05 and 19/06),
 44. Law on Extra-judiciary Proceeding („Official Gazette of the FBiH“, number 2/98, 39/04, 73/05)
 45. Law on Administrative Proceeding (“Official Gazette of the FBiH”, number: 2/98 and 48/99)
 46. Criminal Law of the Federation of BiH (Official Gazette of the Federation of BiH, number 36/03, 37/03, 21/04, 69/04 and 18/05 and 42/10)
 47. Law on Criminal Proceeding (“Official Gazette of the FBiH”, number 35/03, 37/03, 56/03, 78/04, 28/05, 55/06, 27/07, 53/07, and 9/09)
 48. Law on Classification of Activities in the Federation of BiH (“Official Gazette of the FBiH”, number 64/07)
 49. Law on Registration of Business Entities in the Federation of BiH (“Official Gazette of the FBiH”, number 27/05, 68/05, and 43/09)
 50. Law on Tax Administration in the Federation of BiH (“Official Gazette of the FBiH”, number 33/02, 28/04, and 57/09)
 51. Law on Implementation of Penal Sanctions in the Federation of BiH (“Official Gazette of the FBiH”, number 44/98, 42/99 and 12/09)

52. Law on Crafts and Similar Activities (“Official Gazette of the FBiH”, number 35/09)
53. Law on Tourist-Catering Activity (“Official Gazette of the FBiH”, number 19/09 and 28/03)
54. Law on Trading (“Official Gazette of the FBiH”, number 64/04)
55. Law on Unified System of Control Registry and Collection of Contributions (“Official Gazette of the FBiH”, number 42/09)
56. Law on Payment of Liabilities based on Old Foreign Currency Savings in the Federation of BiH (“Official Gazette of the FBiH”, number 62/09)
57. Law on Determination and Payment Method of Internal Liabilities of the Federation of BiH (“Official Gazette of the FBiH”, number 66/04, 49/05, 35/06, 31/08, 32/09 and 65/09)
58. Guidelines to Open and Close Accounts to Perform Payment Transactions and Records („Official Gazette of the FBiH“, number: 55/00, 61/05)
59. Guidelines on Conditions and Proceeding to Transporting Cash, Securities and Securities Registered as Foreign Currencies („Official Gazette of the FBiH“, number: 35/00)

Laws of BiH

1. Law on Prevention of Money Laundering (“Official Gazette of BiH“, number: 53/09)
2. Law on Deposit Insurance in BiH („Official Gazette of BiH“, number 20/02, 18/05, 100/08, and 75/09)
3. Law on Central Bank of BiH (“Official Gazette of BiH”, number 1/97, 29/02, 8/03, 13/03, 14/03, 9/05, 76/06)
4. Law on Competition („Official Gazette of the FBiH“, number 48/05, 76/07, and 80/09)
5. Law on Consumer Protection in BiH („Official Gazette of BiH“, number: 25/06)
6. Law on Protection of Personal Data („Official Gazette of BiH“, number: 49/06)
7. Law on Electronic Signature („Official Gazette of BiH“, number: 91/06)
8. Law on Classification of Activities in BiH („Official Gazette of BiH“, number 76/06 and 100/08)
9. Law on Meeting Liabilities for Old Foreign Currency Savings („Official Gazette of BiH“, number 28/06, 76/06 and 72/07)
10. Law on Temporary Postponement of Execution of Claims from Executive Decision 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)
11. Law on Accounting and Audit of Bosnia and Herzegovina (“Official Gazette of BiH“, number: 42/04)
12. Law on Temporary Suspension of Disposal of State Property of BiH (“Official Gazette of BiH“, number: 32/07)
13. Law on Supervision over the Markets in BiH (“Official Gazette of BiH“, number 45/04 and 44/07)
14. Law on Central Records and Data Exchange (“Official Gazette of BiH“, number 16/02 and 32/07)
15. Law on Indirect Taxation (“Official Gazette of BiH“, number 52/04 and 32/079)
16. Law on Treasury of Institutions of BiH («Official Gazette of BiH», number 27/00)
17. Law on Violations (“Official Gazette of BiH“, number: 41/07)
18. Roof Law on Pledges (“Official Gazette of BiH“, number 27/04 and 54/04)
19. Law on Value Added Tax (“Official Gazette of BiH“, number 9/05 and 35/05 and 100/08)
20. Law on Electronic Legal and Business Turnover (“Official Gazette of BiH“, number: 88/07)
21. Law on Conflict of Interest in the Government Institutions of Bosnia and Herzegovina (“Official Gazette of BiH“, number 16/02, 12/04 and 63/08)
22. Law on Courts of Bosnia and Herzegovina (“Official Gazette of BiH“, number 29/00, 16/02, 24/02, 3/02, 37/03, 4/04 and 9/04, 32/07)
23. Law on High Court and Judicial Council (“Official Gazette of BiH“, number 15/02, 26/02,

- 35/02, 42/03, 10/04 and 32/07)
24. Law on Judiciary of Bosnia and Herzegovina (“Official Gazette of BiH“, number 42/03, 9/04 and 35/04)
 25. Criminal Law of BiH (“Official Gazette of BiH“, number 37/03, 61/04, 30/05, 53/06, 55/06 and 32/07)
 26. Law on Administrative Disputes of BiH (“Official Gazette of BiH“, number 19/02, 83/08 and 88/07)
 27. Law on Criminal Proceeding of Bosnia and Herzegovina (“Official Gazette of BiH“, number 36/03, 26/04, 76/06, 32/07, 76/07, 15/08 and 58/08)
 28. Law on Administrative Proceeding (“Official Gazette of BiH“, number 29/02 and 12/04, 88/07)
 29. Law on Civil Proceeding before the Courts of Bosnia and Herzegovina (“Official Gazette of BiH“, number 36/04, 84/07);
 30. Law on Civil Proceeding („Official Gazette of BiH“, number: 53/03);
 31. Law on Mediation (“Official Gazette of BiH“, number: 37/04);
 32. Law on Public Supplies of BiH („Official Gazette of BiH“, number 49/04, 19/05, 52/05, 8/06, 24/06 and 70/06)
 33. Guidelines on Data, Information, Records, Identification Methods and Minimum Other Indicators for Effective Implementation of the Provisions of the Law on Prevention of Money Laundering („Official Gazette of BiH“, number: 17/05)
 34. Conclusion on Authentic Interpretation of Laws, Other Regulations and General Acts (“Official Gazette of BiH“, number: 24/04)
 35. Law on Customs Tariffs (“Official Gazette of BiH“, number 1/98, 5/98, 7/98, 22/98, 31/02, 32/04, 48/05, 76/06, and 39/09)

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 and 86/10)
3. Decision on Minimum Standards for Loan Risk and Assets Classification Management in Banks (“Official Gazette of the F BiH“, 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 and 86/10)
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 Provisional Measures for Renegotiation of Credit Liabilities of Citizens and Legal Entities in Banks (Official Gazette of the FBiH, number 20/10 and 86/10)
20. Decision on Requirements and Manner of Bank’s Action taken upon Customer’s Complaint (Official Gazette of the FBiH, number 32/10)
21. Decision on Interest and Fee Accrual for Dormant Accounts (“Official Gazette of the F BiH”, number 7/03)
22. Decision on Amount and Conditions for Origination of Loans to Bank Employees (“Official Gazette of the F BiH”, number 7/03 and 83/08)
23. Guidelines for Licensing and Other Approvals Issued by the Banking Agency of the Federation of the F BiH”, 6/08 cleaned text)
24. Decision on Minimum Standards for Market Risks Management in Banks (“Official Gazette of the Federation of BiH“, number: 55/07, 81/07, 6/08 and 52/08 and 79/09)
25. Decision on Unified Accrual and Declaration of Effective Interest Rate on Loans and Deposits (“Official Gazette of the Federation of BiH“, number 27/07 and 46/09)
26. Decision on Minimum Standards for Operating Risk Management in Banks („Official Gazette of the FBiH“, number: 6/08 and 40/09).
27. Decision on Temporary Measures for Renegotiation of Citizen and Legal Entities’ Credit Liabilities (“Official Gazette of the FBiH”, number 02/10)
28. Decision on Determining Level of Fees to Conduct Supervision of Development Bank of the Federation of BiH (“Official Gazette of the FBiH”, 65/09)

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).

DECISIONS OF THE BANKING AGENCY OF THE FEDERATION OF BIH REGULATING WORK OF LEASING COMPANIES

1. Decision on conditions and procedure for issuing and revoking the license for performing leasing operations („Official Gazette of the Federation of BiH“, number: 46/09) ,
2. Decision on conditions and procedure for issuing and revoking approvals to leasing companies (Official Gazette of the FBiH, number 46/09),
3. Decision on minimum standards for the activities of leasing companies on prevention of money laundering and terrorism financing (Official Gazette of the Federation of BiH, 46/09),
4. Decision on unified manner and method for accrual and reporting of effective interest rate for financial leasing contracts („Official Gazette of the Federation of BiH“, number: 46/09),
5. Decision on unified manner and method for accrual and reporting of effective interest rate for financial leasing contracts („Official Gazette of the Federation of BiH“, number: 46/09),
6. Decision on form and content of reporting that the leasing companies submit to the Banking Agency of Federation of BiH and reporting deadlines („Official Gazette of the Federation of BiH“, number: 46/09),
7. Decision on minimal amount and manner for allocation, managing and maintaining the reserves for losses and managing the leasing company risks („Official Gazette of the Federation of BiH“, number: 46/09),
8. Decision on supervision of leasing companies („Official Gazette of the Federation of BiH“, number: 46/09),
9. Decision on the fees that the leasing companies pay to the Banking Agency of the Federation of BiH („Official Gazette of the Federation of BiH“, number: 46/09).

ATTACHMENT 3

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

in 000 KM

No.	DESCRIPTION	31.12.2008.	31.12.2009.	31.12.2010.
	ASSETS			
1.	Cash funds and deposit accounts at depository institutions	4.207.559	4.782.297	4.443.614
1a	Cash and non-interest deposit accounts	417.601	496.720	452.188
1b	Interest deposit accounts	3.789.958	4.285.577	3.991.426
2.	Trading securities	10.923	12.815	233.178
3.	Placements in other banks	90.415	111.019	145.007
4.	Loans, receivables in leasing and past due receivables	10.434.377	9.797.817	9.981.911
4a	Loans	10.199.978	9.442.689	9.414.597
4b	Receivables on leasing	221	145	132
4c	Past due receivables - loans and leasing	234.178	354.983	567.182
5.	Securities held until maturity	7.630	106.411	142.074
6.	Premises and other fixed assets	440.887	498.959	521.625
7.	Other real estate	24.144	26.260	31.139
8.	Investments in non-consolidated related enterprises	40.732	42.716	44.753
9.	Other assets	206.338	336.955	193.609
10.	MINUS: Reserves for potential losses	400.120	477.611	661.213
10a	Reserves on item 4 in Assets	381.215	455.666	635.792
10b	Reserves on Assets except item 4	18.905	21.945	25.421
11.	TOTAL ASSETS	15.062.885	15.237.638	15.075.697
	LIABILITIES			
12.	Deposits	10.461.850	11.045.869	11.232.830
12a	Interest deposits	9.586.215	10.180.008	10.134.101
12b	Non-interest deposits	875.635	865.861	1.098.729
13.	Loans - past due	3.025	2.744	1.723
13a	Balance of payable loans, unpaid	0	0	0
13b	Unpaid - called for payment off-balance sheet items	3.025	2.744	1.723
14.	Loans from other banks	3.089	3.089	7.000
15.	Payables to Government	0	0	0
16.	Payables on loans and other borrowings	2.176.594	1.771.978	1.403.451
16a	payable within one year	793.837	678.607	381.305
16b	payable longer than one year	1.382.757	1.093.371	1.022.146
17.	Subordinated debts and subordinated bonds	267.737	250.483	226.847
18.	Other liabilities	520.612	486.122	507.221
19.	TOTAL LIABILITIES	13.432.907	13.560.285	13.379.072
	CAPITAL			
20.	Permanent priority shares	26.136	25.028	25.028
21.	Common shares	1.091.879	1.145.627	1.148.269
22.	Shares issued	152.892	143.725	136.485
22a	Permanent priority shares	8.420	8.420	8.420
22b	Common shares	144.472	135.305	128.065
23.	Undistributed income and capital reserves	307.464	354.621	489.557
24.	Currency rate difference			0
25.	Other capital	51.607	8.352	-102.714
26.	TOTAL CAPITAL (20. TO 25.)	1.629.978	1.677.353	1.696.625
27.	TOTAL LIABILITIES AND CAPITAL (19+26)	15.062.885	15.237.638	15.075.697
	PASSIVE AND NEUTRAL SUBBALANCE	626.468	622.094	659.059
	TOTAL BALANCE SHEET IN BANKS	15.689.353	15.859.732	15.734.756

ATTACHMENT 4

MARKET PARTICIPATION OF BANKS IN FBiH

in 000 KM

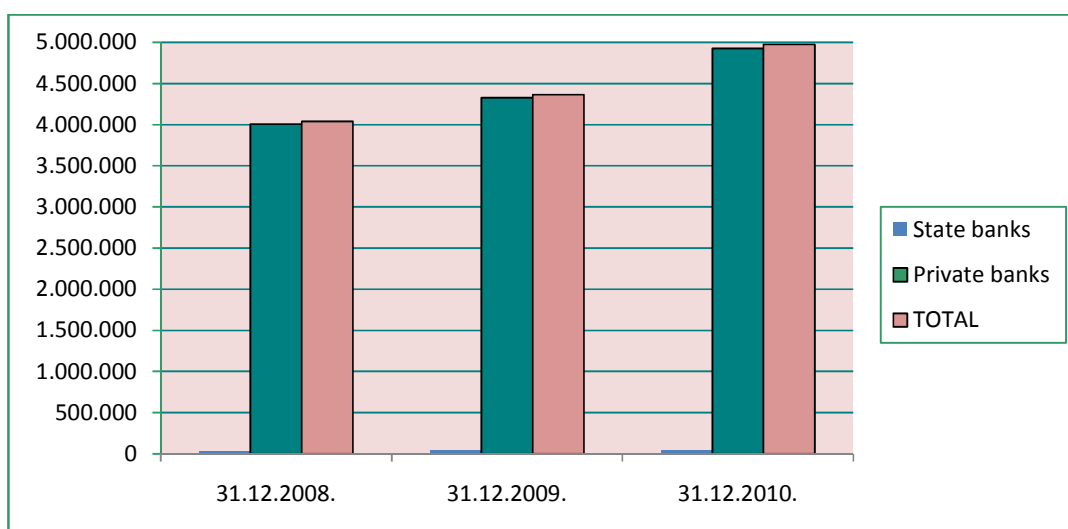
No.	BANK	31.12.2010.	PARTICIP. %
1	RAIFFEISEN BANK BH dd SARAJEVO	3.741.683	24,82%
2	UNI CREDIT BANKA BH dd MOSTAR	3.606.639	23,92%
3	HYPO ALPE ADRIA BANK dd MOSTAR	1.859.121	12,33%
4	INTESA SANPAOLO BANKA dd BiH	1.287.272	8,54%
5	NLB TUZLANSKA BANKA dd TUZLA	934.946	6,20%
6	VOLKSBANK BH dd SARAJEVO	805.012	5,34%
7	SPARKASSE BANK dd SARAJEVO	780.415	5,18%
8	BOSNA BANK INTERNATIONAL dd Sarajevo	307.855	2,04%
9	PROCREDIT BANK dd SARAJEVO	306.400	2,03%
10	VAKUFСКА BANKA dd SARAJEVO	216.707	1,44%
11	PRIVREDNA BANKA dd SARAJEVO	213.737	1,42%
12	INVESTICIONO KOMERCIJALNA BANKA dd ZENICA	178.387	1,18%
13	TURKISH ZIRAAT BANK dd SARAJEVO	173.295	1,15%
14	UNION BANKA dd SARAJEVO	167.263	1,11%
15	BOR BANKA dd SARAJEVO	153.467	1,02%
16	MOJA BANKA dd SARAJEVO	144.560	0,96%
17	HERCEGOVACKA BANKA dd MOSTAR	84.729	0,56%
18	KOMERCIJALNO INVESTICIONA BANKA dd VELIKA KLADUŠA	59.692	0,40%
19	POŠTANSKA BANKA dd SARAJEVO	54.517	0,36%
	TOTAL	15.075.697	100,00%

ATTACHMENT 5

NEW CITIZEN SAVINGS BY PERIODS IN THE BANKS IN FBiH

in 000 KM

	31.12.2008.	31.12.2009.	31.12.2010.
State banks	32.481	35.275	47.148
Private banks	4.003.184	4.325.928	4.926.361
TOTAL	4.035.665	4.361.203	4.973.509



ATTACHMENT 6

**CLASSIFICATION OF ASSETS AND OFF-BALANCE SHEET RISK ITEMS IN
BANKS IN FBiH
As of 31.12.2010.**

- ACTIVE BALANCE SHEET -

in 000 KM

No.	BALANCE SHEET ASSETS AND OFF-BALANCE SHEET ITEMS	CLASSIFICATION					TOTAL
		A	B	C	D	E	
1.	Short-term loans	1.750.092	340.107	33.366	5.619	-	2.129.184
2.	Long-term loans	5.867.348	960.440	293.253	164.504	-	7.285.545
3.	Other placements	409.305	577	30	885	-	410.797
4.	Interest accrued	38.154	13.185	9	-	-	51.348
5.	Past due receivables	62.397	87.059	134.453	282.719	1	566.629
6.	Receivables on guarantees paid	221	226	80	26	-	553
7.	Other assets	5.250.096	33.068	5.368	475	3.847	5.292.854
8.	TOTAL ACTIVE BALANCE SHEET	13.377.613	1.434.662	466.559	454.228	3.848	15.736.910
	a) Guarantees payable	297.226	52.922	861	424	-	351.433
9.	b) Performing guarantees	493.809	82.750	1.398	21	-	577.978
10.	Unsecured LoC	48.420	19.373	63	-	-	67.856
11.	Irrevocable loans	1.278.734	54.144	2.624	514	3	1.336.019
12.	Other potential liabilities	16.791	1.899	-	116	-	18.806
13.	TOTAL OFF-BALANCE SHEET	2.134.980	211.088	4.946	1.075	3	2.352.092
14.	TOTAL BALANCE AND OFF-BALANCE SHEET (8+13)	15.512.593	1.645.750	471.505	455.303	3.851	18.089.002
15.	General credit risk and potential loan losses (#14 x % of loss)	209.555	132.048	113.962	258.297	3.851	717.713
16.	Allocated general reserves (A) and special reserves (B, C, D, E)	209.612	132.048	113.960	258.297	3.851	717.768
17.	MORE (LESS) of the allocated reserves (#16 - 15) +or -	57	-	-2	-	-	55

ATTACHMENT 7

INCOME STATEMENT

in 000 KM

ELEMENTS	PERFORMED 31.12. 2009.		PERFORMED 31.12.2010.		RATIO 4 : 2
	Amount	Partic.in total income	Amount	Partic. in total income	
INCOME					
Interest income	918.692	113%	856.528	100%	93
Interest expenses	396.702	49%	325.773	38%	82
Net interest income	521.990	64%	530.755	62%	102
Fee income and other operating income	294.025	36%	328.573	38%	112
TOTAL INCOME	816.015	100%	859.328	100%	105
EXPENSES					
Reserves for potential losses	237.596	29%	386.102	45%	163
Salaries and contribution expenses	248.716	30%	242.690	28%	98
Fixed assets and overhead expenses	158.884	19%	152.737	18%	96
Other expenses	164.423	20%	172.018	20%	105
TOTAL EXPENSES (without interests)	809.619	99%	953.547	111%	118
NET INCOME BEFORE TAX	6.396	-	-94.219	-	N/A
Income Tax	-5.589	-	8.757	-	N/A
NET INCOME	807	-	102.976	-	N/A

ATTACHMENT 8

**COMPARATIVE SCHEDULE OF CAPITAL BALANCE AND ADEQUACY IN
BANKS IN FBiH
ACTIVE SUB-BALANCE SHEET**

in 000 KM

No.	DESCRIPTION	31.12.2008.	31.12.2009.	31.12.2010.
1	BANK'S CORE CAPITAL			
1.a.	Share capital, reserves and income			
1.1.	Share capital - common and perm. priority non-cumulat. shares - cash payments	1.102.636	1.155.790	1.157.918
1.2.	Share capital - comm. and perm. prior. non-cumul. shares-invested posses. And rights	12.550	12.550	12.550
1.3.	Issued shares income at share payments	152.892	143.725	136.485
1.4.	General regulatory reserves (reserves as regulated by the Law)	84.319	78.317	183.807
1.5.	Other reserves not related to assets quality assessment	168.927	201.758	228.867
1.6.	Retained - undistributed income from previous years	134.220	161.562	165.532
1.a.	TOTAL (from 1.1. to 1.6.)	1.655.544	1.753.702	1.885.159
1.b.	Offsetting items from 1.a.			
1.7.	Uncovered losses transferred from previous years	73.464	82.324	92.058
1.8.	Losses from current year	38.938	52.966	157.933
1.9.	Book value of treasury shares owned by the bank	81	595	81
1.10.	Amount of intangible assets	60.311	63.119	63.249
1.b.	TOTAL (from 1.7.to 1.10.)	172.794	199.004	313.321
1.	AMOUNT OF CORE CAPITAL: (1.a.-1.b.)	1.482.750	1.554.698	1.571.838
2	BANK'S SUPPLEMENTARY CAPITAL			
2.1.	Share capital - common and perm. priority non-cumulat. shares - cash payments	2.829	2.829	2.829
2.2.	Share capital - comm. and perm. prior. non-cumul. shares-invested posses. And rights	0	0	0
2.3.	General reserves for losses on loans from class. A - performing assets	230.596	205.254	209.612
2.4.	Accrued income for current year audited and confirmed by external auditor	74.543	49.186	52.090
2.5.	Income under FBA's temporary restriction on distribution	0	0	0
2.6.	Subordinated debts, the most 50% of core capital	211.360	184.093	159.056
2.7.	Hybrid convertible items - the most 50% of core capital	0	0	0
2.8.	Items-permanent liabilities without repayment duty	56.377	66.390	66.399
2.	AMOUNT OF SUPPLEMENTARY CAPITAL: (from 2.1. to 2.8.)	575.705	507.752	489.986
3	OFFSETTING ITEMS FROM BANK'S CAPITAL			
3.1.	Part of invested share capital that according to FBA's assessment represents accepted and overestimated value	0	0	0
3.2.	Investments in capital of other legal entities exceeding 5% of bank's core capital	16.036	16.036	15.938
3.3.	Receivables from shareholders for significant voting shares - approved aside from regulations	0	0	0
3.4.	VIKR to shareholders with significant voting shares in the bank without FBA's permission	3.422	0	0
3.	AMOUNT OF OFFSETTING ITEMS FROM BANK'S CAPITAL (3.1. to 3.4.)	19.458	16.036	15.938
A.	AMOUNT OF BANK'S NET CAPITAL (1.+2.-3.)	2.038.997	2.046.414	2.045.886
B.	RISK FROM RISK-WEIGHTED ASSETS AND CREDIT EQUIVALENTS	12.301.441	11.790.234	11.713.116
C.	POR (RISK-WEIGHTED OPERATING RISK)	130.975	882.928	942.707
D.	PTR (RISK-WEIGHTED MARKET RISK)	0	0	0
E.	TOTAL RISK-WEIGHTED RISKS B+C+D	12.432.416	12.673.162	12.655.823
F.	NET CAPITAL RATE (CAPITAL ADEQUACY) (A.:B.) X 100	16,4%	16,1%	16,2%

ATTACHMENT 9

NUMBER OF EMPLOYEES BY BANKS

No.	BANK	31.12.2008.	31.12.2009.	31.12.2010.
1	BOR BANKA dd SARAJEVO	45	51	54
2	BOSNA BANK INTERNATIONAL dd Sarajevo	171	185	207
3	HERCEGOVACKA BANKA dd MOSTAR	87	77	75
4	HYPO ALPE ADRIA BANK dd MOSTAR	626	600	568
5	INTESA SANPAOLO BANKA dd BiH	501	514	519
6	INVESTICIONO KOMERCIJALNA BANKA dd ZENICA	179	174	178
7	KOMERCIJALNO INVESTICIONA BANKA dd VELIKA Kladuša	67	68	67
8	MOJA BANKA dd SARAJEVO	149	133	143
9	NLB TUZLANSKA BANKA dd TUZLA	507	473	474
10	POŠTANSKA BANKA dd SARAJEVO	119	111	91
11	PRIVREDNA BANKA dd SARAJEVO	175	195	211
12	PROCREDIT BANK dd SARAJEVO	888	662	501
13	RAIFFEISEN BANK BH dd SARAJEVO	1.745	1.669	1.630
14	SPARKASSE BANK dd SARAJEVO	379	426	426
15	TURKISH ZIRAAT BANK dd SARAJEVO	149	152	150
16	UNA BANKA dd BIHAĆ	59	56	-
17	UNI CREDIT BANKA BH dd MOSTAR	1.418	1.389	1.362
18	UNION BANKA dd SARAJEVO	175	175	180
19	VAKUFСКА BANKA dd SARAJEVO	204	212	222
20	VOLKSBANK BH dd SARAJEVO	354	334	330
	TOTAL	7.997	7.656	7.388