BSCEE

BSCEE
Review
2014

INTRODUCTION

The Group of Banking Supervisors from Central and Eastern Europe (the BSCEE Group) was established in 1991. The Agreement of the BSCEE Group was signed during the Stockholm International Conference of Banking Supervisors (ICBS) in 1996. The BSCEE Group is operating according to its Agreement and Operational Bylaws that determine its organizational structure and the rules governing its operations. As of today it is signed by twenty five member institutions from twenty four member countries: Albania, Armenia, Austria, Republic of Belarus, Bosnia and Herzegovina (Banking Agency of the Federation of Bosnia and Herzegovina and Banking Agency of Republika Srpska of Bosnia and Herzegovina), Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Turkey and Ukraine. The Chairmanship of the BSCEE Group rotates on annual basis. In 2014 Mr. Mher Abrahamyan, Head of Financial System Regulation Department of the Central Bank of the Republic of Armenia chaired the Group.

In 1996 the Members of the BSCEE Group entered into an agreement setting out a framework for cooperation and coordination in organizing common events. The primary role of the BSCEE Group Secretariat is to provide technical assistance in organizing conferences, leaders' meetings, workshops and training seminars. The Secretariat also facilitates cooperation among the member countries, the Basel Committee on Banking Supervision (BCBS) and other international institutions and organizations in the sphere of banking supervision. The permanent Secretariat of the Group until 2005 was located at the premises of the Hungarian Financial Supervision Authority(HFSA) and as of January 2006 is located in Poland, at the KNF – Polish Financial Supervision Authority (PFSA).

According to the previous years' practice, the Annual Review of the BSCEE Group summarizes the developments of the member countries in 2014. This publication gives an overview of the macroeconomic circumstances in the twenty four member states, and it describes the banking sector as well as the supervisory activities. It was prepared on the basis of the information given by the member countries. The Annual Review also summarizes the main events of the BSCEE Group, including the workshops co-organized by the Financial Stability Institute (FSI) and other regional meetings. The 27th Annual Members' Conference was organized by the Central Bank of the Republic of Armenia in Yerevan on June 12 – 14, 2014.

This Annual Report intends to provide in-depth information reflecting the mission of the BSCEE Group in a detailed and accurate manner regarding the banking sector of the member countries.

We hope that you will find this publication informative and useful. We are sure that this will help you become acquainted with our supervisory job in the Central and Eastern European region, the cooperation among the supervisory authorities of the member countries and with the Basel Committee.

BSCEE Secretariat

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2014 DEVELOPMENTS IN THE BANKING SYSTEM OF THE MEMBER COUNTRIES

2014 DEVELOPMENTS IN THE ALBANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The Albanian economy recovered during 2014, while inflation remained steadily low. Real GDP growth averaged 1.9%. Output growth was concentrated in the production and services sectors. Employment increased, but private sector wage dynamics remained subdued. Annual inflation averaged 1.6%, standing below Bank of Albania's target. Annual inflation ranged 1.4-2.2%. Compared to the previous year, inflation fell due to the positive shocks from the domestic and external costs, in the presence of demand-side low inflationary pressures.

On the other hand, unemployment rate remained high. External demand resulted weaker than expected and net exports gave a negative contribution to aggregate demand growth. The last quarter of 2014 was characterized by higher public investments which compensated for the slowdown in private demand. Meanwhile public sector contribution to growth corrected for the repayment of the arrears was negative.

In 2014, the output gap remained negative and generated weak inflationary pressures. In addition, low inflationary pressures from the main trading partners persisted primarily due to the fall in oil prices during the second half of last year. In response, monetary policy was even more expansionary. The policy rate was lowered in 3 occasions during 2014 and once more in January 2015. Currently the policy rate stands at 2.00%. Lek lending rates have been declining steadily easing domestic financing costs. Credit to the economy improved slightly. The expansionary monetary policy was supplement by forward guidance to the markets and the injection of liquidity into the banking system.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

At the end of 2014, the ratio of financial system assets to the GDP grew by 2 percentage points reaching 101.6 %. The banking sector owns 90.3 % of financial system assets and 91,7% of GDP. Total banking sector assets reached 1,293.7 billion ALL, at an annual growth rate of 4.81 %. On the assets side, transactions in the interbank market and securities accounted for most of the growth, mainly reflecting the increased participation of the banking sector in the auctions of government debt securities. Funding has been provided by increasing the activity of deposits from the public, although at lower rates. During the year, loans increased by 4.9 %. At the end of the year, nonperforming loans to total loans reached 22.8 % compared with 23.5 % at the end of 2013. Such decrease was due to growth in total credit portfolio. Non-performing loans are covered at the level of 67.1 % by total provisions. Deposits amounted to 1,072.2 billion ALL, increasing by 4.6 % from a year ago. The Loan to deposits ratio stood at 55.5 %. The banking system recorded a positive financial result with net profits reaching 11.2 billion ALL, compared with 6.6 billion ALL a year ago. By the end of 2014, the banking system's capital adequacy ratio stood at 16.8 %.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN ALBANIA

During 2014, the Bank of Albania has continued the process of reviewing intensively the regulatory and supervisory framework, aiming at approximating it to standards of the Basel Committee and the European directives, and adapting the framework to the domestic financial market dynamics. The changes consist in either full or partial amendments of regulatory acts.

Regulatory acts fully revised and approved during 2014:

- Regulation on the risk management from large exposures of banks, which sets out rules and criteria for calculating, supervising and reporting bank's large exposures to a person/client or group of persons/clients connected between them or with the bank, for the purpose of managing the risk arising from concentrated exposure to them;
- Regulation on the bank's regulatory capital, which lays down the structure, components and method of calculating regulatory capital of the bank and set forth its minimum level requirements;
- Regulation on credit risk management from banks and branches of foreign banks - partial amendments which aims to promote a write-off of loss loans, especially when a specified period of time has passed since the loan is categorized as lost and have been fully provisioned;
- Regulation on the licensing, organization, activity and supervision of foreign exchange bureaus - partial amendments to strength the supervisory processes and to increase market discipline and transparency to the consumer, in the field of foreign exchange activity;
- Regulation on capital adequacy ratio - partial amendments to the existing regulation regarding the form of reporting the data to Bank of Albania by the banks, according to the new COREP (Common Reports) templates and also amendments to prolong the period of implementation of the package of measures to improve lending in Albania;
- Regulation on the organization and functioning of the Supervision Department - partial amendments regarding the definition of "systemic banks" with significant impact on the stability of the banking system;
- Guideline on recovery plans, which lays down the core principles and supervisory requirements on the structure and content of recovery plans drawn by "systemic banks", and their reports to the Bank of Albania;
- Regulation on granting the license and the exercise of banking activity of banks and branches of foreign banks in the Republic of Albania – partial amendments that aims to strength the authority requirements for the approval of the significant participation's transfer in banks, also amendments regarding the determination of some criteria for conducting cross-border banking services.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

Compliance with Development Policy Loans criteria

Development Policy Loans (DPL) is an instrument of the World Bank, which aims at the preliminary compliance with some essential development criteria, to grant support loans to the Government of Albania. The criteria set in the DPL arise from some of the conclusions of the Financial System Assessment Process. The Bank of Albania has had a key role in fulfilling these criteria, mainly related to legal and regulatory amendments, with a view to improving the functioning and soundness of the financial system.

To comply with these criteria, a number of regulatory amendments were made during 2014. Regulation 'On credit risk management' was amended, stipulating an obligation for banks to write off loss loans that have been classified in that group for more than three years, along with implementation modalities. Regulation 'On the Risk Management from Large Exposures of Banks' introduced some criteria, whereby the Steering Councils of banks are given the obligation in the process of the risk management from such exposures. In addition, banks shall compile recovery and resolution plans on large borrowers. These processes were enriched with the obligation to conduct analyse the risk of large exposure, based on audited financial statements.

Moreover, pursuant to the recommendations left to the Bank of Albania, we have been working since the first half of 2014 on the new draft law on Savings and Loans Associations. For the same financial institutions, we have been cooperating with the Deposits Insurance Agency to include them in the deposit insurance scheme.

Risk-based supervision

Another recommendation of the Development Policy Loans was the implementation of the risk-based supervision, an element that is envisaged in the medium-term supervision strategy.

To comply with this criterion, during 2014, the "Supervision Policy Document" was revised. The Document sets out the policy of risk-based supervision of banks and other financial institutions, for which the Bank of Albania is the responsible supervisory authority. The main objective of the risk-based supervision is to provide efficient process of resource allocation for assessing and addressing problems facing the supervised institutions, for a stable banking system. This document introduces a series of advantages, both for the supervisors and the banks, focusing on the supervision of banks and of activities posing higher risk or adverse trend, coordinating it with internal resources for duly addressing them. Also, it encourages more frequent and open communication between banks and supervisors, which are provided through meetings at different stages of the process and enable supervisors to better understand the strategy of the bank, the risks it come across, risk management quality and the results in addressing the shortfalls identified during the supervision process.

The Supervision Policy enhances the quality of bank supervision, and provides a better and time-efficient management of human resources, focusing on key issues during on-site inspections, given that a series of preliminary analysis is carried out off -site.

In addition, the Risk Assessment Manual was completed. This document introduced qualitative changes from the previous Manual, as regards implementing new procedures for the examination and assessment of new risks (strategic and organisational, interest rate in bank books, and operational risk, which should include modules on the IT risk, compliance, AML/FT, and transparency). The new risk assessment system reveals a structured algorithm to determine the assessment of general risk of the bank based on the individual assessment of each risk. The systems also introduces six assessment levels from five that were before, and assigns a specific quantitative and qualitative score to individual risks. It also assigns a certain weight to each of the risks, hence assigning more importance to risks that draw most the attention of supervisors.

Basel II Implementation

Pursuant to the strategic objectives of the Bank of Albania for a gradual approximation of the regulatory supervisory framework related to capital requirements for banks, with Basel II standards and the European Directive for Credit Institutions, in 2013 the Regulation "On capital adequacy ratio was approved". For a complete framework, during 2014, we worked intensively on drafting the regulation on banks regulatory capital, in compliance with the above-stated standards. The Regulation was approved by the Supervisory Council of the Bank of Albania in December 2014.

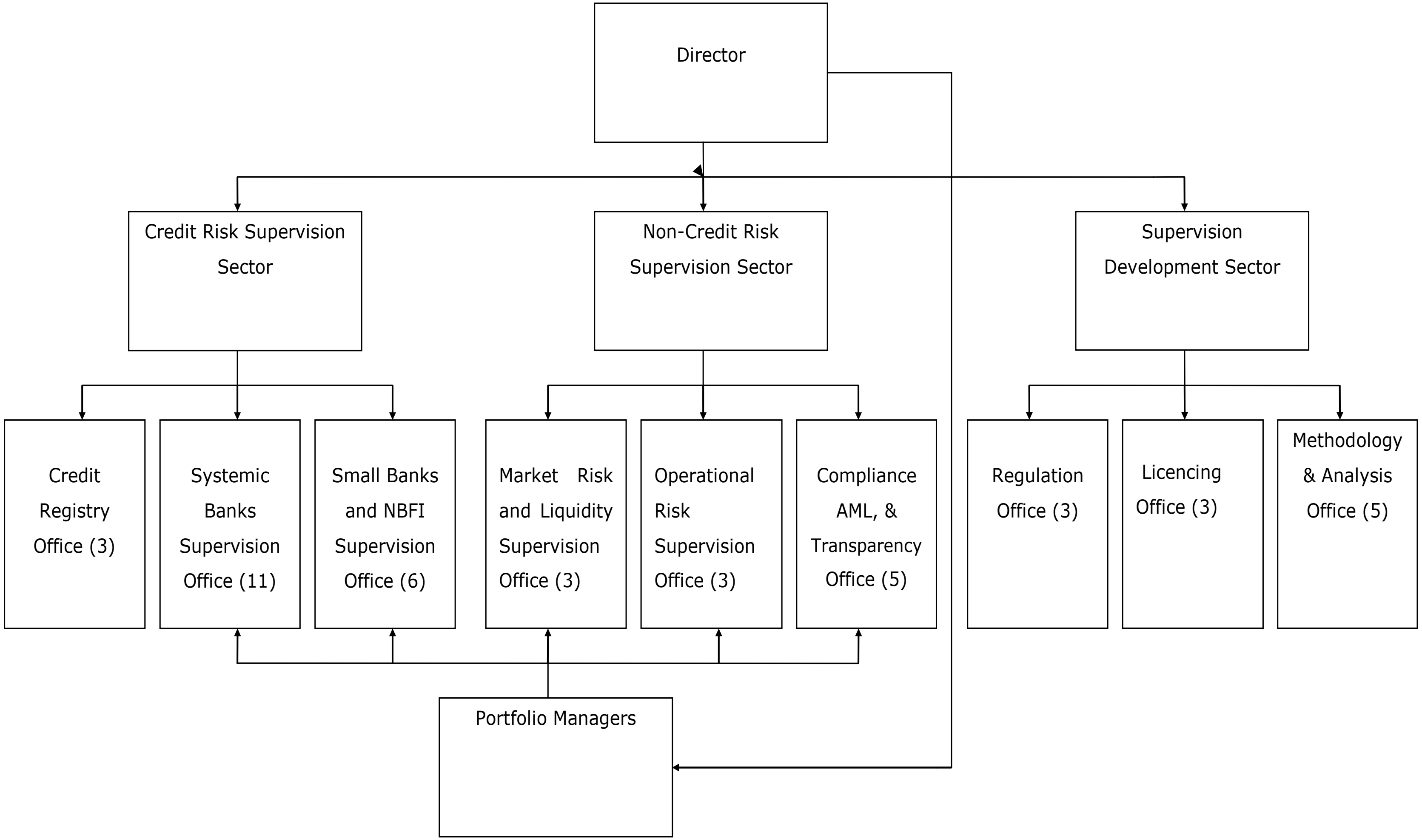
The Regulation on capital adequacy was envisaged to enter into force on 1 January 2015. However, for a smooth transition of the calculation methodology for the capital adequacy ratio according to the new methodology (standard methods for the credit risk and market risk, and the base indicator and standard approach for operational risk) banks were asked to report throughout the quarters of 2014, in parallel according to the requirements of this regulation (according to COREP), in addition to existing ones in force. This would avoid potential problems during the implementation and also provide banks with the practical opportunity to familiarise with the new requirements. Identification of potential problems during calculations was subject to ongoing discussions between the Bank of Albania and the banks, a process that helped clarify a number of necessary elements.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

On-site examinations, a very important part of the supervisory process, aimed at closely examining and evaluating the risk profile of institutions licensed by the Bank of Albania. Their planning and organisation is based on several main pillars, such as moving towards a risk-based supervision, ensuring compliance of licensed institutions' operations with the effective legal and regulatory framework, and enhancing the effectiveness of supervision instruments. During 2014, nine inspections were carried out in bank and non-bank financial institutions. They include four full-scope examinations for the overall evaluation of bank institutions and one full-scope examination for a non-bank

financial institution. Also, two targeted examinations were carried out to assess specific risks facing bank institutions, mainly credit risk. Furthermore, one examination was carried out in a bank institution and one examination in a non-bank financial institution, on compliance and level of implementation of the plan with corrective measures.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

An extended cooperation with world bank have been performed during 2014 with special focus on the Development Policy Loan recommendations, their appropriate implementation and identifications of new issues that might improve the on-performing loans concerns.

On the basis of cooperation agreements with foreign supervisory authorities, for specific banks, whose subsidiaries perform banking activity in the Albania, a set of information has been exchanged.

Bank of Albania did also take part in the asset quality review process performed by the European Central Bank through a joint on-site examination with Bank of Italy of the subsidiary of Intesa SanPaolo Bank.

COOPERATION WITH OTHER SUPERVISORY BODIES IN ALBANIA

Cooperation with other supervisory authorities, such as the Albanian Financial Supervision Authority has also been at the attention of the Bank of Albania. During the year, is formalized the cooperation with a MOU, and four examinations were carried out in depository banks and administrators of common funds.

During 2014 Bank of Albania has strengthen its cooperation with General Directorate for Prevention of Money Laundering, which is the competent authority for prevention of money laundering and terrorist financing in Albania, mainly in the fight against financial crime in the context of the implementation of the National Strategic Document "For the investigation of financial crime”. This cooperation that is formalized on june 10-th 2014 with a MOU, it is not limited only to periodic reporting, regarding the implementation of the strategic document for the investigation of financial crime, but also includes joint on- site inspections of banks, NBFI and Foreign exchange offices, joint activities in order to expand the supervisory capacity and exchange different professional experiences, training of other subjects etc. During 2014, there have joint collaboration with FIU in some training tables in Tirana, for banks and one joint training in one money value transfers institution. On the other hand, cooperation with various institutions which monitor specific activities of the financial market, such as Deposit Insurance Agency has continued to be effective during 2014. The cooperation has been focused in the exchange of information and carrying ou joint training for banks on data recording and AML/CFT and transparency issues.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

Following a series of legal and regulatory initiatives aimed at reducing the level of non-performing loans and boosting lending, the Bank of Albania has undertaken a special initiative at the end of 2013 in cooperation with the Financial Sector Advisory Centre (FinSAC) of the World Bank to address loan restructuring. This initiative aimed at analysing business borrowers facing difficulties in the payment of debt, exposed simultaneously to several banks, to draft a cooperation platform among the banks, with a view to finding sustainable solutions, and enhance their payment capacity to the banking sector, ensuring, at the same time, business continuity. For this initiative, FinSAC engaged two international companies experienced in this field.

The initiative began to be implemented during 2014. The main problem the banks found, which was not so insignificant, was the lack of the willingness by borrowers' representatives to be part of this initiative. Thus, they hesitated to agree on exchange of information between banks, to which they are simultaneously exposed, caring for their short-term benefit versus the long-term vision, which is more beneficial to them.

However, work on the initiative has continued in 2015. Due to the complexity of the process, insofar results show that a solution has been found only on a limited number of borrowers. In the meantime, a number of other cases are subject to discussion.

STATISTICAL TABLES

Number of financial institutions (head offices/branches)
(at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	16	16	16
Branches of foreign credit institutions	0	0	0
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**16**	**16**	**16**

Ownership structure of the financial institutions
on the basis of registered capital (%)
(at year-ends)

Type of financial institution	2012	2013	2014
Public sector ownership	0	0	0
Other domestic ownership	10.2	9.7	10.5
Domestic ownership total	10.2	9.7	10.5
Foreign ownership	89.8	90.3	89.5
Banking sector, total	100.0	100.0	100.0

Concentration of asset by the type of financial institutions
(at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	56.44%	73.83%	0.14
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	56.44%	73.83%	0.14

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	3.78%	6.43%	10.53%
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	3.78%	6.43%	10.53%

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	100	100	100
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%) (at year-end)

	2012	2013	2014
Claims from			
Financial sector	17	16.07	8.49
Nonfinancial sector	42.37	38.58	39.00
Government sector	35.22	40.86	23.16
Other assets	5.4	4.49	29.35
Claims due to			
Financial sector	3.4	3.35	3.43
Nonfinancial sector	83.0	82.11	82.3
Government sector	2.4	2.14	1.97
Other liabilities	2.63	4.03	3.72
Capital	8.57*	8.37*	8.58*

Capital adequacy ratio of banks

Type of financial institution	2012	2013	2014
Commercial banks	16.2%*	17.96%*	16.84%*
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	16.2%*	17.96%*	16.84*

(* - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification*	2012	2013	2014
Non financial sector**	22.5	23.49	22.80
- households	17.2	16.71	16.5
- corporate	25.9	27.69	26.7

The structure of deposits and loans of the banking sector in 2014 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:		
Households	85.69	25.46
Corporate	11.56	69.61
Government sector	2.76	4.93
Financial sector (excluding banks)	**n/a**	**n/a**

P&L account of the banking sector (at year-ends)

P&L account	2012	2013	2014
Interest income	76,731.57	74,310.07	67,077.22
Interest expenses	36,960.64	34,778.01	22,455.99
Net interest income	39,770.93	39,532.06	44,621.22
Net fee and commission income	6,294.80	6,471.66	7,028.58
Other (not specified above) operating income (net)	-6,737.15	-1,029.38	-7,990.09
Gross income	**30,505.61**	**35,109.85**	**39,456.84**
Administration costs	25,930.61	26,223.19	27,001.73
Depreciation	N/A	N/A	N/A
Provisions	20,292.14	14,797.33	11,819.42
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	N/A	N/A	N/A
Profit (loss) before tax	5,160	7,900.25	13,812.30
Net profit (loss)	3,768.57	6,564.02	11,192.28

Total own funds in 2014 (in EUR)

Type of financial institution	Total own funds	Tier 1	Tier 2	Tier 3
Commercial banks	833.46*	682.48*	150.98*	n/a
Cooperative banks	n/a	n/a	n/a	n/a
Banking sector, total:	833.46*	682.48*	150.98*	n/a

(* - for Basel I; ** - for Basel II; *** - for Basel III)

2014 DEVELOPMENTS IN THE ARMENIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The main risks affecting financial stability of Armenia persisted during 2014, meanwhile the impact of a set of risks to financial stability of Armenia expanded. The unsteady pace of economic growth recovery of developed countries and continuous slowdown of developing countries' economic growth of the first half of the year were maintained further. Decreased prices of base metals in international markets, the reduced demand for main products exported from Armenia and the absence of growth of the Armenian industry contributed to lower domestic economic growth. Geopolitical developments created additional obstacles to Russia's economic growth, which in turn affected negatively the inflow of private transfers to Armenia and export volumes to Russia, highlighted in November-December 2014.

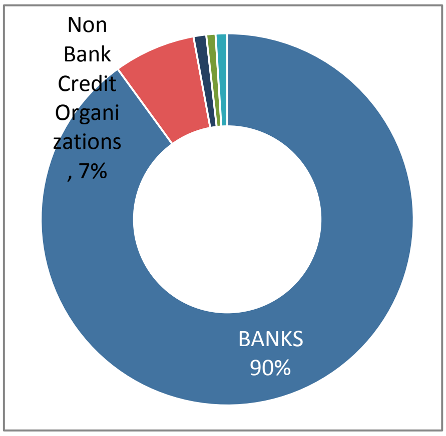
The economic developments in Armenia's main trade partners- some countries of the European Union and Russia have been unexpectedly unfavorable, and their impact on the domestic economy manifested in the second half of the year. In 2014, the economic growth in Armenia was 3.4% (3.5% in 2013). The slower growth rate was mainly due to the lack of growth in industry, decline in construction indicators and the decreased growth rates reported in other sectors of the economy. The growth rate of lending by banking sector reduced as compared to the previous years due to low economic growth and fall in private remittances. Parallel a slowdown of decreasing trend of capital adequacy was recorded. Armenian banking system had capital adequacy and liquidity ratios above the regulatory requirements, and manageable market risks.

In spite of some challenges on an upside track, risks in the financial system remain manageable in terms of financial stability.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

As of 31 December, 2014, 21 commercial banks and one development bank (Panarmenian Bank OJSC) operated in Armenia. The banking sector of Armenia accounts for 90% of the financial system assets.

During 2014, parallel to nominal GDP growth, an accelerating growth in banking system balance sheet indicators was recorded, resulting in significant increase in the banking system intermediation indicators.



The banking system assets to GDP ratio has increased by 6.4 pp. relative to the previous year and amounted 75.4%. The ratio of loans to economy to GDP was 45.8%, pushing the ratio up by 5.7 pp. The deposits to GDP ratio has decreased by 0.2 pp., and reached 35.5 %.

During the year, total capital of the banking sector has grown by 2.9% (AMD 13.1 billion, and amounted to AMD 469.1 billion. As a result, the leverage ratio (capital to assets ratio) has dropped by 1.7 pp. to 13.8 %.

The capital increased due to net profit of AMD 21.2 billion and replenishment of AMD 27.1 billion statutory capital, AMD 10.1 billion of which was replenished from external sources . Non-resident participation in the statutory capital of the banking sector has reduced by 8.1 p.p. to 66.5% due to changed residency status resulting from a shift in a center of economic interest of a bank shareholder.

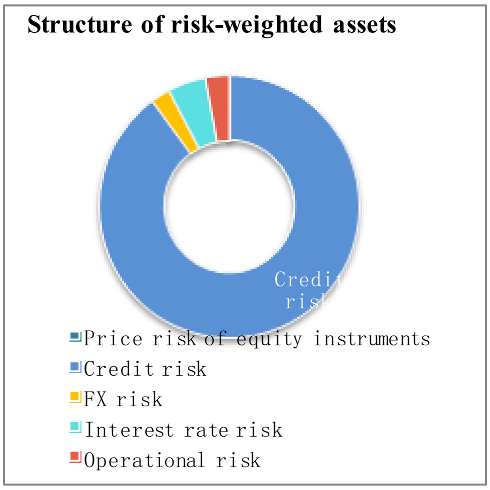
Banking System Capital Adequacy

In 2014, commercial banks' total capital adequacy ratio fell by 2.2 p.p. to 14.5%, which was driven by the loan portfolio's fast growing rate and loan portfolio impairment.

The share of Tier 1 capital in total regulatory capital increased by 0.9 p. p. to 87.5%.

All the banks maintained capital adequacy ratio within the required prudential threshold (12%).

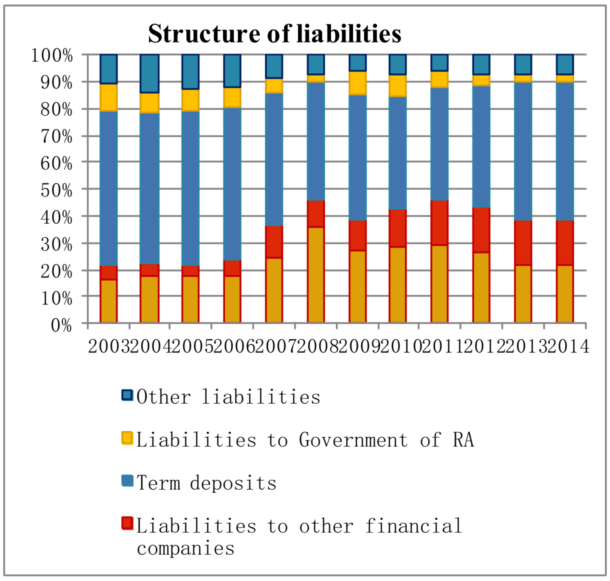
The share of credit, market and operational risks in the structure of risk weighted assets was respectively 89.9%, 7,2% and 2.9 % (as of 31.12.2013 the indicators were respectively 91.1%, 5.9% and 3.0 %). Hence, the credit risk was still considered as a major risk factor for the banking system.



In 2014, total liabilities of the banking system increased by 18.3 % (AMD 454.1 billion) to AMD 2 trillion 941 billion.

Dram liabilities increased by 13.6 % and foreign exchange liabilities increased by 20.9 %. As a result, the share of foreign exchange liabilities increased by 1.4 p. p. to 65.3 %.

The growth of liabilities was mainly driven by the growth of liabilities to banks (including the Central Bank), liabilities to other financial institutions and deposits from natural and legal persons

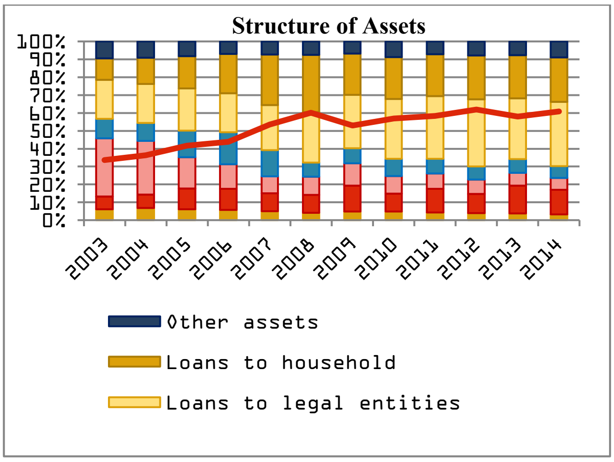


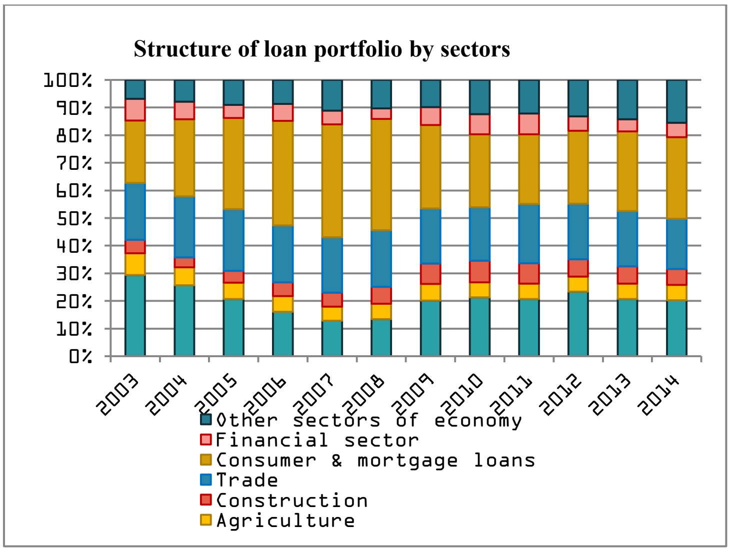
Banking system assets

At the end of 2014, total assets of the banking system increased by 15.9 % (by AMD 467 billion) to AMD 3 trillion 411 billion. Growth of assets was mainly driven by the growth of loans to economy.

Compared with the previous year the loans to economy increased by 21.3 % to AMD 2 trillion 73.4 amounted to AMD 1 trillion 223 billion and 851 billion at the end of the year.

Relative to the previous year, the share of non-performing loans and receivables in total loan and receivables portfolio grew by 2.7 p. p. to 10.0% and the net loan loss provisions-to-assets ratio increased by 1.0 p. p. to 2.2%.





Banking system financial performance

In 2014 the net profit of the banking system, calculated in accordance with the Central Bank supervisory reports, amounted to AMD 21.2 billion. During the year, 16 banks reported profit and 6 banks incurred losses. Compared with the previous year, return on assets (RoA) and return on equity (RoE) of the banking system have decreased by 0.7 pp. and 4.6 pp. and amounted to 0.7% and 4.5%, respectively.

The decrease in banking system profitability is mainly conditioned by the growth of net loss provisions to assets ratio owing to loan portfolio quality deterioration and the decline of net interest margin owing to interest rate spread narrowing.

The banking system net profit, calculated in accordance with International Financial Reporting Standards (IFRS), amounted to AMD 25.8 billion, while the return on assets (RoA) was 0.8 % and return on equity (RoE) 5.2 %.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS.
LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN ARMENIA

New Developments

In 2014 the CBA implemented several amendments in the regulatory framework of banking system envisaging to straighten financial stability and to encourage attraction of long term funds. In this context the CBA has implemented the following amendments:

1. Definition of lower risk weights on FX assets outstanding for export financing, in order to encourage financing of export sector.
2. Differentiation of reserve requirements for short and long term funds, in order to encourage attraction of long term funds.
3. Introduction of requirements on capital adequacy ratio concerning minimal requirements on Tier 1 capital which will enter into force in 2020.
4. Introduction of new requirements for subordinated debt eligible for inclusion in calculation of regulatory capital, mainly introduction of principles of subordinated debt's conversion to banks' core capital.

Legal Competence of the Banking Supervisory Authority in the Country

One of the main objectives of the Central Bank of Armenia is to ensure stability and normal activity of the financial system of the Republic of Armenia, including ensuring of necessary conditions for stability of the banking system, liquidity, solvency and normal activities of the Republic of Armenia.

According to the Law on the Central Bank of Armenia, in performing the underlying objectives stipulated in the Law, the Central Bank shall:

license banks, as well as other entities, in case if envisaged by law, and regulate and supervise activities thereof,

provide loans to the banks as a last-resort-lender,

collect, coordinate and analyze information concerning legalization of criminal proceeds and financing of terrorism, exchange and deliver such information to intra-governmental competent authorities and international organizations, and competent authorities of other countries, if stipulated by international agreements of Armenia.

In implementation of its tasks, the Central Bank shall be independent from the state authorities.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

The Central Bank (mainly Financial Supervision Department, Financial Monitoring Centre, Financial Stability and Development Department) performs off-site and on-site inspections of the financial institutions aimed at the disclosure of potential risk, legal compliance, combating money laundering and terrorism financing, protection of financial system consumer rights and other.

In 2014 on-site and offsite inspections of the Central Bank in the financial institutions were focused on the following areas: asset quality assessment, internal control system, legal compliance, risk management system, integrity of corporate management principles, compliance with the requirements relating to security and sustainability of business operations, IT area, transparency, compliance of organizations to the changes of regulatory framework, control over transparency, combat against money laundering and terrorism financing, consumer rights protection, prevention of operations by non-licensed entities, quality control of rendered services.

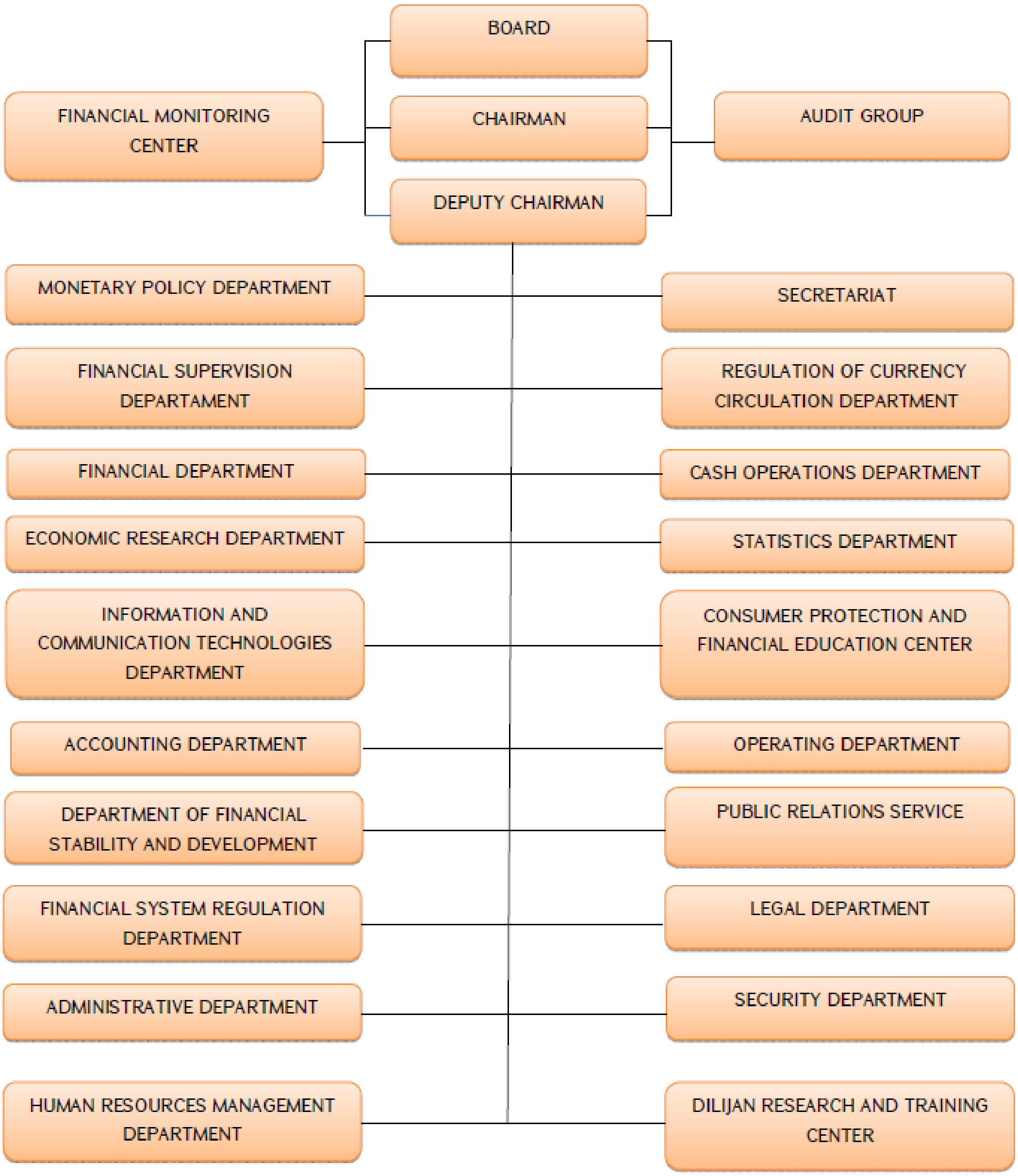
THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2014, the Financial Supervision Department of the Central Bank performed both off-site and 369 on-site inspections.

Compared with the previous year, in 2014 the number of infringements of banks dropped in total number of infringements identified during on-site and off-site inspections performed by the Central Bank Financial Supervision Department. Compared to the previous year, the number of penalties also decreased.

ORGANIZATIONAL CHART OF BANKING SUPERVISORY AUTHORITY

ORGANIZATIONAL CHART OF THE CENTRAL BANK OF THE REPUBLIC OF ARMENIA



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

The Central Bank continued implementation of the policy aimed at enhancing the professional qualification of human resource. In 2014, the Central Bank continued multilateral and bilateral cooperation with international and foreign organizations. In the context of participation in foreign seminars the

Central Bank continued cooperation with International Monetary Fund, Financial Stability Institute, Bank for International Settlements, Joint Vienna Institute, central banks of member countries of Switzerland, Germany, France, Italy, Netherlands, Poland, Czech Republic, Austria, Bank of England's Centre for Central Banking Studies (CCBS), member countries of Eurasian Economic Community, International Organization of Securities Commissions and other institutions.

In 2014, the Central Bank continued working with the Representation of the International Monetary Fund in Armenia in the framework of an extended financial assistance. The CBA hosted working meetings with the IMF delegations led by Mark Horton and Menno Snel. During the year, a technical assistance mission on the pension reform visited Armenia as part of the cooperation between the Bank and the World Bank.

In October 7-9, 2014, the Dilijan Training and Research Center of the CBA hosted a regional seminar on Risk-Based Supervision for Sound and Transparent Insurance Markets, jointly organized by the Financial Stability Institute, The International Association of Insurance Supervisors, and the CBA. Representatives of central/national banks from 14 countries attended the seminar.

The year saw more agreements and memoranda of understanding signed between the CBA and foreign central banks in the framework of both bilateral and intergovernmental commissions; the Agreement on Cooperation between the Central Bank of the Republic of Armenia and People’s Bank of China was signed in Beijing on March 27, 2014.

Several specialists from the Central Bank attended online training courses arranged by the Financial Stability Institute (FSI). In 2014, highly experienced supervision specialists of the Central Bank continued to organize training courses for younger colleagues for sharing their experience and knowledge.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

CBA is the sole supervisory body of the financial system of Armenia.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

The Central Bank proceeded with large scale actions aimed at development of financial system, modernization of financial sector regulation framework, financial supervision, consumer rights protection and financial education of various target groups. In 2014, the Central Bank initiated large scale legislative and regulatory reforms aimed at the implementation of Basel III standards. The Central Bank started developing ground for implementing a risk based supervision system for the financial institutions.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	22	22	22
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**22**	**22**	**22**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2012	2013	2014
Public sector ownership	3.1	3.0	2.67
Other domestic ownership	23.6	22.4	30.81
Domestic ownership total	**26.7**	**25.4**	33.48
Foreign ownership	**73.3**	**74.6**	66.52
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	33.9 %	51.5 %	0.0727
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	33.9 %	51.5 %	0.0727

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	11.2%	9.07%	4.5%
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	11.2%	9.07%	4.5%

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	100	100	100
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%) (at year-end)

Claims from	2012	2013	2014
Financial sector	30.97	34.51	25.4
Nonfinancial sector	64.86	60.89	61.54
Government sector	7.13	7.56	6.82
Other assets	6.48	6.20	5.81
Claims due to	**2012**	**2013**	**2014**
Financial sector	10.84	10.31	15.46
Nonfinancial sector	36.75	37.18	36.34
Government sector	2.73	2.00	1.6
Other liabilities	15.86	15.41	13.5
Capital	**4.20**	**3.89**	**1.99**

Capital adequacy ratio of banks

Type of financial institution	2012	2013	2014
Commercial banks	16.8%	16.7%	14.5%
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	16.8%	16.7%	14.5%

(* - for Basel I; ** - for Basel II; *** - for Basel III))

Asset portfolio quality of the banking sector* (share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non financial sector	3.9%	4.6%	6.8%
- households	**3.7%**	**5.5%**	**6.4%**
- corporate	**4.0%**	**4.3%**	**6.3%**

The structure of deposits and loans of the banking sector in 2014 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	94.61	98.36
Households	67.75	38.84
Corporate	26.86	59.52
Government sector	0	0
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2012	2013	2014*
Interest income	424 652	468 567	482 817
Interest expenses	208 863	248 327	259 488
Net interest income	215 789	220 240	223 330
Net fee and commission income	47 619	56 853	56 530
Other (not specified above) operating income (net)	303 092	535 556	323 205
Gross income	775 364	**944 983**	1 045 415
Administration costs	84 499	**93 518**	**97 004**
Depreciation	20 568	21 710	**21 053**
Provisions	281 602	57 261	115 537
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	63 314	78 844	50 239
Profit (loss) before tax	102 376	90 676	51 263
Net profit (loss)	79 709	70 171	36 687

*Exchange rate: 1Euro=577.47 AMD

Total own funds in 2014 (in EUR)

Type of financial institution	Total oun funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	783352		685430	97922	
Cooperative banks					
Banking sector, total:	783352		685430	97922	

(* - for Basel I; ** - for Basel II; *** - for Basel III))

2014 DEVELOPMENTS IN THE AUSTRIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

At the beginning of 2014, growth forecasts for Austria were cautiously optimistic. GDP growth was expected to rise to about 1½%, after economic activity had quickened at the end of 2013 and various leading indicators had given positive signals. These **forecasts did not materialize**, however. Instead, the growth outlook was scaled back notably in the fall of 2014, which was attributable to a revision of historical growth values and a revaluation of the short-term and medium-term growth prospects. In fact, the **Austrian economy expanded by a mere 0.4%** in real terms **in 2014**. For the third consecutive year, Austria's real GDP growth came to less than 1%, falling well short of the average recorded for the period from 1999 to 2013 (+1.7%). In 2014, Austria moreover underperformed the euro area growth figure for the first time since 2009.

Subdued domestic demand and sluggish net exports were at the root of weak GDP expansion in 2014. Private consumption, the most important demand component of GDP, remained flat throughout 2014. Not only did households' real disposable income stagnate amid relatively high inflation, but also consumer and business sentiment was down in a European comparison, which led to consumer restraint. Exports made a marginally positive contribution in 2014, with growth for the year remaining unchanged from the level registered in 2012 and 2013 and, hence, clearly below the long-term average. The expansion of imports outpaced that of exports in 2014 as a whole, which is why net exports contributed negatively to GDP growth.

Inflation has been receding continually in Austria since 2011 (3.6%) and, in 2014, averaged out at 1.5% year on year. Price growth was almost exclusively driven by the uptrend of services prices. The year-on-year **decrease in overall inflation** (2013: 2.1%) is primarily **attributable to energy prices and industrial goods** as well as, to a lesser extent, to food prices.

The **changeover to the ESA 2010 system** in September 2014 had a profound impact on fiscal statistics and on the Austrian GDP level. For one thing, Austria's **GDP increased by 3%**. For another, the **debt level rose significantly** after various government-controlled companies had to be reclassified under general government.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

The consolidated **net result** of Austrian banks (including foreign subsidiaries) **returned to positive territory in 2014** (EUR 1.4 billion), following a first-time loss in 2013 (–EUR 1.0 billion). These figures translated into a **return on assets of 0.1%.** The 2014 result does not reflect the losses of Hypo Alpe Adria International, though, which has been put into resolution. The most important components of operating income – net interest and fee-based income – exceeded 2013 results.

This improvement reflects a **moderate increase in interest margins** as well as a **decline in the risk aversion of investors**. Lower write-downs reported by one bank also had a positive impact. Credit risks provisions, while continuing to remain at elevated levels, declined in 2014. **Adjustments for goodwill**, which drove some banks into negative territory also 2014, **reflect** above all **weaker growth outlooks** and weaker macroeconomic conditions **in CESEE**.

Austrian banks have continuously strengthened their capital positions in recent years. At the end of 2014, the sector's **tier 1 ratio** amounted to **11.8%.** This corresponds to an increase of more than 4 percentage points since the outbreak of the financial crisis in 2008. The core tier-1 capital ratio also averaged 11.8% at the end of 2014. At the same time, the **capital positions of Austrian banks continue to be lower than those of their international peers**. This is also one of the outcomes of the comprehensive assessment conducted by the European Central Bank (ECB) in preparation of the implementation of the Single Supervisory Mechanism (SSM).

At the end of 2014, the consolidated foreign claims of majority Austrian-owned banks totaled approximately EUR 288 billion, with **cross-border funding provided to CESEE** accounting for **EUR 185 billion**. The activities of Austrian banks' subsidiaries in CESEE remain an important business area, even though their higher profits come with higher risks in some markets. In recent years, profits were increasingly concentrated in the Czech Republic and Slovakia as well as in Russia and Turkey, which are subject to higher volatility.

Total assets of the Austrian banking system (on a **consolidated level**) **decreased** in

2014 by 1% yoy **to 1,079 bn EUR**. This corresponds to 328% of the Austrian GDP.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN AUSTRIA

The FMA is an independent, autonomous and integrated supervisory authority for the Austrian financial market, established as an institution under public law. It is responsible for supervising credit institutions (together with the ECB), payment institutions, insurance undertakings, pension companies, corporate provision funds, investment funds, licensed investment service providers, credit rating agencies and stock exchanges, as well as for prospectus supervision. The FMA is also responsible for monitoring trading in listed securities to ensure that this is carried out properly and for monitoring issuers' compliance with information and organization obligations. Further tasks include combating the unauthorised provision of financial services and taking preventive action against money laundering and terrorist financing.

In 2014 the most fundamental change in the supervision of the banking sector took place since the FMA assumed responsibility for this area in 2002. On

4. November 2014 the Single Supervisory Mechanism (SSM) became operational establishing a decentralized system for the supervision of credit institutions within the eurozone based on a close cooperation between the European Central Bank (ECB) and the National Competent Authorities (NCAs). The FMA is the NCA in Austria.

Within in the SSM, in general, the supervision of significant supervised entities (SI supervision) falls within the competence of the ECB. SI supervision takes place in so-called Joint Supervisory Teams (JSTs), consisting of the relevant NCAs and chaired by the ECB. In the field of supervision of less significant supervised entities (LSI supervision) the FMA remains the competent authority for the direct supervision of credit institutions in Austria, whereas the ECB has only an oversight function. In case of common procedures (granting and withdrawal of authorization, qualifying holdings procedures), the decision-making competence for both, significant supervised entities and less significant entities lies exclusively within the ECB. However, the FMA is the entry point for notifications and prepares draft decisions for the ECB. In the field of consumer protection, the combat of unauthorized business and anti-money laundering / combating the financing of terrorism the FMA remains the sole competent authority for both categories of credit institutions.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

- Clarification of the role of the NCA within the SSM and allocation of duties within the new supervisory framework
- The quality and effectiveness of operative banking supervision is further enhanced, especially standard proceedings are conducted in a consistent and swift manner.
- Operative banking supervision is in line with the new legal requirements (especially CRD IV / CRR / BRRD).
- Focuses on the supervision of credit institutions undergoing a restructuring process are set and preparation for the role as National Resolution Authority (NRA).
- FMA-Priorities concerning the developments of European regulatory and supervisory initiatives are set and acted on.
- The international cooperation with banking supervision authorities in the context of consolidating supervision is further intensified and an adaptation to the changing legal framework is taking place.
- A common management culture in order to strengthen motivation and employee engagement is in place.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

Licensing processes

Two new licenses pursuant to the Bankwesengesetz (BWG) and the Zahlungsdienstegesetz (ZaDiG) were granted in 2014. There were no license extensions granted in 2014, however, one license extension process was still pending as of 31. December 2014. A total of 28 licenses were declared expired or revoked in the year under review. As of the launch of the SSM on 4. November 2014, the granting of licenses to institutions subject to the CRR falls within the competence of the ECB. Yet applications for initiating the process still have to be submitted to the FMA that prepares a draft decision for the ECB to be adopted.

No licence is required by credit institutions and financial institutions that are licensed in another Member State of the EEA. Such institutions may, on the basis of the fundamental freedoms applicable in the EEA, also offer their services in Austria. In 2014 40 credit institutions and 100 payment institutions from other Member States provided notification of taking up activities in Austria ("passive notification"). A total of 32 Austrian credit institutions provided notification via the FMA to the supervisory authorities in other Member States of their plans to make use of the freedom of establishment or the freedom to provide services ("active notification").

Ownership provisions

Any person intending to acquire or sell a qualifying holding in a credit institution must notify the FMA. Such a sale or acquisition can be prohibited within 60 working days. This applies where the new owners do not meet the requirements set in the interests of the sound and prudent management of a credit institution. A total of 27 notifications of a planned acquisition of holdings in an Austrian credit institution or payment institution were submitted to the FMA in 2014. Of these, eight resulted in the acquisition not being prohibited while one notification was withdrawn. The proceedings in the remaining 18 cases had not yet been completed at the end of 2014. As of 4. November 2014 the ECB has become competent to assess the interested acquirers of credit institutions established within the SSM.

Obtaining of information for supervisory purposes

To enable the FMA to duly fulfill their official tasks, credit institutions in Austria are subject to extensive ex lege reporting, notification and information obligations. Also, the FMA actively approaches the supervised banks. The FMA may request information pursuant to Article 70 para. 1 no. 1 BWG and Article 63 para. 2 no. 2 ZaDiG at any time from the supervised credit and payment institutions. There were 401 instances of information being obtained or of documentation being inspected in 2014. Since the FMA may obtain information also from bank auditors and auditing associations, protection schemes and government commissioners, the FMA issued 19 such requests for information as well.

Other key sources of information are on-site inspections at credit institutions. Therefore the FMA issued a total of 43 inspection mandates to the OeNB in 2014. Expert opinions to be prepared by the OeNB as part of the model approval process regularly require additional on-site presence of the OeNB as well: nine on-site activities related to model approval took place in 2014.

Additionally, the FMA conducts regular structured talks with the management of the credit institutions. In 2014, 54 such meetings took place.

General and official supervisory measures

In accordance with its statutory mandate, the FMA is responsible for monitoring compliance with statutory provisions pertaining to banking, for ascertaining facts in cases involving the endangering of creditors' interests and for introducing appropriate remedial measures where necessary. The relevant statutory provisions in this regard are Article 70 BWG and Article 64 ZaDiG, which provide the FMA with the means of implementing these objectives, including powers to intervene and impose sanctions.

If there is a risk of a credit institution or payment institution being unable to fulfil its obligations to creditors and customers, pursuant to Article 70 para. 2 BWG the FMA may prohibit distributions of capital or profits, appoint a government commissioner, relieve directors of their duties or prohibit the further pursuit of business activities. The FMA ordered such measures on two occasions in 2014.

One official power that is particularly relevant in practice is the one specified in Article 70 para. 4 BWG. In cases where a licensing requirement is no longer met or where a credit institution violates provisions of the BWG or another specific law, the FMA may introduce measures as described in the following. Firstly, the credit institution will be issued with a request to restore compliance with the statutory provisions or be subject to a coercive penalty. Should the institution fail to comply with this request, the FMA is required to completely or partially prohibit the directors from managing the business, except where such would be an inappropriate measure given the type and severity of the breach and it is expected that renewed imposition of the first measure will result in compliance with the statutory provisions. In such a case, the FMA is required to impose the threatened coercive penalty and to reissue the request under threat of a more severe penalty. If these measures are not sufficient to guarantee the ability of the credit institution to function, the institution's license is to be revoked as a last resort. On 16 occasions during the period under review, the FMA ordered credit institutions, under threat of a coercive penalty, to establish compliance with statutory provisions within an appropriate period of time.

A special type of empowerment is specified in Article 70 para. 4a BWG. Where for a credit institution, affiliation of credit institutions or group of credit institutions the risks arising from banking transactions and banking operations are inadequately limited, and where such risks are not expected to become limited in the short term, the FMA must, irrespective of any other measures, impose a minimum capital requirement that is higher than the statutory minimum capital requirement ("capital add-on" measure). A capital add-on was required twice during the year under review.

A further official measure intended to enforce compliance with the statutory provisions is specified in Article 97 BWG. Specifically, the FMA is required to charge interest in the event of breaches of the law involving failure to comply with thresholds, either by exceeding or falling below them. This occurs in cases where, for instance, limits for large exposures are exceeded or the minimum capital requirement is not met. One of the intentions here is to negate any competitive advantages that arise through disregarding provisions of law. Interest was charged in 15 such cases (pursuant to Article 97 BWG) in 2014.

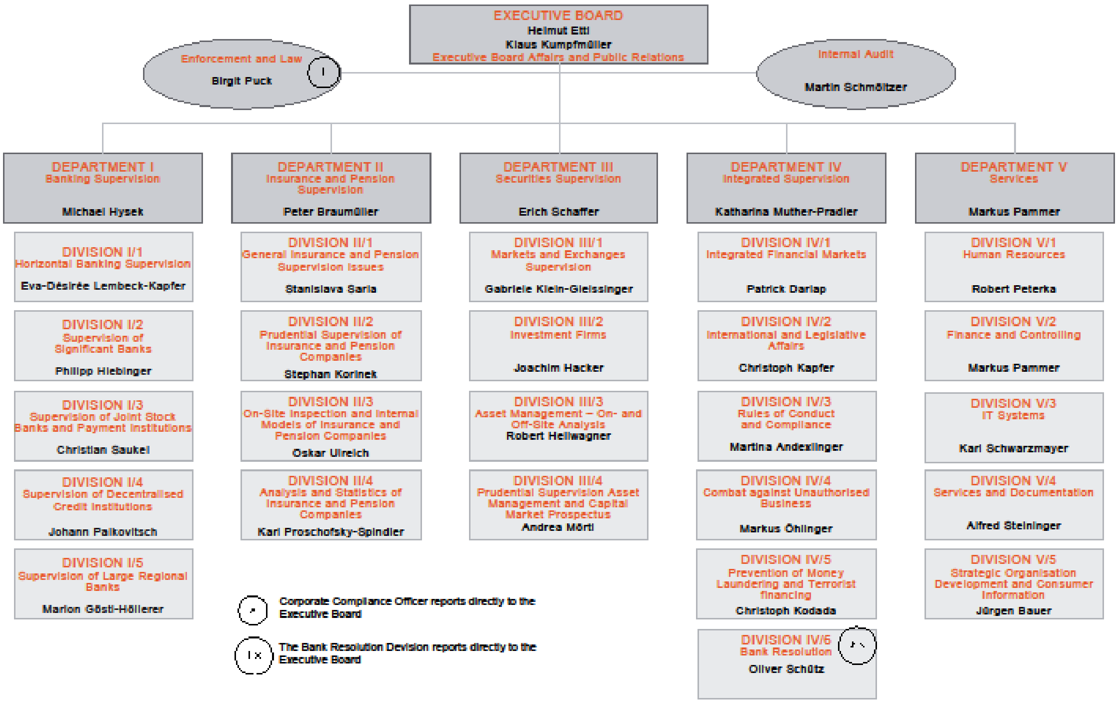
Consolidating Supervision and Colleges

While collaborating in international organisations, in some cases in a leading capacity, the FMA is strongly concerned with maintaining bilateral and multilateral relations with other supervisory authorities. In line with the activities of Austrian credit institutions, the CESEE region is a focus of such contacts.

Colleges of supervisors are a key instrument for consolidated supervision of cross-border credit institutions. These colleges are the venue for taking joint decisions in model approval procedures, while also serving as a forum for discussing issues related to ongoing supervision in the context of overall risk management. As of the end of 2014, the FMA has established a total of four supervisory colleges for banking groups operation on a cross-border basis that have at least two significant subsidiary institutions or branch offices in other EEA Member States. Another five supervisory colleges with a more flexible structure existed as of the end of 2014.

Within the SSM the colleges are replaced by the Joint Supervisory Teams (JSTs).

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY[1]



[1] Please note that the FMA is an integrated supervisory authority, therefore banking supervision is one of five departments in the FMA – see also answer to question 3. Division IV/6 is operational only since 1. January 2015 due to the new competences of the FMA as the NRA.

INTERNATIONAL ACTIVITIES OF THE AUTHORITY AND COOPERATION WITH OTHER SUPERVISORY BODIES

The FMA attends the Integrated Financial Supervisors Conference (IFSC) on a regular basis as well as meetings of the Basel Consultative Group (BCG), a subgroup of the BCBS.

In addition, the FMA is part of the European cooperation within the European System of Financial Supervision (ESFS) as well as National Competent Authority within the Single Supervisory Mechanism (SSM) and National Resolution Authority within the Single Resolution Mechanism (SRM). For details, please see answers to questions 3 and 9.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

In handling official activities related to supervision, the FMA must, as far as possible, draw on analysis and inspection results as well as the results of the expert opinions prepared by the *Oesterreichische Nationalbank* (OeNB) during model approval procedures, in addition to using information from third parties or from the respective bank. The collaborative setup calls for intensive, timely coordination between the two institutions. This reconciliation process is supported by a database, the joint information system. Various reporting data, relevant information available from the FMA's supervisory activities as well as data and results of OeNB analyses are filed in this database. This close cooperation continues within the framework of the SSM.

In line with the macro-prudential measures set out in the CRD IV, a new national institutional body, the Financial Market Stability Board (*Finanzmarktstabilitätsgremium*), entered into force as of 1. January 2014. Its main tasks are to promote financial market stability, reduce the systemic threat and lower the systemic and procyclical risks. It consists of representatives of the Federal Ministry of Finance, the FMA, the OeNB as well as the Fiscal Council. In accordance with the European Systemic Risk Board (ESRB) warnings and recommendations, the Financial Market Stability Board should act on a possible threatening of the Austrian financial stability amongst others with warnings and recommendations.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

The SSM is only the first pillar of the European Banking Union. The other two pillars are the Single Resolution Mechanism (SRM) and the Common Deposit Guarantee Scheme (CDGS).

Single Resolution Mechanism

Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions (BRRD) has been implemented in Austria as of 1. January 2015. The FMA is the National Resolution Authority (NRA) within the framework of the Single Resolution Mechanism (SRM). Banks and groups of credit institutions are obliged to draw up recovery and resolution plans and to submit them to the FMA. Additionally, in the form of early intervention, the FMA is able to get involved at an early stage as soon as signs begin to emerge that a bank is failing or likely to fail. At a further stage, if all resolution conditions are fulfilled, the FMA can make use of the following resolution instruments: sale of business, bridge bank, asset separation and bail-in.

Common Deposit Guarantee Scheme

The amendment of the Directive on Deposit Guarantee Schemes forms the third pillar of the European Banking Union. The Directive has to be implemented by mid-2015 and introduces a harmonisation of national deposit guarantee schemes.

STATISTICAL TABLES

Number of financial institutions (head offices/branches)
(at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	192	190	183
Branches of foreign credit institutions	29	30	30
Cooperative banks	584	570	551
Banking sector, total:	**809**	**790**	**764**

Source: OeNB, unconsolidated data.

Ownership structure of the financial institutions
on the basis of registered capital (%)
(at year-ends)

Type of financial institution	2012	2013	2014
Public sector ownership	10.1	9.7	10.3
Other domestic ownership	66.8	66.7	63.1
Domestic ownership total	76.9	76.3	73.4
Foreign ownership	23.1	23.7	26.1
Banking sector, total:	**100.0**	**100.0**	**100.0**

Source: OeNB, unconsolidated data.

Concentration of asset by the type of financial institutions
(at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	39.6	48.3	759
Branches of foreign credit institutions	63.8	74.8	2,666
Cooperative banks	39.5	50.0	708
Banking sector, total:	**28.7**	**35.8**	**386**

Source: OeNB, unconsolidated data.

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	3.4	-5.3	-17.8
Cooperative banks	5.2	4.7	-0.8
Other	-	-	-
Banking sector, total:	4.2	-1.2	-9.9

Source: OeNB, unconsolidated data.

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	62.6	62.5	62.8
Branches of foreign credit institutions	1.3	1.5	1.7
Cooperative banks	36.1	36.1	35.5
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

Source: OeNB, unconsolidated data.

The structure of assets and liabilities of the banking system (%)
(at year-end)

Assets	2012	2013	2014
Financial sector	n.a.*	n.a.	n.a.
Nonfinancial sector			
Government sector			
Other			
Liabilities	**2012**	**2013**	**2014**
Financial sector	n.a.*	n.a.	n.a.
Nonfinancial sector			
Government sector			
Capital			
Other			

* a breakdown of the whole balance sheet into these categories is not possible because this structure is only given for loans and deposits

Capital adequacy ratio of banks

Type of financial institution	2012	2013	2014
Commercial banks **	13.9	15.4	15.1
Cooperative banks **	14.7	15.3	16.3
**Banking sector, total: ** **	14.2	15.4	15.6

Source: OeNB, unconsolidated data.
(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non financial sector	4.7	4.1	4.4
- households	n.a.	n.a.	n.a.
- corporate	n.a.	n.a.	n.a.

Source: OeNB, unconsolidated data; NPL of domestic business.

The structure of deposits and loans of the banking sector in 2014 (%) (at year-end)

	Deposits	Loans
Households	69.6	42.9
Government sector	5.5	8.6
Corporate	16.8	41.8
Other (excluding banks)	8.1	6.7
Total	**100.0**	**100.0**

Source: OeNB, unconsolidated data; only domestic business

P&L account of the banking sector (at year-ends)

P&L account	2012	2013	2014
Interest income	25.6	21.2	20.0
Interest expenses	16.8	12.4	10.7
Net interest income	8.8	8.8	9.3
Net fee and commission income	3.8	4.1	4.3
Other (not specified above) operating income (net)	6.5	6.1	6.4
Gross income	**19.1**	**19.0**	**20.0**
Administration costs	10.4	10.8	11.8
Depreciation	0.5	0.5	0.8
Provisions	2.5	6.6	6.0
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	n.a.	n.a.	n.a.
Profit (loss) before tax	4.3	0.2	-5.6
Net profit (loss)	3.2	-0.9	-6.7

Source: OeNB, unconsolidated data in EUR bn.

Total own funds in 2014 (in EUR)

Type of financial institution	Total own funds (for CAR)	Tier 1	Tier 2	Tier 3
Commercial banks	52.7	39.7	13.0	n.a.
Cooperative banks	34.9	26.7	8.2	n.a.
Banking sector, total:	87.8	66.6	21.2	n.a.

Source: OeNB, consolidated data in EUR bn.

2014 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF BELARUS

MACROECONOMIC ENVIRONMENT

External conditions for development of the Belarusian economy in 2014 were characterized by a more moderate, than it was expected, growth of the economies and depreciation of the national currencies in the countries which are main trading partners of the Republic of Belarus. In 2014, the economic growth in the Republic of Belarus was achieved mainly due to an improvement in the foreign trade situation, with the growth rates of domestic demand decelerating and investment activity in the country declining.

In 2014, the volume of Gross Domestic Product grew (in comparable prices) by 1.6% on the 2013 level (by 0.9% in 2013). In 2014, consumer prices grew by 16.2%, in 2013 by 16.5%.

DEVELOPMENT OF THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

As at January 1, 2015, the banking sector of the Republic of Belarus comprised 31 operating banks. In 2014, the number of branches fell from 94 to 65 owing to the streamlining by banks of their regional structures. At the same time, the total number of banks' organizational units (branches, bank services centers, settlement and cash centers, and exchange offices) in the territory of the country grew by 0.9% in 2014, amounting to 4,728 as at January 1, 2015. Foreign banks ran seven representative offices in the territory of the country.

Foreign capital participated in the authorized capital of 26 banks. The share of foreign investors in the authorized capital exceeded 50% in twenty of them and accounted for 100% in six of those. As at January 1, 2015, the share of foreign investments in the total volume of registered authorized capital of Belarusian banks stood at 21.34%, with the share of Russian capital in banks' authorized capital accounting for 12.96%. As at January 1, 2015, the share of the State Committee on Property of the Republic of Belarus in the authorized capital of nine banks was 68.9% of the banking sector's aggregate authorized capital.

As at January 1, 2015, the banking sector's aggregate registered authorized capital amounted to BYR33.6 trillion, or around USD2.8 billion in equivalent, a 5.7% increase in 2014.

As at January 1, 2015, banks' regulatory capital totaled BYR62.2 trillion, or around EUR4.3 billion in equivalent, a 16.1% increase in 2014. As at January 1, 2015, the regulatory capital/GDP ratio stood at 8.0% (8.4% as at January 1, 2014).

In 2014, banks' assets grew by 21.9%, amounting to BYR481.5 trillion (around EUR33.5 billion in equivalent) as at January 1, 2015. As at January 1, 2015, the assets/GDP ratio accounted for 61.9% (62.1% as at January 1, 2014).

Banks' profit in 2014 amounted to BYR7.6 trillion (around EUR0.5 billion in equivalent), an 11.3% increase compared with 2013.

The banking sector's return on assets stood at 1.70% (1.87% as at January 1, 2014) and the return on regulatory capital – 13.12% (13.77% as at January 1, 2014).

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS

In 2014, the work to improve the regulatory framework for current banking supervision was going on (the Board of the National Bank passed three resolutions). In 2014, the Board of the National Bank adopted nine resolutions with a view to streamlining supervisory requirements and procedures.

As part of the continuous work to improve mechanisms for banking regulation, the Board of the National Bank of the Republic of Belarus adopted Resolution No. 193 "On Amending and Modifying Recommendations concerning Methodology for Auditing Banks and Non-bank Financial Institutions by the National Bank of the Republic of Belarus and Making Risk Assessment" dated March 28, 2014 which updated recommendations taking into account new requirements for corporate governance organization, risk management and internal control systems, and other prudential requirements imposed by the Banking Code and the National Bank's regulatory legal acts.

With a view to developing the financial market, the National Bank set differentiated requirements for the size of the regulatory capital of non-bank financial institutions depending on risk exposure of bank operations carried out thereby and the level of threat to the depositors and creditors' interests.

For the purpose of raising awareness of banking risks among households and organizations, procedures were clarified for ensuring that liquidation commission makes information about bank liquidation and procedures and the deadline for lodging claims by its creditors available.

In order to resist an impact of external destabilizing factors, the National Bank adopted a package of countercyclical regulation measures designed to abolish increased capital requirements for individual categories of assets as well as establish, at a higher rate, special provisions for credit risk on consumer loans.

In particular, risk weights associated with credit debt, securities and payment instruments denominated in foreign currency, as well as credit debt, interbank credits, and deposits collateralized by the pledge of Belarusian legal persons' securities, guarantees, and sureties in foreign currency were adjusted to the standard value of 100%.

In addition, the risk weighting associated with consumer credits extended at increased interest rates was also adjusted to the standard level of 75% as well as the need for establishing special provision for potential losses at a higher rate of 100% was obviated.

It should be noted that changes in risk weights for foreign assets represent not a reduction in requirements for banks, but a return to the standard risk weighting for requirements imposed on legal persons. In 2013, the National Bank noted a significant increase in risks arising from an excessive growth of lending in foreign currency. More strict requirements for covering such risks with capital were imposed for the purpose of containing them.

Such approach is fully consistent with the international practice and suggests that more stringent requirements for capital adequacy are imposed during the periods of economic well-being when banks' asset-related operations in relation to the real economy sector become excessive. The imposition of more stringent requirements during the period of growth makes it possible to provide an additional protection for the capital of the banking sector during the periods of financial uncertainty when the system bears heightened risks.

Banks' capital and profit released as a result of the abolition of increased requirements were channeled to cover heightened risks that emerged late in 2014.

As part of the plan for implementing Basel III capital, leverage, and liquidity international standards, the Board of the National Bank of the Republic of Belarus adopted Resolution No. 604 "On Amending and Modifying Methods for Calculating by Banks Capital, Leverage, and Liquidity Indicators Prescribed by Basel III International Standards" dated September 30, 2014 which is aimed at improving methods for calculating indicators having regard to new approaches taken by the Basel Committee as well as law enforcement practice of introducing new performance indicators in Belarusian banks and banks' proposals.

Values of Basel III capital, leverage, and liquidity indicators as well as liquidity monitoring instruments were analyzed on a quarterly basis.

LEGAL FRAMEWORK FOR ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In the Republic of Belarus, the National Bank – the central bank of the country which incorporates a special unit the Banking Supervision Directorate – is entrusted with the supervisory functions.

In carrying out banking supervision in the Republic of Belarus, the National Bank performs the following functions:

- development of secure functioning requirements and other prudential requirements for banks to ensure the banking system's stability and soundness;
- state registration of banks and banks' activities licensing;
- financial stability monitoring;
- regulation of the foreign capital access to the banking system of the Republic of Belarus;
- analysis of banks' reports;
- on-site inspection of a bank's activities and the assessment of risks posed by its activities;
- identification of violations of banking legislation;
- banking sector's risks monitoring;
- setting rules for publication of the information used to assess the degree of banks and non-bank financial institutions' reliability; and
- regulation of banks' reorganization and liquidation.

Also, the system for guaranteeing the repayment of funds attracted by banks from natural persons is operated in the Republic of Belarus. The guarantee fund for the natural persons' deposits is created at the expense of monthly irrevocable contributions made by banks licensed to take natural persons' funds on deposits which are subsequently accumulated by the Agency on the Guaranteed Repayment of the Natural Persons' Deposits.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

In 2014, the goals and tasks of the banking supervision were determined by the need to ensure a stable functioning of the banking sector and protect the interests of depositors and other banks' creditors. Their implementation was associated with an improvement in prudential requirements and supervisory procedures and a raise in the level of all components of the supervisory process (prior supervision at the stage of state registration of banks and licensing of banks' activities; current supervision, including off-site and macroprudential supervision and inspections).

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2014

During 2014, the National Bank was monitoring, on an ongoing basis, banks' compliance with safe functioning requirements and other prudential norms and restrictions. The work was continued to provide equal conditions for functioning of banks and ensure fair competition. However, it was impossible to completely abandon preferences that are given to banks if they comply with certain prudential requirements, which was mainly due to the need for servicing government programs and banks' adjustment to significant changes in banking legislation.

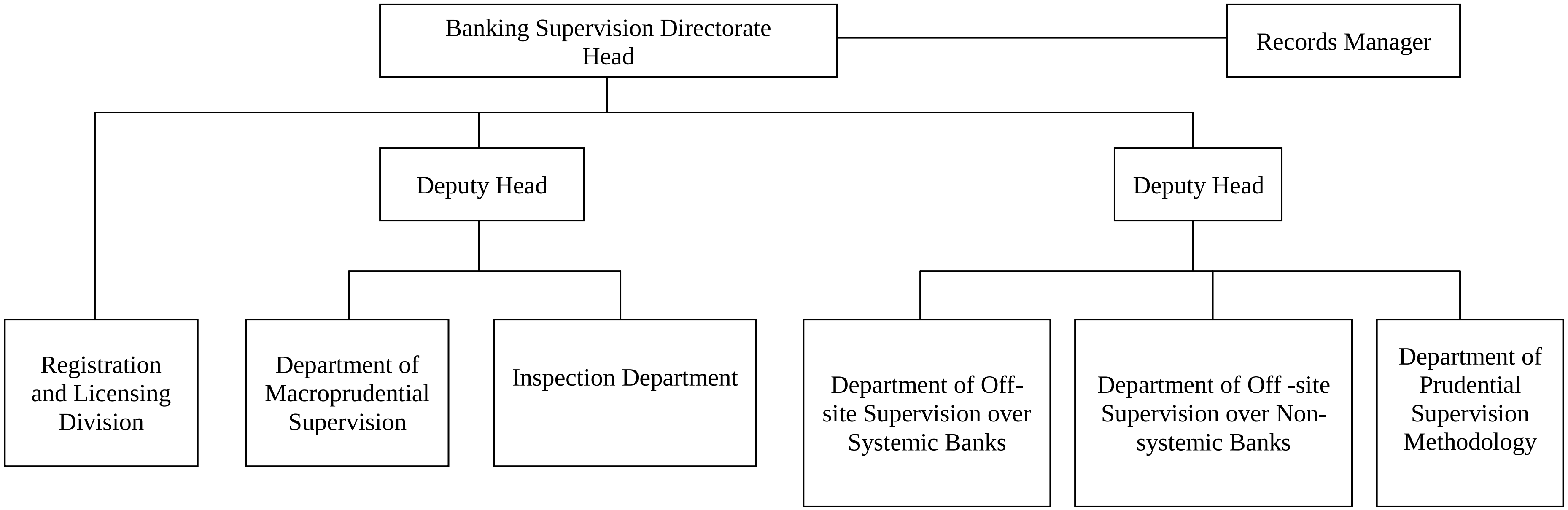
In 2014, the National Bank conducted 14 full-scope and limited-scope audits of banks. The results of audits of some banks were addressed in the meetings of the Board of the National Bank in connection with identified violations of law and deficiencies in the corporate governance, internal control, and risk management systems.

In 2014, a purposeful work was underway to tighten the off-site supervision in terms of improving the analysis of banks' performance indicators and their compliance with safe functioning requirements and identifying negative trends and crisis developments at early stages. The work was continued to improve the National Bank's information and analytical system for the purpose of automating and accelerating the processing of banks' financial and other reporting data.

Based on the results of the analysis of reports and other information received, in 2014 the National Bank took against banks, on the basis of motivated judgment, appropriate supervisory response measures such as sending instructions to remedy identified violations and take adequate enforcement actions, as well as holding meetings with banks' executive bodies and sending them letters to halt negative trends and avoid (prevent) situations threatening the depositors and other creditors' interests.

The National Bank continued to constructively cooperate with audit organizations and the Association of Belarusian Banks.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL COOPERATION

The National Bank makes endeavors to establish and develop contacts and exchange information with foreign banking supervisory authorities. Cooperation with those countries in which representative offices of Belarusian banks are located and with the countries whose banks established subsidiaries and representative offices in the Republic of Belarus is of particular interest.

In 2014, 17 bilateral agreements with foreign banking supervisory authorities were in force.

COOPERATION WITH THE OTHER SUPERVISORY BODIES IN THE REPUBLIC OF BELARUS

In carrying out banking supervision functions, the National Bank of the Republic of Belarus cooperates on a regular basis with the Ministry of Finance of the Republic of Belarus, Ministry of Internal Affairs of the Republic of Belarus, General Prosecutor's Office of the Republic of Belarus, State Control Committee of the Republic of Belarus, State Customs Committee of the Republic of Belarus, financial intelligence units, and tax authorities.

OTHER INFORMATION

More detailed information on the developments in the banking sector and banking supervision in the Republic of Belarus is available on the official website of the National Bank of the Republic of Belarus (*www.nbrb.by/engl/*).

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	32	31	31
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total	**32**	**31**	**31**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2012	2013	2014
Public sector ownership	66.3	65.4	65.0
Other domestic ownership	1.2	1.1	1.2
Domestic ownership total	67.5	66.5	66.2
Foreign ownership	32.5	33.5	33.8
Banking sector, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	68.0	79.0	0.22
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**68.0**	**79.0**	**0.22**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	12.74	13.77	15.66
Cooperative banks	-	-	-
Banking sector, total:	**12.74**	**13.77**	**15.66**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%)
(at year-end)

Claims from	2012	2013	2014
Financial sector	2.3	1.9	2.3
Nonfinancial sector	68.6	71.7	72.0
Government sector	4.9	6.3	7.0
Other assets, including	24.2	20.1	18.6
- non-resident	4.2	3.5	2.9
Claims due to	**2012**	**2013**	**2014**
Financial sector	2.4	2.0	2.8
Nonfinancial sector	51.3	48.7	49.0
Government sector	9.4	9.9	11.3
Other assets, including	22.4	25.3	23.3
- non-resident	16.3	19.7	18.1
Capital	**14.5**	**14.1**	**13.5**

Capital adequacy ratio of banks

Type of financial institution	2012	2013	2014
Commercial banks	20.8%**	15.5%**	17.4%**
Cooperative banks	-	-	-
Banking sector, total:	**20.8%****	**15.5%****	**17.4%****

(* - for Basel I; ** - for Basel II *** - for Basel III)

Asset portfolio quality of the banking sector
(share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non financial sector	5.82%	4.68%	4.60%
- households	7.16%	5.67%	5.41%
- corporate	0.40%	0.93%	1.36%

The structure of deposits and loans of the banking sector in 2014 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	87.9	53.0
Households	62.8	20.0
Corporate	25.1	32.9
Government sector	8.8	45.9
Financial sector (excluding banks)	3.3	1.1
Total	**100.0**	**100.0**

P&L account of the banking sector (in EUR) (at year-ends)

P&L account	2012	2013	2014
Interest income	3690.7	3460.2	3618.0
Interest expenses	2666.7	2470.7	2492.2
Net interest income	**1024.0**	**989.5**	**1125.8**
Net fee and commission income	**515.9**	**560.8**	**585.8**
Other operating income (net)	**-727.1**	**-829.7**	**-1049.0**
Net provision assignments	**409.0**	**221.9**	**313.0**
Net other income	**151.2**	**124.4**	**278.1**
Gross income	9594.2	11283.9	13907.2
Profit (loss) before tax	**555.0**	**623.1**	**627.7**
Income tax	79.3	101.5	99.6
Net profit (loss)	**475.7**	**521.6**	**528.1**

(* - for Basel I; ** - for Basel II *** - for Basel III)

Total own funds in 2014 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	4328.3**	3220.4**	-	1107.9**	0.0**
Cooperative banks	-	-	-	-	-
Banking sector, total:	**4328.3****	**3220.4****	**-**	**1107.9****	**0.0****

2014 DEVELOPMENTS IN THE BANKING SYSTEM OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

MACROECONOMIC ENVIRONMENT

According to preliminary data,[2] the nominal value of the GDP in Bosnia and Herzegovina in 2014 amounted to BAM 26 934 million. In the third quarter of 2014, a nominal annual increase in the gross domestic product (GDP) in the amount of 4.96% was recorded. With a GDP deflator of 4.38% in the third quarter, the annual growth of the real GDP was estimated to be 0.58%. The growth of the real GDP in the first three quarters of 2014 was estimated to be 0.99%.

Compared to the first three quarters of 2013, the nominal growth was mostly influenced by the economic activities of Manufacturing, Construction and Wholesale and Retail Trade, while the economic activities of Agriculture, Forestry and Fishing, as well as Electricity, Gas, Steam and Air Conditioning Production and Supply had a negative impact. Compared to the same period of the previous year, the volume of industrial production in the fourth quarter of 2014 decreased by 0.5%. In the fourth quarter a deflation of 0.1% per annum was recorded.

The trend of active lending to domestic sectors continued, as well as the growing trend of deposits caused mainly by the increase in retail deposits. The sector structure of deposits shows that the largest increase in other deposits is recorded by public non-financial enterprises and retail. Total loans in the banking sector amounted to BAM 16.87 billion at the end of December 2014. The dynamics of the new indebtedness of the retail sector indicate a continuous lending to consumption since the majority are purpose loans. Total deposits of commercial banks continued their upward trend in the fourth quarter of 2014 as well, and amounted to BAM 15.45 billion at the end of December, representing an increase of 8.5% on an annual and 1.2% on a quarterly basis. Retail deposits have exceeded the amount of BAM 9 billion in November 2014. As a result of such an increase, retail deposits have the largest share in total deposits. The secured deposit amount, which is paid by the Deposit Insurance Agency of B&H per depositor per member bank (25 member banks), amounts to BAM 50 000. Data on average weighted interest rates for the fourth quarter of 2014 indicate that there are no significant changes in interest rate trends relative to previous quarters.

[2] Preliminary data of the Central Bank of Bosnia and Herzegovina that are used as preliminary data by the Agency for Statistics of B&H.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

In 2014, positive trends have been recorded and they are reflected in the increase in the balance sheet volume, loans, deposits, especially retail savings, as well as the improved profitability of the entire banking sector. It can be concluded that the banking sector has remained stable, adequately capitalised, with satisfactory liquidity. Banking sector operations with negligible economic growth, a difficult situation in the real sector, as well as natural disasters (floods) that hit businesses and the population in Bosnia and Herzegovina in spring and summer had a negative impact on the state and prospects of the banking sector.

As of 31.12.2014, 17 banks in the FB&H had banking licences, as was the case at the end of 2013 as well (16 banks in the private and majority private ownership and 1 bank in state and majority state ownership). In 2014, the trend of a slight decline in the number of bank employees in the FB&H continued. As of 31.12.2014, the number of employees was down by 1% compared to the end of 2013.

In 2014, a slighly larger increase in the balance sheet volume was recorded compared to 2013, which is a positive sign, and it is expected that the same trend will continue in the period to come. As of 31.12.2014, the balance sheet volume of the banking sector amounted to BAM 16.2 billion and is up by BAM 719 million or 4.7% compared to the end of 2013. Loans, as the largest banking assets item, recorded an increase in the amount of 2.9% or BAM 318 million in 2014 and amounted to BAM 11.2 billion at the end of the year. Retail loans amounted to BAM 5.4 billion and grew by 5%, with a share of 48.8% in total loans. Loans to legal entities amounted to BAM 5.8 billion and are at the same level as they were at the end of 2013, with a share of 51.2%. The share of non-performing loans in total loans is 13.9% as of 31.12.2014. Cash funds amounted to BAM 4.6 billion or 28.2% of the balance sheet volume of banks in the FB&H, up by 3.2% compared to the end of 2013.

In the structure of banks' sources of funding, deposits in the amount of BAM 12.1 billion and with a share of 75% are still the most significant source of funding for banks in the FB&H, and they increased by 5.3% or BAM 607 million in 2014. Savings deposits, as the most significant segment of the deposit and financial potential of banks, maintained a positive trend of growth and amounted to BAM 6.7 billion at the end of 2014, up by 7.9% or BAM 491 million compared to the end of 2013. The total capital of banks as of 31.12.2014 amounted to BAM 2.43 billion, up by 5.5% or BAM 127 million compared to the end of 2013. Regulatory capital amounts to BAM 2.2 billion and is down by 5% or BAM 110 million compared to the end of 2013, with minor changes in its structure. As of 31 12. 2014, the capital adequacy ratio of the banking system amounted to 16.1%, still significantly above the legal minimum (12%), which represents a satisfactory capitalisation of the overall system and a strong foundation and basis for preserving its security and stability.

The liquidity of the banking system in the FB&H is evaluated as good, with a satisfactory share of liquid assets in total assets as well as a good maturity adjustment of financial assets and liabilities, with a trend of slight improvement since the end of 2010. According to unaudited data from the income statement for 2014, banks in the FB&H have recorded the best financial result so far, profit in the amount of BAM 131 million.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN BOSNIA AND HERZEGOVINA

A) Legal framework (new changes in 2014):

1. Law on Protection of Users of Financial Services ("Official Gazette of the FB&H", No. 31/14);
2. Law on Prevention of Money Laundering and Terrorism Financing ("Official Gazette of B&H", No. 47/14)

B) Prudential regulatory framework issued by the FBA (new changes in 2014):

1. Decision on Minimum Standards for Capital Management in Banks and Capital Hedge ("Official Gazette of the FB&H", No. 46/14);
2. Decision on Minimum Standards for Managing Liquidity Risk in Banks ("Official Gazette of the FB&H", No. 48/12 – consolidated text and 110/12, 46/14);
3. Decision on Provisional Measures for Rescheduling of Credit Liabilities of Legal Entities and Natural Persons in Banks ("Official Gazette of the FB&H", No. 2/10, 86/10, 1/12 and 111/12 and 1/14);
4. Decision on Minimum Standards for Documenting Lending Activities of Banks ("Official Gazette of the FB&H", No. 3/03, 23/14);
5. Decision on Conditions for Assessing and Documenting Creditworthiness ("Official Gazette of the FB&H", No. 23/14);;
6. Decision on Provisional Measures for Treatment of Loan Commitments of Bank Clients Affected by Natural Disasters ("Official Gazette of the FB&H", No. 55/14);
7. Decision on Amending the Decision on Uniform Method of Calculation and Disclosure of Effective Interest Rate on Loans and Deposits ("Official Gazette of the FB&H", No. 23/14);
8. Decision on Reporting Forms Banks Deliver to the Banking Agency of the Federation of Bosnia and Herzegovina ("Official Gazette of the FB&H", No. 110/12 and 15/13, 46/14, 62/14);
9. Decision on Conditions and Manner of Customer Complaint Management in Banks, Microcredit Organisations and Leasing Companies ("Official Gazette of the FB&H", No. 23/14, 26/14-correction and 62/14);
10. Decision on Minimum Standards for Documenting Lending Activities of Microcredit Organisations and Assessing Creditworthiness ("Official Gazette of the FB&H", No. 23/14);
11. Decison on Minimum Standards for Documenting Financial via Leasing Arrangements and Assessing Creditworthiness ("Official Gazette of the FB&H", No. 46/14);
12. Decision on Provisional Measures for Treatment of Liabilities on the Basis of Leasing Arrangements of Lessees' Affected by Natural Disasters ("Official Gazette of the FB&H", No. 88/14.);

13. Decision on Conditions and Manner of Handling of Guarantors' Requests for Release from the Guarantor's Obligation ("Official Gazette of the FB&H", No. 23/14, 62/14);
14. Decision on Minimum Requirements in Terms of Content, Comprehensibility and Availability of General and Special Business Conditions of Providers of Financial Services ("Official Gazette of the FB&H", No. 62/14);
15. Instructions for Licensing and Other Approvals of the Banking Agency of the Federation of Bosnia and Herzegovina ("Official Gazette of the FB&H", No. 1/14 – consolidated text);
16. Code of Conduct of Ombudsmen of the Banking System ("Official Gazette of the FB&H", No. 62/14).

Legal competences of the Agency:

- issuance of licences for the establishment and operations of banks, microcredit organisations and leasing companies, issuance of licences for changing the organisational structure of banks and microcredit organisations and leasing companies, issuance of approvals for the appointment of their managerial staff,
- supervision of banks, microcredit organisations, leasing companies and supervision of authorised exchange offices as well as implementation of measures in accordance with laws and regulations,
- revocation of operating licences of banks, microcredit organisations and leasing companies in accordance with the law,
- appointment of provisional and liquidation administrators in banks, supervision of provisional administration and liquidation of banks, monitoring of liquidation proceedings of microcredit organisations and filing requests for insolvency proceedings against banks and microcredit companies;
- adoption of bylaws regulating the operations of banks, microcredit organisations, leasing companies and authorised exchange offices;
- collection, processing and recording of data banks, microcredit organisations, leasing companies and authorised exchange offices submit to the Agency in accordance with regulations;
- aiding anti-terrorist measures related to banks, microcredit organisations and leasing companies at the request of the competent authority, in accordance with the applicable law;
- taking all necessary actions, including freezing client accounts in any bank on the territory of the FB&H in order to prevent the financing of activities that obstruct or threaten to obstruct the peace implementation process as pursued under the aegis of the General Framework Agreement for Peace in Bosnia and Herzegovina in accordance with special law;
- promotion and protection of the rights and interests of consumers, i.e. natural persons as users of financial services.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

The Agency's operations have been focused on maintaining a strong and stable banking, microcredit and leasing system, market-oriented and based on international standards of business operations and supervision of banks, microcredit organisations, leasing companies and authorised exchange offices, and thus the planned activities in that respect are related to:

- taking measures and activities within its competences in order to overcome and mitigate the effects of the global financial crisis on the banking, microcredit and leasing sector in the FB&H;
- maintaining continuous banking supervision by means of examinations via reports and on-site examinations with a focus on the examination of dominant risk segments of banking operations with a view to achieving more efficient supervision:
    - insistence on capital strengthening of banks, especially those recording an above average increase in assets and decrease in the capital adequacy ratio,
    - continuous monitoring of banks, primarily those of systemic importance to the development of lending activities in which a large amount of savings and other deposits is concentrated, in order to protect depositors,
    - the systematic monitoring of banks' activities in terms of preventing money laundering and terrorism financing has been continued, and cooperation with other supervisory and control institutions is to be improved,
    - activities in terms of improving secondary legislation have been continued, starting with EU directives, the Basel principles, as part of the preparations for B&H joining the European Union,
    - the review and regular updating of the Comprehensive Emergency Plan as part of crisis preparations,
    - monitoring the compliance of banks with laws and regulations and practices applied in banks in the segment of the protection of users of financial services and guarantors,
    - the establishment of and closer cooperation with supervisory authorities in countries whose investors are present in the banking sector of the FB&H, as well as with other countries in order to maintain effective supervision,
    - continued cooperation with the ECB and EBA towards the signing of mutual memorandums and the exchange of information in terms of banking supervision, especially from the perspective of the SSM, as well as with the IMF, the World Bank, the EBRD, etc.
- the continued upgrade of information systems that will enable early warnings and preventive action in terms of the elimination of weaknesses in banks;
- the accelerated completion of liquidation proceedings.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2014

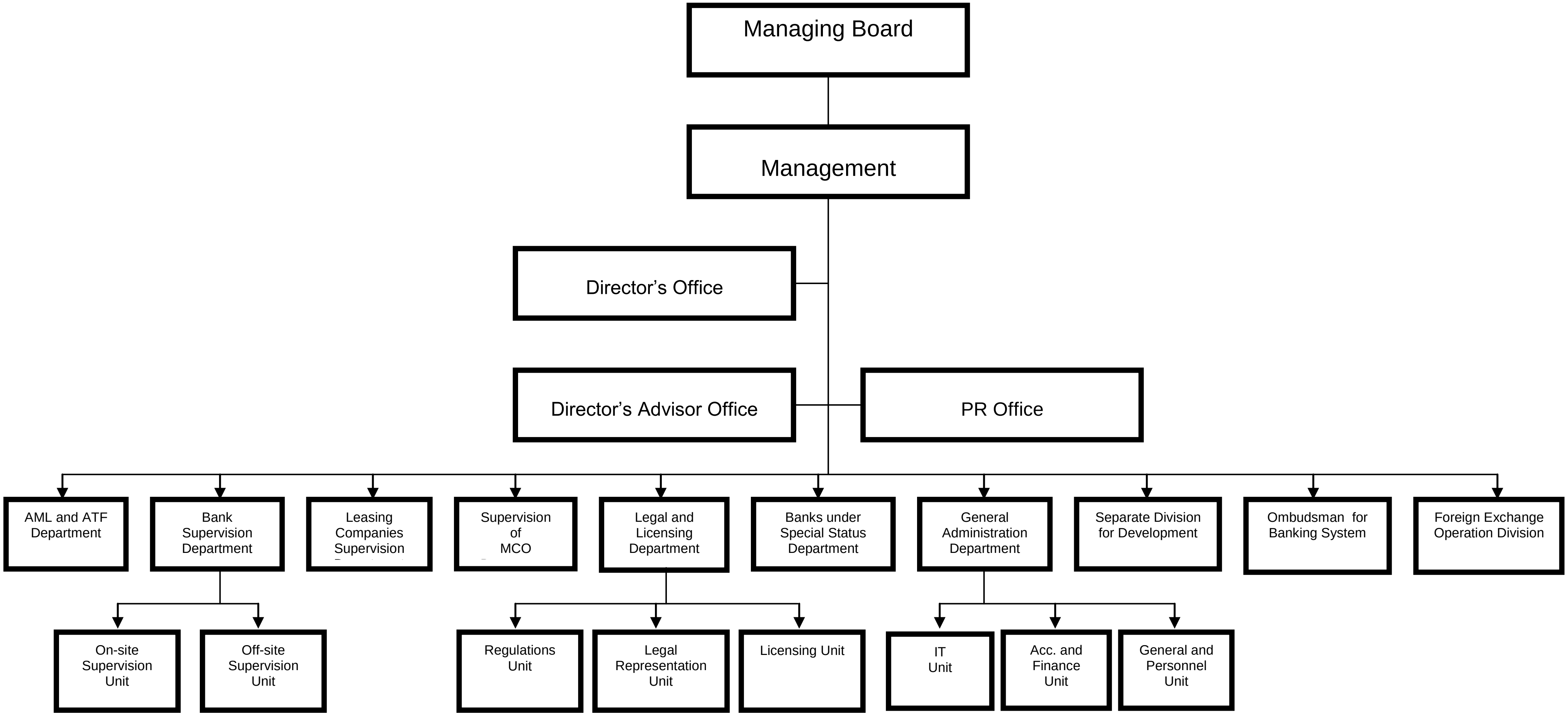
In 2014, the Banking Agency of the FB&H carried out the, among others, the following activities:

- continuous monitoring of the business operations of all banks in the system through on-site and off-site examination processes, with a focus on asset quality, credit risk management, the impact on capital and liquidity;
- the implementation of all measures in accordance with legislation;
- the continuation of activities to improve the existing and create a new regulatory framework;
- participation in the Financial Sector Assessment Program – FSAP in Bosnia and Herzegovina, which was conducted by a joint team of the IMF and the World Bank. In terms of the issue of supervision in B&H , the Mission included the risk of the financial sector and its vulnerability, the quality of financial sector supervision, financial safety net arrangements, financial inclusion, insolvency and creditors' rights regimes, deposit insurance, corporate financial reporting, capital markets and the governance of banks in state or majority state ownership in the assessment;
- the continuation of activities to implement the international framework in terms of capital and capital standards. Considering that the Strategy provides for the aforementioned being adjusted with respect to the content and dynamics of activities in accordance with changes that will be taking place in the regulatory framework on a global scale, the name of the document was changed from "Strategy for the Introduction of an International Agreement for Capital Measurement and Capital Standards – Basel I" to "Strategy for the Introduction of Basel III". All activities related to preparing the draft regulatory framework in the area of Pillar II for a public discussion have been carried out (Decision on Calculation of Bank Capital), as well as the draft regulatory framework in the area of Pillar II (Decision on Risk Management in Banks, Decision on Process of Internal Assessment of Capital Adequacy in Banks, decisions on large exposures of banks, decisions on managing interest rate risk in the banking book). The activities related the development of the bylegal framework with respect to reporting on capital and capital requirements of banks in accordance with the EU Implementing Regulation 680/2014, i.e. the Implementing Regulation 2015/227 on amending the EU Implementing Regulation 680/2014 on determining implementing technical standards on supervisory reporting to institutions in accordance with Decree No. 575/2013 of the European Parliament;
- the continuation of activities related to the project of conducting stress tests in order to assess the level of resilience of the banking sector to stress in cooperation with the IMF, the CBBH and the BARS;
- the completion of the tool development process for the early warning system (EWS), as an additional tool for early detection and identification of problems in high-risk areas of banking, timely and preventive undertaking of appropriate supervisory measures in order to prevent further escalation of problems and negative trends in the bank's

operations. During 2014, the necessary tests were carried out and acts have been drafted regarding the methodology of and Manual for the EWS;

- an additional off-site examination tool, the ”Risk Matrix”, has been created in order to improve the consistency of the methodology for planning the supervision and examination of banks.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

During 2014, the Agency, in collaboration with the CBBH and the BARS, continued activities to strengthen and improve international cooperation with international financial institutions, regional and other organisations, as well as bilateral and multilateral cooperation with the banking regulators from other countries.

On the issue of the signing of the MoU between B&H and the relevant banking regulators from Austria, significant progress has been made. In November 2014, the first draft of the MoU was received from the Financial Market Authority in Austria (FMA), which was discussed at a meeting in early March 2015 at the FMA, in Austria. The harmonisation of the text of the MoU was completed and, in accordance with the Single Supervisory Mechanism (hereinafter: the SSM), the FMA forwarded the draft of the MoU to the ECB for the purpose of comment submission. The completion of the process is expected shortly.

In late October 2014, the EBA updated the new assessment cycle, i.e. sent a unified form for the assessment of regulatory compliance/equivalence of third countries on the issue of confidentiality and information sharing with the new Capital Requirements Directive (CRD IV – Directive 2013/36/EU) to non-EU countries in the context of the updating the assessment as a prerequisite for the participation of regulators' representatives from third countries in supervisory colleges of banking group memberss. In April 2015, an official notice was received from the EBA that B&H, i.e. that the entity banking agencies had received a positive assessment regarding the equivalence of the confidentiality/professional secrecy regime of non-EU countries for the purpose of the relevant supervisory authorities' participation of in colleges of the European Economic Area (EEA).

With the establishment of the SSM and in the context of the EBA's positive assessment, in the first phase of information exchange with the ECB, the Banking Agency of the FB&H, at the ECB's official request, gave its approval regarding national regulators that are members of the ECB – SSM, in the context of the supervision of credit institutions that have subsidiaries on the territory of the FB&H and are supervised by the ECB, being allowed to forward data they receive from the Banking Agency of the FB&H to the ECB as well. With respect to the second phase, a draft Memorandum of Understanding between the banking supervisory authorities of Albania, the entity banking agencies in B&H, Macedonia, Montenegro and Serbia, and the EBA was prepared. The purpose of the aforementioned MoU is to improve and strengthen cooperation between the Host Authorities and the EBA in relation to cross-border banking operations in order to agree on procedures for supervisory cooperation, information exchange, assessments in situations of crisis and bank resolution. In order to achieve cooperation between the Host Authorities and the EBA, a dedicated forum will be established based on a financial cooperation group with a view to strengthening banking regulation and supervision through the exchange of information and promoting supervisory cooperation.

In the context of bilateral cooperation, the Banking Agency of the FB&H continued to cooperate with banking regulators during 2014: Slovenia: regular exchange of information (college participation); Austria: regular exchange of information (quarterly newsletter) with the FMA on banking groups and their subsidiaries in the Federation; Turkey: regular exchange of information with the regulator in Turkey. By the end of 2014, the Banking Agency of the FB&H, together with the CBBH and the BARS, signed a multilateral agreement with the competent regulators/supervisors of Southeast European countries, namely: Albania, Greece, Macedonia, Romania, Bulgaria, Serbia, Montenegro and Cyprus, as well as MoUs with the competent regulators/supervisors of Slovenia, Croatia, Serbia, Montenegro and Turkey. The MoU, among other things, defines the following more precisely: exchange of information, on-site examinations, requests for information and examinations, protection of information, ongoing cooperation.

COOPERATION WITH OTHER SUPERVISORY BODIES IN BOSNIA AND HERZEGOVINA

In 2014, the Agency has established cooperation with supervisory and other institutions in the country (MoU with the Central Bank of B&H, the Deposit Insurance Agency in B&H, the Insurance Supervisory Agency, the Securities Commission of the FB&H, the Intelligence-Security Agency and other relevant institutions in the country).

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

The Banking Agency of the FB&H participated in the Financial Sector Assessment Program – FSAP in Bosnia and Herzegovina, which was conducted by a joint team of the IMF and the World Bank. In addition to the Banking Agency of the FB&H, all relevant institutions in B&H participated in the FSAP Mission. On the issue of supervision of financial institutions that are under the authority of the entity banking agencies, the FSAP Mission contained the following segments: self-assessment of the entity banking agencies' compliance with the Basel Core Principles for effective banking supervision, assessment of the financial sector, system liquidity management, protection mechanisms for the financial sector, insolvency framework and macroprudential policy, the banking sector's resilience to stress, governance of banks in state and majority state ownership, financial inclusion, financial safety net, corporate governance, corporate reporting, etc. According to the final reports of the FSAP Mission, submitted up until and in June 2015, progress has been made in relation to the 2006 FSAP, there are certain shortcomings, and thus recommendations have been given to further strengthen and improve supervision in B&H.

The Agency has actively participated in the work of both the full forum of the Vienna Initiative 2.0 and the work of regional meetings in the interest of preparing and assuming joint positions for participation in the work of the Vienna Initiative 2. The Agency, together with the BARS, actively participated in the work of BSCEE and collaborated in the drafting of the report Prospects of the Western Balkans Financial Sector in the part related to B&H.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	18	17	17
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**18**	**17**	**17**

Ownership structure of the financial institutions (at year-ends)

Type of financial institution	2012	2013	2014
Public sector ownership	1,4	1,6	2,3
Other domestic ownership	7,6	7,4	7,1
Domestic ownership total	9,0	9,0	9,4
Foreign ownership	91,0	91,0	90,6
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI*
Commercial banks	56,5	69,2	1.408
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	56,5	69,2	1.408

*Whole percentages are used.

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	5,1	-0,1	5,1
Cooperative banks	-	-	-
Banking sector, total:	5,1	-0,1	5,1

*Return on average equity (ROAE).

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	100,0	100,0	100,0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking sector (%) (at year-end)

	2012	2013	2014
Claims from			
Financial sector	n/a	n/a	n/a
Nonfinancial sector	n/a	n/a	n/a
Government sector	n/a	n/a	n/a
Other assets	n/a	n/a	n/a
Claims due to			
Financial sector	n/a	n/a	n/a
Nonfinancial sector	n/a	n/a	n/a
Government sector	n/a	n/a	n/a
Other liabilities	n/a	n/a	n/a
Capital	n/a	n/a	n/a

*Breakdown of the total balance sheet not applicable. Loans and deposits structure is given in a table below.

Capital adequacy ratio of banks

Type of financial institution	2012	2013	2014
Commercial banks	17,3*	18,0*	16,0*
Cooperative banks	-	-	-
Banking sector, total:	17,3*	18,0*	16,0*

(Please, mark for each item: * - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector
(share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non financial sector*	13,3	14,8	14,0
- households	10,5	10,0	9,7
- corporate	15,9	19,4	18,4

*Share of NPL (past due 90 days) to total gross loans. Financial and government sectors not included.

The structure of deposits and loans of the banking sector in 2014 (%)
(at year-end)

	Deposits	Loans
Non-financial sector, including:	88,3	97,9
Households	61,0	48,8
Corporate	27,3*	49,1*
Government sector	7,1	1,7
Financial sector (excluding banks)	**4,6**	**0,4**
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2012	2013	2014
Interest income	809.424	781.045	770.716
Interest expenses	269.769	239.302	224.418
Net interest income	539.655	541.743	546.298
Net fee and commission income	n/a	n/a	n/a
Other (not specified above) operating income (net)	n/a	n/a	n/a
Gross income*	848.628	858.965	873.562
Administration costs	243.133	246.087	248.007
Depreciation	n/a	n/a	n/a
Provisions	144.750	232.804	143.575
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	n/a	n/a	n/a
Profit (loss) before tax	127.190	15.025	144.679
Net profit (loss)	110.356	-2.670	121.813

*Net interest income and gross operational income.

Total own funds in 2014 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	1.014.509*	-	908.929*	211.124*	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	1.014.509*	-	908.929*	211.124*	-

(Please, mark for each item: * - for Basel I; ** - for Basel II; *** - for Basel III)

2014 DEVELOPMENTS IN THE BANKING SYSTEM OF REPUBLIKA SRPSKA OF BOSNIA AND HERZEGOVINA

MACROECONOMIC ENVIRONMENT

Natural disasters and floods which hit the Republika Srpska and the neighbouring countries had a direct impact on the shaping of total results of domestic economy which grew at an inter-annual rate of 0.2% in 2014. Namely, after a growth of 0.5% in Q1, Republika Srpska GDP got a negative sign in Q2 (-1.0%). During Q3 and Q4, the overall Republika Srpska economic activity grew at a rate of 0.1% and 1.4% respectively.

In 2014, Republika Srpska industrial production achieved positive results. Namely, a growth in foreign demand, triggered primarily by domestic manufacturing sector (+5%), positively reflected on the overall industrial production which recorded a rise of 0.7%. The increase in demand coupled with production growth in the observed period resulted in the Republika Srpska export growth of 3.5%. On the other hand, Republika Srpska import grew by 8.5% which ultimately resulted in an increase of 7.0% in Republika Srpska foreign trade volume in 2014 at an inter-annual level.

Owing to a constant growth in the value of performed civil engineering works, 2014 was also marked by a trend of growth in the total Republika Srpska construction activity (+9.4%). Also, there were evident positive results on the domestic labour market; the average number of unemployed persons registered by the Republika Srpska Employment Institute decreased by 3.6% with a simultaneous increase of 1.3% in the number of persons who were deleted from the records due to employment.

Due to openness and high extrovert orientation, the main reference for the domestic economic trends will continue to be trends and developments in the neighbouring countries and the European Union, i.e. major Republika Srpska and Bosnia and Herzegovina foreign trade partners. Expecting a continuation of positive trends in the neigbouring countries as well as envisaged reform measures within the Economic Policy of the Republika Srpska for 2015, the projections of the Republika Srpska Government are that domestic economy will grow at a rate of 1.9% during 2015, while the International Monetary Fund forecast for the Bosnia and Herzegovina level is even more optimistic and it stands at 3.5% y/y.

Source: Economic Monitor, The Republika Srpska Investment-Development Bank.

DEVELOPMENT IN THE BANKING SECTOR (INCLUDING THE ASSETS TOTAL / GDP)

Taking into account the results realized in 2014, it can be stated that the banking sector of Republika Srpska, despite the challenges it encountered, as a whole has remained stable. The licence was revoked from one small bank, but it did not jeopardize the stability of the banking sector.

Although somewhat slower, the increase of bank activities has been continued, which is very important in the conditions of somewhat difficult business operations of numerous business entities, especially after the floods that hit Republika Srpska in 2014.

Additionally, the increase of total deposits has been continued, which is particularly expressed in household deposits. However, the high share of non-performing loans represents and will represent the highest threat and challenge for the banking system in future and requires broader engagement of all relevant institutions in Republika Srpska and Bosnia and Herzegovina.

The banking sector of Republika Srpska has a total of 9 banks, out of which 8 having majority private capital dominated by foreign private capital and 1 state owned bank.

Basic indicators of the banking sector operation as of 31/12/2014:

- total balance sheet amount was EUR 3.9 billion with a growth rate of 1% if compared to the balance as of 31/12/2013.
- cash funds (EUR 0.8 billion) were 22% out of total assets with an increase rate of 14% in comparison with the previous year. Out of total banks' cash funds, 32% was on accounts abroad (foreign currency current accounts and the funds termed up to 30 days).
- total gross loans (EUR 2.4 billion) decreased by 3%, primarily due to liquidation of one bank and transfer of non-performing portfolio of one bank to Asset Management Company.
- share of non-performing loans in the total loan portfolio decreased by 1.88 percentage points in comparison to the end of 2013 (from 16.23% to 14.35% as of 31/12/2014).
- total calculated reserves for the coverage of potential loan and other losses under regulatory requirement decreased by 7% in comparison with the previous year, while the coverage rate of classified assets by reserves amounted to 11% (as of 2013, the rate of coverage amounted to 11.6%).
- deficient amount of reserves under regulatory requirement, representing the balance between reserves under regulatory requirement and value adjustment and reserves under the IAS, amounted to EUR 31.1 million (as of the end of 2013 amounted to EUR 31.6 million).
- average coverage rate of classified assets by the value adjustments under International Accounting Standards amounted to 8.8% (as of 31/12/2013 amounted to 8.9%).
- deposits (EUR 2.4 billion) were a basic source of funding banks' operation, with the share of 71%. Since 2011, deposits have had a trend of increase. As of 31/12/2014, deposits increased by 3% in comparison with the previous year.

- trend of growth in households' deposits continued also in 2014 and as of 31/12/2014 increased by 7%. Share of households' deposits in total deposits increased from 48% to 50%.
- banks' total capital (EUR 0.4 billion) is almost at the same level as it was as of 31/12/2013.
- based on the shareholder ownership structure, private capital was 93%, while the state owned (share owned by Republika Srpska) amounted to 7%. In the private capital structure, the share of foreign capital (also including foreign state capital) was 83%, while domestic capital was 17%.
- average capital adequacy rate amounted to 16.92%, as of 31/12/2013 it was 17.42% (legally required minimum is 12%).
- banking sector of Republika Srpska is liquid and able to meet all its obligations in due terms.
- at the level of total banking sector as of 31/12/2014, the profit amounted to EUR 14,4 million (as of 31/12/2013, loss amounted to EUR 18,4 million). One bank operated with a loss amounting to EUR 11 million, while eight banks generated a profit in the amount of EUR 25,4 million.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY

The amendments of laws in 2014:

- Law on prevention of money laundering and terrorist financing (Official Gazette of BiH, number: 47/14);

The new prudential regulation issued by the Banking Agency of Republika Srpska hereinafter: the BARS) in 2014:

- Decision on minimum standards for information system management in banks ("Official Gazette of Republika Srpska, number: 01/14"). This decision stipulates the minimum standards and criteria that the bank is obliged to provide and implement in relation to the management of information systems in banks;
- Decision on minimum standards of outsourcing management ("Official Gazette of Republika Srpska, number: 01/14"). This decision sets out minimum standards a bank has to provide in the process of implementing and managing outsourcing and risks that may result from outsourcing;
- Decision on temporary measures for loan obligations of clients affected by natural disasters ("Official Gazette of Republika Srpska, number: 57/14"). This decision stipulates measures related to the loan obligations of bank clients affected by natural disasters in Bosnia and Herzegovina in May 2014.

The BARS legal competences

The BARS has a mandate to regulate and supervise banks, microcredit organizations, leasing companies and saving-credit organizations.

Namely, the BARS is authorized to:

- issue licenses for foundation and operation of banks, licenses for status changes and changes in both the organizational structure of banks and type of operation the banks perform;
- supervise safety and soundness and legality of banks' operations – through off-site and on-site examination of banks, and undertake appropriate supervisory measures;
- revoke banking licenses;
- introduce provisional administration in banks and appoint a provisional administrator, institute liquidation proceeding in banks and appoint a liquidation administrator, direct and supervise the proceeding of provisional administration and liquidation in banks, submit a request to institute bankruptcy proceeding in banks;
- adopt acts regulating banks' operation;
- evaluate whether the requirements have been met, and approve of the following issuance of shares;
- supervise and undertake necessary activities regarding anti-money laundering and terrorism financing related to banks, microcredit organizations, saving-credit organizations and other financial organizations, all in cooperation with the competent institutions and in accordance with regulations governing this field;
- supervise and undertake other activities in accordance with regulations governing the introduction and implementation of certain interim measures for the purpose of effective enforcement of international restrictive measures;
- adopt adequate acts in the field of anti-money laundering and terrorism financing, and cooperate with the competent authorities and institutions within this field;
- adopt acts and undertake actions in order to ensure the protection of consumers' rights, i.e. of physical persons as beneficiaries of financial services in the banking system, supervise the implementation of regulations governing this field and undertake other activities and adequate measures within the scope of its authority;
- perform other tasks in accordance with the law governing operation of banks;
- issue and revoke licenses and approvals to microcredit organizations, saving-credit organizations and leasing companies, control the legality of their operation, adopt general acts regulating operations of microcredit organizations, saving-credit organizations and leasing companies etc.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

The BARS main strategic objective is to safeguard and strengthen the banking system stability, as well as to improve its safe, good quality and lawful operations. In that sense, strategic objectives are:

- undertake activities and adopt measures within the scope of the BARS's authority with the aim to alleviate negative effects of global financial and economic crisis on the banking system of Republika Srpska;
- insist on capital strengthening, especially of banks, but also of other financial organizations;
- enhanced supervision of credit risk, primarily in the sense of adequacy of reserves for potential loan losses, and bank capital adequacy;
- further development and improvement of supervision along with the technical assistance of international institutions;
- active role on the protection of rights of financial service consumers;
- improvement of the project for bank „Stress tests";
- professional training of bank employees and development of information system;
- monitoring of international banking and accounting standards (Basel Principles and EU Directives) and incorporating the same in our regulation;
- work on the regulations for dealing with problem banks;
- continue with enhanced (daily) off-site supervision of current bank liquidity;
- activities directed to further strengthening of transparency of the business activities of banks and other financial organizations, and maintaining the trust in banking system;
- continue with the adequate monitoring of payment transactions and activities for the prevention of money laundering and terrorism financing, and in that sense, improve the cooperation with other competent institutions;
- further improvement and establishment of cooperation with the banking supervisors, especially from the countries whose banks have equity shares in the banks from Republika Srpska;
- actively participate in the work of Committee for Coordination of Financial Sector of Republika Srpska.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2014, one bank, one microcredit organization and one leasing company had their licenses revoked by the BARS, while one license to microcredit organization was issued, hence the banking system of Republika Srpska as of 31/12/2014 consists of 9 banks, 6 microcredit organizations and 1 leasing company.

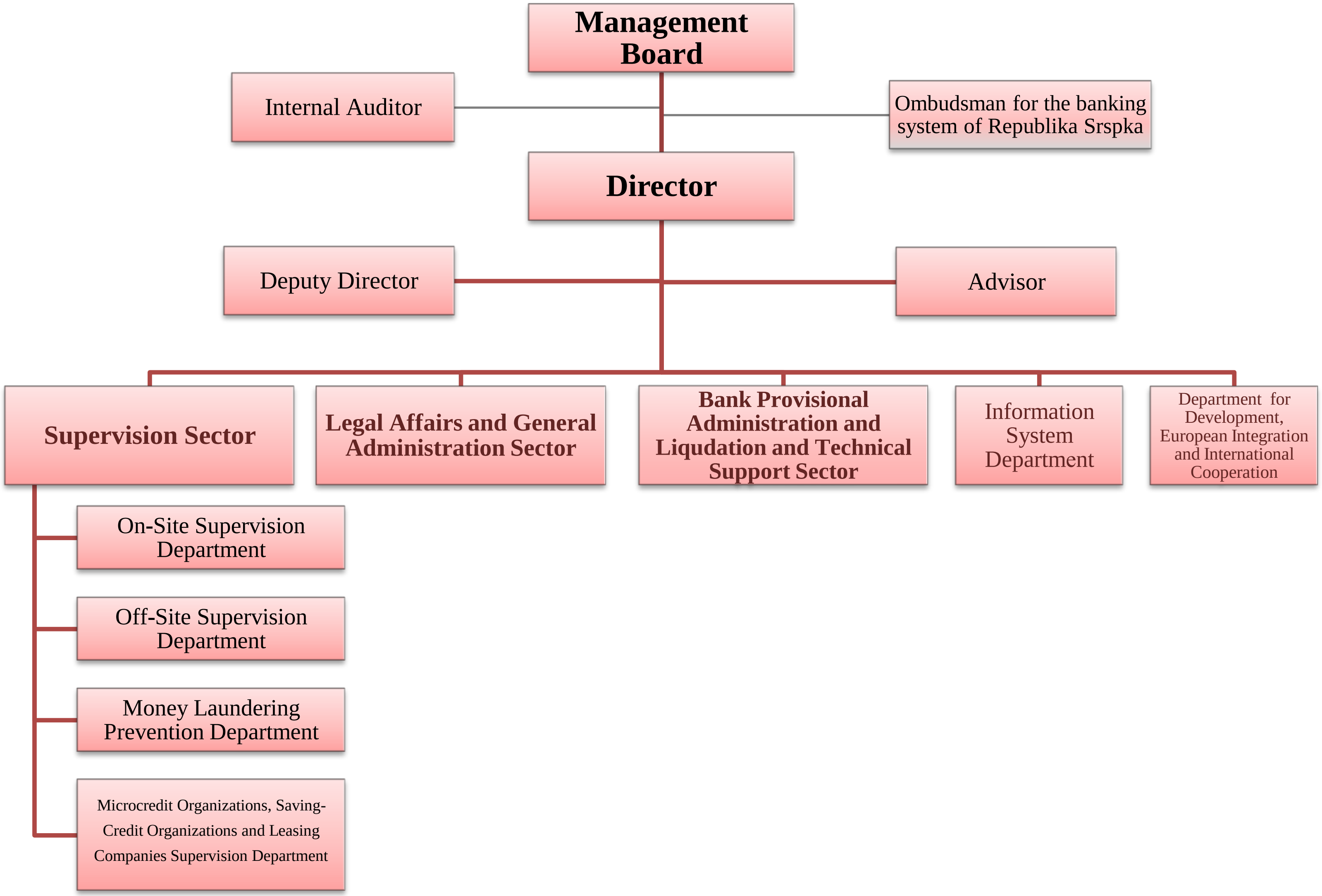
The BARS activities were aimed at maintaining the stability and improvement of quality and legality of the operations of the Republika Srpska banking system, on the basis of continuous supervision of banks, microcredit organizations and leasing companies.

The BARS has continuously controlled the operations of financial organizations through the off-site and on-site supervision, primarily by means of monitoring the solvency, liquidity, capitalization and profitability of all individual financial organizations, as well as the system as a whole. The BARS orders are primarily aimed at strengthening of capital, improving of loan policies and consistent application of the same, improving the management of credit and liquidity risk. In addition, a special attention has been also dedicated to the control segments which are related to the assessment of harmonization of banks, microcredit organizations and leasing companies with the standards for the prevention of money laundering and terrorism financing, as well as ensuring and improving the protection of rights and interests of banking service consumers.

The BARS other activities:

- the BARS has continued with the activities on strengthening and improving the cooperation with international and domestic institutions, regional and other organizations, as well as bilateral cooperation with regulators from other countries;
- the BARS was actively involved in the preparation of documents and submitting data for the purposes of the Financial Stability Assessment Program (FSAP) performed by the International Monetary Fund and World Bank;
- the BARS prepared the Self-assessment on equivalence of confidentiality regime of the BARS with the CRD IV, which was submitted to the European Banking Authority;
- the BARS, in cooperation with the Central Bank of Bosnia and Herzegovina and International Monetary Fund, develops on a continuous basis the methodology for collecting and analyzing FSIs indicators, as well as the methodology for banks' stress tests based on the macroeconomic assumptions (credit risk and impact on capital adequacy).
- the BARS was actively involved in preparation of amendments to legislation governing the operations of financial organizations;
- the BARS continue to perform activities in accordance with the BARS adopted Strategy for Introducing Basel II, which are primarily aimed at strengthening of institutional capacities of the BARS and gradual transition to the new regulatory framework (harmonization with the provisions of the EU directives and Basel principles) as well as further development and advancement of the existing secondary regulatory framework;
- Ombudsman for the banking system of Republika Srpska, who acts within the BARS, has continued to perform the function of protection of rights of financial service consumers.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

During 2014, the BARS has continued with the activities on strengthening and improving the cooperation with international financial institutions, regional and other organizations, as well as bilateral cooperation with regulators from other countries. The BARS has responded, on a regural basis, to the inquiries and requests of international institutions and organizations (European Central Bank, European Banking Authority, International Monetary Fund, World Bank, EBRD, BSCEE, etc.).

The BARS submitted reports on progress regarding the implementation of legislation in the banking sector, which the European Commission uses for the needs of regular meetings of Sub-Committee on Internal Market and Competition between the Bosnia and Herzegovina and European Union.

The BARS continued to cooperate with home supervisory authorities through regular contacts and exchange of relevant information and the participation of representatives of the BARS in the Supervisory Colleges organized by home supervisors.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

In 2014, the BARS continued active cooperation with the Insurance Agency of Republika Srpska and Securities Commission of Republika Srpska in accordance with the Law on Committee for Coordination of Republika Srpska Financial Sector Supervision.

Also, the BARS participated in the work of permanent Financial Stability Committee established by the Fiscal Council of Bosnia and Herzegovina, Central Bank of Bosnia and Herzegovina, Deposit Insurance Agency of Bosnia and Herzegovina, Banking Agency of the Federation of Bosnia and Herzegovina and the BARS.

Furthermore, under the signed Memorandum of Understanding, intensive bilateral cooperation with the Central Bank of Bosnia and Herzegovina, Banking Agency of the Federation of Bosnia and Herzegovina and Deposit Insurance Agency of Bosnia and Herzegovina was continued in 2014.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

For further information on the BARS supervisory activities and regulations, please visit the BARS website at www.abrs.ba.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	10	10	9
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**10**	**10**	**9**

Ownership structure of the financial institutions on the basis of assets total

Item	2012	2013	2014
Public sector ownership	-	4,1	4,4
Other domestic ownership	5,7	7,2	26,2
Domestic ownership total	5,7	11,3	30,6
Foreign ownership	94,3	88,7	69,4
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	58,1	85,6	1.601
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Financial institutions, total	58,1	85,6	1.601

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	2,0	-4,4	3,4
Cooperative banks	-	-	-
Financial institutions, total	2,0	-4,4	3,4

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	100,0	100,0	100,0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Financial institutions, total	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2012	2013	2014
Commercial banks	16,2*	17,4*	16,9*
Cooperative banks	-	-	-
Banking sector, total:	16,2*	17,4*	16,9*

(* - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector
(share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non financial sector	14,1	16,2	14,4
- households	**13,1**	**13,0**	**11,7**
- corporate	**14,7**	**18,2**	**16,2**

The structure of deposits and loans in 2014 (%)
(at year-end)

	Deposits	Loans
Non-financial sector, including:	93,4	99,6
Households	56,2	40,5
Corporate	26,7	43,0
Government sector	10,6	16,2
Financial sector (excluding banks)	6,6	0,4
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-end)

P&L account	2012	2013	2014
Interest income	177.705	176.735	169.654
Interest expenses	65.028	68.973	65.987
Net interest income	112.677	107.762	103.666
Net fee and commission income	-	-	-
Other (not specified above) operating income (net)	-	-	-
Gross income	**176.408**	**178.486**	**175.883**
Administration costs	**108.143**	**120.831**	**110.952**
Depreciation	-	-	-
Provisions	-	-	-
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	47.243	63.200	36.965
Profit (loss) before tax	12.161	-15.240	28.828
Net profit (loss)	7.993	-18.351	14.380

Total own funds in 2014 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2*	Tier 3
Commercial banks	401.820	342.540	342.540	90.353	-
Cooperative banks	-	-	-	-	-
Financial institutions, average	401.820	342.540	342.540	90.353	-

Note: *Additional regulatory deductions amounted to EUR 31.073 thousand

2014 DEVELOPMENTS IN THE BULGARIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Macroeconomic environment in 2014 continued to be characterised by relatively sluggish economic activity although real GDP growth accelerated to 1.7% compared to 1.1% in 2013. In contrast to 2013 when the economic growth was fuelled by the net exports, in 2014 domestic demand was the main driver of economic growth with final consumption and gross formation of fixed capital posting 2.4% and 2.8% real growth, respectively. Although both exports and imports increased in real terms, the growth rate of exports slowed down to 2.2% (against 9.2% in 2014) and fell below the growth rate of imports (3.8%). As a result, net exports had negative contribution to the real GDP growth rate (-1.1 p.p.). On the supply side, gross value added in real terms grew by 1.6% with services having the main contribution (0.8 p.p.) followed by industry (0.6 p.p.) and agriculture (0.3 p.p.).

Recovery of private consumption can be partially attributed to the improvement of labour market conditions. According to national accounts data, employment rose by 0.4% after 0.4% drop in 2013 while unemployment rate (labour force survey data) decreased to 11.4% from 13% in 2013.

Investment activity was driven mainly by the growth of public investments. At the same time, corporations from most of the economic sectors restrained their costs for fixed capital probably due to the uncertainty in the economic environment.

Gross external debt rose by EUR 2.8 billion to EUR 39.8 billion (94.7% of GDP) driven by the increase of the general government borrowing. External debt of the general government grew by EUR 2.6 billion with its ratio to GDP increasing from 8.3% in 2013 to 14.3% in 2014.

Changes in consumer prices as measured by HICP were characterised by deflationary developments. End-of–year inflation rate was negative (-2%) driven by the declining global prices of energy and commodities and, to a lesser extent, by the still subdued domestic demand.

DEVELOPMENT IN THE BANKING SECTOR (INCLUDING THE ASSETS TOTAL / GDP)[3]

In 2014 the challenges of the economic and political environment and the resulted uncertainty affected negatively the credit activity and supported the high propensity of households to save. Maintaining the stability of the banking sector was the main challenge in the second half of the year with regard to the liquidity pressure experienced by banks in June 2014. The banking system was under pressure as a result of active withdrawal of attracted funds from the

[3] The revocation of the licence of Corporate Commercial Bank to conduct bank operations is a key factor for the banks' balance sheet indicators dynamics, and the qualitative indicators due to the exclusion of the bank (the fourth largest bank in terms of assets) from the scope of data.

Corporate Commercial Bank (CCB). As a result the banking group consisting of CCB and the Commercial bank Victoria was placed under conservatorship. In November the BNB Governing Council revoked Corporate Commercial Bank's license for conducting banking activities and decided that in December CB Victoria EAD (former Credit Agricole Bulgaria) will restart carrying out all activities under its banking license. The case did not affect negatively the banking sector. The aforementioned decision of the Bulgarian National Bank in connection with it, in combination with existing liquidity buffers allocated by banks, allowed for the stability of the banking system to be sustained. These actions also helped to revive confidence in banks and the inflows of deposits recovered in the following months. The banking system managed to improve liquidity, and maintain capital buffers.

Another major priority in 2014 was the management of credit risk. The level of loans past due more than 90 days improved and their impairment coverage ratio enhanced. The quality of assets other than loans remained good. Credit institutions maintained their capital positions in line with their risk profiles.

Banks ended 2014 with EUR 43.5 billion of assets which was 0.5% less than in the previous year. The market share of domestic banks decreased to 23.7% as a result of the closure of Corporate Commercial Bank which was the fourth biggest bank in the country. EU subsidiary banks' and bank branches' assets grew to 74.9%. Non-EU banks' and branch share decreased to 1.4%.

Despite some signs of economic recovery lending remained subdued while attracted funds continued to grow. Gross loans (excluding loans to credit institutions) decreased by 5% and at the end of the year their amount was EUR 28.4 billion. In the reporting period the attracted funds declined by 0.5% and were EUR 37.6 billion at year-end. The profitability of credit institutions improved in comparison to 2013 as a result of adjusted pricing strategies and lower interest expenses.

Market structure

By the end of 2014 there were 28 credit institutions of which one was a state-owned bank. The five largest banks in the banking balance sheet accounted for 54.3% of total assets. The ratio of total banking assets to GDP was 103.6%.

Asset quality

In 2014 a decrease by 5.1% of the gross amount of loans past due more than 90 days was registered which led to a reduction in their share in total loans (excluding loans to credit institutions) to 16.75%. Their net value decreased due to impairment costs. The measures which were undertaken to manage credit risk contributed to the further increase in the rate of provisioning of non-performing loans (all loans which are past due more than 90 days). The coverage ratio of NPLs improved from 52.5% (for 2013-year end) to 59.1%.

Profitability

Profitability of credit institutions remained impacted by limited business opportunities and continuous impairment of assets. By 31 December 2014 the audited profit of the banking system was EUR 363 million which compared to 2013 represents 41% growth rate. The increase in profit led to improvement in profitability indicators. The ROA was 0.85% and ROE was 7.15%. Net interest margin remained almost unchanged at the level of 3.38%. Impairment costs at year end were EUR 600 million which compared to the previous year implies 2% increase. All major components of the financial and operating income contributed to its increase. The net interest income grew due to a higher rate of decrease of the interest expenses than the interest income.

Solvency

Under Regulation (EU) No 575/2013, since early 2014 the new reporting framework on the capital adequacy and components unified for EU banks has been applied. In order to preserve the accumulated capital reserves in the banking system in previous years BNB introduced a capital conservation buffer in the amount of 2.5% of the total risk exposures (effective from May 2014) and a systemic risk buffer in the amount of 3% of the risk exposure amount in Bulgaria (effective from October 2014). The total capital adequacy ratio of the banking system as of end-December 2014 was 21.95%. Common equity tier one capital accounted for 97.7% in the structure of tier one capital and the ratio was 19.51%. Throughout the year no significant changes in the structure of risk exposures for the different risk categories were observed. The banking system leverage ratio at the end of the year was 11.53%.

The amount and quality of regulatory capital remained high, with the banking system capital reserves increasing significantly since 2013. This reflects both the removed requirement for reporting specific provisions for credit risk (reported until 2013 as a discount of own funds, equally split between primary and supplementary capital) and BNB supervisory recommendations regarding banks' capital positions. The capital excess over the minimum regulatory level of 8% was EUR 3.5 billion which is 8.4% of Bulgarian GDP for 2014.

Liquidity

After the bank run in June the liquidity of credit institutions was strengthened in order to restore confidence in the banking system. Attracted funds from households and corporates started to increase again and in the context of weak credit activity this also contributed to liquidity buffer growth.

The implementation of macro-prudential requirements was among the factors allowing banks to overcome the pressure of the liquidity shock which resulted in a liquid assets ratio[4] reaching 30.1% at the end of the year. In the structure of liquid assets cash retained its largest share (44%) followed by funds on current accounts with other banks and interbank deposits of up to seven days (35.2%). The share of marketable securities issued by central governments or central banks and Bulgarian government securities (other than those for trading) accounted for 20.2%.

Products and distribution channels

At the end of 2014 there are 52 points of sale (branches, offices, representative offices and remote workstations), 80 ATMs and 1115 POS terminals per 100 000 population.

[4] Liquid assets to liabilities ratio.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN BULGARIA

In March 2014 were adopted amendments to the Law of Credit Institutions (LCI), which aimed at achieving consistency with Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms. Essentially these changes together with the entry into force of Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms (the package CRD IV/CRR) introduced the European version of the rules of the Third international agreement of the Basel Committee on Banking Supervision on capital standards and measures, so called Basel III. The new framework necessitated changes in the supervisory approach of BNB in order to preserve the accumulated buffers over the years in the banking system.

In April the Governing Council of BNB adopted amendments of several major BNB ordinances on banking supervision and approved new ordinances on banks' capital buffers and on organisation and risk management of banks. So the ordinances were brought into line with the new EU legal framework for the activity of credit institutions, established by adoption of the package CRD IV/CRR, as well as with the amendments of the LCI, published in Darjaven Vestnik, issue 27 of 2014.

The new Ordinance No. 7 of BNB on Organisation and Risk Management of Banks introduced provisions on requirements for the structure and organisation of risk management, the establishment of a risk committee and expansion of previously existing requirements for the technical criteria for the treatment of various types of risk.

The new Ordinance No. 8 of BNB on Banks' Capital Buffers introduced provisions related to the development of a methodology for maintaining the capital conservation buffer, the bank-specific countercyclical capital buffer, the buffer for global systemically important institution (G-SII), the buffer for other systemically important institution (O-SII) and the systemic risk buffer. The BNB introduced a mandatory capital conservation buffer of 2.5% (effective as of May 2014) and a systemic risk buffer of 3% for all credit institutions in the country (in force since October 2014). In mid-November the BNB informed all relevant European partners in order to observe the formal requirements and obligations of BNB and the Banking Supervision Department.

In 2014 a European standardized supervisory reporting framework entered in force, covering the whole reporting of banks regarding the package CRD IV/CRR. In order to facilitate the process of introduction of the new requirements, the BNB conducted an active communication with banks regarding Regulation (EU) No. 575/2013 and made all efforts to ensure uniform practices for the interpretation of key issues in the implementation of the framework.

With the introduction in 2014 of a macro-prudential framework in the EU as part of the changes in the international regulatory environment, the macro-prudential powers of BNB were further strengthened. In the second quarter of 2014 a structural change was carried out, as the function, responsible for the analysis of financial stability became part of the activities of the Banking Supervision Department.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

The BNB's main strategic objectives in the field of banking supervision for 2014 were:

- Effective micro-prudential supervision of credit institutions and the broader macro-prudential goal of maintaining stability of the banking system;
- Strengthening the resilience of the banking system towards risks and vulnerabilities stemming from national and international environment;
- Amendment of the national regulatory and supervisory framework to achieve harmonisation with the EU requirements and also to keep the ability of BNB to maintain anti-cyclical policy;
- Further development of operative banking supervision and cross-border cooperation within supervisory colleges; to deliver timely and well-reasoned risk assessments on local bank subsidiaries within the joint risk assessment and decision process related to EU banking groups presented in Bulgaria.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

The main task of the macro-prudential supervision activity and financial soundness through the year was related to the analysis and assessment of risks in the Bulgarian banking system. To this end, the applicability of various macro-prudential tools used in the European banking system was examined. A stress test for resilience under credit and liquidity risk was carried out. The results were used to determine the recommended levels of liquidity buffers, as well as the maximum levels of the capital conservation buffer and the systemic risk buffer in accordance with the new Ordinance No. 8 of BNB.

In the third quarter of the year the BNB carried out a macro-prudential solvency stress test. It was performed at the individual level through the application of unified methodology and shocks for all banks (i.e. a bottom-up approach). At the same time the degree of credibility in performing the simulation was verified by a formal assessment of the quality of the implementation of the stress test (a top-down approach). The exercise covered credit, market, sovereign risk and funding risk, as the main focus was on modelling the credit risk. Based on the findings of the test results was confirmed the effectiveness of the macro-prudential measures taken in the year and were given additional recommendations. The existing weaknesses in banks' balance sheets were identified and addressed. The requirements regarding emergency plans of credit institutions were increased.

An additional macro-prudential reporting was developed, including comparable data and reporting templates with additional data. In parallel to the work of the Single data repository, a mechanism for reception and verification of the new statements was provided, as well as the generation of information to the EBA.

In the past one year the main priority of banking supervision activities continued to be the supervisory review and evaluation of individual banks performed by off-site analysis and on-site inspections. Subject to enhanced monitoring were the dynamics of the main risks of banks' activities and the impact of the introduction of the new supervisory and financial reporting in accordance with Regulation (EU) No. 575/2013. In this period the ongoing monitoring of the financial condition of banks continued through the quarterly supervisory analyses reflecting the level and development of banking risks, as well as ratings on CAEL, which identified the risk profiles of individual banks. Based on the on-going monitoring of credit institutions and the results of on-site inspections the BNB's staff made the relevant rating assessments under CAMELOS, reflecting the level and management of risks in their activity in 2013. In establishing violations and weaknesses at the level of individual credit institutions, the BNB proposed measures for their adjustment and for the overall improvement of risk management in order to restore their stability and resilience. In addition a review of the quality of banks' annual internal capital adequacy assessment was performed, focusing on its adequacy to cover current and potential banking risks.

A total of 11 on-site inspections were carried out through the year. The main focus was on the analysis and assessment of the risk profile of the institutions, on the evaluation of the quality of the systems for risk identification and monitoring, and the adequacy of capital, profitability, liquidity and compliance with the regulatory framework.

In addition 5 on-site inspections of 2 banks were carried out regarding the analysis and valuation of IRB approach. Following the adoption of a joint decision between the BNB and the competent authority responsible for the supervision of the banking group, a subsidiary bank was given permission to apply the IRB approach to capital requirements.

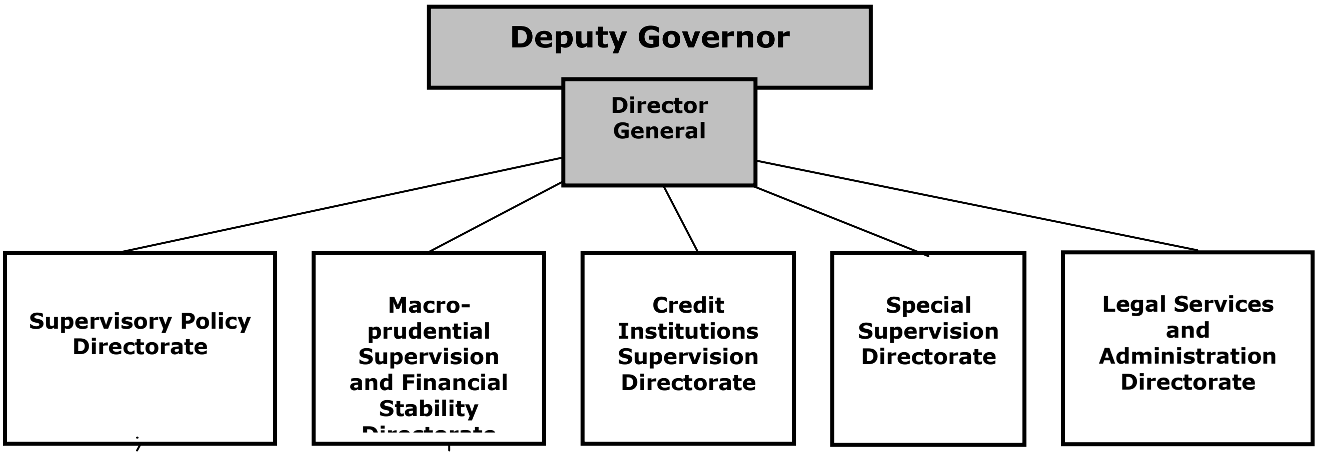
In response to the processes related to liquidity pressure on the banking system and the subsequent placement of Corporate Commercial Bank and Commercial Bank Victoria under conservatorship, additional supervisory reporting was introduced. The active oversight also included the development of macro-prudential recommendations to credit institutions related to their business models and opportunities for further strengthening of their capital and liquidity buffers. The BNB developed additional expertise to support some decisions regarding the Bulgarian banking system. An element of the macro-prudential analysis was the intensive communication with the European Central Bank (ECB), the European Banking Authority (EBA) and the European Systemic Risk Board (ESRB).

Beside the banking sector, BNB was carrying out also monitoring of non-banking financial institutions. The amendments to Ordinance No. 26 increased the capital levels, introduced requirements for disclosure of beneficial owners and identified additional criteria for the reputation of managers and qualified owners. The amendments aimed to improve market discipline and ensure transparency in the ownership structure.

An important topic on which the BNB was committed at national and European level was the protection of the banking sector from penetration of money of criminal nature. During the scheduled on-site inspections at credit institutions the BNB's staff reviewed the adequacy of controls for prevention, with focus on the applied enhanced measures for reviews of correspondent relations with third countries, very risky customers and politically exposed persons.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

Banking Supervision Department



INTERNATIONAL ACTIVITIES

Due to the large public response to the case Corporate Commercial Bank and to prevent possible speculative criticism (with internal political coloration), in September BNB asked the European Banking Authority (EBA) to assist with an opinion and assessment of the organisation and operation of banking supervision to the Central Bank.

In this regard, the BNB answered in detail to the EBA study aimed at analysing: a) organisational structure, strategy and supervisory process in the BNB; b) the supervisory approaches, methods and tools; c) the oversight carried out of banks; and d) international supervisory cooperation.

The main objective of the study was to determine the suitability of supervision as applied to local banks, and subsidiaries and branches of international active banks in Bulgaria. The survey was conducted in November, in course of which the BNB submitted a filled-in detailed questionnaire for analysis and assessment, on which basis and upon judgment of the EBA may be drawn up recommendations.

Along with the above undertaken actions, in August 2014 the BNB, in liaison with the IMF, sent a Call for Mission of the Fund and the World Bank for Bulgaria within the Financial System Assessment Programme (FSAP). In December, a set of necessary documents was received for preparing the mission. The first stage of preparations began in late 2014. A preliminary analysis was done on the implementation of the Basel Principles for Effective Banking Supervision by BNB. FSAP-Mission took place in the first quarter of 2015.

COOPERATION WITH OTHER SUPERVISORY BODIES IN BULGARIA

When performing a number of tasks in its activity BNB continued to cooperate and interact with other competent authorities in the country.

In 2014 experts of Banking Supervision and the Financial Supervision Commission carried out joint inspections of the rules and procedures of commercial banks applied in custody. Immaterial gaps were marked, and supervisory recommendations to banks were made in response.

In close cooperation with the Deposit Insurance Fund the Bulgarian National Bank contributed to the development of guidelines for testing the system for deposit insurance. Checks for compliance with the Law on Bank Deposit Guarantee were carried out. Where necessary, recommendations were provided, and further inspections conducted for assessing follow-up actions aimed at improving quality of processes. The Deposit Insurance Fund was duly notified.

BNB interaction with judiciary and investigation authorities in 2014 was in the usual range and intensity. Joint inspections were carried out with the Specialised Administrative Directorate for Financial Intelligence of the State Agency of National Security. Regular meetings of the Joint Advisory Committee were held. Information and views on EU restrictions applied to certain countries were shared, and their possible impact at national level assessed. Exchange of information on UN resolution sets in this regard continued. Further, BNB shared also information and views within the European Banking Authority and keeps track of possible developments in the banking sector.

In 2014 the BNB continued to examine complaints from customers of banks and financial institutions aimed at monitoring the market conduct of the institutions. Resolution of consumer protection cases lies in the powers of the Commission of Consumer Protection.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	24	24	22
Branches of foreign credit institutions	7	6	6
Cooperative banks	n.a.	n.a.	n.a.
Banking sector, total:	**31**	**30**	**28**

Ownership structure of banks on the basis of assets total

Type of financial institution	2012	2013	2014
Public sector ownership	2.04	2.08	2.25
Other domestic ownership	24.38	28.15	21.45
Domestic ownership total	26.42	30.23	23.70
Foreign ownership	73.58	69.77	76.30
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	39.32	54.25	
Branches of foreign credit institutions	6.25	7.04	
Cooperative banks	n.a.	n.a.	
Banking sector, total:			935.72

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks			
Cooperative banks			
Banking sector, total:	5.29	4.90	7.15

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	93.23	93.66	92.94
Branches of foreign credit institutions	6.77	6.34	7.06
Cooperative banks	n.a.	n.a.	n.a.
Other	n.a.	n.a.	n.a.
Banking sector, total:	**100.0**	**100.0**	**100.0**

**The structure of assets and liabilities of the banking system (%)
(at year-end)**

Assets	2012	2013	2014
Cash in hand, balances with central banks	11.47	10.39	11.49
Loans and advances to credit institutions	8.36	11.25	12.85
Loans and advances to customers	64.62	62.32	58.91
Financial assets at fair value through profit or loss, held-to-maturity investments, available-for sale assets and investments in associates, subsidiaries and joint ventures	10.11	10.68	11.37
Tangible assets and Intangible assets	2.37	2.41	2.50
Residual assets	3.07	2.95	2.89
Total assets	100.00	100.00	100.00
Liabilities	**2012**	**2013**	**2014**
Amounts owed to credit institutions	12.86	10.41	9.22
Amounts owed to customers	69.96	73.11	75.00
Debts evidenced by certificates	0.55	0.58	0.50
Residual liabilities	0.65	0.60	0.39
Provisions	0.10	0.11	0.13
Subordinated liabilities	2.12	1.76	1.22
Equity (including valuation adjustments)	13.12	12.84	12.70
Profit or loss for the financial year	0.64	0.59	0.84
Total liabilities and equity	**100.00**	**100.00**	**100.00**

Capital adequacy ratio of banks

Type of financial institution	2012	2013	2014
Commercial banks			
Cooperative banks			
Banking sector, total:	16.64**	16.97**	21.95***

(Please, mark for each item: * - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Net Non-performing loans past due over 90 days (excl. those to credit institutions) as a % of net loans (excl. those to credit institutions)	10.57	10.06	9.39

The structure of deposits and loans of the banking sector in 2013 (%) (at year-end)

	Deposits[5]	Loans[6]
Non-financial sector, including:	**90.1 %**	**94.3%**
Households[7]	64.8%	35.0%
Corporate[8]	25.3%	59.3%
Government sector[9]	**4.9%**	**3.0%**
Financial sector (excluding banks)[10]	**5.0%**	**2.7%**
Total	**100.0**	**100.0**

Source: Other monetary financial institutions (S.122 in accordance with ESA'95).

[5] In accordance with the requirements of Regulation ECB/2008/32, in the liability side, instrument deposits also includes loans and repurchase agreements.
[6] In accordance with the requirements of Regulation ECB/2008/32, in the asset side, instrument loans includes also claims on deposits and repurchase agreements.
[7] Data refer to resident sectors S.14 Households and S.15 Non-profit institutions serving households in accordance with ESA'95.
[8] Data refer to resident sector S.11 Non-financial corporations in accordance with ESA'95.
[9] Data refer to resident sector S.13 General government (S.1311 Central government, S.1313 Local government and S.1314 Social security funds) in accordance with ESA'95.
[10] Data refer to resident sectors S.123 Other financial intermediaries, S.124 Financial auxiliaries and S. 125 Insurance corporations and pension funds in accordance with ESA'95.

P&L account of the banking sector (at year-end) (EUR'000)

P&L account	2012	2013	2014
Interest income	2,462,428	2,360,922	2,025,199
Interest expenses	1,120,371	1,063,130	681,043
Net interest income	1,342,057	1,297,792	1,344,156
Net fee and commission income	399,644	418,797	423,967
Other (not specified above) operating income (net)	209,861	178,864	226,810
Gross income	**1,951,562**	**1,895,453**	**1,994,933**
Administration costs	**898,313**	**912,301**	**888,921**
Depreciation	116,724	103,602	98,249
Provisions	1,696	7,328	7,754
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans)	633,729	576,011	591,002
Profit (loss) before tax	301,651	287,531	409,429
Net profit (loss)	268,496	257,702	363,355

Note: The line "Other (not specified above) operating income (net)" previously reported the value according to the category "Other" present in the Income statement and is now revised to show for 2013 and 2014 all residual income, not specified in the categories indicated here.

Total own funds in 2014 (EUR'000)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks					
Cooperative banks					
Banking sector, total: (* for all items)**	**5,531,997**	**4,917,486**	**5,033,346**	**498,651**	n.a.

(Please, mark for each item: * - for Basel I; ** - for Basel II; *** - for Basel III)

2014 DEVELOPMENTS IN THE CROATIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2014, the economic activity in the Republic of Croatia mostly stagnated and remained at the low level recorded at the end of 2013, resulting in a drop of 0.4% in real activity at the level of entire 2014. The rise in exports contributed positively to economic developments. On the other hand, the contraction in domestic demand continued due to a further strong decrease in investments, household deleveraging and unfavourable expectations related to future economic developments. The drop in raw material prices on the global market spilled over to domestic consumer prices, which, coupled with subdued domestic pressures on the rise of prices, resulted in a fall in inflation. Against such a backdrop, the main fiscal indicators deteriorated further in spite of consolidation efforts made, causing the public debt to reach a very high level. Using expansionary monetary policy, the central bank attempted to improve financing conditions and stimulate lending on the domestic market, while maintaining the stability of the nominal exchange rate of the kuna against the euro as the key prerequisite for preserving financial stability. The CNB's policy allowed the government to borrow on the domestic financial market under more favourable terms in spite of the increasing public debt; however, domestic lending activity aimed at the corporate sector failed to gain pace.

DEVELOPMENTS IN THE BANKING SYSTEM

There were 33 credit institutions or 27 banks, one savings bank and five housing savings banks operating in the Republic of Croatia at the end of 2014. Two institutions less were in business compared with 2013. In early December 2014, one bank went into bankruptcy, while the other was merged with another bank. The number of credit institutions thus continued to decrease slowly for the fifth consecutive year.

Assets of credit institutions stood at HRK 403.0bn[11] (122.5% of GDP) at the end of 2014, decreasing slightly from the end of 2013 (-0.6%). Assets of banks continued to decline for the third consecutive year (-0.7%), while assets of housing savings banks rose somewhat (2.8%). Nevertheless, the market share of housing savings banks remained small. Their assets constituted merely 1.9% of total assets of credit institutions, while the remaining 98.1% was accounted for by the assets of banks (including the savings bank).

Due to unfavourable economic developments extending over a number of years, credit risk continued to materialise and asset value adjustments increased further, while the level of caution, both of banks and their clients, remained high. The lending activity of banks weakened (-2.4%), and the ageing of the non-performing portfolio motivated banks to increase activities aimed at the resolution of such loans, such as sale and write-off. Household deleveraging vis-

[11] Data for 2014 are based on audited reports of credit institutions.

à-vis banks continued into the sixth consecutive year, particularly with regard to home loans, while only general-purpose cash loans exhibited a noticeable upward trend. A substantial drop in loans to the corporate sector was observed, in spite of the new model of stimulating corporate sector lending introduced by the CNB in late 2013.

The drop in lending activity caused B and C category loans to remain at a high level in spite of a noticeable slowdown in their growth. At the end of 2014 the aforementioned categories comprised 17.1% of total bank loans, compared with 15.7% at end-2013. The coverage of B and C category loans by value adjustments grew noticeably by almost five percentage points, reaching 51.3%. Due to portfolio ageing and the drop in the value of real estate collateral, the amount of losses climbed, additionally driven by the regulatory requirement for gradual value adjustment increase (depending on the time which has elapsed since the debtor's delinquency in repayment). In addition, the level of provisions was significantly affected by the recording of additional value adjustments, primarily based on asset quality review (AQR), as well as by the additional assessments related to AQR in line with the EU Council recommendations. However, expenses on provisions were lower than in 2013, when they were greatly affected by the preparations of foreign parent banks for the AQR and the changes in the rules on the classification of placements in effect since October 2013 (rules related to collateral had a particularly strong one-off effect[12]).

Substantially lower provisioning expenses, down by almost a fifth, had the strongest effect on the increase in banks' profits in 2014. ROAA rose to 0.5%, ROAE to 2.8%. Although showing recovery from 2013, returns indicators remained low compared with the previous years, primarily due to the cost of risk. Operating profitability (profitability before provisioning expenses) increased in 2014 after a two-year drop, mainly as a result of interest rate decrease and lower funding costs. The decrease of expenses related to household time deposits was particularly prominent. However, the main source of income, interest income, continued to drop. In addition to the slow lending activity and the growth in non-performing claims, new consumer credit regulations restricting the level of interest rates on loans also had a strong effect on the drop in interest income. As a result, interest income in the household sector shrank significantly, particularly the interest income from household home loans indexed to the Swiss franc, the interest rates of which were fixed at 3.23% at the beginning of 2014.

The deleveraging vis-à-vis foreign owners continued at a significantly faster pace than in the preceding year. A part of foreign sources was partially replaced by domestic ones, primarily through household and corporate deposits, which sufficed to meet the modest demand for loans. Liquidity reserves grew through increasing investments in securities (particularly those of the central government) and other liquid types of assets. However, the growth in domestic sources was slower. In the corporate sector, this can partly be attributed to a high base, i.e. the increase in such deposits in 2013 supported by intensified measures of fiscal discipline. In the household sector, the effect of the fall in the funding capacity of the sector prevailed, coupled with the effect brought about by the introduction of tax on savings interest in 2015.

Business risks remained adequately covered by capital in the new framework for determining capital and capital ratios (CRR/CRD IV), in effect since the beginning of 2014. The conservative approach used in the previous years ensured a high level and quality of capital; in addition, measures

[12] The introduction of minimum impairment factors of the market price and minimum collection periods.

concerning capital buffers were adopted in 2014 as well. At the end of the same year, all capital ratios defined by new regulations were considerably higher than the required minimum. The total capital ratio of banks increased slightly, reaching 21.8%, primarily due to the weakened lending activity of banks.

The increase in housing savings banks' assets in 2014, particularly in loans granted, was mostly based on the accrual of government incentives. Housing loans rose by 7.0%, maintaining a very good quality. The increase in profit was strong mainly owing to better performance in debt instrument trading, which included RC bonds and T-bills. Returns indicators increased considerably to 0.9% (ROAA) and 8.9% (ROAE), as did the total capital ratio (to 23.5%). The rise in the total capital ratio was mainly brought about by reduced exposure, or more precisely, reduced exposure to credit risk thanks to the more favourable exposure weighting in the retail category under the new capital regime.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN CROATIA

The normative adjustment to the new approach governing the operation and supervision of credit institutions, known as CRD IV/CRR, began in 2013, following the accession of the Republic of Croatia to the European Union, by the adoption of the new Credit Institutions Act[13] transposing Directive 2013/36/EU[14] (the so-called CRD IV). The Act entered into force on 1 January 2014, at the same time as Regulation (EU) No 575/2013 (the so-called CRR), directly applicable to credit institutions and investment firms. These two regulations and the Act on the Financial Stability Council[15] jointly constitute the new fundamental normative framework governing the entire operation and supervision of credit institutions based on which a variety of subordinate pieces of legislation, decisions, standards and guidelines related to prudential requirements are adopted at a certain pace for credit institutions and the exercise of supervision by the CNB.

Consequently, at the end of 2013 and in 2014, the CNB drafted and published nine new decisions whose regulatory framework incorporates the new supervisory requirements for credit institutions. Furthermore, for the purpose of harmonisation with the new legal framework, the CNB amended fourteen applicable decisions to incorporate the provisions of Regulation (EU) No 575/2013 or to elaborate on particular provisions in some cases.

Supervision of credit institutions consists of several coordinated activities aimed at verifying compliance of credit institutions with risk management rules, provisions of the Credit Institutions Act and regulations adopted under that Act as well as other relevant laws and regulations governing the performance of

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[13] OG 159/2013

[14] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176/2013), the so-called Capital Requirements Directive IV (CRD IV)

[15] OG 159/2013

financial activities, their own rules, and professional standards and rules. In addition to supervision, the CNB exercises oversight of the implementation of the Act on the Croatian National Bank, regulations adopted under that act, and the implementation of other laws and regulations for which it is competent.

The CNB exercises supervision of credit institutions by:

- collecting and analysing reports and information, ongoing monitoring of credit institutions' operations;
- carrying out on-site examinations of credit institutions' operations;
- imposing supervisory measures in order to take actions at an early stage to improve the safety and stability of credit institutions' operations and to eliminate any illegalities established, and
- issuing opinions, authorisations, approvals and assessment of credit institutions.

The CNB exercises supervision of credit unions in a similar manner.

Other supervisory bodies in the Republic of Croatia operating in the area of financial system supervision are the Ministry of Finance and the Croatian Financial Services Supervisory Agency. Their competence includes the regulation and oversight of non-banking financial services.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

As in the previous years, the main objectives of supervision exercised by the CNB were to maintain confidence in the Croatian banking system, and to promote and safeguard its safety and stability. In order to improve the quality and efficiency of supervision, the process of harmonising the domestic regulatory framework with EU regulations continued in 2014, as did the improvement of other parts of domestic legislation regulating the operation of credit institutions. Special attention was paid to credit risk management and the adequacy of value adjustments and provisions for partly recoverable and fully irrecoverable placements, particularly in large banks. Furthermore, supervision focused on management and control systems and the compliance with legal provisions, internal rules and supervisory requirements.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

As regards banking regulations, 2014 saw strong efforts in amending subordinate legislation, which is a final stage of the transposition of the EU acquis in the field of banking into the Croatian legislation. Employees of the CNB actively participated in the work of the EBA committees and sub-committees engaged in the drafting of technical standards for particular areas.

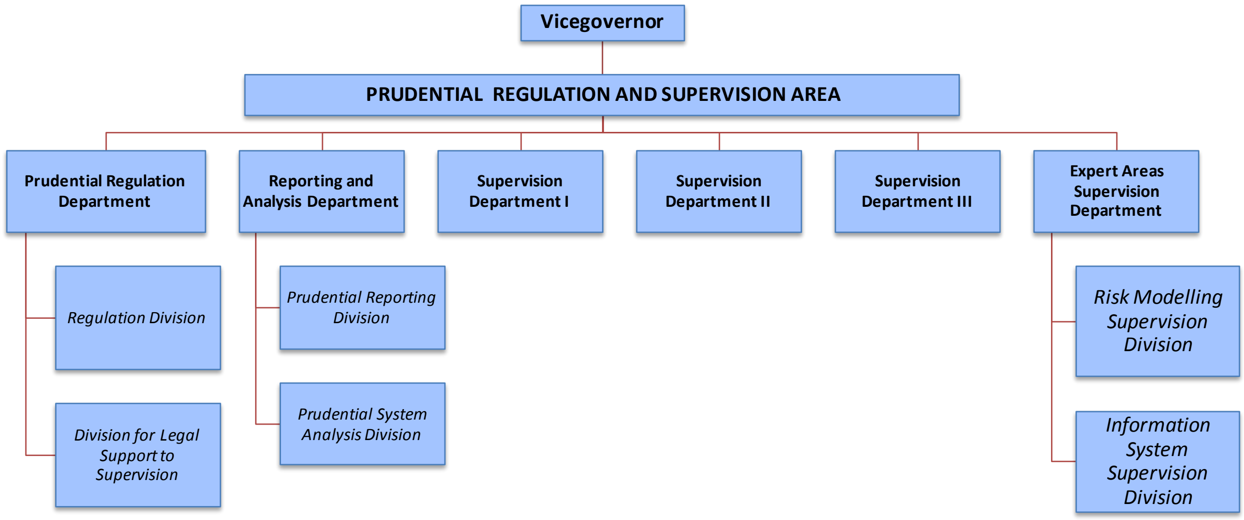
In 2014, supervisory resources were particularly focused on the continuous monitoring of credit institutions' operations through regular communication or the analysis of specific operating areas assessed to carry an increased degree of risk. In addition to regular supervisory activities, resources were directed at special supervisory activities – the AQR, implemented according to the recommendations of the EBA and the ECB in the first half of 2014 and the portfolio screening exercise (PSE) to complement the AQR in line with the recommendation of the European Commission in the second half of 2014. Assessments based on AQR and PSE demonstrated that the established asset quality adjustment of credit institutions had a relatively small impact on the capital ratio of observed credit institutions and the banking system as a whole. Reviewed banks, as well as the entire banking system of the Republic of Croatia, have a high capitalisation rate that provides credit institutions with the adequate protection against potential contingent losses and ensures them the necessary resilience to stress, even during extended recession and in an unfavourable macroeconomic environment.

In 2014, the CNB carried out the supervisory cycle of credit institution assessment, which includes the assessment of the risk profile of credit institutions in relation to all the risks to which they are exposed or may be exposed in their business operations, an assessment of the adequacy of the process of assessment and the maintenance of the internal capital of a credit institution, continuous cooperation based on a dialogue between the supervisors and the credit institution and the imposition of supervisory measures aimed at taking timely actions to ensure the stability of credit institutions’ operations, improve the safety of their operations and eliminate any illegalities established, as well as the monitoring of the implementation of such measures. Reports on the risk assessment of credit institutions were compiled accordingly in 2014. A part of the reports involved credit institutions for which cross-border colleges of supervisors were established and which are subject to specific prudential requirements laid down by joint decisions. Analysis elements for the remaining credit institutions which were subject to on-site examination in 2014 were included in the reports on examination findings. Based on the above mentioned reports, the CNB adopted measures imposing the maintenance of a required minimum level of own funds until the next supervisory assessment and introduced additional measures aimed at the improvement of credit institutions' operations in cases where the risk profile analysis indicated that such measures were necessary.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

Supervisory activities are organised within the Prudential Regulation and Bank Supervision Area. At the end of 2014, the Area had 109 employees.

Organisational chart of the Prudential Regulation and Bank Supervision Area at the end of 2014[16]:



INTERNATIONAL ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2014, the CNB continued its cooperation with foreign supervisors, within which it is responsible for the drafting of the Supervisory Risk Report, i.e. the annual risk profile assessment of a domestic credit institution which serves as an element for the adoption of the Joint Risk Assessment Decision, as well as for the adoption of a joint decision on the required amount of capital of a banking group. In addition, the exchange of quarterly supervisory newsletters on the business of domestic banks majority-owned by Austrian banks has continued with the Austrian supervisory body.

Furthermore, the CNB joined forces with the EBA to organise a two-day international conference on the supervision of IT systems in October 2014, gathering supervisors of IT systems from 20 European countries.

[16] As of 1 May 2014, the organisational unit in charge of consumer protection has been separated from the Prudential Regulation and Bank Supervision Area and established as a separate Consumer Protection Monitoring Office.

In 2014, the CNB's resources were also directed at the participation in EBA and ECB working groups, particularly with regard to the following areas:

- prudential regulations (credit risk, market risks, operational risk, liquidity risk, own funds, credit institution governance arrangements, advanced approaches to risk measurement, crisis management),
- reporting, accounting, auditing and public release of data,
- improving the exercise of supervision,
- improving the safety of Internet and mobile payments and the supervision of IT systems and
- consumer protection.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

In 2014, the CNB continued its cooperation with the Croatian Financial Services Supervisory Agency (HANFA) through the joint Working Committee. At the Committee meetings, the institutions exchange information on current topics in the banking sector and the sector supervised by the Agency, resolve open issues on the exchange of data and arrange the coordination of supervisory activities.

In June 2014, the Working Committee for the Cooperation with the State Agency for Deposit Insurance and Bank Rehabilitation was established. At the Committee meetings, the institutions exchange data and information on entities subject to supervision within their area of competence.

Furthermore, as a member of the Commission for Making the Draft Proposal of the National Cyber Security Strategy (and head of the working group for the area of cyber security of electronic financial services), the CNB participated in the making of the aforementioned draft proposal in 2014.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

More information on the supervisory activities of the CNB, the regulations based on which supervision is exercised by the CNB and other regulatory texts are available on the CNB's website (*www.hnb.hr*).

STATISTICAL TABLES[17]

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution*	2012	2013	2014
Banks	30	29	27
Savings banks	1	1	1
Housing savings banks	5	5	5
Banking sector, total:	**36**	**35**	**33**

*The data refer to credit institutions operating in Republic of Croatia (RoC): banks, savings banks and housing savings banks. There are no branches of foreign credit institutions operating in RoC.

Ownership structure of the financial institutions on the basis of assets total (%) (at year-ends)

Type of financial institution	2012	2013	2014
Public sector ownership	5,3	5,2	5,1
Other domestic ownership	5,0	5,0	4,6
Domestic ownership total	10,2	10,2	9,7
Foreign ownership	89,8	89,8	90,3
Financial institutions, total	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions (end-2014)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Banks*	58,6	73,9	1 423,9
Housing savings banks	56,0	100,0	2 441,7
Banking sector, total:	**57,5**	**73,1**	**1 390,4**

*From this table onwards, data for savings banks are included in line Banks.

[17] Data for 2013 have been updated.

Return on Equity (ROE) by type of financial institutions* (%)

Type of financial institution	2012	2013	2014
Banks	4,8	0,8	2,8
Housing savings banks	12,8	5,1	8,9
Banking sector, total:	**4,8**	**0,9**	**2,8**

*ROAE

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Banks	98,2	98,1	98,1
Housing savings banks	1,8	1,9	1,9
Banking sector, total:	**100,0**	**100,0**	**100,0**

The structure of assets and liabilities of the banking system (%)
(at year-end)

	2012	2013	2014
Claims from			
Financial sector	17,6	17,8	17,0
Nonfinancial sector*	56,8	55,1	53,2
Government sector	18,1	18,5	19,3
Other assets**	7,5	8,6	10,5
Claims due to			
Financial sector	10,4	9,0	8,8
Nonfinancial sector*	54,6	57,3	59,1
Government sector	2,1	2,0	2,4
Other liabilities**	18,6	17,7	15,7
Capital	14,2	13,8	14,0

* households and corporates
**Includes claims from/due to non-residents.

Capital adequacy ratio of banks

Type of financial institution	2012**	2013**	2014***
Banks	20,9	21,0	21,8
Housing savings banks	21,3	20,5	23,5
Banking sector, total:	20,9	21,0	21,8

* Basel I, ** Basel II, *** Basel III

Asset portfolio quality of the banking sector
(share of impaired receivables / share of non-performing loans)*

Asset classification	2012	2013	2014
Non financial sector, including:	16,4	19,1	20,7
- households	9,3	11,1	12,0
- corporate	24,9	28,3	30,8

*share of partly recoverable (risk category B) and fully irrecoverable (risk category C) loans
Note: Up to 2013 bank loans were classified into risk categories A, B and C pursuant to the Decision on the classification of placements and off-balance sheet liabilities of credit institutions (OG 1/2009, 75/2009, 2/2010 and 89/2013). As of 2014, bank loans are classified into risk categories A, B and C pursuant to the Decision on the classification of placements and off-balance sheet liabilities of credit institutions (OG 41/2014).

The structure of deposits and loans of the banking sector in 2014 (%)*
(at year-end)

	Deposits	Loans
Non-financial sector, including:	80,6	80,0
Households	65,0	45,7
Corporate	15,6	34,3
Government sector	2,5	16,7
Financial sector (excluding banks)	3,9	2,1
Other**	13,1	1,1
Total:	**100,0**	**100,0**

*excluding deposits from/loans to banks
**non-residents

**P&L account of the banking sector (at year-end)
(in million EUR)**

P&L account	2012	2013	2014
Interest income	2 922,1	2 636,4	2 505,9
Interest expenses	1 502,6	1 288,4	1 146,1
Net interest income	1 419,5	1 348,0	1 359,7
Net fee and commission income	389,1	394,3	410,1
Other (not specified above) operating income (net)	187,4	165,0	195,8
Gross income	1 996,0	1 907,2	1 965,6
Administration costs	878,6	899,6	893,9
Depreciation	108,5	97,1	90,9
Provisions	19,1	11,9	-2,4
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	511,8	801,8	704,1
Profit (loss) before tax	478,0	96,8	279,2
Net profit (loss)	369,9	66,4	208,0

Total own funds in 2014 (in EUR)

Type of financial institution	Total own funds***	Core Tier 1	Tier 1***	Tier 2***	Tier 3
Banks	7 019 538 086	-	6 647 678 367	371 859 719	-
Housing savings banks	92 585 988	-	83 910 969	8 675 019	-
Banking sector, total:	**7 112 124 074**	**-**	**6 731 589 336**	**380 534 738**	**-**

* Basel I, ** Basel II, *** Basel III
Note: Amount of Common Equity Tier 1 capital equals the amount of Tier 1 Capital.

2014 DEVELOPMENTS IN THE CZECH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The Czech economy returned to growth in 2014. Following almost two years of decline, 4Q13 saw a renewal of annual growth in economic activity. Real GDP picked up by 2.0% for 2014 as a whole. This reflected the favourable impact of the easing of the monetary conditions via the weakening of the koruna by the CNB, an unwinding of the restrictive effect of fiscal policy and a slight improvement in the economic situation in the euro area. All components of domestic demand contributed to the economic growth. Household consumption growth accelerated, whereas the dynamics of government consumption remained unchanged. Gross fixed capital formation also contributed to the favourable economic developments for the first time in a long time. Its growth was driven by a year-on-year increase in investment in manufacturing and in the government sector. On the other hand, the contribution of net exports to annual GDP growth was negative.

Inflation dropped compared to the previous year, averaging 0.4% in 2014. Annual headline and monetary policy-relevant inflation both stood well below the lower boundary of the tolerance band around the CNB's target in 2014.

At all its monetary policy meetings in 2014, the CNB Bank Board decided to continue using the exchange rate as an additional instrument for easing the monetary conditions and confirmed the CNB's commitment to intervene on the foreign exchange market if needed to weaken the koruna against the euro so that the exchange rate of the koruna is kept close to CZK 27 to the euro. The average CZK/EUR exchange rate depreciated from 26.0 in 2013 to 27.5 in 2014. The average CZK/USD rate also weakened in year-on-year terms, reaching 20.7 (compared to 19.6 in 2013).

The current account ended 2014 in a surplus of 0.6% of GDP. In absolute terms the surplus amounted to CZK 26.1 billion. The financial account (including changes in reserve assets) recorded net lending, i.e. an outflow of funds abroad, amounting to CZK 48.0 billion in 2014, down by CZK 20.3 billion on a year earlier.

The general unemployment rate stood at 6.2% on average in 2014. Following stagnation a year earlier, the average gross nominal wage in the national economy returned to growth (2.4%). With the increase in the nominal wage outpacing the inflation rate, the average real wage rose again by 2.0% in 2014 as a whole. Aggregate labour productivity also recorded an annual increase, up by 1.6% in 2014. The seasonally adjusted gross saving rate of households was slightly above 10% in 2014.

The general government deficit rose to 2% of GDP in 2014, but this result was due to several extraordinary and one-off factors. The overall effect of fiscal policy on economic activity was slightly expansionary in connection with a marked increase in government investment and stronger wage growth in the government sector. However, the government debt-to-GDP ratio fell to 42.6% in 2014 in connection with the use of the government's liquidity reserves as a source of financing and with the renewed GDP growth.

In 2014 the Czech National Bank left key interest rates unchanged at technical zero. The two-week repo rate thus remained at 0.05% in 2014 (since the Bank Board's decision of 2 November 2012) and the discount and Lombard rates stayed at 0.05% and 0.25% respectively.

DEVELOPMENT IN THE BANKING SECTOR (INCLUDING THE ASSETS TOTAL / GDP)

In 2014 the Czech banking sector was sound and very well capitalised. The overall quality of loans remained relatively stable. The sector as a whole continued to be highly profitable and faced no liquidity problems.

As of 31 December 2014, the Czech banking sector consisted of 45 banks and foreign bank branches. The structure of the banking sector and the shareholder structure have long been stable.

In 2014 the banking sector continued to grow. Total assets increased by 3.3% to CZK 5,309.9 billion. Traditional banking based on collecting deposits and providing loans prevails. The total receivables of the banking sector, which make up a large part of its balance-sheet assets, grew slightly throughout 2014. Domestic banks' total loans to clients rose by 4.8% year on year to more than CZK 2,635 billion at the end of 2014. The rise in lending was chiefly due to loans provided to households and non-financial corporations. As of the end of 2014, bank loans to individuals, which represent the biggest component of client loans, amounted to more than CZK 1,141 billion. Household debt consists mostly of loans for house purchase and these loans account for more than 73% of all loans to individuals. Demand for loans for house purchase is concentrated in mortgage loans, which increased by CZK 50.3 billion during 2014 to more than CZK 797 billion. On the other hand, consumer credit to households decreased by CZK 1.4 billion to cca CZK 194 billion as end of 2014.

The Czech banking sector as a whole recorded good financial results in 2014. It generated net profit of CZK 63.2 billion, an increase of 3.5% compared to the previous year. Interest profit, accounted for almost 66% of the CZK 167 billion profit from financial activities, while profit from fees and commissions accounted for almost 63% of non-interest profit. Total administrative expenses increased by 6.7% year on year to CZK 70.2 billion, and the banking sector paid CZK 13.1 billion in aggregate income tax, i.e. CZK 0.8 billion more than in 2013.

Credit risk remains the most serious risk undertaken by the Czech banking sector. In 2014 the quality of the loan portfolio was stable and the non-default loans made up a large majority of the investment portfolio (94.4%). The total value of default receivables rose by CZK 13.0 billion to CZK 174.7 billion owing to a reduced ability of non-financial corporations and individuals to repay their obligations. The share of troubled loans as a % of the total investment portfolio receivables remains relatively low at 5.6%, representing an increase by 0.4 percentage points.

Domestic banks are mostly local in nature and their activities are mostly focused on domestic clients. As a result, the shares of transactions with non-residents and bank foreign currency activities are relatively small with the exposure of the banking sector to territorial and foreign exchange risk in 2014 being limited.

The liquidity of the Czech banking sector remains solid as all the liquidity sub-indicators remained stable during the year 2014. Domestic deposits remain the key source of funding for the Czech economy with client deposits to client loans ratio being around 130%. Resident deposits represented more than 95% of the deposit base and they continue to be dominated by households.

The capitalisation of the Czech banking sector stays high. At the end of 2014 the CET1 capital ratio stood at 17.2%, the T1 capital ratio increased by 0.8 percentage point to reach 17.3% and the total capital ratio stood at 17.8%. The value of total capital rose by 7.8% to more than CZK 397 billion, while the value of Tier 1 increased by more than 8.6% to almost CZK 386 billion. Tier 1 capital represents more than 97% of total capital with the remaining part being represented mostly by subordinated debt.

All banks were compliant with the set minimum total capital ratio of 8%, the Tier 1 capital ratio of 6% and the Tier 1 (CET1) capital ratio of 4.5% during the whole of 2014.

The depth of banking intermediation as measured by the ratio of total bank assets to GDP has been increasing in the Czech Republic since 2006. However, it decreased in 2014 due to GDP growth. This ratio stood at 124.5% at the end of 2014 or 7.9 percentage points lower relative to 2013.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN THE CZECH REPUBLIC

In accordance with *Act No. 6/1993 Coll., on the Czech National Bank*, the Czech National Bank is the financial market supervisory authority in the Czech Republic. The CNB as an integrated supervisor supervises the banking sector, the capital market, the insurance industry, pension funds, credit unions, bureaux-de-change and payment system institutions. The CNB lays down rules safeguarding the stability of the banking sector, the capital market, the insurance industry and the pension scheme industry. It systematically regulates, supervises and, where appropriate, issues penalties for non-compliance with these rules.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

The Czech National Bank endeavours to supervise the financial market and its institutions in accordance with international standards. It actively monitors developments in this area and prudently implements new requirements or initiates steps to implement them.

The key strategic framework for the supervisory work of the Czech National Bank is the Core Principles for Effective Banking Supervision published by the Basel Committee for Banking Supervision in 2012. This strategy therefore:

- reflects, in its structure, the principles of this document relevant to supervision,

- indirectly declares identification with the specific requirements of this document, and
- briefly comments on how those requirements are implemented.

The Czech National Bank has developed a system of financial market supervision that has clear responsibilities and objectives. The CNB applies its legal powers, all the while pursuing its main objective, namely to safeguard the stability of the financial system of the Czech Republic. Supervisory actions are taken in a timely manner in a form that is appropriate to the situation to which they respond. When proposing sanctions, the supervisor draws on the full range of options laid down in the legislation.

The Czech National Bank applies its legally defined independence in the area of supervision. This independence gives it full discretion to take actions against supervised institutions. The Czech National Bank takes organisational measures to ensure that supervision is independent of any other activities that might give rise to a conflict of interest with its supervisory work. In its supervisory work, it takes into account the conclusions of financial stability analyses conducted within the framework of macro-prudential policy and provides feedback to ensure that the regulatory framework reflects practical supervisory experience.

To ensure that supervision is transparent to the public, the CNB regularly publishes a Financial Market Supervision Report and communicates major supervisory actions and selected findings and approaches in a prompt and flexible manner.

Supervision is organised so that information flows smoothly and appropriate decisions are taken at every level of governance. The Czech National Bank applies measures to avoid conflicts of interest between its supervisory work and the private interests of its staff. The Czech National Bank provides adequate resources, including material resources, to ensure independent, competent and effective supervision. When allocating its resources, it takes into account systemic supervisory priorities based on the risk profile and systemic importance of supervised institutions.

The Czech National Bank performs supervision that is based on a forward-looking assessment of the risk profile of supervised institutions, proportionate to their systemic importance. This system identifies material risks relating to their activities and quantifies their impact. It also captures systemic risks regarding the behaviour of financial market participants. The Czech National Banks determines the intensity of its supervision of individual areas of the financial market and specific institutions on the basis of the outputs of this system. When performing supervision, the Czech National Bank assesses compliance with legal requirements in the areas of prudence and professional care. These two areas are supervised in a mutually consistent manner, reflecting the links between them.

The Czech National Bank applies its supervisory powers by means of off-site and on-site supervision. In its supervisory activities, the Czech National Bank uses a wide information base. The information obtained is subject to both regular and extraordinary assessments. These tools include regular stress tests of individual banks and insurance companies and a system for monitoring financial market transactions. The supervisor communicates relevant findings to supervised entities. As a follow-up, the supervisor then checks whether corrective action has been taken. Czech National Bank supervisors are in frequent contact with the senior management of systemically important institutions. The senior management of systemically important institutions is also directly presented with material supervisory findings and any other topics of special importance.

The Czech National Bank has in place a system of regular reporting by supervised institutions and their consolidated groups. The reports defined by the Czech National Bank contain both financial and non-financial data. The range of information that the Czech National Bank uses for supervisory purposes extends beyond the regularly reported information. In some cases, it is also entitled to request information from persons not subject to its systematic supervision.

An essential element of supervision is that the Czech National Bank supervises groups of financial institutions on a consolidated basis. The aim of this activity is to identify links between the risks that can arise at group level and the stability of the supervised institution. With regard to consolidated supervision, the Czech National Bank works in cooperation with foreign supervisory authorities, regularly communicates with the management of important subsidiaries and branches that are members of the consolidated group, and examines their risk profile and systemic importance.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2014, attention was paid to the continued implementation of binding EU prudential rules associated with the CRD IV and the CRR, whose aim is to enhance the regulatory framework and create conditions for stability, security and resilience of the financial system. Here it is worth mentioning that an amendment to the Banking Act was approved, which strengthens the quality and quantity of own funds, establishes requirements for members of the management and supervisory body of financial institutions and stipulates the obligation of institutions to develop a framework for crisis management and recovery plans. In addition, the list of corrective measures and penalties available has been expanded.

Owing to the persisting uncertainty in the European economy, main attention was devoted primarily to credit portfolios (categorisation of claims, sufficient provisioning, collateral amount, etc.), capital adequacy, liquidity and the overall performance and management of credit institutions.

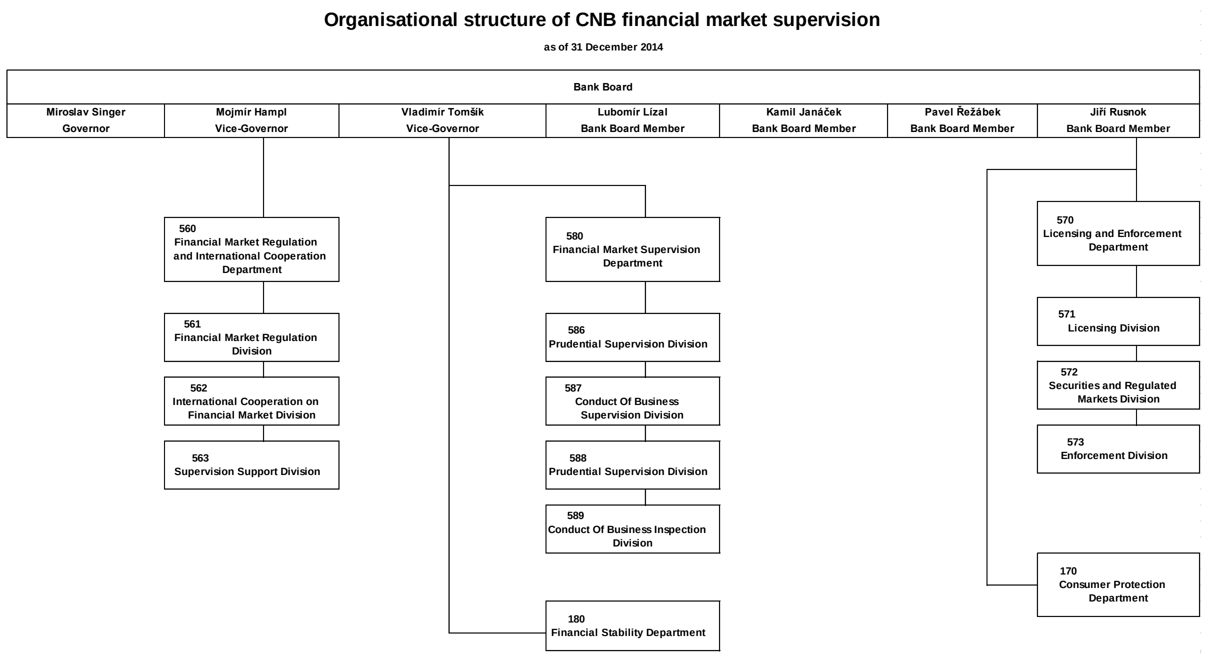
In compliance with BRRD banks submitted to CNB supervisors the gradually supplemented and revised versions of their recovery plans for assessment, continuing the process that started in 2013. A number of consultative meetings were held where further procedures for plan preparation were discussed with banks.

The CNB continued regular stress tests of banks, whose results are regularly published on the CNB website. Stress tests confirm the good resilience of domestic banks, which would, according to their results, maintain sufficient capital buffer also in the case of unfavorable macroeconomic developments. Contrary to previous practice the scope of the stress tests, conducted by the CNB in cooperation with banks, was widened to test also interest rate risk, in addition to credit risk.

Despite its relatively small market share, the credit unions sector is subject to intensive CNB supervision to respond to developments in this sector. CNB surveillance concentrated in particular on assessing the current situation and developments in individual credit unions and on resolving their problems, mainly with respect to specific risks undertaken by individual entities. Given the numerous shortcomings identified, supervision is focused mainly on credit portfolio categorisation, sufficiency of provisioning, financing of economically connected groups, compliance with regulatory limits and the origin of credit unions' capital. Also, in connection with developments in this sector, an amendment of a respective law was approved in 2014.

After the new Civil Code took effect on 1 January 2014, CNB supervision also focused on verifying the procedures of credit and payment institutions and their compliance with the Civil Code rules. The CNB also paid considerable attention to building societies' procedures for changes in, or withdrawals from, building savings contracts. The CNB continued to focus on proper execution of payments, particularly on compliance with the time limits for executing transactions.

ORGANIZATIONAL CHART OF BANKING AUTHORITY



Note:
The President of the Czech Republic appointed Jiři Rusnok as a member of the CNB Bank Board with effect form 1 March 2014. Jiři Rusnok replaced Eva Zamrazilová, whose mandate ended.

INTERNATIONAL ACTIVITIES OF THE AUTHORITY

The Czech National Bank has a framework – based on legislation or specific agreements and arrangements – for cooperation with other (foreign) supervisors. Among other things, the framework provides for protection of confidential information shared by supervisory authorities. The Czech National Bank cooperates actively with other (foreign) supervisors to ensure effective supervision within its area of competence and coordinated handling of crisis situations.

Where the Czech National Bank is the home supervisor, it establishes a supervisory college and manages the work of the college, which is the basic platform for cooperation. In doing so, it takes into account the risk profile and systemic importance of the supervised group and of the individual institutions that make up the group.

Where the Czech National Bank is the host supervisor, it coordinates and plans its activities in cooperation with the home supervisor, identifying areas of common interest. It aims for open communication and close cooperation with the home supervisor in order to cover its area of competence effectively. Such communication mainly concerns material risks relating to the supervised group or to the institution subject to supervision by the Czech National Bank. The Czech National Bank participates in on-site examinations organized by the home supervisor and allows the home supervisor to participate in examinations conducted by the Czech National Bank.

The Czech National Bank cooperates in the area of supervision with European institutions (the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets

Authority) on unifying supervisory procedures and creating conditions for close cooperation between home and host supervisors.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The CNB's activities include cooperation with the Czech Ministry of Finance and other state administration bodies. The CNB works in close cooperation with the Czech Ministry of Finance, which has primary responsibility for preparing laws in the financial market area. It thus acts in accordance with the agreement on cooperation in the preparation of draft national legislation concerning the financial market and other regulations concluded between the Czech National Bank and the Ministry of Finance.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

The Czech National Bank has operated the Central Credit Register since 2002. The register is an information system which enables banks and foreign bank branches operating in the Czech Republic to share information on the credit commitments and payment discipline of businesses. The level of the use of CCR data by banks shows that this information is part of the lending process in individual banks, contributing to the assessment of potential and existing bank clients.

CCR data play an ever-increasing role in European cooperation and they will also play a role in the collection of granular credit data by the European System of Central Banks within the AnaCredit project. On the basis of an ECB Decision, two transfers of anonymised client data for the previous ten quarters took place in the preparatory phase in 2014; further data transfers are expected in March 2015. At the same time, a long-term solution is under preparation in the form of a draft ECB Regulation on the collection of granular data from 2018. The CCR continues to be involved in international data exchange with countries participating in the joint project on the basis of the MoU.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	23	23	23
Branches of foreign credit institutions	20	21	22
Credit unions	13	12	11
Banking sector, total:	**56**	**56**	**56**

Ownership structure of banks on the basis of assets total (%) (at year-ends)

Type of bank	2012	2013	2014
Public sector ownership	4.2	3.8	4.3
Other domestic ownership	0.4	0.5	3.1
Domestic ownership total	4.6	4.3	7.4
Foreign ownership	95.4	95.7	92.6
Banking sector, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (2014 year-end)

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	48.0	61.4	0.115
Branches of foreign credit institutions	62.1	76.1	0.150
Credit unions	76.5	91.7	0.238
Banking sector, total:	47.8	61.0	0.094

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	21.41	18.40	16.8
Credit unions	n.a. i)	n.a. i)	1.3
Banking sector, total:	n.a. ii)	n.a. ii)	16.2

i) Indicators don't have information content due to the different accounting periods in the credit unions sub-sector.
ii) Within the CNB we have only banking sector data due to the different accounting periods in the credit unions sub-sector.

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	89.8	90.2	89.7
Branches of foreign credit institutions	9.3	9.2	9.7
Credit unions	0.9	0.6	0.6
Banking sector, total:	**100.0**	**100.0**	**100.0**

Note: Banking sector = commercial banks + bank foreign branches + credit unions.

The structure of assets and liabilities of the banking system (%)
(at year-end)

Assets	2012	2013	2014
Claims from			
Financial sector	10.0	8.8	13.2
Nonfinancial sector	48.3	48.4	19.9
Government sector	1.7	1.6	9.2
Households	n.a.	n.a.	22.1
Other assets	40.0	41.2	35.6
Claims due to			
Financial sector	8.9	11.3	12.0
Nonfinancial sector	60.0	58.8	20.3
Government sector	8.3	8.4	7.4
Households	n.a.	n.a.	44.4
Other liabilities	13.6	12.4	4.8
Capital	**9.2**	**9.0**	**11.1**

Note: Banking sector = commercial banks + bank foreign branches.
Note: The structure by sector according to Loans and receivables + Held to maturity investments on the Assets side and Deposits total + Equity on the Liabilities side.

Capital adequacy ratio of banks

Type of financial institution	2012**	2013**	2014***		
			Total capital	Tier 1 capital	CET 1 capital
Commercial banks	16.42	17.08	18.01	17.54	17.41
Credit unions	13.27	14.34	13.56	12.49	12.49
Banking sector, total:	n.a.	n.a.	n.a.	n.a.	n.a.

(* - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector (%)
(share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non financial sector.	6.2	6.2	6.4
- households	5.2	5.0	4.7
- corporate	7.4	7.2	6.6

Note: Banking sector = commercial banks + bank foreign branches; share of receivables in default (substandard, doubtful and loss) by sector.

The structure of deposits and loans of the banking sector in 2014 (%)
(at year-end)

	Deposits	Loans
Non-financial sector.	95.5	93.6
- households	59.5	53.2
- corporate	25.6	37.8
- government	10.4	2.6
Finacial sector (excluding banks)	4.5	6.4
Total	**100.0**	**100.0**

Income statement of the banking sector
Absolute indicators
(data as of the given date; in CZK millions)

	31.12.2012	31.12.2013	31.12.2014
Financial & operating income and expenses	167 152	168 171	167 899
1. Interest income	170 378	154 787	158 940
2. Interest expenses	62 469	49 315	48 520
3. Expenses on share capital repayable on demand	0	0	0
4. Dividend income	6 607	8 823	6 728
5. Fee and commission income	49 151	49 868	48 965
6. Fee and commission expenses	11 876	12 817	12 935
7. Gains or (-) losses on derecognition of financial asset and liabilities not measured at fair value throught profit or loss, net	633	5 737	1 856
8. Gains or (-) losses on financial assets and liabilities held for trading, net	7 571	-9 554	4 147
9. Gains or (-) losses on financial assets and liabilities designated at fair value through profit or loss, net	888	-636	-205
10. Gains or (-) losses from hedge accounting, net	-422	-1 098	-277
11. Exchange differences (gain or (-) loss) net	5 192	23 053	8 260
12. Gains or (-) losses on derecognition of non financial assets, net	1 433	88	276
13. Other operating income	4 460	5 306	2 952
14. Other operating expenses	4 395	6 071	2 289
15. Administrative expenses	66 646	65 825	70 248
15.1. Staff expenses	34 437	34 319	34 708
15.2. Other administrative expenses	32 209	31 506	35 540
16. Depreciation	6 747	6 496	6 413
17. Provisions or (-) reversal of provisions	721	1 558	1 290
18. Impairment	16 179	21 018	13 716
18.1. Impairment or (-) reversal of impairement on financial assets not measured at fair value through profit or loss	14 386	18 866	14 027
18.2. Impairment or (-) reversal of impairement of investments in subsidiaries, joint ventures and associates	1 386	610	-435
18.3. Impairment or (-) reversal of impairement on non-financial assets	407	1 541	123
19.Negative goodwill recognised in profit or loss	0	0	0
20. Share of the profit (-) or loss of investments in subsidiaries, joint ventures and associates	0	21	-1
21. Profit or (-) loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations	-205	4	-8
PROFIT OR (-) LOSS BEFORE TAX FROM CONTINUING OPERATIONS (1.-21.)	76 655	73 301	76 223
22. Tax expense or (-) income related to profit or loss from continuing operations	12 348	12 253	13 089
PROFIT OR (-) LOSS AFTER TAX FROM CONTINUING OPERATIONS (1.-22.)	64 307	61 048	63 134
23. Profit or (-) loss after tax from disccontinued operations	0	0	37
PROFIT OR (-) LOSS FOR THE YEAR (1.-23.)	64 307	61 048	63 171

Note: Commercial banks and foreign bank branches.

Total own funds in 2014 (in EUR millions)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	14,322	13,952	13,850	370	x
Credit unions	134	123	123	11	x
Banking sector, total:	14,456	14,075	13,973	381	x

Note: Banking sector = commercial banks + credit unions.
Note: EUR = 27.725 CZK as at 31 December 2014.

2014 DEVELOPMENTS IN THE ESTONIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The major risks and vulnerabilities for the Estonian banking market identified during the observation period have been as follows:

- Possible realisation of risks deriving from economic environment in the parent banks' economies which could impact the Estonian banks via liquidity risk;
- Geopolitical risks which could potentially impact economy and banks' loan portfolio;
- Prolonged period of low interest rates and the impact on financial system stakeholders;
- Deceleration of economic growth at the local level.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

As at 31 December 2014, there were 8 locally authorised credit institutions and 7 branches of foreign credit institutions operating in Estonia. The aggregate market share of four major banks by asset volumes – Swedbank AS, AS SEB Pank, Nordea Bank AB Estonian Branch and Danske Bank A/S Estonian Branch – totalled 86% (also 86% in 2013). The ratio of banking sector's total assets to GDP was 109%.

The aggregate loan portfolio of banking sector increased 4.5%. Activity in the lending business of banks somewhat picked up in 2014, especially in the area of corporate loans. Volume of deposits continued its growth as well, the annual increase being 9.2%.

The total volume of overdue loans decreased in the end of 2014 as compared to 2013, both in absolute figures and as a share of the combined loan portfolio. At the end of 2014, loans overdue for more than 90 days accounted for 1.8% of the combined loan portfolio (2.0% in 2013). The coverage of long-term overdue loans with valuation reserves was still good: 75% of loans overdue for more than 90 days were covered by valuation reserves at the end of 2014 (82% in 2013).

Annual profits earned by banks totalled € 337.3 million on solo basis and € 308 million on consolidated basis (€ 445.5 million and € 310.6 million respectively in 2013). Profits earned in 2014 remained on a lower level than in 2013: on solo basis 24% less and on consolidated basis 1% less than in the previous year.

Similarly to previous years, interest revenue from lending activities continued to form the main source of income for banks in 2014. Banks' incomes somewhat decreased compared to the previous year, primarily on the account of diminishing dividend income. The second half of 2014 witnessed a volume increase in the loan portfolio leading to additional interest revenue that balanced the drop in interest revenue caused by the continuously low level of Euribor.

Despite the increased cost, the cost to income ratio of the banking sector remained on an excellent level - 44.3% (40.4% in 2013).

As at 31 December 2014, the composite capital adequacy of credit institutions on solo basis was 35.7% and on consolidated basis 43.7% (respectively 20.0% and 24.4% in 2013). This great difference compared to the previous year was mostly caused by the technical changes introduced to the calculation rules of capital adequacy indicators. Namely, in the case of the banks that directly applied the Internal Ratings-Based Approach, the minimum limit applicable during the transition period was not considered for the calculation of capital adequacy indicators as at 31 December 2014. In the future, this restriction should be taken into account in the calculations of individual minimum capital adequacy level of banks. Without considering the effect of these technical changes, the capital adequacy of the sector was 24.0% on solo basis and 28.9% on consolidated basis. Capital structure of the banking sector remained relatively simple and was still primarily based on Tier 1 capital. Tier 1 capital was thus on an adequate level both on solo and consolidated basis: Tier 1 capital was on solo basis 35.2% and on consolidated basis 43.1%. When considering the minimum limit applicable during the transition period, the respective indicators were 23.7% and 28.6% (respectively 19.7% and 24.2% in 2013).

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN ESTONIA

Year 2014 was characterized by significant volumes of legislative drafting in the financial sector area – both material amendments to existing legislation and drafting of completely new legislation. The FSA contributed to legislative drafting, within the limits of its powers and capacities, by presenting opinions to working parties that prepared the relevant draft acts and by participating in the work of these working parties.

The FSA was engaged in four major legislative projects in 2014:

- Financial Crisis Prevention and Resolution Act (FCPRA). FCPRA is based on the Directive 2014/59/EU of the European Parliament and of the Council and is primarily applicable to credit institutions. FCPRA provides measures that would be most efficient for the prevention of financial crisis or would allow the resolution of financial crisis at minimal cost. The Financial Supervision Authority would be the national resolution authority.
- Credit Providers and Intermediaries Act (CPIA). CPIA is aimed at harmonizing the requirements applicable to financial institutions, increasing the liability of credit providers and intermediaries for the performance of requirements related to their activities, and gaining a picture of the scope of their activities on Estonian markets. CPIA provides requirements applicable to the activities of credit providers and intermediaries, and introduces the obligation to apply for a respective license. CPIA brings additional credit providers and intermediaries under the FSA’s supervision in addition to previously supervised credit

institutions. CPIA is related to the Directive 2014/17/EU of the European Parliament and of the Council.

- Insurance Activities Act (IAA). The new IAA is aimed at regulating insurance activities and insurance mediation area, complementing and updating the existing insurance and intermediation regulations. The updating of regulations in the area of insurance was a EU-wide initiative. IAA insures that national legislation is in compliance with new EU requirements that are provided by the following insurance-related Directives: Directives 2009/138/EC and 2014/51/EU of the European Parliament and of the Council.
- Investment Funds Act (IFA). IFA is aimed at enabling the establishment of new fund structures and expanding thus the possibilities of investors to make investments through investment funds. The draft act is related to the following EU legislation: Directives 2003/41/EC, 2007/44/EC, 2009/65/EC, 2011/61/EU and 2013/14/EU of the European Parliament and of the Council and Commission Directives 2007/16/EC and 2010/44/EU.

The Financial Supervision Authority explains in its Advisory Guidelines various legislative provisions that regulate the financial sector and directs the activities of supervised entities so that they comply with legislative requirements.

The establishment of European Single Supervisory Mechanism (SSM) and participation in the network of European financial supervision authorities mean that various national supervisory practices and regulative frameworks will be harmonized. This is reflected by the increased number of documents that have been transposed into Estonian law and enacted as the FSA's advisory guidelines.

In 2014, the FSA transposed and enacted as its advisory guidelines the following guidelines issued by European financial supervision authorities:

- Guidelines on the model MoU concerning consultation, cooperation and the exchange of information related to the supervision of AIFMD entities (ESMA/2013/998);
- Guidelines on retail deposits subject to different outflows for purposes of liquidity reporting under Regulation (EU) No 575/2013, on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (Capital Requirements Regulation – CRR) (EBA/GL/2013/01);
- Guidelines on ETFs and other UCITS issues (ESMA/2014/937);
- Guidelines and Recommendations regarding the implementation of the CPSS-IOSCO Principles for Financial Market Infrastructures in respect of Central Counterparties (ESMA/2014/1133);
- Guidelines on reporting obligations under Articles 3 and 24(1), (2) and (4) of the AIFMD (ESMA/2014/869);
- Guidelines on disclosure of encumbered and unencumbered assets (EBA/GL/2014/03);
- Guidelines on harmonised definitions and templates for funding plans of credit institutions under Recommendation A4 of ESRB/2012/2 (EBA/GL/2014/04).

Several EIOPA guidelines that were enacted as the FSA's advisory guidelines and clarified the transition to Solvency II became effective in 2014:

- Guidelines on Pre-application for Internal Models (EIOPA-CP-13/011). These Guidelines are aimed at clarifying various pre-application-related issues to insurers who are planning to use internal models for the calculation of their capital needs from 2016 onwards;

- Guidelines on the System of Governance (EIOPA-CP-13/08) clarify how fit&proper requirements for key persons, risk management, the principle of reasonable investments, own funds, internal control system and key functions are linked with the whole system of governance;
- Guidelines on Forward Looking Assessment of Own Risks (based on the ORSA principles) (EIOPA-CP-13/09) clarify the nature, principles and scope of the assessment of own risks in the preparatory phase of Solvency II.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

The Supervisory Board of the FSA has approved the strategy for financial supervision (2011-2015). This strategy outlines three main operational goals for these years: to increase the supervisory capacities of the FSA; to foster cooperation partnerships; and to increase the role of the FSA in providing advice and guidance to consumers of financial services.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2014, the FSA issued licenses to four companies, and revoked all licenses issued to a supervised entity in one occasion and a supplementary licence for investment consultation services in another occasion.

The following branch was established by a EU Member State's financial institution in Estonia in 2014: Nordea Bank AB. The establishment was related to the internal reorganization of Nordea Bank AB (publ): activities, assets and liabilities of the former Nordea Bank Finland Plc Estonian Branch were transferred to the Nordea Bank AB Estonian Branch (established at the beginning of 2014).

As usual, the risk analysis of credit institutions performed by the FSA was based on traditional quarterly reports in 2014.

Similarly to previous years, the FSA prepared its supervisory evaluation of banks in the framework of the Supervisory Review Evaluation Process (SREP). As a result of SREP, the FSA can set an additional capital requirement for a credit institution above the minimum capital requirement.

The additional capital requirement of the banking sector under Pillar 2 (one of the components of SREP) amounted to € 226.6 million in 2014. The additional capital requirement under Pillar 2 was 29.4% higher than under Pillar 1 for two major banks operating in Estonian market, and 30.6% higher in case of smaller banks. The FSA considers the capitalisation level of credit institutions that operate in Estonia to be strong and adequate for regulative requirements. All three Estonian credit institutions that participated in the Comprehensive Assessment (CA) performed in 2014 under the leadership of the European Central Bank passed this exercise with flying colours.

Significant banks in the meaning of the European Single Supervisory Mechanism (SSM) were subjected to stress testing in 2014 in order to evaluate the capitalization level of credit institutions and their resilience to crises. Strength testing covered a conservative crisis scenario that showed that potential negative situations would have no effect on the capital adequacy of systemically important banks in Estonia. Potential additional loan losses could be covered through interest income or existing capital buffers, and the effect on the capital adequacy indicator of these banks remained under the level on one percentage point.

In 2014, the FSA conducted besides other supervisory activities also on-site inspections in 9 credit institutions and branches.

These on-site inspections covered the following areas:

- Compliance with the requirements of responsible lending;
- Activities of the depository;
- Compliance with the provisions of the Money Laundering and Terrorist Financing Prevention Act;
- Performance of assessment obligations when concluding an investment deposit contract, which are related to the suitability of investment deposit;
- Corporate governance;
- Management of operational risk;
- Functioning of internal audit;
- Credit activities and the management of credit risk, quality of loan portfolio;
- Liquidity management and raising of resources;
- Management of investments;
- Handling of transaction orders issued by clients.

As a result of on-site inspections in the area of prudential supervision, the FSA discovered several deficiencies in the business arrangement of credit institutions and requested a schedule for the elimination of these deficiencies from 4 credit institutions, in order to mitigate the existing risks as soon as possible.

As far as the prevention of money laundering and terrorist financing is concerned, the supervisory activities performed in 2014 in respect of credit institutions and branches were aimed at mapping all crosscutting specific risks in this sector.

On-site inspections in respect of 4 market participants examined whether and how they complied with legislative requirements when establishing business relations with high risk clients, including the performance of subsequent monitoring of clients' activities and notification of potential risks. As a result of these inspections, the FSA requested from all 4 supervised entities to complement their internal rules on the prevention of money laundering and terrorist financing and to amend their work arrangement, in order to ensure better compliance with legislative norms.

The adherence to responsible lending principles was examined in 2 credit institutions. The FSA checked whether these banks assessed the solvency of their clients before making a decision regarding the loan. As a result of these inspections, the FSA requested these two market participants to clarify their internal rules related to responsible lending.

On-site inspections performed in 2 credit institutions examined whether these banks assessed the suitability of relevant financial products for clients who had concluded an investment deposit contract. These inspections revealed no deficiencies.

An inspection of depositary services was performed in one credit institution. The FSA assessed whether the design of this area complied with legal requirements. As a result of this inspection the relevant credit institution was requested to complement the respective internal rules.

In 2014, an on-site inspection covering the area of securities market was performed in one credit institution where the handling of transaction orders as well as the registration and storage of data were examined. This inspection discovered deficiencies in the registration of transaction data, the storage of initial transaction orders, and the practice of and internal rules on the handling of transaction orders.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

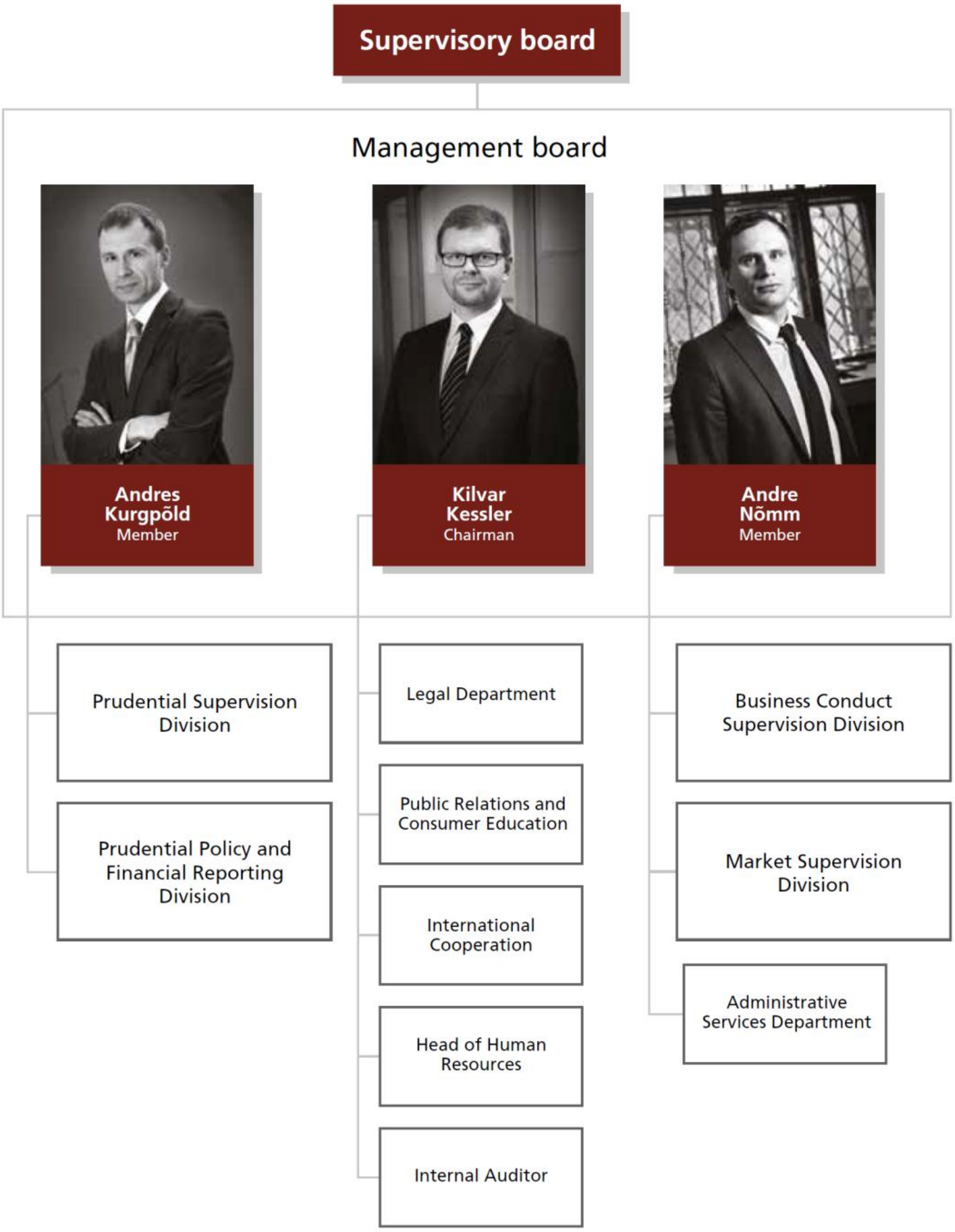
As at 31 December 2014, the Management Board of the Financial Supervision Authority included:

Chairman:

- Kilvar Kessler

Members:

- Andre Nõmm
- Andres Kurgpõld



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

European Single Supervisory Mechanism SSM consisting of the European Central Bank and euro-area national banking supervisory authorities became fully functional from 4 November 2014. Its task is to ensure the safety and reliability of the European banking system, enhance financial integration and stability and guarantee the consistency of supervision.

SSM together with the Single Resolution Mechanism are the two main pillars of the European Banking Union. All euro-area countries are participating in the SSM.

SSM does not include the supervision of financial services and anti-money laundering or the prudential supervision of other financial intermediaries. Credit institutions are classified as significant institutions and less significant institutions under the Council Regulation (EU) No 1024/2014.

The European Central Bank (ECB) performs direct supervision over 123 significant banking groups in the euro-area. Among the credit institutions operating in Estonia, Swedbank AS and AS SEB Bank are subjected to the ECB's direct supervision. Direct supervision means that the decisions are made by the Supervisory Board of the SSM, and the activities are planned and executed by the ECB in cooperation with the FSA who provides main resources for the supervision.

Other credit institutions operating in Estonia are still subjected to the FSA's direct supervision. The FSA follows general instructions, if any, given by the ECB.

Besides ensuring the compliance of 123 euro-area banks with capital and liquidity requirements, the tasks of the ECB include, since putting in place a system of common bank supervision, also the authorisation of credit institutions and the withdrawing of authorisations of credit institutions and the approval of qualifying holding acquisitions in banks.

Supervisory activities in respect of significant banks are performed by Joint Supervisory Teams (JSTs) that consist of ECB's experts and national supervisors of the relevant bank.

SSM's key decision-making body is the Supervisory Board. Its decisions are approved by the ECB's Governing Council. The Supervisory Board consists of the representatives of ECB and national financial supervision authorities of euro-area. Mr Kilvar Kessler, Chairman of the FSA's Management Board, is the member of the Supervisory Board, and his alternate is Mr Andres Kurgpõld, Member of the FSA's Management Board.

The Supervisory Board held 22 meetings in Frankfurt and discussed 208 agenda items in 2014. It adopted 101 decisions by a written procedure in 2014.

As 2014 was above all a preparatory year for the common banking supervision, most of the decisions adopted before the introduction of common supervision on 4 November 2014 were aimed at making preparations for the single system.

In order to draw a comparative picture of the situation, the SSM together with the ECB performed the Comprehensive Assessment (CA) of euro-area banks. It consisted of the Asset Quality Review (AQR) and strength analysis. Asset Quality Review encompassed also the assessment of the actual value of banks' assets and the adequacy of collaterals as at 31 December 2013.

Besides participating in the work of the SSM's Supervisory Board, Mr Kilvar Kessler, Chairman of the FSA's Management Board, participated also in the work of the SSM's Steering Committee. The Steering Committee is a body consisting of 8 members, 3 of them from the ECB and 5 from national supervision authorities, based on rotation principle. Its task is to support the activities of the Supervisory Board and make preparations for its meetings.

Experts of the FSA were involved in 21 different working parties or committees in 2014 and participated in 68 meetings in total.

In addition, the FSA participated as a member in the work of following global organisations in 2014: International Association of Insurance Supervisors (IAIS), Bank of International Settlements (BIS), including the Group of Banking Supervisors from Central and Eastern Europe (BSCEE), International Organisation of Securities Commission (IOSCO) and the Organisation for Economic Cooperation and Development (OECD).

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	8	8	8
Branches of foreign credit institutions	8	7	7
Banking sector, total:	**16**	**15**	**15**

Ownership structure of banks on the basis of assets total

Type of financial institution	2012	2013	2014
Public sector ownership	0.0	0.0	0.0
Other domestic ownership	4.2	5.2	5.3
Domestic ownership total	4.2	5.2	5.3
Foreign ownership	95.8	94.8	94.7
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Banks	76.6	89.3	2,414.9

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Banks	9.5	11.7	11.4

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	69.6	71.2	73.1
Branches of foreign credit institutions	30.4	28.8	26.9
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2012	2013	2014
Commercial banks	19.3 **	20.0 **	35.7 ***

(* - for Basel I; ** - for Basel II; *** - for Basel III

Asset portfolio quality of the banking sector
(share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non financial sector	3.1	2.0	1.8
- households	**3.2**	**2.6**	**2.2**
- corporate	**3.7**	**1.8**	**1.9**

The structure of deposits and loans of the banking sector in 2014 (%)
(at year-end)

	Deposits	Loans
Households	39.9	46.9
Government sector	43.6	43.6
Corporate	8.0	3.6
Other (excluding banks)	8.5	5.9
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)
mln EUR

P&L account	2012	2013	2014
Interest income	568	480	492
Interest expenses	175	101	87
Net interest income	393	379	405
Net fee and commission income	134	132	148
Other (not specified above) operating income (net)	81	247	134
Gross income	**831**	**920**	**823**
Administration costs	258	268	266
Depreciation	11	12	15
Provisions	5	9	0
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	41	23	19
Profit (loss) before tax	363	462	344
Net profit (loss)	**348**	**445**	**334**

2014 DEVELOPMENTS IN THE GEORGIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2014 economic growth in Georgia reached 4.8%. Major contributors to the growth in 2014 were construction (13.5%), and trade (6.1%). High growth rates were recorded in construction, trade, financial, operation with real estate and transportation sectors. After flat growth in 2013 output of communication sector has increased by 7.1%.

Under 7% growth rate of private consumption, it accounted for more than 50% of nominal growth of GDP in 2014. Other source of growth, namely, export of goods and services, has increased by 4%. Tourism sector has also supported the growth of export revenues in 2014. Investments in fixed capital made up 26% of GDP, increased from last year 22% level.

Savings rate remained same on 20% of the national income. Unemployment rate remained high, however, decreased significantly 12.4% compared to previous year (14.6%).

Inflation rate was picking up in the first half of 2014, but the trend reversed and it had decreased to 2.0% by December. As a response on GEL devaluation National Bank of Georgia (NBG) has increased the policy rate from 3.75% to 4.0% in Q1 of 2014 and remained unchanged till the end of year.

Consolidated budget deficit has reached 3.2% of GDP compared with 2.6% in 2013 and 2.8% in 2012. Tax revenues of consolidated budget have increased significantly by 8.9%, while budget expenditures increased by 14.3% in 2014. Tax burden made up 23.5% of GDP, which is less then 24.8 in 2013. Public debt to GDP remained on sustainable level and made up 35.5% in 2014, while in 2013 it was 36.8%.

Current account deficit reached 10.3% of GDP in 2014, which is (4.3 percentage points) higher than in 2013. The growth of import was 7.1%, but export growth made up to -1.6%, that is lower than its growth rate of 21.2% in 2013. Trade deficit has broadend and made up 36.6% of GDP in 2014, when in 2013 it was 21.7%. Revenues from tourism, as well as transfers and remittances were significant sources of financing of trading good’s deficit. Other sources of financing of current account deficit were FDIs, which made up about 1.3 billion USD in 2014 that is by 35% more than in 2013. At the same time, inflow of portfolio investments made up 250 mln in 2014, unlike the previous ear, when it was negligible amount. As the result, total external debt increased by 228 million USD up to the 13.5 billion USD, which is 0.3[18] percentage points increase to 85.9% of GDP. In the same period, external public debt declined to 26.8% of GDP. Large portion of the state borrowing consisted of low interest bearing loans from donor organizations.

[18] In absolute amount it increased by 9.2%, but to GDP it increase by 0.4%

DEVELOPMENTS IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL/GDP)

Banking is the main financial intermediary in Georgian economy. Foreign investments dominate banking sector and accounts for more than 80% percent of total equity. Banking sector was growing in 2014, with 22% growth rate during the Q1-Q3 year, but growth has slowed down in Q4, that was related with decreased economic activities. Credit portfolio increased by YoY 23.7% at the end of 2014, compared with 21% in 2013. In total, credit portfolio accounted for 45% of GDP,[19] which is 6% higher than in 2013. As for the total assets of banking sector, they accounted for 71% of GDP that is 6.5 percentage points higher than in 2013.

In 2014, the highest growth rate was recorded in retail lending (30% annual growth), followed by corporate and SME sectors. Banking sector loan portfolio break-down by products is the following: 37% accounts for corporate sector, 44% - retail sector, and 19% - SMEs.

Throughout the year, loan portfolio quality remained the same. According to NBG's more forward-looking methodology and taking into account restructured loans with no evidence of being able to repay them under the new schedule, NPL ratio has increased by 0.1 percentage points and made up 7.6% of total portfolio. At the same time, NPL ratio calculated with widely accepted methodology - the loans with more than 90 days overdue to total portfolio remained at 3.1% in 2014, same as in 2013.

In 2014, banking sector accumulated liquidity ratio above the prudential minimum. The share of liquid assets to total assets and non-bank deposits made up 22% and 39%, respectively.

Banking system still remained highly dollarized, contributing to currency induced credit risk. In 2014, the dollarization of loans decreased by 1.8 percentage points, down to 60.4%, and dollarization of deposits, was on the same level and made up 60.1%. To mitigate this risk, NBG employs additional risk weights for foreign currency exposures and higher reserve requirement for foreign currency deposits.

Georgian banking system is well capitalized, mainly driven by aforementioned risk weighting. At the end of 2014, CAR for Tier I capital and regulatory capital were 13.6% and 17.4%, respectively, which are significantly higher than the required prudential minimum. The same indicators, calculated based on Basel II/III methodology, were 13.1% and 16.5%, respectively.

Profitability of banks had increased in 2014. Financial profit of the system has jumped from 389 million GEL in 2013 to 475 million GEL in 2014. At the end of 2014 RoA made up 2.6% and RoE made up 14.8%. Moderate growth rate of credit portfolio and improvement of loan quality led to higher profitability in banking system. In addition, the efficiency of banking system continued to improve with the increase of scales of operations. Cost to income ratio declined from 52.5 % in 2013 to 49.6% in 2014.

[19] Includes only non-bank loans.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN GEORGIA

The authority to supervise commercial banks, as well as non-bank financial institutions - securities market, credit unions, microfinance organizations, money remittance units, currency exchange bureaus and qualified credit institutions, is vested with the National Bank of Georgia. NBG is the central bank of Georgia and an independent public body.

The legal framework of the operation and supervision of financial institutions is primarily defined by Constitution of Georgia (Articles 95 and 96); Organic Law on Georgia on the National Bank of Georgia; Law on the Activities of Commercial Banks; Law of Georgia on the Securities Market; Law of Georgia on Microfinance Organizations; Law of Georgia on Non-Bank Depository Institutions - Credit Unions and relevant by-laws.

In 2014, important legislative amendments have been introduced to the legislation.

Decree N100/04 of October 28, 2013 of the Governor of the NBG on approving „the Regulation on Capital Adequacy Requirements for Commercial Banks" was amended (Decree N81/04 of August 25, 2014 of the Governor of the NBG) to define the list of the institutions authorized by the NBG for the external credit assessment (ECAIs) based on Basel II/III. In 2014, components of Pillar I and Pillar II of the capital adequacy framework were fully launched. From the second half of 2014, all commercial banks in Georgia were required to comply with the requirements of the regulation.

The new edition of the Regulation on Licensing of Banking Institutions was approved (Decree N52/04 June 17, 2014 of the Governor of the NBG), which is more in line with the international practice.

Certain changes have been introduced to the Decree N134 /01 of October 22, 2010 of the Governor of the NBG on Approving „the Regulation on Conducting External Audit of Commercial Banks" on June 17, 2014. The amendments clarify that NBG is entitled to arrange meetings with external auditor without the consent of the commercial bank. Provision of information by the external auditor to NBG shall not mean the breach of confidentiality. Adverse developments identified by the external auditor should be submitted to NBG immediately.

The new edition of "the Regulation on Fit and Proper Criteria for Administrators of Commercial Banks" was approved (Decree N50/04 of June 17, 2014 of the Governor of the NBG). Its scope was extended to members of supervisory board and audit committee. According to the regulation the fitness and proprietary should be in line with the complexity and activities of a given bank at a given position.

„The Regulation on the Dealing Operations" was approved (Decree N33/04 of March 28, 2014 of the Governor of the NBG). According to this Regulation, commercial banks have to create internal policies and procedures for managing the dealing securities' portfolio. The regulation ensures readiness in case commercial banks enhance trading book activities, which is virtually nonexistent.

"The Regulation on the Operational Risk Management in Commercial Banks" was approved (Decree N47/04 of June 13, 2014 of the Governor of the

NBG). According to the regulation, each commercial bank operating in Georgia, domestic as well as branches of foreign banks, must have operational risk management framework. The framework must be consistent with the size and complexity of the bank and must be in line with the operations conducted by the commercial bank. In addition, framework must be fully integrated in overall risk management process of commercial banks.

"The Regulation on the Risk Management in Commercial Banks" was approved (Decree N48/04 of June 17, 2014 of the Governor of the NBG). Abovementioned regulation ensures active supervision of bank management, policies and procedures, risk identification and assessment, definition of limits, monitoring of these limits as well as implementation of IT systems, risk and internal control procedures.

The new edition of "the Regulation on Credit Concentration and Large Risks in Commercial Banks" (Decree N49/04 of June 17, 2014 of the Governor of the NBG) was issues, which prescribes relevant limits on concentration risk and large exposures.

"The Regulation on Assets Classification and the Creation and Use of Reserves for Losses by Commercial Banks" was approved (Decree N51/04 of the Governor of the NBG, dated June 17, 2014), which requires banks to have adequate asset classification and loan loss provisioning in line with international standards and to establish and maintain written policies and procedures for credit risk management purposes. The aim of the regulation is commercial banks to form and implement internal procedures and reporting requirements concerning the classification of their assets and liabilities related to their reserves. The abovementioned will enhance assessment of realistic financial stance of banks and ensure objective information for depositors, management, shareholders, potential investors, NBG and other stakeholders.

Amendment was initiated in the "Rules for Determining and Charging Fines for Commercial Banks" (Decree N242/01 of the Governor of the NBG, dated December 25, 2009). According to the amendment (Decree N54/04 of June 17, 2014 of the Governor of the NBG) in case of breach of requirements set under Law of Georgia on Activities of Commercial Banks and sub-legal normative acts of banking activities, also, when administrator does not perform his/her relevant obligations that result in breach of legislation by bank, the administrator of a commercial bank will be fined, not only bank.

Along with the development of the legislative framework, important steps were taken towards supporting the implementation of the best international practice of corporate governance and supervisory framework at commercial banks. In this regard, the National Bank of Georgia plans to develop corporate governance guidelines, which will be based not only on structural/organizational requirements, but will also reflect the expectations of the NBG's contextual and behavioral practices. Over the past year, the National Bank of Georgia has also supported commercial banks in developing the recovery and resolution plans, which constitutes one of the most important components for the stability of the financial sector. In particular, commercial banks are required to develop comprehensive practical action plans for specific stress scenarios, which, in case these scenarios materialize, will assist them in timely recovery or resolution.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

In 2014, main strategic objective of National Bank of Georgia was to continue successful implementation of Basel II/III framework, including pillar 2. In that regards, NBG developed the instruction for establishing capital requirements for each commercial bank individually, which, during the current year, will be used for the reporting and calibration purposes. As per the abovementioned instruction, the total capital requirement is determined by the minimum requirements of Pillar I and the buffers of Pillar I and Pillar II. These buffers include such as conservation, countercyclical, systematic, stress-tests and concentration buffers and the additional requirements of the General Risk Assessment Program (GRAPE). ICAAP inputs are also used in the process.

Further, one of the major strategies of NBG was to continue conducting reforms for enhancing transparency of financial sector. Throughout 2014, the assessment of the commercial banks' IFRS statements mainly concentrated on the financial instruments' impairment methods and the quality of disclosure of financial risks. As the result, in order to enhance the quality of financial reporting, the National Bank of Georgia started working on the development of the methodology for the impairment of debt instruments in line with the international practice. The latter was discussed with the leading audit companies at the working level. The objective of the mentioned regulation is to specify the methods for the disclosure and calculation of the impairment of financial instruments within IAS 39, which will contribute to adequate and timely reflection of the impaired loans and other debt instruments in financial statements. It also represents the step forwards in terms of implementing IFRS 9.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

Throughout 2014, the National Bank of Georgia enhanced its cooperation with the external auditors of the commercial banks. In order to enhance the quality and transparency of the annual financial reporting, three-way meetings were conducted between the National Bank of Georgia, commercial banks and the external auditors of the commercial banks. Within this cooperation, in October 2014, the NBG introduced the main approaches of its risk-based supervision framework to the external auditors, with particular focus on credit risk assessment principles, consolidated supervision and capital adequacy issues.

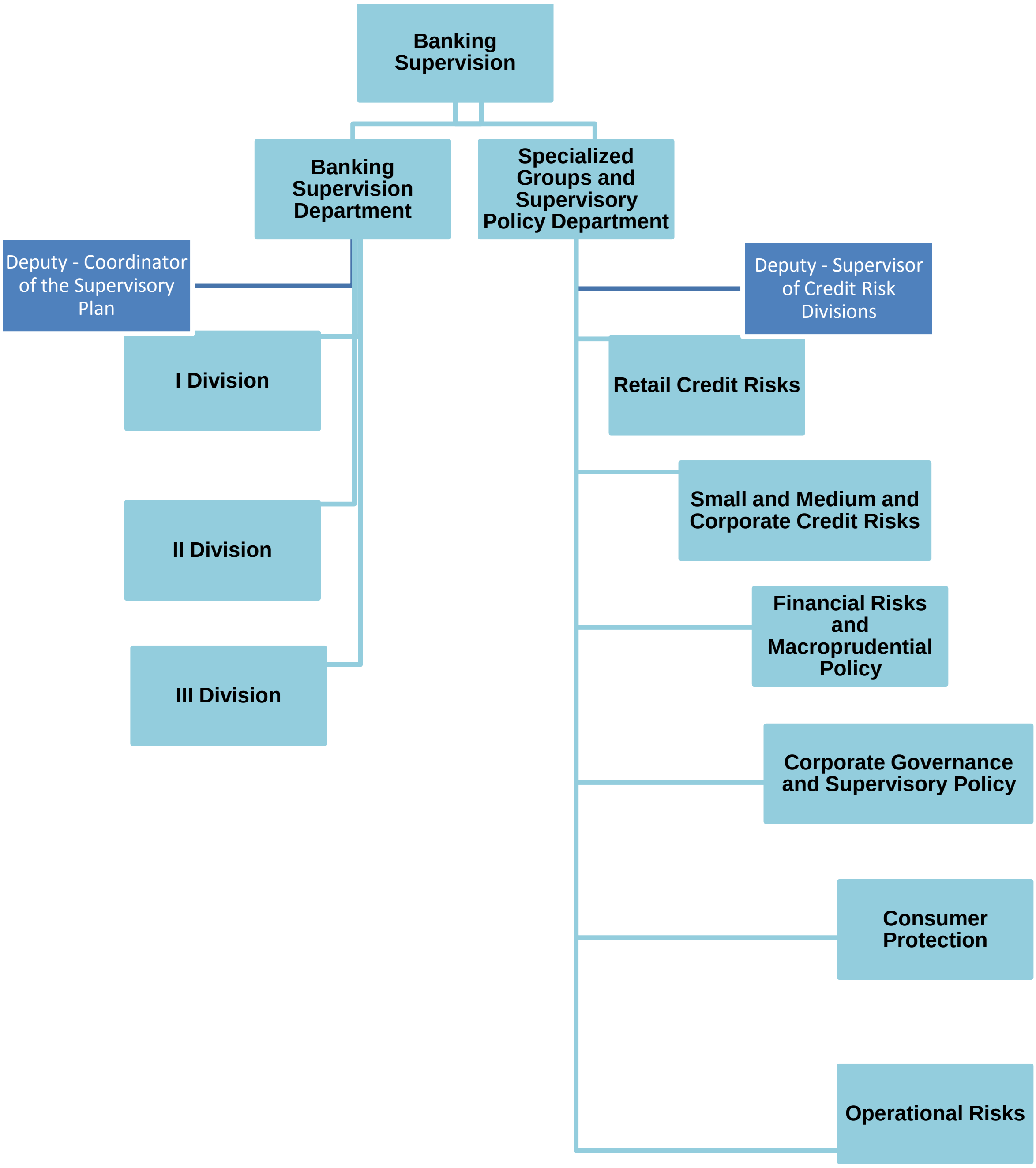
Further, in 2014 the National bank of Georgia started working on the project of fully replacing current reporting system of commercial banks with the IFRS system. As the result, continuous supervisory reporting by commercial banks in line with IFRS will be based on the reporting system established by European Union (FINREP). It will contribute to the enhancement of transparency and efficiency, since the reporting will be based on international standards and will avoid any double reporting burden. However, the NBG will also maintain all existing and available prudential filters, in order to continue the conservative and risk-based supervision process uninterrupted.

In 2014, components of Pillar I and Pillar II of the capital adequacy framework, which are based on Basel II/III, were fully launched. In 2013, the updated regulation was enforced and at the initial stage, entailed only the reporting requirement; however, from the second half of 2014, all commercial banks in Georgia are required to comply with the requirements of the regulation. At present, commercial banks prepare statements within both the existing and the updated frameworks. During the following three years, minimum requirements of Basel I will be gradually reduced and replaced by Basel II/III framework.

In 2014, commercial banks submitted their ICAAP (Internal Capital Adequacy Assessment Program) results, which are subject to the National Bank of Georgia's supervisory review and evaluation process.

In 2014, the rule of General Risk Assessment Program (GRAPE) also came into force. GRAPE's objective is to formalize the risk-based supervisory process of commercial banks. This document constitutes the description of various components of the continuous cycle of risk-based supervision and responsible structural units. GRAPE incorporates the stages of risk identification, analysis and assessment of risks during different phases, periodic summary assessments and supervisory actions. An internal capital adequacy assessment and stress-tests of Pillar I are integral parts of the program. Within the program, the supervisor determines the risk-based supervisory actions.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



The supervisory pillar of NBG is directly managed by one of the two Vice-Governors. Total number of employees involved in banking supervision is around 50, which renders organizational structure simple and communication lines - short. Supervisory functions are performed by two closely related groups – bank supervisors and specialized groups. Bank supervisors (Banking Supervision Department) are responsible for all risk areas across each bank, while specialist risk teams (Specialized Groups and Supervisory Policy Department) are responsible for the system-wide monitoring and assessment of their particular risks across all banks and maintaining systemic stance of the risk. They elaborate risk assessment methodologies, set system-wide benchmarks and are involved in all risk–related tasks.

Normally, the assessment of each risk (inherent risk and risk mitigants) at each bank will be prepared and/or reviewed by these two departments. The separation of the tasks of reviewing/preparing depends on resource availability and task complication level. This approach contributes to more appropriate and consistent benchmarked assessments, while also meeting the "four eyes" principle. It also ensures that a strong peer group review element and consistency of treatment across banks is introduced at an early stage in the risk assessment process, in contrast to other systems where the risk assessment process is driven entirely by the bank supervisor, and any peer group or "panel review" procedures are introduced towards the end of the process. Supervisors are not separated into on-site and off-site supervisors. Both the supervisors and the specialist risk teams undertake on-site and off-site work and perform all necessary steps to identify and assess banks' risks and elaborate relevant supervisory actions.

INTERNATIONAL ACTIVITY OF THE AUTHORITY

In 2014, National Bank of Georgia became a member of Basel Consultative Group (BCG) of the Basel Committee on Banking Supervision (BCBS). Within the frames of the membership of this group, starting from January 2015, the NBG was also actively involved in the main activities of the Basel core committee's Supervision and Implementation Group, which focuses on implementing advanced approaches of international supervisory policy. The supervisory principles that this group develops constitute an international standard, and this is the first time that Georgia was invited to share its experience in the working group of the aforementioned level. It must be noted that in addition to developing modern approaches of banking supervision, the NBG accumulated a vast experience in terms of evaluating risks associated with asset quality. The National Bank of Georgia expresses its readiness to actively engage in the development of international practice in terms of promoting the continuous improvement of the risk management. At the same time, BCBS invited the NBG representatives as experts in the Regulatory Consistency Assessment Program (RCAP) team.

In 2014, based on the recommendation and funding from the World Bank, delegations from the central banks of Tajikistan, Kyrgyzstan and Kazakhstan visited the National Bank of Georgia. The visits mainly aimed at studying the reforms carried out in Georgia in terms of banking supervision, and sharing the NBG's experience. Within the scope of the visit, the visitors were particularly interested in the Basel II/III transition process, implemented by the National Bank, including the issues of consolidated supervision, stress-test methodology, quality analysis of credit assets and other reforms carried out within the risk-based supervision.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

Until April 2013, the NBG was the sole regulator for the financial sector in Georgia. At that date, the insurance supervision function was separated from the National Bank of Georgia and a separate public body – State Insurance Supervision Service of Georgia – was established for performing insurance supervision. Therefore, a Memorandum of Understanding (MOU) between the NBG and State Insurance Supervision Agency of Georgia Regarding the Enhancement of the Effectiveness of Inter-Agency Cooperation was signed on June 25, 2014.

NBG and Financial Monitoring Service have a formal memorandum of understanding on sharing information regarding money laundering and illicit income issues.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

In addition to the development of the supervisory framework, it is important for the National Bank of Georgia that its regulatory reforms and existing practices are reasonable and compliant with international best practices. In this regard, in 2014, the assessments of FSAP, Financial Sector Assessment Program, conducted jointly by International Monetary Fund (IMF) and the World Bank, were particularly important.

Within the frames of the program, the mission comprehensively assessed the supervisory approaches of the National Bank of Georgia. The mission concluded that as a result of introducing important reforms and maintaining conservative approaches, the NBG implemented a comprehensive, advanced and risk-based supervisory framework, which provides for early identification of risks and the most effective allocation of resources. As the result, according to the mission, the National banks' supervisory practice is highly in line with the Core Principles for Effective Banking Supervision of BCBS (Basel Committee on Banking Supervision). The assessors underscore in the report that the framework is comprehensive, because it addresses all risks emanating from banks and the banking system; it is forward looking, because it includes elements such as stress test, business model, corporate governance, and capital and contingency planning; it is risk-based, because it focuses on the most important risks.

It must be noted that innovative practices implemented by the National Bank of Georgia in different fields were positively assessed by the mission. The mission's report specifically highlights that in some instances, the NBG's approaches constitute a very advanced practice that can serve as an example for other developed countries. The NBG's advanced supervisory tools, credit risk supervisory practice, macro prudential supervisory framework, and other elements are particularly noteworthy.

According to the mission, the quality of the supervisors is impressive, which is a prerequisite for the effective implementation of reforms, and solving complex questions on the NBG's agenda. However, based on the salary research, highly competitive salary scales in the Georgian banking system remain an important challenge. As per the mission's assessment, in order for the NBG to maintain a strong supervisory and regulatory framework, the salaries must be in line with the Organic Law of Georgia on the National Bank of Georgia, which states that the amount of remuneration of employees of the NBG shall be commensurate with the level of wages of the Georgian banking system (Article 19 of the NBG Law). In addition to the reforms carried out, the mission positively assessed the NBG's current activities and vision, the implementation of which will further strengthen the risk management in the sector.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	16	19	19
Branches of foreign credit institutions	3	2	2
Cooperative banks			
Banking sector, total:	**19**	**21**	**21**

Ownership structure of banks on the basis of assets total

Type of financial institution	2012	2013	2014
Public sector ownership			
Other domestic ownership			
Domestic ownership total	3.6%	4.0%	4.3%
Foreign ownership	96.4%	96.0%	95.7%
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	65.21%	77.33%	18.52%
Branches of foreign credit institutions	0.43%	0.43%	0.003%
Cooperative banks			
Banking sector, total:	65.21%	77.33%	18.52%

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	5.85%	14.62%	14.79%
Cooperative banks			
Banking sector, total:	5.85%	14.62%	14.79%

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	99.61%	99.57%	99.23%
Branches of foreign credit institutions	0.39%	0.43%	0.77%
Cooperative banks			
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%) (at year-end)

	2012	2013	2014
Claims from	**100.0%**	**100.0%**	**100.0%**
Financial sector	9.9%	9.3%	7.0%
Nonfinancial sector	59.1%	59.3%	61.7%
Government sector	22.2%	24.0%	24.0%
Other assets	8.8%	7.4%	7.3%
Claims due to	**83.3%**	**83.2%**	**82.6%**
Financial sector	23.0%	20.8%	18.9%
Nonfinancial sector	49.3%	52.2%	50.0%
Government sector	4.0%	3.9%	6.2%
Other liabilities	7.1%	6.4%	7.4%
Capital	**16.7%**	**16.8%**	**17.4%**
Claims from	**100.0%**	**100.0%**	**100.0%**

Capital adequacy ratio of banks

Type of financial institution	2012	2013	2014
Commercial banks*	16.99%*	17.16%*	17.35%*
Cooperative banks			
Banking sector, total*:	16.99%*	17.16%*	17.35%*

(* - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non financial sector	4.81%	4.35%	3.10%
- households	5.00%	3.44%	2.40%
- corporate	4.71%	4.89%	3.70%

The structure of deposits and loans of the banking sector in 2014 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	95.2%	99.4%
Households	50.3%	39.1%
Corporate	44.8%	60.4%
Government sector	4.8%	0.6%
Financial sector (excluding banks)	0.0%	1.3%
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends) (EUR thousands)

P&L account	2012	2013	2014
Interest income	1,549,935,178	1,714,135,144	1,844,152,039
Interest expenses	754,762,988	751,904,241	737,254,352
Net interest income	795,172,190	962,230,903	1,106,897,687
Net fee and commission income	182,407,071	205,045,098	243,564,520
Other (not specified above) operating income (net)	192,047,866	210,984,311	250,291,581
Gross income	1,924,390,115	2,130,164,552	2,338,008,140
Administration costs	351,129,316	396,187,437	438,598,953
Depreciation	80,265,139	80,384,355	89,912,278
Provisions			
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	326,063,358	218,239,688	245,200,932
Profit (loss) before tax	178,590,858	436,958,594	561,416,989
Net profit (loss)	134,230,695	389,131,586	474,807,717

Total own funds in 2014 (in EUR)

Type of financial institution	Total own funds		Core Tier 1	Tier 1		Tier 2		Tier 3
Commercial banks	1,572,164,906*	1,643,458,317***	1,297,817,328	1,235,997,430 *	1,301,851,166***	336,167,476 *	341,607,151***	
Cooperative banks								
Banking sector, total:	1,572,164,906*	1,643,458,317***	1,297,817,328	1,235,997,430 *	1,301,851,166***	336,167,476 *	341,607,151***	

(* - for Basel I; ** - for Basel II; *** - for Basel III)

2014 DEVELOPMENTS IN THE HUNGARIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2014, gross domestic product (GDP) increased by 3.6 while inflation rate was -0.2 per cent. Meanwhile, the budget deficit remained below 3 per cent. As seen in previous periods, the four-quarter value of the economy's external position continued to be high in the third quarter of 2014.

In the past period, the Hungarian economy continued to expand dynamically, while inflation remained steadily far below the 3 per cent inflation target. Favourable cost developments, restrained demand, the gradual adjustment of expectations and cuts in regulated prices all contributed to the moderate inflation.

The real economy continued to grow in 2014, GDP increased in every quarter. This growth was led by domestic demand, and in particular investments increased at an outstanding degree. Household consumption expenditures gradually increased in 2014, mainly on the back of the improving labour market situation and dynamically increasing real wages in the low inflation environment. In 2014, there was a substantial increase in investments, and the investment ratio rose to 21.6 per cent.

Economy-wide investments were primarily fuelled by recovering demand and government investments implemented with EU funding, while the Funding for Growth Scheme (FGS) launched by Magyar Nemzeti Bank substantially eased the financing constraints on small and medium-sized enterprises, thus boosting investment activity in the private sector. The investment activity of households increased in Q4, but in terms of its level it still considerably below the pre-crisis average. In parallel with the central bank base rate cuts, interest rates continued on the downward trend seen in recent quarters. Banks reported an easing of non-price conditions on corporate loans, and conditions eased generally according to the respondents of the Lending Survey. Respondents anticipate further easing in the first half of 2015. By contrast, tightening of credit conditions is expected in the household segment, but this is largely explained by the technical effects of the recently adopted debt cap rules. The moderation of inflation expectations pushed down the one-year forward-looking real interest rate in January.

Total employment increased slightly in Q4, owing to the decrease in the number of private sector employees and the increase in public sector employment. The unemployment rate decreased to 7.7 per cent in the fourth quarter of 2014. The number of long-term unemployed has been decreasing since mid-2013, and thus the average time of unemployment declined.

The external financing capacity rose to 8 per cent of GDP in 2014, reflecting the decrease of the financing requirements of the state while the net financial saving of the private sector stabilised at a high level. The decline in general government net borrowing is due to the fact that economic growth, the high wage dynamics and the increasing employment boosted the government tax revenues, which may have been further enhanced by the improved efficiency of VAT collection stemming from the installation of tax authority cash registers.

Net lending under the real economy approach was stable in Q3 as well, at close to 8 per cent of GDP. The trade surplus slightly decreased, primarily due to increased investments and imports related to the filling of natural gas storage facilities. The increase in the transfer balance surplus was primarily due to the fact that the four-quarter value of the utilisation of EU transfers increased to EUR 5.7 billion. There was no material change in the income balance, however the deficit amounting to almost 4 per cent of GDP is still considerably behind the levels typical in former years. Based on the preliminary monthly data, the trade surplus may have increased at the end of the year, while the large amount of EU transfers in Q4 slightly fell short of the year-on-year value.

DEVELOPMENT IN THE BANKING SECTOR (INCLUDING THE ASSETS TOTAL / GDP)

In 2014 the Hungarian banking sector was characterised by adequate shock-absorbing capacity, along with high capitalisation and accumulation of liquid assets. At the same time recovery in lending developments still lags behind the level that would support a sustainable economic growth. This is mitigated by the extension of the Funding for Growth Scheme (FGS), both in terms of time and credit risk spread, which further accelerates corporate lending. At the end of 2014 the total assets to GDP ratio of the banking sector decreased 2 percentage points to 96.6 per cent related to the end of 2013. Shrinking of the household credit portfolio continued during 2014, which was dominated by FX loans; however, signs of a turnaround could already be seen in forint lending. The volume of housing loans significantly increased within the newly disbursed loans: decreasing financing costs and the increase in consumption and household investments together had a positive impact on household borrowings. Credit conditions to households slightly eased during the year, but the standards may still be deemed tight compared to the pre-crisis period.

Corporate lending expanded in the second half of 2014, thus the loans outstanding increased materially for the fiscal year for the first time since the beginning of the crisis. New disbursements under FGS also significantly contributed to the overall lending: at the end of 2014 the annual growth rate of the credit portfolio was 1.9 per cent, while – according to our estimates – in the absence of FGS it would have decreased by 4 per cent.

The high share of non-performing loans outstanding is one of the highest domestic risks in the banking sector given its negative impact on profitability and lending. During the second half of the year the portfolios of corporate loans being overdue for more than 90 days decreased, by the end of the year the corporate NPL ratio went down to 15.6 per cent. The improvement of the corporate portfolio quality is primarily attributable to the intensive portfolio cleaning and to a lesser extent to the lessening of the portfolio deterioration. In the second half of 2014 the non-performing loan ratio reached its historic peak within the entire banking system's household loan portfolio. The NPL ratio climbed to 19.2 per cent at the end of the year. Within the non-performing household loans the high volume of the portfolio secured by mortgage and the slow cleaning rate of these loans represent major problems.

In 2014 the profitability of the banking system was dominated by one-off items both in the entire sector and at the level of the individual institutions. At sector level the net result is at its historic low, i.e. a loss of HUF 506 billion, as a consequence of the FX loan settlement. With the termination of the one-off impacts - that have been burdening the banking sector's profit for several years – and with the exclusion of loan losses, profitability of the banking sector may increase to an acceptable level even in international comparison. The ROE of the sector was -17.5 per cent, and its ROA was -1.8 per cent in 2014. Nevertheless, the capital position of the banking system is adequate, primarily due to the capital injection of almost HUF 340 billion made by the owners during the year. As a result, the banking sector's capital adequacy ratio (CAR) slightly decreased from 17.4 per cent to 16.8 per cent, still a relatively high level in international comparison.

The liquidity position of the Hungarian banks continued to strengthen; however as a result of the conversion of FX mortgage loans to forint, the HUF maturity mismatch between assets and liabilities is more apparent. This has a negative impact on the banking sector's liquidity through the increased refinancing risk; however, the mortgage lending adequacy regulation, anticipated by the MNB, may divert the banks' adjustment to the proper direction. A major part of the short-term external funds may flow out of the banking sector, which is a positive development in terms of the external vulnerability of the banking sector and the economy.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN HUNGARY

Basel III is being implemented in the European Union from January 2014 through the Capital Requirements Directive IV (CRD IV and its RTS, ITS) and the Capital Requirements Regulation (CRR). The aim of these regulations is to improve the resiliency of the banking sector by requiring more and higher quality capital and more balanced liquidity.

The CRD IV was implemented in Hungary by the Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (Hpt.), while the CRR has direct effect.

The Bank Recovery and Resolution Directive (the BRRD – 2014/59/EU) states its aim as to establish "a framework for the recovery and resolution of credit institutions and investment firms" ('institutions'). The BRRD was implemented by the Hpt. and by the Act XXXVII of 2014 on the further development of the institutional system strengthening the safety and security of certain participants of the financial intermediary system.

MAIN STRATEGIC OBJECTIVES OF THE HFSA IN 2014

Following the integration of the HFSA and the MNB, the MNB had to develop a new strategy for the integrated authority. In July 2014 the Financial Stability Board approved the new supervisory strategy for the period of 2014–2019. According to the strategy, the mission of the MNB is to maintain and support the stability of the financial system and to strengthen the confidence of participants both in the system and in one another with the assistance of the integrated supervisory instruments. The management of the MNB designated confidence and stability as priority values for the supervisory area.

The strategy also determines clearly defined objectives for the next years that the MNB wishes to achieve in the supervised markets and with respect to itself as an institution, by taking advantage of the opportunities provided by the instruments at its disposal. The tasks required for the achievement of the long-term objectives have been designated for each supervised sector and supervisory area. The strategy will be reviewed and updated every year.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

Microprudential supervision is intended to facilitate the prudent operation of credit institutions, supervise the careful exercise of owners' rights, identify and assess the risks associated with individual institutions, mitigate or eliminate risks, and take preventive measures in order to ensure prudent operations. In order to make these preventive measures more efficient and could control the identified risks, the MNB has made its inspection framework more flexible and modified the scheduled inspection timetable to examine the institutions where the risks are building up quickly. Both in on-site and off-site microprudential supervision, priority inspection areas included the management and mitigation of high accumulated credit risk at credit institutions and the examination of the inspected institution's capital position, profitability and the sustainability of its business model. In addition, special focus was given to the evaluation of liquidity and the adequate calculation of capital position according to the EU new regulation. In the cooperative bank sector, the integration of cooperative credit institutions called for non-standard licensing and supervisory tasks, which were addressed by the MNB with special care. As the new EU requirements (CRD IV/CRR) for credit institutions and investment firms entered into force on 1 January 2014, besides the regular supervisory work, the monitoring of implementation of these new regulations also played an important and continuous role as increasingly more implementing and regulatory technical standards (ITS/RTS) are entering into force.

In the year of 2014 a remarkable purifying was passed in the Hungarian financial sector. The license of 1 small commercial bank and 6 cooperative credit institution were revoked. The MNB with its new microprudential supervisory tools and the integration of cooperative credit institutions showed a strong presence regarding the institutions did not suite the concerning legislation.

In the year 2014 87 inspections (comprehensive, ICAAP-reviews, target end thematic investigations) were completed and 37 were in progress on 31 December 2014.

In 2014 European Central Bank (ECB) conducted comprehensive asset quality review (AQR) for the 130 biggest banks in euro area. In Hungary 5 systematically important banks were selected for AQR. The MNB has actively participated in the international review, and besides, performed its own asset quality review on the biggest bank in Hungary (OTP Bank Ltd) accordingly to the methodology of comprehensive assessment published on 23 October 2013 by ECB.

Number of on-site inspections	2014 actual	
	comprehensive	other
Large banks	2	16*
Small and medium banks	11	4
Credit cooperatives	20	1
Financial intermediaries	0	15
Insurance companies	10	1
Insurance associations	3	0
Pension, healthcare and voluntary mutual funds	18	0
Capital market institutions	17	7
Total:	81	43

*including ICAAP-reviews

Table 1: Number of inspections at credit institutions, insurance companies, funds and intermediaries

ORGANIZATIONAL CHART OF THE HFSA BANKING SUPERVISORY AUTHORITY

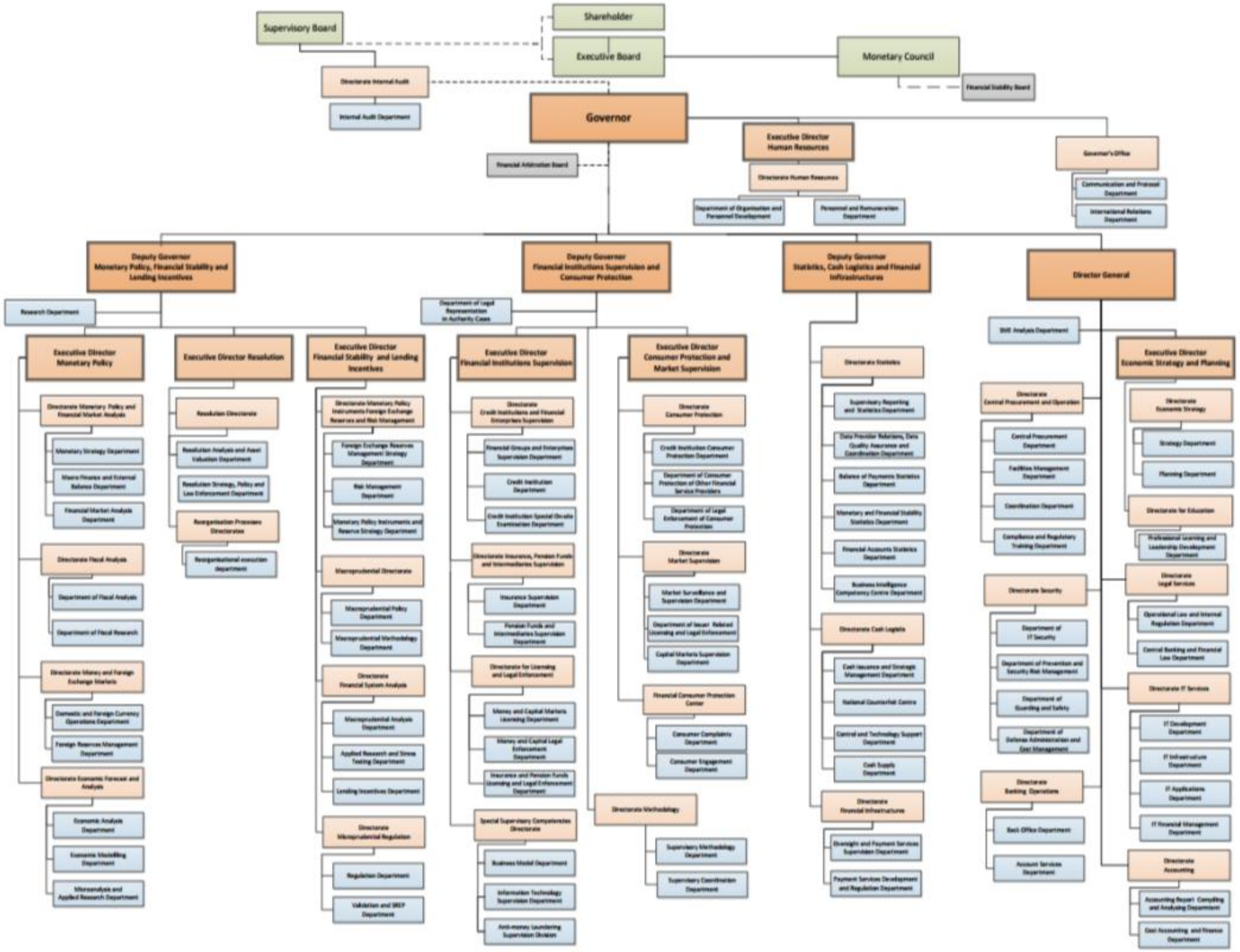
The organizational units under the Deputy Governor are responsible for the supervision of financial institutions and consumer protection. The Directorate Methodology and the Department of Legal Representation in Authority Cases report directly to the Deputy Governor. The Executive Director of Financial Institutions Supervision supervises the Business Model Department, the Directorate for Credit Institution Supervision, the Directorate for Insurance, Pension Funds, Financial Enterprises and Intermediaries Supervision and the Directorate for Licensing and Legal Enforcement. The Executive Director responsible for consumer protection and market supervision oversees the activities of the Directorate for Consumer Protection, the Directorate for Market Supervision and the Financial Consumer Protection Centre.

The organization chart of the MNB is available on the following link:

http://english.mnb.hu/Root/Dokumentumtar/ENMNB/A_jegybank/szervabra_en.pdf

Organisation Chart of Magyar Nemzeti Bank

30 June, 2015



INTERNATIONAL ACTIVITY OF THE AUTHORITY

Supervisory colleges

The supervisory colleges of financial groups operating in multiple countries are forums of supervisory cooperation. Under the framework of cooperation in supervisory colleges, regular and significant exchange of information takes place among national supervisory authorities.

From 1 October 2014 European Central Bank is the consolidating (home) supervisor in case of parent institution of the financial group in SSM-countries. At this date reorganization of supervisory colleges' work and form of the cooperation with college members has started. Colleges are organized and led by the joint supervisory team (JST) representing ECB and national supervisory authority supervising the parent institution (former home supervisor). College members (home and host supervisors) regularly exchange supervisory information on the group concerned, assess risks of the group, parent company and subsidiaries, evaluate the appropriateness of the group's and subsidiaries' recovery plan and may request each other to carry out supervisory procedures. As a result of college's work college members made joint decision on capital and liquidity adequacy and recovery plan.

In total, the MNB participates in 13 banking colleges as host supervisor authority. As home supervisor MNB leads the banking supervisory college of the OTP Group. In Central and Eastern Europe, the MNB is the only supervisory authority to perform home supervisor functions, regularly holding meetings with the participation of the supervisors of foreign OTP group member institutions and EBA representatives.

Memorandum of Understanding

The Magyar Nemzeti Bank (MNB) and the State Bank of Viet Nam signed a Memorandum of Understanding concerning their cooperation in the field of supervision of financial institutions and their cross-border establishments in February 2014.

ESRB

The MNB actively participates in the ESRB's work both at managerial and expert levels in several working groups and expert groups. The leaders of national supervisory authorities and central banks meet four times per year in General Board sessions, while members of the Advisory Technical Committee meet with the same frequency preceding the GB meetings. Regular discussion topics at these sessions include risks and vulnerabilities, the capital and liquidity position of banks, the ratio of non-performing and restructured loans and other key issues of financial stability.

FSB Regional Consultative Group for Europe

The MNB and the Ministry for National Economy are both members of the FSB's regional substructure. The Hungarian authorities were represented at managerial level at the sessions of both meetings of the FSB European Regional Consultative Group in 2014.

EBA

MNB staff members actively contributed to the professional efforts of the EBA and participated in the elaboration and assessment of professional materials on a regular basis.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The MNB and the Ministry for National Economy (MNE) are the most important Hungarian organisations responsible for the establishment and maintenance of financial stability. Accordingly, the cooperation of the central bank on a domestic level basically means close ties and the exchange of information.

The cooperation of the MNB with the MNE is closest in the area of legislation. The central bank plays an active role in working out the regulatory policy concepts of the financial intermediary system, the institutions and markets, and itself has regulatory powers to issue binding decrees.

In addition to authorities and government organisations, the MNB maintains close ties with domestic financial institutions (predominantly with credit institutions, due to their key role in the financial institutional system) and their organisations such as the Hungarian Banking Association, the Hungarian Leasing Association, the National Federation of Savings Co-operatives and organisations operating the financial infrastructure (Budapest Stock Exchange, KELER Central Clearing House and Depository, etc).

MNB collaborates with other competent Hungarian authorities as well, such as the Hungarian Authority for Consumer Protection and the National Tax and Customs Administration of Hungary.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	35	37	39
Branches of foreign credit institutions	9	9	10
Cooperative banks	128	122	110
Banking sector, total:	**173**	**168**	**159**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2012	2013	2014
Public sector ownership	-	-	6,6
Other domestic ownership	13,4	14,5	15,8
Domestic ownership total	13,4	14,5	22,4
Foreign ownership	86,6	85,5	77,6
Banking sector, total:	**100**	**100**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	44,7%	59,9%	0,116
Branches of foreign credit institutions	66,2%	90,4%	0,191
Cooperative banks	10,8%	16,0%	0,014
Banking sector, total:	**39,2%**	**52,5%**	**0,090**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	-6,4	0,8	-19,2
Cooperative banks	6,6	-2,4	-6,2
Banking sector, total:	**-5,8**	**0,6**	**-18,7**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	88,4	86,6	87,7
Branches of foreign credit institutions	6,1	7,7	7,6
Cooperative banks	5,5	5,8	4,7
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%) (at year-end)

	2012	2013	2014
Claims from			
Financial sector	26,1	28,4	30,7
Nonfinancial sector	42,7	40,8	38,4
Government sector	15,1	15,7	16,3
Other assets	16,1	15,1	14,6
Claims due to			
Financial sector	14,9	18,9	21,3
Nonfinancial sector	42,0	42,2	41,0
Government sector	2,0	2,4	2,9
Other liabilities	32,1	26,9	26,4
Capital	**9,0**	**9,7**	**8,4**

Capital adequacy ratio of banks

Type of financial institution	2012**	2013**	2014***
Commercial banks	15,8	17,4	17,0
Cooperative banks	16,9	16,7	19,2
Banking sector, total:	**15,9**	**17,4**	**17,0**

(* - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non financial sector	16,6%	17,2%	16,4%
- households	16,1%	18,5%	19,0%
- corporate	17,1%	15,8%	13,6%

The structure of deposits and loans of the banking sector in 2014 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	74,3	75,7
Households	41,7	38,1
Corporate	32,6	37,6
Government sector	5,1	3,5
Financial sector (excluding banks)	20,6	20,8
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-end, in HUF million)

P&L account	2012	2013	2014
Interest income	2 380 453	1 977 038	1 568 785
Interest expenses	1 453 828	1 056 025	650 037
Net interest income	926 625	921 013	918 748
Net fee and commission income	265 410	412 641	446 304
Other (not specified above) operating income (net)	-343 674	-265 550	-322 057
Gross income	848 361	1 068 105	1 042 996
Administration costs	636 357	618 367	611 390
Depreciation	56 382	60 116	59 702
Provisions	-177 819	-278 758	-862 325
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	-78 434	110 864	-490 421
Net profit (loss)	-154 654	25 959	-543 516

Total own funds in 2014 (in million EUR)***

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	7 637 323 843	5 982 586 367	6 039 316 575	1 598 007 267	-
Cooperative banks	318 922 445	309 103 413	309 561 340	9 361 102	-
Banking sector, total:	7 956 246 288	6 291 689 780	6 348 877 915	1 607 368 369	-

(* - for Basel I; ** - for Basel II; *** - for Basel III)

2014 DEVELOPMENTS IN THE LATVIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Latvia's GDP increased by 2.5% in 2014, its pace of growth vis-à-vis 2013 decelerated (4.8%). A loss in growth momentum is projected for 2015 as well. Being the key driver of growth dynamics in 2014, private consumption expanded by 2.6% and contributed 1.6 percentage points to the pickup in GDP. A rather steep rise in disposable income, supported by an increase in average wages, brought about an upswing in population's purchasing power: the annual rate of growth in real net wages preserved high levels throughout the year. It can partly be associated with some reduction in the size of shadow economy. Nevertheless, the contribution from consumption turned out to be smaller than predicted earlier, because spending was restricted by precautions about the economic perspective. In early 2014, spending was subdued due to recovery of saving practices after the euro changeover. Since spring, in turn, the related precautionary attitudes and uncertainty about future incomes were heightened by the conflict between Russia and Ukraine, economic sanctions imposed by Russia and still sluggish economic development of the euro area countries.

Exports ranked second among most important GDP growth engines in 2014. Latvia managed to preserve a positive growth rate of its foreign trade in goods, despite the falling demand from Russia and weak economic development of the EU countries. Real exports of goods and services increased by 2.2%. Deterioration in the demand from Russia and the weakness of Russian rouble adversely impacted the economic activity of several companies; nevertheless, their attempts to find new markets in combination with a weaker euro (the latter enabling Latvia to compete more effectively when exporting outside the euro area) resulted in maintained production and export volumes.

The current account deficit rose to 3.1% of GDP in 2014. In comparison with 2013, its increase depended on the falling value of transportation services exports, which, in turn, was primarily determined by lower transportation services prices under the impact of stiffening competition related to geopolitical situation in Russia. The current account deficit was covered by EU funding and long-term capital in the form of foreign direct investment.

Untypical for Latvia's circumstances, inflation was lingering at a low level for the second year in a row in 2014 (average annual HICP at 0.7%). A rise in inflation vis-à-vis 2013 was primarily on account of domestic factors.

Unemployment continued on a downward trend, mainly on account of the structural component. Its further decrease is likely to rely on the efficiency of the policy targeted at individual population groups and regions. Employment growth was delayed by negative demographic developments (shrinking numbers of population in general and of working-age population) and slowing economic dynamics.

Latvia's financial environment saw also such positive developments as the sovereign credit rating upgrades by several international credit rating agencies, which intensified investors' interest about Latvia and boosted their confidence.

The general government consolidated budget posted a deficit of 1.4% of GDP in 2014 according to the accrual principle. At the end of 2014, Latvia's net external debt stood at 7.5 billion euro or 31.1% of GDP, while net government debt was 7.4 billion euro.

DEVELOPMENT IN BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

At the end of 2014, there were 17 banks and nine Member State bank branches operating in Latvia. Despite the fact that other financial and capital market participants expanded their activities and the banking sector share in the total financial sector assets continued to decline, still banks dominate the financial sector in Latvia, accounting 89.1% of total financial sector assets or approximately 128% of GDP.

Foreign capital accounts for a significant part in the shareholding structure of Latvian banks. At the end of December 2014, the share of foreign capital in the paid-up share capital of banks amounted to 80.5%, with Scandinavian capital prevailing. All banks in Latvia are privately owned, except for one government-controlled bank. State-owned share in the banking shareholder structure comprised 5.6% at the end of 2014.

Despite some uncertainty in the geopolitical situation and economic growth, in 2014 like in previous years, the banks continued to follow a development route, improving their key performance indicators and demonstrating high shock absorption levels. The banks were well-capitalized and the total banking sector capital adequacy by the end of December 2014 was 20.8%, whereas the CET1 capital ratio stood at 18%. The amount of demand deposits continued growing as well as their share in total deposits; however, liquidity risk was still limited because of growing liquid assets. By the end of December, the liquidity ratio reached 63.1% (minimum requirement – 30%).

Following a steep growth at the end of 2013, resident deposits continued to grow also in 2014. The increase in households' deposits materially facilitated the total resident deposit growth and resident deposits by the end of the year reached 10.7 billion euro. The rapid rise in the value of the US dollar (12%) significantly affected the increase in non-resident deposits. Over the year, non-resident deposit stock had grown by 2.2 billion euro. Thus, the total amount of deposits increased substantially (by 13.8%) reaching 22 billion euro at the end of the year.

The total loan portfolio of the banking sector reduced by 6.1% in 2014, including the resident corporate portfolio shrank by 7.2% and resident household portfolio – by 7.1%, while the non-resident portfolio grew by 4.1%. To a great extent, reduction in the loan portfolio was affected by the decreasing number of market operators. The decrease in loan portfolio was facilitated also by a lesser amount of new loans granted to resident non-financial corporations (i.e., 1.2 billion euro in 2014). At the same time, no rapid changes were observed in resident household crediting where the loans in the amount 434 million euro were available.

The share of loans that were past due more than 90 days in the total loan portfolio continued shrinking and by the end of 2014 it was 6.9%. The total share of overdue loans in the banking sector loan portfolio shrank from 14.6% to 12.3% (year-on-year). The balance of loan loss provisions made by the banks at the end of 2014 shrank to 5.3% of total banking loan portfolio, but the ratio of provisions to the balance of loans with payments more than 90 days overdue remained high, 77.2%.

In 2014, the banking sector demonstrated sound profitability and reported a profit of 311 million euro (compared to 246.2 million euro in 2013). Meanwhile, 13 Latvian banks and three foreign bank branches (covering almost 80% of total banking sector assets) made a profit of 339.7 million euro in total.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN LATVIA

The Financial and Capital Market Commission (FCMC) is an autonomous public institution and has been performing in this capacity for 14 years as of its establishment on 1 July 2001. It carries out the supervision of Latvian banks, credit unions, insurance companies and insurance brokerage companies, investment management companies, participants of financial instruments market, electronic money institutions, payment services providers as well as private pension funds. The FCMC ensures supervision and the regulatory framework for the Latvian financial and capital market as well as protects the interests of customers of market participants and promotes soundness, competitiveness and development of the sector in general.

The scope of the FCMC competence is set forth in the Law on the Financial and Capital Market Commission and other relevant laws (e.g., Credit Institution Law). As regards the banking sector, the FCMC has authority to issue regulations and guidelines governing activities of banks, to request and receive information from banks necessary for the execution of its functions, to impose restrictions on the activities of banks, to examine compliance of the activities with the legislation and FCMC regulations, and to apply sanctions set forth by the regulatory requirement on banks and their officials in case any violations of regulatory requirements.

Since November 2014, when the Single Supervisory Mechanism (SSM) was introduced, the FCMC has been sharing banking supervision powers with the European Central Bank (ECB), namely, the ECB in close cooperation with the FCMC supervises three banks in Latvia (i.e. Swedbank, SEB banka and ABLV Bank).

MAIN STRATEGIC OBJECTIVES OF FCMC IN 2014

Also in 2014, the FCMC's activities were based on three main strategic objectives stemming from the FCMC Strategic Priorities for 2012–2014, which were approved by the FCMC Board in 2012, namely:

- **streamlining the regulatory framework for the financial sector**, including participation of the FCMC in the work of the European financial supervisory authorities and in implementing the EU regulatory requirements. The FCMC participates in the process of establishing a single EU framework for crisis management to ensure the

representation of the national position in the process of elaborating a recovery and resolution framework for credit institutions and investment brokerage firms. The priority also includes promoting free and fair competition and diversification of the financial market as well as preparing for the introduction of the euro to ensure readiness of the Latvian financial market for the transition to the new currency;
- **strengthening supervisory framework** and notably enhancing macro-supervision in cooperation with the Bank of Latvia for timely identification of systemic risks and taking preventive or mitigating measures in respect of these risks. Enhanced supervision also includes stronger monitoring of the performance of market participants and supervision of the internal control system, improving cross-border supervision of the security of information systems of market participants and enhancing cooperation with domestic and foreign supervisory authorities of the financial and capital market;
- **improving the level of financial education and awareness**, raising customer awareness of both the financial services and the risks thereof and the nature of the activities of the financial sector to encourage customers to make well-informed choices about each financial service.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

Regulatory developments

In 2014, the FCMC continued to improve the regulatory framework, implementing provisions of the EU laws into Latvian legislation.

Due to establishment and implementation of the SSM, Amendments to the Credit Institution Law have been made to ensure the rights of the FCMC within its competence to exchange restricted information with the ECB as well as to lay down the reference to the rights and obligations of the FCMC within the scope of the SSM.

In 2014, implementation of the EU Directive establishing a framework for the recovery and resolution of credit institutions and investment firms was launched; accordingly a new Law on Recovery and Resolution of Credit Institutions and Investment Firms, as well as Amendments to the Financial and Capital Market Commission and Credit Institution Laws were drafted.

Supervision

In 2014, the FCMC continued strengthening its intensive supervisory framework, aiming at taking risk-based and result-orientated supervisory measures and enabling the FCMC to timely intervention into banking operations as well as taking the necessary actions to resolve potential and existing problems or reduce losses.

During the reporting year, priority areas in supervising banks were to assess the adequacy of the capital base and liquidity maintenance, administration adequacy and quality thereof, taking into account the business model chosen by the bank, to assess the adequacy of the quality of bank activities with problem loans and recognition of loan impairment losses in bank statements, to assess the potential impact of the bank operating strategy on the structure and volume of risks, as well as to assess the bank recovery plan. Significant supervisory activities were also part of the framework of SSM establishment and implementation.

In 2014, the FCMC carried out intensive off-site monitoring of banking activities, based on analysis of regular reports and operational statements submitted by banks, as well as evaluation of the quality of the cooperation of banks with correspondent banks. In addition, 23 on-site inspections were performed, paying particular attention to assessing capital adequacy, lending process, as well as risk management functions and banking strategies.

In cooperation with the Bank of Latvia, the FCMC continued to carry out regular stress tests of credit risk and liquidity risk. Moreover, the FCMC developed and conducted banking sector stress tests to carry out as full as possible analysis of the potential impact of geopolitical events in Russia and the Ukraine on the performance indicators of Latvian banks.

With a view to promoting greater transparency on the decisions passed in the supervisory process and to ensure implementation of the requirements set in the capital requirements directive and regulation (CRDIV/CRR), the FCMC began to publish its decisions taken on sanctions applied to banks.

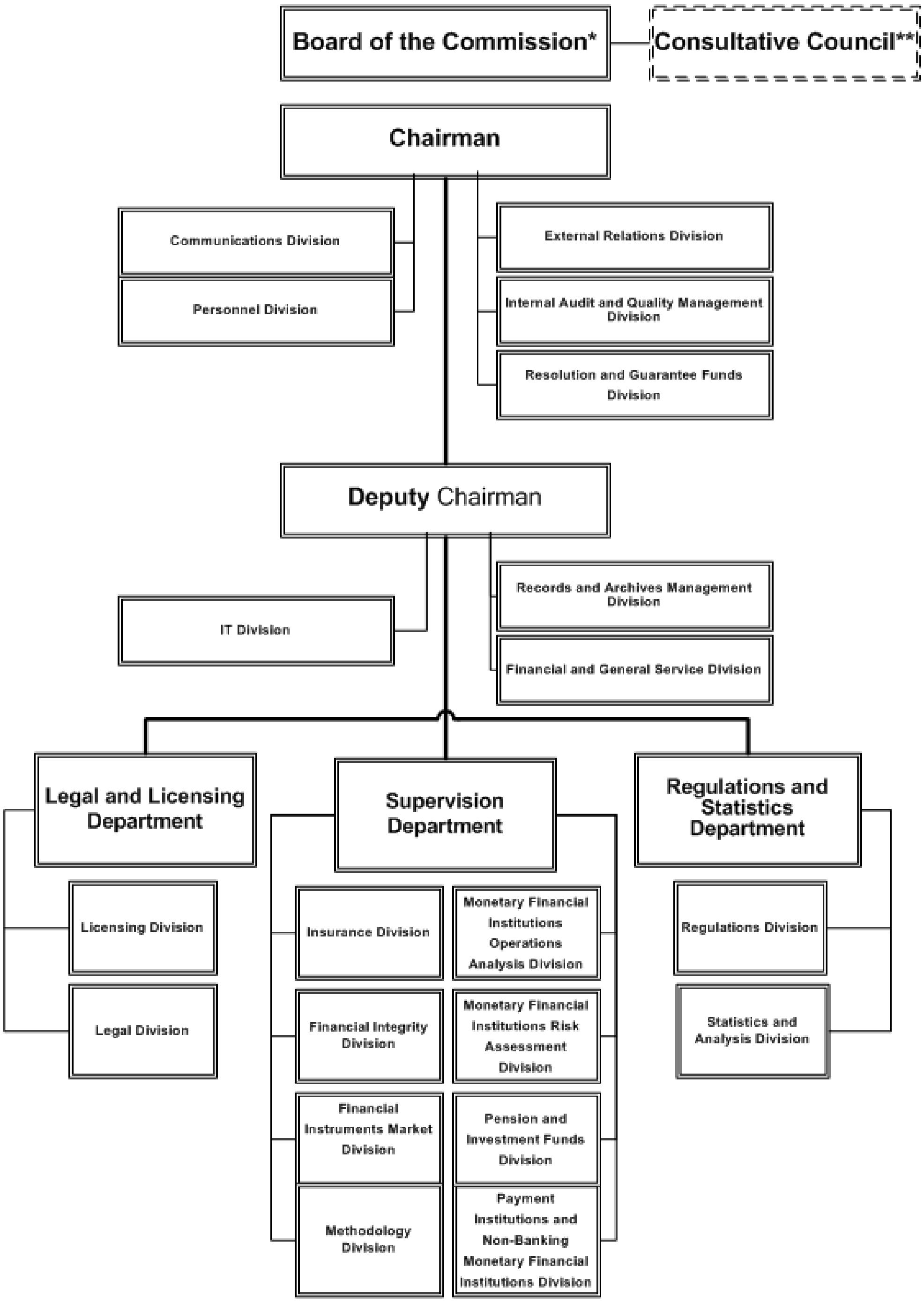
The FCMC continued its cooperation with other supervisory authorities within the group supervisory framework. During the reporting year the FCMC participated in five colleges of supervisors, int.al, chairing one of the colleges in the capacity of the responsible supervisory authority. Commencing the work in the SSM and because the ECB directly supervises the largest banks in Latvia, the FCMC transferred its membership status into two colleges to the ECB assuming an observer status.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

In November 2014, there have been changes introduced in the structure of the FCMC.

In order to implement requirements of *Directive 2014/59/EU of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms* and taking into account that from 2015 the FCMC has to operate also as a National Resolution Authority, the FCMC had to take steps to separate its supervision and resolution functions. To ensure above the Guarantee Funds Division of Supervision Department was closed and a new Resolution and Guarantee Funds Division subject to the Chairman was established.

In order to improve the supervision process in the FCMC a new division under Supervision Department – Payment Institutions and Non-Banking Monetary Financial Institutions Division – was established. The Division is responsible for supervision of payment institutions, electronic money institutions, payment systems and credit unions.



*The Board consists of five Board members: Chairman of the Commission, Deputy Chairman of the Commission and three Board members, who are simultaneously directors of the departments of the Commission.

**The Consultative Council of the Financial and Capital Market is formed on a parity basis from representatives of the Commission and heads of professional organizations of financial and capital market participants.

INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In the area of international cooperation, the FCMC's priority is to take part in developments in the European Region. The FCMC participates in the discussions of draft regulatory provisions at the Council of the European Union (EU) and the committees of the European Commission, as well as in the work of European financial supervisory authorities and SSM. It is also important to continue bilateral cooperation with supervisory authorities of the countries involved in cross-border cooperation with Latvia.

In 2014, negotiations on the legislative proposals concerning the bank recovery and resolution mechanism, including the single resolution mechanism, deposit guarantee schemes, payment accounts directive and proposals on anti money laundering, interbank commission fees were finalized at the level of the Council of the EU. The negotiations on proposal on banking structural reform have been started. The FCMC's experts were involved in developing the national positions and discussing proposals in the Financial Services Working Group of the Council of the EU, especially in the second part of 2014 in order to be ready to take over the Presidency of Council in 2015.

As the national supervisory authority the FCMC regularly participated in the work of the EBA, the European Systemic Risk Board (ESRB) and ECB (SSM composition), their committees and working groups and made its contribution to the documents elaborated and negotiated by those institutions. EBA was to continue working on the formation of a single rulebook for the European banking sector to improve the quality of the regulatory framework of the financial sector and functionality of a single market. The work continued regarding implementation of the CRDIV/CRR in the field of credit risk, market risk, liquidity requirements etc. As Latvia joined the euro zone in 2014, one of the most important challenges was preparation for SSM and establishment of the new institutional framework for banking supervision in the euro area including related governance structures of the SSM. SSM took effect as of 4 November 2014.

As regards cooperation with other supervisory authorities, exchange of information with the supervisory authorities of banking groups functioning in Latvia have been ensured on a regular basis, especially within the framework of the colleges of supervisors.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The FCMC is a unified financial sector supervisory authority in the Republic of Latvia.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	20	19	17
Branches of foreign credit institutions	9	9	9
Cooperative banks	0	0	0
Banking sector, total:	**29**	**28**	**26**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2012	2013	2014
Public sector ownership	9.0	8.9	8.0
Other domestic ownership	27.1	26.6	35.7
Domestic ownership total	36.1	35.6	43.7
Foreign ownership	63.9	64.5	56.3
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	48.7	71.2	0.119
Branches of foreign credit institutions	94.8	98.2	0.567
Cooperative banks	-	-	-
Banking sector, total:	42.5	63.5	0.100

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	5.6	8.7	11.1
Cooperative banks	-	-	-
Banking sector, total:	5.6	8.7	11.1

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	86.6	88.2	87.2
Branches of foreign credit institutions	13.4	11.8	12.8
Cooperative banks	0	0	0
Banking sector, total:	**100**	**100**	**100**

The structure of assets and liabilities of the banking system (%)
(at year-end)

	2012	2013	2014
Claims from			
Financial sector	28.7	33.1	34.6
Nonfinancial sector	60.2	56.1	52.8
Government sector	5.3	5.3	7.5
Other assets	5.8	5.5	5.1
Claims due to			
Financial sector	23.7	18.1	14.5
Nonfinancial sector	54.9	60.3	65.0
Government sector	3.6	3.9	4.1
Other liabilities	8.4	7.8	6.5
Capital	**9.4**	**9.9**	**9.9**
Claims from			

Capital adequacy ratio of banks

Type of financial institution	2012**	2013**	2014***
Commercial banks	17.61	18.94	20.85
Cooperative banks	-	-	-
Banking sector, total:	17.61	18.94	20.85

(* - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector
(share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non financial sector	11.6	8.8	7.3
- households	15.1	11.9	9.6
- corporate	9.2	6.6	5.7

The structure of deposits and loans of the banking sector in 2014 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	90.3	93.6
Households	33.3	39.9
Corporate	57.0	53.7
Government sector	5.7	0.4
Financial sector (excluding banks)	4.0	6.0
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2012	2013	2014
Interest income	764 763	674 877	625 859
Interest expenses	317 081	180 429	141 322
Net interest income	447 682	494 447	484 537
Net fee and commission income	269 768	306 425	331 939
Other (not specified above) operating income (net)	215 231	178 810	110 432
Gross income	932 681	979 683	926 908
Administration costs	457 874	476 147	443 679
Depreciation	28 532	28 973	26 462
Provisions	228 197	177 666	96 431
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	228 197	177 666	96 431
Profit (loss) before tax	218 078	296 897	360 336
Net profit (loss)	174 079	246 201	311 407

Total own funds in 2014*** (thousand of EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	2 990 766	2 597 252	2 597 252	393 514	0
Cooperative banks	-	-	-	-	-
Banking sector, total:	2 990 766	2 597 252	2 597 252	393 514	0

(* - for Basel I; ** - for Basel II; *** - for Basel III)

2014 DEVELOPMENTS IN THE LITHUANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

On 1 January 2015, Lithuania adopted the single currency of the EU — the euro — and became the nineteenth member of the euro area. The Bank of Lithuania joined the Eurosystem and got a mandate to participate together with the ECB and other euro area central banks in the decision-making process related to euro area monetary policy setting and implementation, ECB foreign reserve management, banking supervision in Single Supervisory Mechanism and other important financial matters.

Lithuania’s economy is growing sustainably, however a more moderate increase in external demand determined slightly slower economic growth in Lithuania. The fundamentals of Lithuania’s economy are good: the tradable sector maintains the recovered competitiveness, whereas the impact of factors that limited domestic demand during the recession is fading.

In 2014 Lithuania’s economy grew by 3.0 per cent (in seasonally and working-day adjusted terms). Such development is slower than in 2012 and 2013, however, it is still one of the strongest in the whole EU. Lithuania’s economic growth slowed down due to less favourable developments in the exports of goods and services. It was mostly influenced by a more moderate growth of external demand, unfavourable developments in the global oil product market and the embargo introduced by Russia in August.

DEVELOPMENT OF THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

At the end of 2014, 7 banks and 8 foreign bank branches operated in Lithuania. The assets of the banking sector increased by 7.4 per cent over the year to reach EUR 24.1 billion on 1 January 2015. This growth was driven by a substantial inflow of deposits ahead of the euro changeover (the bulk of that amount was transferred to the banks’ accounts with the Bank of Lithuania). The amount of customer deposits in banks increased by EUR 2.5 billion or 18.1 per cent, over the year, to reach new highs of EUR 16.3 billion as of 1 January 2015. Late in 2014, the long-term trend of deposit growth was additionally supported by the approaching switchover to the euro. The loan portfolio and leases of the banking system decreased marginally (0.3%) in 2014, to reach EUR 15.7 billion as of 31 December.

In 2014 all banks complied with the established liquidity and capital adequacy ratios. The planned adoption of the euro significantly contributed to the strong liquidity situation of banks. As of 1 January 2015, the aggregate liquidity ratio of banks was 43.4 per cent (vs. the minimum requirement of 30%), and the capital adequacy ratio was 21.3 per cent (well above the minimum requirement of 8%). Taking into account the outcome of the annual review and evaluation of the banks operating in the country, the Bank of Lithuania extended the application of tighter capital adequacy requirements for two banks.

The indicators defining the operating efficiency of banks remained broadly unchanged. The net interest margin edged up to 1.59 per cent as of 1 January 2015, from 1.51 per cent a year before. The return on assets slid to 0.92 per cent, from 1.02 per cent, in the same time period and the return on equity — to 8.05 per cent, from 8.94 per cent, as a result of a year-on-year decrease in profit and a substantial increase in bank assets. Total assets to GDP ratio comprised 68 per cent.

In 2014 the Lithuanian banking sector remained profitable thanks to the profits generated by six of seven banks and five of eight foreign bank branches. In total, the banks and foreign bank branches earned EUR 213.4 million. Despite increases in both net interest income of the banking system and its net fee and commission income, a EUR 44.5 million rise in loan impairment charges and administrative costs had a substantial dampening effect on the aggregate profit performance.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN LITHUANIA

After Lithuania joined the euro area and became a member of the ECB Single Supervisory Mechanism, the adaptation of the bank supervisory model to the SSM requirements was continued in order to ensure the effectiveness of the supervisory model and constructive dialogue with the ECB. Comprehensive risk assessment of the three largest banks was conducted according to the ECB methodology in 2014, which demonstrated that bank asset quality is good and their capital is adequate. In addition, banks solidly withstood the stress testing.

While implementing the Bank Recovery and Resolution Directive (2014/59/EU), amendments to the Law on Financial Sustainability and related legislation had been drafted. The banks submitted their first ever recovery plans to the Bank of Lithuania. The Bank of Lithuania reviewed those recovery plans and organised a meeting with the banks' officials in order to hold a broader discussion of the shortcomings identified in those documents and to present the requirements for recovery plans.

In 2014 the banking sector was mainly concerned about the aspects of CRD IV/CRR implementation, draft implementing legislation for the directive and the requirements for bank recovery plans.

MAIN STRATEGIC OBJECTIVES OF THE BANKING SUPERVISORY AUTHORITY IN 2014

The Bank of Lithuania is responsible for the supervision of the entire financial market. The purpose of ongoing prudential supervision of its participants and the provision of financial services is to ensure reliable and effective functioning of the financial market and its sustainable development, responsible behaviour of market participants and rational decision-making by consumers.

The Bank of Lithuania keeps working to improve the licencing process so as to make sure that the participants entering the market are transparent and financially sound, and their executives and other persons in charge are competent and well-reputed.

A lot of focus is on the processes of integration into the EU single market. The implementation of CRD IV/CRR was a vital EU legislative package. The Board of the Bank of Lithuania drafted resolutions implementing CRD IV. Some of these drafts were adopted by the Board. A new package for the reporting of financial and supervisory information on banks was introduced successfully in 2014.

The Bank of Lithuania continues to implement the Bank Recovery and Resolution Directive (2014/59/EU), which established a framework for the recovery and resolution of credit institutions and investment firms as it entered into force on 1 January 2015. It has started drafting amendments to the Law on Financial Sustainability and related legislation. In 2014, the banks submitted their first ever recovery plans to the Bank of Lithuania.

Supervision of credit unions was stepped up. Once adopted by the Seimas, the amendments to the Law on Credit Unions and related legislation, which aim to enhance credibility and safety of credit unions' operations, put an obligation on credit unions to strengthen their capital base and improve the management of risks being undertaken.

Much emphasis was put on communication with market participants and their consultation last year. The Supervision Service of the Bank of Lithuania organised annual meetings with all market participants under supervision or their associations to present regulatory developments, which have already been implemented or will be implemented in the future, to review the expected trends of the Union's supervisory regulation and to discuss the existing situation in the market. As in previous years, the Bank of Lithuania held compliance meetings with market participants to discuss the issues of compliance with legislative requirements, which are encountered in practice by each market participant.

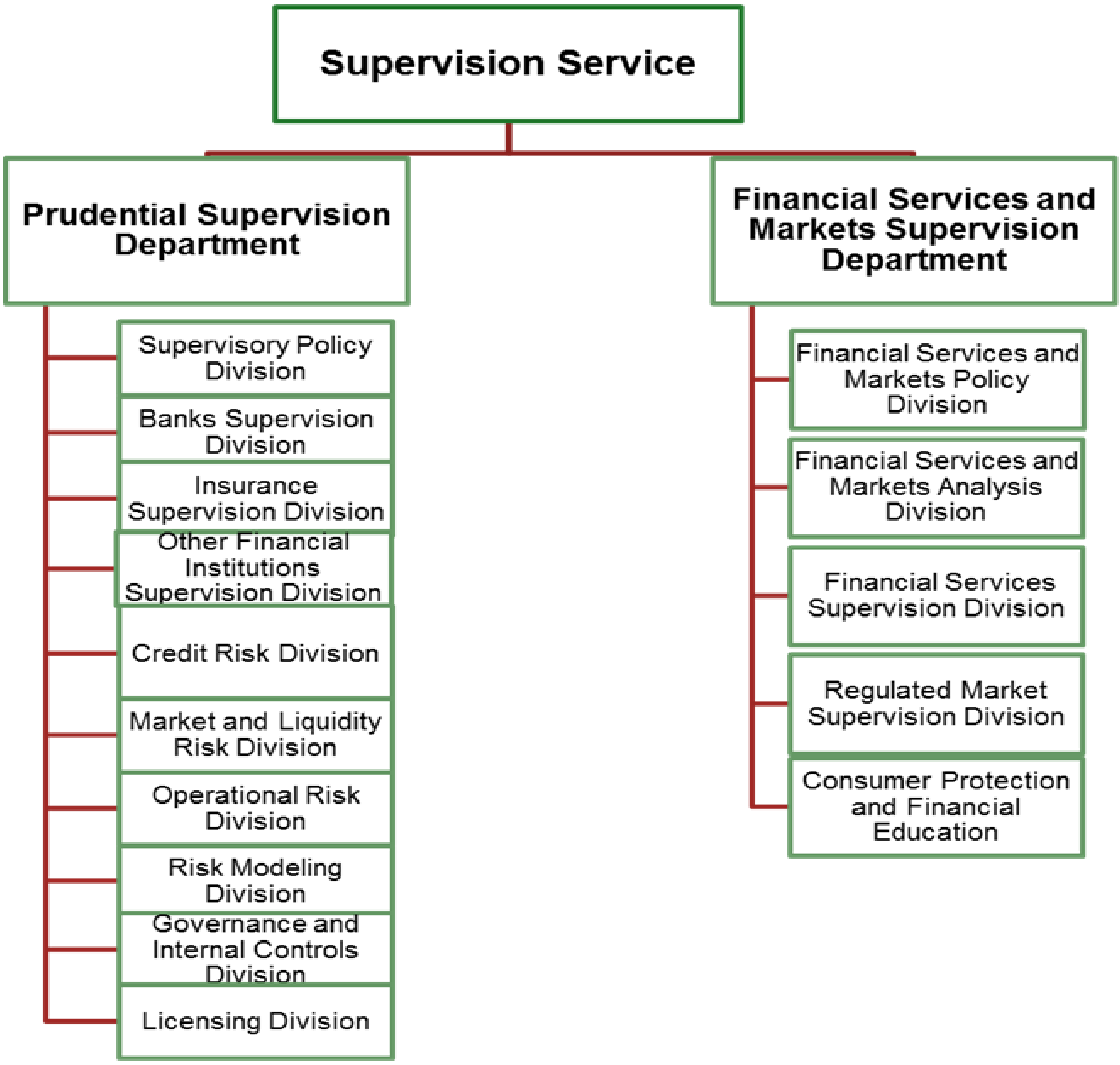
THE ACTIVITIES OF BANKING SUPERVISORY AUTHORITY

In 2014 the Bank of Lithuania performed a comprehensive assessment (CA) of the country's three biggest banks as part of the preparatory phase of joining Single Supervisory Mechanism (SSM). The exercise was unprecedented in its scale and scope. Although the period for carrying out the CA for Lithuania was around 4 months shorter than for other SSM countries, the exercise was finished on time. One of the reasons for this achievement was the commitment as well as the flexibility on the ECB side.

The results of CA have confirmed that the 3 largest banks operating in Lithuania (which make over 70 per cent of the country's banking system) are healthy and that they comply with the supervisory requirements with a large reserve. The 3 banks, i.e. AB SEB bankas "Swedbank", AB and AB DNB bankas, have been reconfirmed to hold sufficient capital and quality assets to cover their liabilities. Even in the stress-test's adverse scenario the banks' capital adequacy ratios confidently exceeded the required minimum.

2015 onward, the banks operating in the country and the LCCU will have to ensure compliance with the liquidity coverage ratio (LCR), which shall be calculated in accordance with the provisions of CRD IV and CRR. As part of preparations to implement the new liquidity requirements, the banks have been reporting the data required to calculate the LCR and the net stable funding ratio (NSFR) to the Bank of Lithuania since 1 April 2014, although the reporting of LCRs calculated by banks will only become mandatory on 1 October 2015. The available data shows that the banks, which hold sufficiently large buffers of liquid assets, comply with the respective ratios with a sufficient safety margin.

THE ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

The Bank of Lithuania actively participated in the activities of the ESCB, other EU institutions and international organisations, closely cooperated with the IMF and other international organisations, rating agencies, national central banks and supervisory authorities. After the EU Council took the decision on Lithuania's membership in the euro area, representatives of the Bank of Lithuania started their participation as observers in the activities of the ECB Governing Council and Supervisory Board, as well as the ESCB committees consisting of Eurosystem members. The agenda of the EU institutions concentrated on the issues related to the SSM implementation and long-term financing of the European economy.

By ensuring the supervision of the financial market, the Bank of Lithuania actively participates in the work of European institutions responsible for micro-prudential oversight such as the European Supervisory Authorities (ESA) by addressing the issues relevant to the EU market and expressing properly the position of the Bank of Lithuania.

The major banks and branches of foreign banks in Lithuania's financial sector belong to large financial groups. Therefore, a particularly intensive cooperation is with supervisors of Scandinavia and the Baltic States through the supervisory colleges.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The Bank of Lithuania enhanced cooperation with the supervisory authorities in charge of respective companies, which are kept informed about the deficiencies in the provision of external audit or property valuation services identified in the course of on-site inspections. Those authorities initiated investigations towards the quality of audit or property valuation performed on the basis of the information provided. A cooperation agreement on the exchange of information pertaining to the take-up of European structural funds was signed with the National Paying Agency for cases where these projects are financed by credit institutions.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

The Bank continues to search for an operational and supervisory model, which would be the most suitable for credit unions in Lithuania's environment and would mitigate the threat posed by this sector to public interests. The Seimas of the Republic of Lithuania in May 2014 established a task force, which involved experts from the Bank of Lithuania and developed a concept of sustainable activities of credit unions.

Once implemented, the objectives and principles outlined in the concept will help enhance integration in the credit unions' sector, ensure more sustainable capital formation in the unions and tighten risk management and supervision. Moreover, the Bank of Lithuania drafted the rules on credit unions' investment in non-equity securities, which established the requirements for the credit unions to follow when investing available cash as well as building and assessing securities portfolios. In line with the draft, investment made by credit unions shall not undermine the ultimate objective of credit unions, which is to serve the borrowing needs of their members, i.e. credit unions must retain their traditional operating model and investment in securities should be made with the purpose of liquidity management. In addition, the draft stipulates that investment in securities by a credit union cannot exceed 30 per cent of its assets.

STATISTICAL TABLES

Number of financial institutions (head offices/branches)
(at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	8	7	7
Branches of foreign credit institutions	8	8	8
Cooperative banks*	78	77	75
Banking sector, total:	**94**	**92**	**90**

Ownership structure of the financial institutions
(at year-ends)

Type of financial institution	2012	2013	2014
Public sector ownership	-	-	-
Other domestic ownership	-	-	-
Domestic ownership total	12.7	10.9	10.3
Foreign ownership	87.3	89.1	89.7
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions
(at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	87.73	98.40	1753.69
Branches of foreign credit institutions	96.75	98.65	189.44
Cooperative banks	15.49	24.92	-
Banking sector, total:	67.90	86.35	1943

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	6.57	11.67	7.96
Branches of foreign credit institutions	-30.80	-19.70	1.11
Banking sector, total:	-	-	-

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	77.5	78.7	77.4
Branches of foreign credit institutions	19.9	18.6	20.1
Cooperative banks	2.6	2.7	2.5
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2012**	2013**	2014***
Commercial banks	14.17	15.41	21.12
Cooperative banks	16.53	18.44	22.65
Banking sector, total:	14.23	15.51	21.17

(* - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector
(share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non-financial sector	13.87	10.70	6.32
- households	**x**	**x**	**x**
- corporate*	**x**	**x**	**x**

The structure of deposits and loans in 2014 (%)
(at year-end)

	Deposits	Loans
Non-financial sector, including:	90.63	88.68
Households	60.13	45.50
Corporate	30.50	43.18
Government sector	7.10	7.51
Financial sector (excluding banks)	2.27	3.81
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2012	2013	2014
Interest income	664.4	568.8	561.8
Interest expenses	334.8	234.0	206.3
Net interest income	329.6	334.8	355.5
Net fee and commission income	176.0	186.0	190.6
Other (not specified above) operating income (net)	-21.7	-14.9	16.85
Gross income	527.3	568.3	627.7
Administration costs	130.8	145.9	157.6
Depreciation	18.7	15.0	15.2
Provisions	2.4	-1.2	-3.7
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-16	-0.9	35.5
Profit (loss) before tax	236.6	307.1	255.4
Net profit (loss)	209.0	277.4	211.2

Total own funds in 2014 (in mln EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	2205.4		2165.4	40.0	
Cooperative banks	55.0		46.1	8.9	
Banking sector, total:	**2260.4**		**2211.5**	**48.9**	

(* - for Basel I; ** - for Basel II; *** - for Basel III)

2014 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF MACEDONIA

MACROECONOMIC ENVIRONMENT

In extremely dynamic and uncertain external environment, in 2013 and 2014, the Macedonian economy managed to depart remarkably from the dynamic conditioned by the growth pace of our major trading partners. Thus, despite the fragile recovery of the foreign effective demand, in 2014, the Macedonian economy substantially accelerated the real GDP growth to 3.8%, which was mainly generated by domestic factors, primarily investments and exports. Within the investment, one should note the contribution of public investment, particularly in infrastructure and foreign direct investments. Increased exports and reduced trade deficit mainly reflect the effect of new foreign export oriented companies, which exceeded the expectations in NBRM's projections.

Generally, the environment of conducting monetary policy was favorable, but still quite complex. Inflation during 2014 registered a trend of deceleration, so that in the second quarter it entered a zone of negative annual changes and reduced to -0.3% per annum, on average. The slowdown in inflation is mainly due to factors on the supply side, particularly the negative contribution of the prices of food and fuel, amid assessments for negative output gap and expectations for its closing in late 2014. During 2014, the foreign exchange market generally remained balanced, with relatively small net interventions. In addition, the exchange rate remained stable and foreign reserves went up to Euro 2.437 million. Their adequacy ratios were maintained at a solid level during the year.

In 2014, the current account deficit continued to narrow, hitting a record low in eight years of 1.3% of GDP. The main reason behind the narrowing of the current account deficit is the improving trade balance in goods, amid slight deterioration in the secondary income and services. These favorable foreign trade developments largely stem from the structural changes in the export sector, supported by the moderate recovery of external demand, and the decline in stock prices of energy sources in the second half of the year that contributed to lower import pressures. Factor that contributes to this "benign" external position is the negative output gap. Thus, there are no major pressures on imports from domestic demand. Financial flows in 2014 were sufficient for financing the current account deficit, but also for rapid buildup of foreign reserves during the year. In 2014, high inflows of 5.6% of GDP were registered through the financial account of the balance of payments, which is an annual increase of 4.8 percentage points of GDP. The government external debt through the issuance of the third Eurobond in 2014 was a major factor for creating these flows (around 5.4% of GDP). Foreign direct investment made significant contribution to the financial account flows, which in 2014 equaled 3.3% of GDP, largely in the form of loans from parent companies, with a smaller contribution of equity.

At the end of 2014, the gross external debt stood at Euro 5,954.4 million, or 69.8% of GDP, which is an increase of 5.4 percentage points of GDP, compared with the end of 2013. The growth of gross external debt stems solely from higher public debt (due to the intensive growth of long-term liabilities of the central government in the form of debt securities as a result of the issued Eurobond), amid annual drop of private sector debt.

In 2014, fiscal policy kept its stimulating role and substantially supported the economic recovery. Also, credit support by the banking sector mainly strengthened during the year, inter alia, reflecting the banks' perceptions of reduced risks. During 2014, the NBRM continued to conduct accommodative monetary policy, keeping the policy rate at 3.25%. On the other hand, in order to strengthen the effects of the set of monetary instruments applied and further redistribute excess liquidity in the banking sector to support the economy, changes were made in some of the monetary instruments. Given the constant banks' interest to invest funds in deposit facilities, as opposed to their basic function of fine tuning, their interest rates were gradually reduced, the mechanism of assessing the potential demand at CB bill auctions was revised and excess demand was redirected to non-interest bearing deposit facilities. In addition, the implementation of the measure for releasing from reserve requirement on newly granted loans made to export and energy sector was extended in September in order to further support credit growth.

The most significant monetary developments during 2014 include the continuing process of deeuroization and acceleration of credit growth to the private sector. In 2014, the upward trend of the share of Denar deposits in total deposits in accordance with the higher yield of Denar instruments continued, indicating the credibility of the monetary authority.

DEVELOPMENT OF THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL/GDP)

Given the positive trends in the domestic economy and the signals of private sector recovery, activities of domestic banks grew rapidly in 2014. Loans to non-financial entities registered an almost double-digit annual growth (9.9%), which is higher by 50% in comparison with the growth recorded in 2013. The intensified lending activity was especially apparent in the segment of banks' corporate customers, where the annual growth of loans was twice higher compared to 2013, and there was also continued credit support to households whose annual growth has been accelerating for two consecutive years. The favorable developments in the domestic credit market come as a result of the improved perceptions of domestic banks regarding the quality of credit demand, but they also point to the second-round effect of the monetary loosening and the non-standard measures taken by the National Bank to strengthen the credit support to the corporate sector. Deposits from non-financial entities registered a double-digit annual growth rate (10.7%), which is almost twice higher compared to the growth rate achieved in 2013. Traditionally, households are the most important bank depositors, but in 2014, the deposits collected from companies also registered a remarkable growth. Denarization in the banks' balance sheets continued in 2014, being more prominent on the liabilities side.

Regarding the degree of financial intermediation of the banking system, at the end of 2014 there was an increase of all indicators. The assets-to-GDP ratio equaled 76.1%, which is an increase of 2.1 percentage points relative to 2013. The gross credits and the deposits reached 48.1%, i.e. 54.6% of the gross domestic product, respectively (growth of 2.0 percentage points, i.e. 2.7 percentage points, respectively, compared to 2013)[20].

Net interest income that banks earn (net interest margin) in the process of financial intermediation, went up to 3.9% at the end of 2014, which was enough to significantly improve the overall profitability of the banking system. It was significantly supported by the sharper decline in deposit compared to lending interest rates. The reduction of banks' operating costs, registered for the first time in recent years, should also be noted. It indicates improved cost-effectiveness, reflected by the reduced ratio between operating costs and total regular income, which is at the lowest level in the last seven years (55.5%).

The banks' credit channel impairment continued in 2014, but at a slower pace. Non-performing loans continued to grow, but with twice lower growth rate (of 8.3%), with their share in total loans being reduced to 11.3%. Twice lower annual growth of non-performing loans to companies contributed fully to the slower annual change in total non-performing loans. After a few years of almost unchanged level of non-performing loans to households, they registered a small increase in 2014, but their share in total loans continued to decline. The negative effects of possible complete default of non-performing claims on banks' capital are limited, given the high coverage of these loans with impairment. The total credit exposure to non-financial entities is characterized by high coverage with collateral, which further "mitigates" the level of credit risk undertaken by banks.

Banks' liquidity is stable and satisfactory, due to their propensity to maintain a stable level of liquidity, whose share constantly accounts for about one third of total assets. Liquid assets cover approximately 60% of short-term liabilities and more than 90% of the contractual obligations with residual maturity up to 30 days, which confirms the satisfactory liquidity position of domestic banks as one of the main pillars of the overall banking system stability.

Direct exposure of the banking system to the risks of changes in market-determined financial variables increased in the past two years, but their importance is low. There are limited conditions for materialization of currency risk and interest rate risk in the banking book. The depreciation of the euro against other world currencies on the international currency markets has no influence on the stability of the Macedonian banking system, given the applied strategy of maintaining a stable exchange rate of the denar against the euro and the dominance of this currency in banks' items with currency component. In regard to the risk of changing interest rates, the ratio between the total weighted value of the banking book and own funds is low, despite the increase.

Stable solvent position and capital adequacy ratio twice higher than the minimum are the foundation of stability and resilience of the banking system of the Republic of Macedonia. In 2014, indicators of solvency and capitalization of the banking system were dwindling due to accrual reduction in subordinated instruments, but also due to the accelerated growth of banks' activities. The need for higher capital to cover the risks was covered by engaging the "free" capital of banks accumulated in the past. Results from the conducted stress test showed satisfactory resilience of the banking system, although individual banks show hypothetical need for recapitalization under simulated extreme shocks.

Amid accelerated economic growth and simultaneous absence of price pressures in the coming period, in line with the NBRM projections, further strengthening of banking activities is expected. However, the risks from the

[20] Financial intermediation indicators are calculated according to the last available data on GDP. Data on GDP were last revised as on 13.03.2015.

slower recovery of the external environment are still present and can have a corresponding impact on the business activities of domestic entities. The main challenge for banks in the period ahead will be to maintain optimal credit support for the non-financial sector, simultaneously reducing the credit channel impairment, which would in return affect profitability, capital stability and liquidity of banks.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN MACEDONIA

The National Bank of the Republic of Macedonia (NBRM) is the Banking Supervisory Authority responsible for licensing and supervision of banks and savings houses in the Republic of Macedonia. The Supervision, Banking Regulations and Financial Stability Division, through its three departments: Off-site Supervision and Licensing Department, On-site Supervision Department and Financial Stability and Banking Regulations Department, performs the supervisory function.

These competences of the NBRM are regulated with the Law on the National Bank of the Republic of Macedonia and the Banking Law. The Banking Law and relevant by-laws follow the provisions of the European directives and regulations in order to provide a higher degree of compliance with the European legislation, as well as the principles and standards developed by the Basel Committee on Banking Supervision.

In order to achieve further enhancement of the banking regulatory framework, in 2014 the following acts were prepared and adopted:

- The Decision amending the Decision on the methodology for determining the capital adequacy, which is expected to contribute positively to commercial banks' lending to the corporate sector. The adoption of these amendments contributed to the harmonization with the EU Regulation No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, under which performance guarantees are medium/low risk items that are subject to a lower conversion factor of (20%) instead of the previous 50%. Another novelty is that it introduces a more favorable regulatory treatment of funds established by one or more central governments, multilateral development banks or public institutions. For these funds, the risk weight will equal 0%;
- New Decision on the scope of audit of bank’s annual financial statements and operations, which supersedes the old Decision on the scope of audit of the bank’s operations and annual financial statements, is a result of the need to comply with the amendments of the Banking Law in terms of the scope of the audit of the commercial bank operations. The most significant change in the New Decision relates to the inclusion of the process of determining the internal capital of the bank in the scope of the audit;

In addition, the new CRDIV/CRR requirements on Own Funds have been analyzed during 2014 and compared with the Macedonian regulation. In addition, an analysis of Liquidity Coverage Ratio (LCR) has been prepared as a basis for introduction of this standard in the Macedonian banking system.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

Maintaining of the stability of the banking system as a basic prerequisite for financial stability and sustainable economic growth is the main strategic objective of the National Bank as the Macedonian banking supervisory body. This objective is achieved by:

1. Enhancement of financial stability by improvement of the financial stability monitoring instruments, further developement of the model for predicition of NPL levels, performing regular stress-test analyzes, including macro-stress analysis and further capacity building for application of econometric techniques.
2. Strengthening of the supervisory capacity for contingency planning and crisis management.
3. Continuous improvement of banking regulations by undertaking activities for adequate implementation of the new Basel III requirements and CRDIV/CRR.
4. Harmonization of banking supervision and regulatory framework with the new Basel Principles for Effective Banking Supervision (issued in September 2012).
5. Participation in regional initiatives for development of adequate information sharing frameworks, amid the creation of the Single Supervisory Mechanism.
6. Maintaining stability of the financial system by expanding the cooperation with other supervisory authorities, the Deposit Insurance Fund and the Ministry of Finance.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

The off-site supervisory function of the National Bank of the Republic of Macedonia is carried out through 3 cornerstone activities: licensing (issuing licenses and approvals to banks and savings houses), regular off-site supervision of the operations of the banks and the savings houses and undertaking corrective actions. Within this framework, during 2014 the National Bank has performed the following activities:

- 6 different types of licenses and approvals were issued, among which the main were related to issuing: approvals for appointment of members of the Boards of Directors and members of the Supervisory Boards, amending and/or supplementing the Statute of the banks and approvals for shareholders with qualified holdings in the banks. In 2014 a license for a status change - acquisition of one bank by another bank was issued. Also, a prior consent for termination of the operation of one savings house was issued, in the course of its transformation into financial company.

- Regular off-site analysis of the operations and the risk profiles of banks.
- Within its legal authorization, and in order to maintain the stability and the safety of certain banking institutions and the whole banking system, the National Bank undertook corrective actions towards banks and saving houses where irregularities, noncompliance and illegitimacies in their operation were found. The aim of the majority of the undertaken measures was the improvement of certain elements of the risk management systems of banks.

ACTIVITIES OF THE ON-SITE SUPERVISION DEPARTMENT

During 2014, the On-Site Supervision Department conducted 24 examinations of banks, four examinations of savings houses, two examinations of money transfer service providers, 42 examinations of subagents and 123 examinations of authorized foreign exchange offices. In 12 banks and 4 savings houses, the examinations were risk-based. Other examinations were compliance-based. In this period, one examination was conducted in a company for auxiliary services in the area of bank's information system.

Risk examinations were focused on credit risk, considering the significance of this risk for the risk profile of banks in the Republic of Macedonia and the amendments to the credit risk management bylaws, whose application began in 2014. Furthermore, in some banks, the examination was targeted towards assessing the adequacy of systems for anti-money laundering and combating the financing of terrorism, information security management, liquidity risk, interest rate risk, operational risk, profitability and corporate governance.

Examinations show that banks have adequate risk management systems and adhere to the corrective measures imposed by the National Bank. In order to improve the risk management rules and practices in place, appropriate recommendations have been given, which from the aspect of credit risk, are associated with advancing of approval criteria, strengthening of controls designed to ensure proper usage of approved loans, improvement of systems for identifying and monitoring connected parties, systems for determining impairment losses, monitoring of the clients, and improving Internal Audit Department operations. Analyzing the risk from involving in money laundering and financing of terrorism activities, recommendations have been given for improving the process of determining the clients' risk profile when establishing and monitoring business relations, implementation of measures and activities that have to be taken by banks towards their clients depending on their risk level, and further regulation of internal acts and practices regarding the indicators for detecting suspicious transactions.

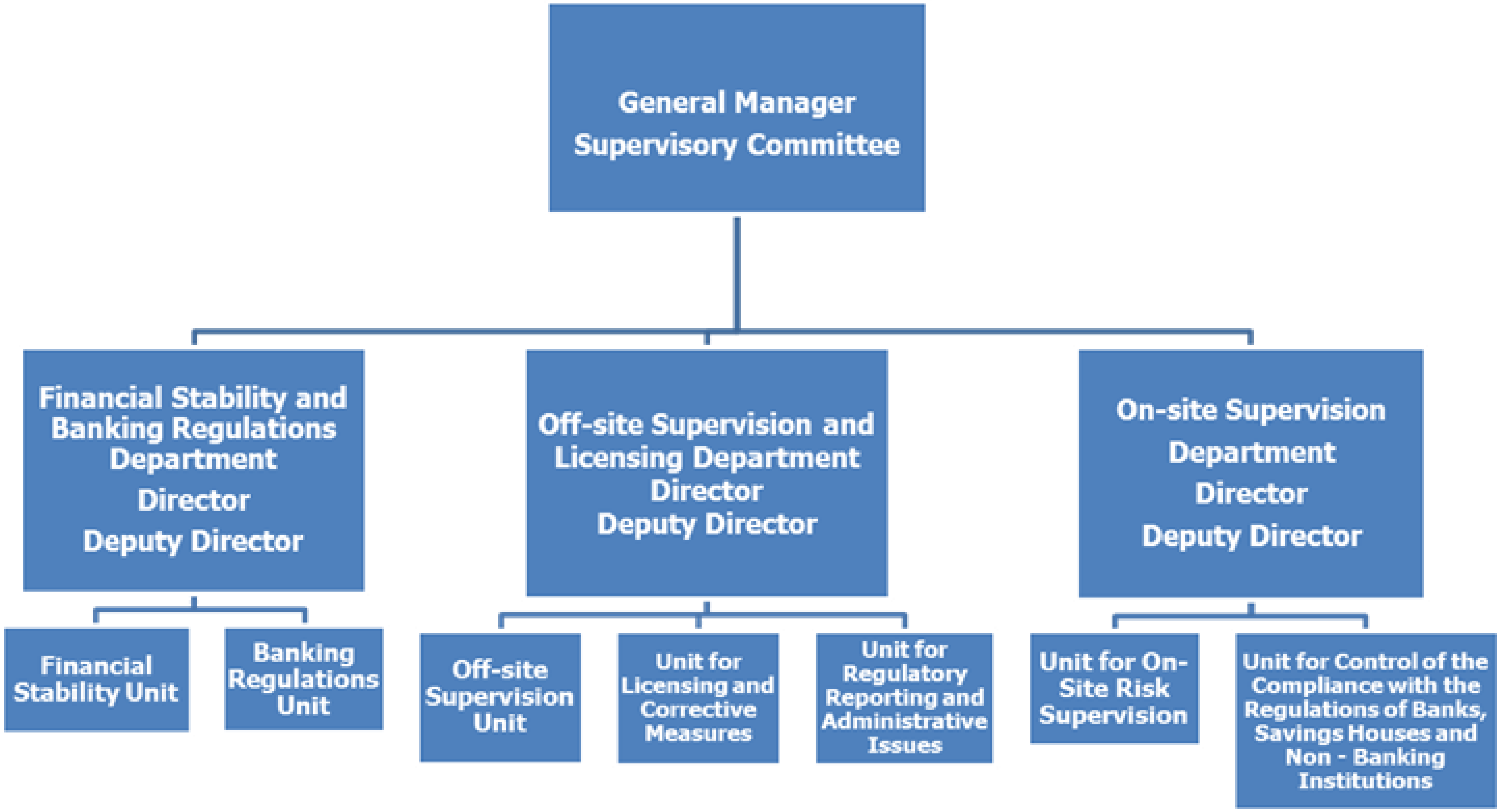
In order to improve operational risk management systems, recommendations have been given in relation to risk assessment processes, administrative, technical, and physical controls, especially in the area of cash management, methods of reporting of data loss events, regular review of business continuity plans, improved engagement of bank bodies in relation to this risk. Concerning information security, recommendations have been given for improving risk analysis process, strengthening control measures, improving audit trail systems and recommendations for more appropriate segregation of duties of those involved in the operational information security management.

In order to improve information security management, the On-Site Supervision Department analyzed risks of using outdated operating system by the banks in the Republic of Macedonia, defined standards for information security of savings houses, and analyzed standards for information security in systemically important banks, particularly focusing on business continuity tests.

In 2014, the National Bank was actively involved in the preparation and defense of the fourth round evaluation report of the Committee of Experts of the Council of Europe-Moneyval of Macedonian anti-money laundering and combating the financing of terrorism system (hereinafter: AML/CFT). In the Moneyval Report, a progress was stated in the area of compliance of legislation with international standards and its practical application by the entities entitled to implement AML/CFT measures and activities. Following up the Moneyval recommendations, a new AML/CFT Law was adopted in September 2014, which took into account the proposals given by the National Bank.

In may 2014, a National risk assessment in the area of money laundering and terrorist financing started. The assessment is performed in accordance with the World Bank methodology, whose implementation involves several supervisory authorities and entities that have obligations under the AML/CTF Law.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In 2014, the European Banking Authority (EBA) performed an assessment of the Macedonian confidentiality regime in order to determine the equivalence to EU standards.

Based on this assessment, in April 2015 EBA published a Recommendation specifying its opinion on the confidentiality regime of several non-EU supervisory authorities to facilitate their participation in supervisory colleges overseeing international banks, led by EU supervisors. According to this Recommendation the overall assessment of the Macedonian confidentiality regime is equivalent with the standards prescribed with the Capital Requirements Directive (CRD), allowing expansion of the cooperation by participating in supervisory colleges established by the European Central Bank or other relevant National supervisory authority.

The cooperation with foriegn supervisory bodies continued in 2014 under the signed MoUs. Among other activities, within this cooperation NBRM supervisory staff attendend three supervisory colleges (for two Greek and one Slovenian subsidiary).

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The cooperation with other domestic supervisory authorities in 2014 continued on a regular basis. Two Memorandums of understanding were signed during 2014. One of them was actually reshaping the structure and the obligations of the current Agreement for using data and information obtained from the Central Registry. The process of negotiation between the National Bank of the Republic of Macedonia and the Council for Promotion and Supervision of the Audit that started in late 2013 was finished in 2014 and resulted in signing of a Memorandum of Understanding between the two authorities.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

In 2014 Crisis Simulation Exercise (CSE) was conducted as part of a Technical Assistance project funded and delivered by the Vienna Financial Sector Advisory Center (FinSAC) for the National Bank of the Republic of Macedonia (NBRM), with the participation of the Ministry of Finance (MOF) and the Deposit Insurance Fund (DIF). The Exercise originated in the NBRM's Contingency Planning Project (CPP), originally launched in 2012 to step up the financial crisis preparedness framework in Macedonia. The overall goal of the Exercise was to examine how the authorities respond to stress in the financial system and to explore the adequacy of existing laws, regulations, policies and procedures to confront those challenges.

Given the relatively high level of non-performing loans in Macedonian banking system, the NBRM conducted a more detailed research on the structure and concentration of banks non-performing loans, according to different loans features. Additionally, analysis of the quality of banks credit decisions was prepared, by tracing the loans performances in the period immediately after the new loans were granted to clients.

STATISTICAL TABLES

Number of financial institutions (head offices/branches)
(at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	16	16	15
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**16**	**16**	**15**

Ownership structure of banks on the basis of assets total
(at year-ends)

Type of financial institution	2012	2013	2014
Public sector ownership	3.5%	3.8%	3.8%
Other domestic ownership	4.4%	27.9%	27.1%
Domestic ownership total	7.9%	31.7%	30.9%
Foreign ownership	92.1%	68.3%	69.1%
Banking sector, total:	**100.0%**	**100.0%**	**100.0%**

Concentration of asset by the type of financial institutions
(at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	60.4%	74.8%	1.422
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	60.4%	74.8%	1.422

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	3.8%	5.7%	7.4%
Cooperative banks	/	/	/
Banking sector, total:	3.8%	5.7%	7.4%

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%)
(at year-end)

Assets	2012	2013	2014
Cash, balances and deposits with central bank (NBRM)	11.7%	10.5%	12.5%
Placements in securities	16.1%	17.1%	14.5%
- issued by domestic government sector	8.5%	10.0%	7.9%
- issued by central bank (NBRM)	7.4%	6.9%	6.4%
- other (including non residents)	0.2%	0.2%	0.3%
Loans, deposits and accounts with financial institutions (excluding central bank, including non residents)	12.2%	12.0%	12.5%
Loans with non-financial sector (including non residents)	54.0%	54.7%	55.5%
- loans with domestic government sector	0.5%	0.6%	0.5%
Other assets	6.0%	5.7%	5.0%
Total	**100.0%**	**100.0%**	**100.0%**
Liabilities	**2012**	**2013**	**2014**
Deposits of financial institutions (including non residents)	4.9%	4.6%	4.1%
Deposits of non financial sector (including non residents)	69.5%	70.1%	71.7%
- deposits of domestic government sector	0.3%	0.2%	0.1%
Borrowings, issued securities and liabilities on the basis of subordinated and hybrid instuments (including non residents)	12.0%	11.6%	10.8%
- domestic financial sector	4.4%	4.0%	3.4%
- domestic government sector	0.4%	0.3%	0.2%
- other	7.2%	7.3%	7.2%
Other liabilities	1.7%	1.7%	1.8%
Equity and reserves (including loss in current year)	11.2%	11.3%	10.8%
Profit after tax in current year	0.7%	0.7%	0.8%
Total liabilities	**100.0%**	**100.0%**	**100.0%**

Capital adequacy ratio of banks

Type of financial institution	2012	2013	2014
Commercial banks*	17.12%**	16.85%**	15.66%**
Cooperative banks	/	/	/
Banking sector, total:	17.12%**	16.85%**	15.66%**

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector

Asset classification	2012	2013	2014
Non financial sector	10.5%	11.5%	11.3%
- households	7.1%	6.4%	5.9%
- corporate	12.9%	15.2%	15.3%

The structure of deposits and loans of the banking sector in 2014 (%)
(at year-end)

	Deposits	Loans
Non-financial sector, including:	94.9%	99.8%
Households	68.3%	40.7%
Corporate	23.4%	58.0%
Government sector	0.2%	0.8%
Financial sector (excluding banks)	5.1%	0.2%
Total	**100.0%**	**100.0**

P&L account of the banking sector
(at year-end)

Type of financial institution	2012	2013	2014
Interest income	20,104	20,100	20,216
Interest expenses	-8,734	-7,942	-7,133
Net interest income	11,370	12,158	13,083
Net fee and commission income	3,790	3,918	4,118
Other (not specified above) operating income (net)	2,092	1,767	1,677
Gross income	17,252	17,843	18,878
Administration costs**	-9,556	-9,645	-9,383
Depreciation	-1,084	-1,013	-953
Provisions***	-567	-1,007	-785
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)****	-4,540	-3,828	-4,200
Profit (loss) before tax	1,504	2,350	3,557
Net profit (loss)	1,461	2,311	3,149

* 1 EUR = 61.4814 MKD, as of 31.12.2014
** Administration costs include all operating expenses.
*** Provision items include: impairment losses of non-financial assets, provisions for off-balance sheet items and other provisions.
**** Presented on net basis.

Total own funds in 2014 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2
Commercial banks	736,917,406	645,711,813	645,711,813	91,205,594
Cooperative banks	/	/	/	/
Banking sector, total:	736,917,406	645,711,813	645,711,813	91,205,594

2014 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF MOLDOVA

MACROECONOMIC ENVIRONMENT

In 2014, the economy of the Republic of Moldova recorded a positive development, but lower than in 2013, GDP increasing by 4.6 percent. In the first half of the year, the economic growth was sustained in most part, by the significant increase in exports. In the second half of the year, domestic demand was the primary factor of the positive dynamics of economic activity. However, this was mitigated considerably by contracting exports following the imposition of restrictions by the Russian Federation for domestic products. Overall, in 2014, household final consumption increased by 2.9 percent against the background of increasing disposable income. Investments registered a more pronounced dynamic, thus, gross fixed capital formation increased by 10.1 percent compared with 2013. Government consumption recorded a contraction of 0.6 percent. Despite the increase in domestic demand, imports have increased slightly only by 0.4 percent. The annual growth rate of exports was also modest, increasing by 1.1 percent. Similar to 2013, agriculture had a substantial impact on GDP growth in 2014, achieving an increase of 8.2 percent and fostering industry growth by 7.2 percent. In 2014, the economically active population increased, while unemployment decreased.

In 2014, National Bank has created the necessary conditions for the inflation to fall within the range of ± 1.5 percentage points from the target of 5.0 percent. Thus, during the last 35 months, inflation has fallen within the range of variation. In early 2014, the annual inflation rate continued the upward dynamics from the second half of 2013, increasing from 5.1 percent in January to 5.8 percent in April. This dynamics was determined mainly by the developments in food prices and core inflation under the pressure of depreciation of the national currency against the US dollar observed in autumn 2013. Later, under the influence of the reduction in the annual growth rate of food prices in the context of a good agricultural year, the CPI annual rate experienced a modest dynamics. Thus, following a significant fall in inflation to lower band of the range in May 2014, reaching a level of 4.7 percent, in the summer months, it recorded an average annual rate of 5.1 percent. In late 2014, along with a more pronounced materialization of the consequences of a rich harvest of fruits and vegetables, and the embargo on some local products, the annual average rate has returned to the lower band of the range from the inflation target, registering a value of 4.8 percent.

During 2014 the nominal official exchange rate of the national currency against the U.S. dollar has weakened by 19.6% and against euro – by 5.7% as compared to the end of 2013.

Meanwhile, in 2014 the real effective exchange rate of the national currency[21] has appreciated by 6.8% as compared to December 2013. This dynamics was driven by a sharper drop in the value of the national currencies of Russia and Ukraine against main currencies as compared to the Moldovan Leu.

[21] December 2000=100

The depreciation pressures on the nominal exchange rate of the Moldovan Leu against the US dollar in 2014 were mostly induced by a negative FX gap on the domestic market, around USD 570 million, as a consequence of lower inflows compared to previous years (weaker remittances, external loan disbursements, declining foreign direct investments and in the context of the embargo imposed by Russia to Moldovan exports). At the same time, a shift from local to foreign currency by individuals has exacerbated these developments and has put a stronger downward pressure on the FX supply. Subsequently, the dollarization ratio has increased from 38.9% in December 2013 to 46.9% in December 2014. On the other hand, the demand for FX on the import side was quite persistent, and seemed to adjust slowly, given a quite modest drop in imports.

In response to these developments the NBM has tightened monetary policy by raising the policy rate in 2014 by 5 percentage points (from 3.5% to 8.5%) and has also sold FX reserves (USD 418.1 million)[22] to cover partially the created FX gap on the domestic market.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

The development of the aggregate indicators per banking sector in 2014 was heavily distorted by some transactions in large proportions at 3 banks. National Bank was determined to establish special administration on these banks by the decisions of the Council of Administration.

At the end of 2014, Tier I capital amounted to 457.6 million EUR, increasing during 2014 by 16.5 million EUR (3.7 percent). As of 31.12.2014 all banks reported Tier I capital corresponding to the minimum required capital (≥10.5 million EUR).

Tier I capital increase was determined by the profit obtained during 2014 and the issuance of shares by 4 banks amounted to 21.0 million EUR (at the year-end exchange rate) in account of additional cash contributions of the subscribers of shares, and the issuance of shares by one bank in account of subordinated debts with their subsequent transfer to the bank's capital in the amount of 1.9 million EUR (at the year-end exchange rate). Simultaneously, the calculated but unreserved amount of the allowances for impairment losses on assets and conditional commitments has decreased by 1.2 million EUR or 0.8 percent (which reduces the amount of Tier I capital). At the same time, 5 banks have distributed dividends in the total amount of 13.4 million EUR (at the year-end exchange rate).

Average risk-weighted capital adequacy ratio on the system was 13.9 percent, decreasing by 9.1 percentage points compared to the end of the previous year. This is due to the fact that the banks under special administration recorded the risk weighted capital adequacy ratios below the minimum allowable level of 16.0 percent.

The total assets of the sector (according to IFRS) constituted 4,944.1 million EUR, increasing by 704.2 million EUR (16.6 percent) compared to the end of 2013, due to increase of liabilities by 689.4 million EUR (19.1 percent) and

[22] This figure does not include data on special interventions performed by NBM to three banks, which are currently under special administration procedure

increase of capital by 14.7 million EUR (2.3 percent). Also, the share of assets in GDP increased from 75.8 percent up to 84.0 percent.

Gross loan portfolio amounted to 2150.0 million EUR as of December 31, 2014, decreasing during 2014 by 196.8 million EUR (8.4 percent).

During the year 2014, the balance of non-performing loans (substandard, doubtful and loss) decreased in absolute value by 19.2 million EUR (7.1 percent), representing 252.2 million EUR, while the share of non-performing loans in total loans increased by 0.1 percentage points compared to the end of the previous year, amounting to 11.7 percent at 31.12.2014. The share of net non-performing loans[23] in total regulatory capital decreased by 2.4 percentage points, amounting to 14.2 percent on 31.12.2014.

In the context of risk distribution the largest share in the total loan portfolio was held by credits granted to trade – 32.9 percent, followed by credits to food industry – 9.8 percent, credits to production industry – 7.4 percent, consumer credits – 7.4 percent, credits to service delivery sector – 6.9 percent, credits to agriculture – 6.4 percent, credits for purchase/building real estate – 5.7 percent, credits for transport, telecommunications and network development – 5.2 percent, other credits - 4.5 percent, credits to individual practicing activity – 3.8 percent, credits to constructions – 3.8 percent, credits to nonbanking financial sector – 3.3 percent, credits to the energy industry - 2.9 percent.

As of 31.12.2015, the profit of the banking sector for the period accounted for 37.9 million EUR. Compared to the same period of the previous year, the profit decreased by 19.0 million EUR (33.4 percent) due to increase of non-interest related expenses by 53.6 million EUR (33.3 percent) and interest expenses – by 4.5 million (3.0 percent). Simultaneously, interest income increased by 27.5 million EUR (10.4 percent) and non-interest related income - by 11.6 million EUR (11.4 percent).

Return on assets and return on equity represented 0.9 percent and 6.1 percent as on December 31, 2014, decreasing by 0.7 percentage points and respectively by 3.5 percentage points compared to 31.12.2013.

Long-term liquidity ratio of the banking system (assets with terms more than two years/financial resources with potential withdrawal term of over two years) recorded a level of 1.5 (average per system). This indicator is respected by all banks, except one bank which registered the liquidity principle I ratio over the maximum allowable level (≤1).

Current liquidity on the system (liquid assets, expressed in cash, deposits at NBM, liquid securities, and net interbank credits with maturity up to one month / total assets ×100%) accounted for 22.5 percent (average per system). The requirement for this indicator is respected by all banks, except 3 banks, which recorded current liquidity indices below the minimum allowable limit of 20 percent.

[23] Net non-performing loans = total classified amount of non-performing loans minus allowances on these loans

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN MOLDOVA

The banking system in the Republic of Moldova consists of two levels: the National Bank of Moldova and 14[24] licensed banks. The National Bank of Moldova regulates and supervises the financial institutions in accordance with the Law on the National Bank of Moldova and the Law on Financial institutions, which provide the competence, main objective, basic attributions of the National Bank and its relationship with financial institutions.

According to the Law on the National Bank of Moldova, The National Bank is exclusively responsible for the licensing, supervision and regulation of the financial institutions activity. To that end, the National Bank shall be empowered:

a) to issue the necessary regulations and to take the proper actions in order to perform its powers and duties under the mentioned law, by way of licensing financial institutions and elaborating supervision standards and establishing the way of implementing the regulations and measures mentioned above;
b) to perform, through its staff or other qualified professionals involved for this purpose, inspections over all financial institutions, and to examine these institutions' books, documents and accounts, conditions in which the business is carried out and financial institutions' compliance with the legislation;
c) to require any employee of the financial institution to provide the National Bank with the information necessary for the purpose of supervision of the and regulating the activity of financial institutions;
d) to prescribe to any financial institution remedial measures or to apply the sanctions foreseen in the Law on Financial Institutions, if the financial institution or its employees:
    - have violated the provisions of the Law on Financial Institutions or a regulation of the National Bank;
    - have violated a fiduciary duty;
    - have engaged in unsafe or unsound operations of the financial institution or any of its branches.

The Law on financial institutions stipulates the main requirements related to the activity of financial institutions, including banking activity. Thus, the respective law determines: general provisions, licensing of banks, organization and administration of banks, conduct of banking operations, banking reporting, violations, remedial measures and sanctions, withdrawal of license.

Concurrently, banks are guided in their activity by normative acts issued by the National Bank of Moldova under the Law on financial institutions that establishes requirements for the licensing process, holding equity interest in the capital of banks, regarding capital of the banks, liquidity, bank's exposures, foreign exchange position, valuation of assets and conditional commitments, equity investments of banks in other legal entities, reporting to the National Bank

[24] At the end of 2014, NBM has established the special administration regime for 3 banks

of Moldova, disclosure of information on the financial activity of the banks, internal control systems, etc.

Therefore, through a number of requirements provided through the normative acts, the National Bank maintains the mechanism of supervision and regulation of banks' activity in the Republic of Moldova.

It should be noted that the regulations of the National Bank of Moldova comply with the principles of Basel Committee and generally transpose the norms and the best practices of the European countries.

MAIN STRATEGIC OBJECTIVES OF THE BANKING AUTHORITY IN 2014

The development of banking supervision function remains an objective of strategic importance to the National Bank of Moldova. In order to strengthen the capacity in banking regulation and supervision field, the National Bank of Moldova has undertaken a number of activities directed towards achieving the implementation of the requirements of Basel II / III through the EU's instrument of support and cooperation - Twinning. Thus, during 2014, the National Bank participated in selection of partners from the Member States of the European Union for the implementation of the Twinning project "Strengthening the capacity of NBM on banking regulation and supervision in the implementation of the EU requirements".

The project itself is expected to start in July 2015 as a result of the completion and signing the Twinning contract.

In 2014 the legal and regulatory framework has been improved regarding the prudential regulations for banks related to risk management, taking into consideration the best international practices in order to develop regulatory framework of the corporate governance in the banking system.

ACTIVITY OF THE BANKING SUPERVISORY AUTHORITY

During 2014, the National Bank of Moldova (further the NBM) has realized a set of actions in order to maintain the stability of the banking system, as well as its further development. In this context, the NBM performed 8 complex inspections and 3 targeted inspections at the licensed banks from Moldova. At the same time the National Bank of Moldova has refined the prudential regulations and supervisory methods taking into consideration the existing regulatory framework and the generally accepted standards in this field.

Within the inspections NBM inspectors have assessed the banks internal control system; verified the compliance of banks activity with their internal regulations requirements, regulations of the NBM and the current legislation; verified the correctness and completeness of financial and prudential reports presented to the NBM; assessed banks capital adequacy and its suitability to the risk size profile at which banks are exposed, etc.

As a result of the inspections, deviations from the regulations in force were found in the activity of banks, deficiencies in corporate governance and drawbacks in the internal control system. As a result, the NBM adopted decisions which prescribed banks to remove all irregularities detected during inspections, and to review their internal control system, in order to not admit future violations.

Following the amendments to the Law on financial institutions, it has been transposed and amended with provisions related to the restrictions on holding equity interest of banks in the capital of legal persons. Were included some definitions and the terminology in regulation was adjusted to the terminology of the legislation in force. As well, there will be made additional changes related to the information on „large" exposures of legal entities, where banks hold shares greater than 20%, as a result of the amendment and completion of the Instruction on preparing and presenting the reports by banks for prudential purposes. (IMF)

Thus, in order to refine the methods of banking supervision, the Instruction on preparing and presenting the reports by banks for prudential purposes was subject to a number of amendments and completions as to transpose the new supervision mechanisms and to enhance the legislation in force relating to ownership structure, shareholdings in the capital of legal entities, requirements for large exposures to affiliated persons of the bank, etc.

The aim of these changes was also determined by necessity of some detailed information related to bank shareholders with qualifying holdings to be reported and are entered in the register of holders of securities of the bank as at the reporting date, information on indirect owners, including beneficial owners of qualifying holdings in a bank's capital, as well as information on shares disposed of. Simultaneously, the reporting shall disclose information on the participation of shareholders that held shares above 1% in the share capital of the bank as at the last shareholders' meeting.

There have been also made a number of amendments aimed at optimizing the reporting process. Thus, in order to promote electronic reporting, some of the information, which was previously reported on paper, will be also reported in electronic form. At the same time, the information presented based on the Instruction was adjusted to the new reporting system (SIRBNM).

In order to properly implement the provisions of the Law no.190-XVI of 26 July 2007 on preventing and combating money laundering and terrorist financing, and in particular due diligence measures by banks to partner institutions in cross-border banking relationships and the beneficial owners of bank clients, there were developed the Recommendations on cross-border relations in the context of legislation on preventing and combating money laundering and terrorist financing and the Recommendations on the identification of the beneficial owner. These recommendations will also ensure compliance with Council of Europe experts' recommendations on preventing and combating money laundering and terrorist financing (MONEYVAL), presented in the 4th Assessment Report of the Republic of Moldova, and in particular compliance with the Recommendation 5 and 7 of the report.

The Recommendations on cross-border relations in the context of legislation on preventing and combating money laundering and terrorist financing are intended to provide banks and other payment service providers methodological guidance in the process of concluding a business relationship with a foreign correspondent institution.

The Recommendations on the identification of the beneficial owner aimed to provide banks and other payment service providers methodological guidance on the application of legislation in preventing and combating money laundering and terrorist financing in the process of identification of the beneficial owner (beneficial owners) of the clients of legal entities or individuals.

Regulation on bank's activity regarding prevention and combat of money laundering and terrorist financing has been also amended and completed. These amendments to the Regulation are related to the implementation of the necessary requirements to be applied to opening of branches and representative offices in other states and completion of the list of persons with high risk, but also due diligence measures to be applied to them. At the same time, the completions to the Regulation are related to the implementation of the requirements for the identification and assessment by the bank of risks relating to money laundering and terrorist financing.

During 2014, the new version of the Regulation on disclosure of information on the financial activity of the licensed banks from the Republic of Moldova was approved which included amendments related to the technical requirements of publishing information (in the context of its extension), both qualitative and quantitative information related to financial and economic activity, services rendering and products, such as bank governance etc. The Regulation includes some additions in order to specify the aspects to be taken into consideration in the disclosure of information pertaining to the financial performance of the bank, accounting policies, bank governance, including criteria and method of disclosure by banks of information on shareholders and / or group of persons acting in concert and owning qualifying holdings in the capital of the bank and their beneficial owners. At the same time, the new version includes elements related to annual effective rate, currency of loan, taking into account the provisions of Article 4 of the Law on credit agreements for consumers. The content of the information provided and the risk profile of the bank have been taken into account when determining the level of disclosure and detail of information.

In connection with the restrictions imposed by the Russian Federation on imports of certain food categories from the Republic of Moldova, the National Bank established certain provisions related to the time limit for the recovery of payments from debts on loans / borrowings to economic agents from agriculture, food industry and wine sector.

For this purpose, it was examined the information on borrowers and their loans, whose core activity is the cultivation and / or processing and preservation and / or marketing of fruits and vegetables, the information on loans to borrowers whose core business is the production, processing and / or preservation of meat and meat products, as well as on loans to borrowers whose activities are related to viticulture, wine-making and trade with wine products.

Thus, there were created temporary indirect premises for the support of banks and debtors affected by the restrictions on food exports. Simultaneously, it should be noted that for the evaluation of conditional assets and commitments concerning these debtors, the bank must take into account the provisions of the Regulation on assets and conditional commitments classification, except for the period of reimbursement. These amendments and completions are aimed at stabilizing the situation created in terms of quality of loan portfolios of banks from the Republic of Moldova.

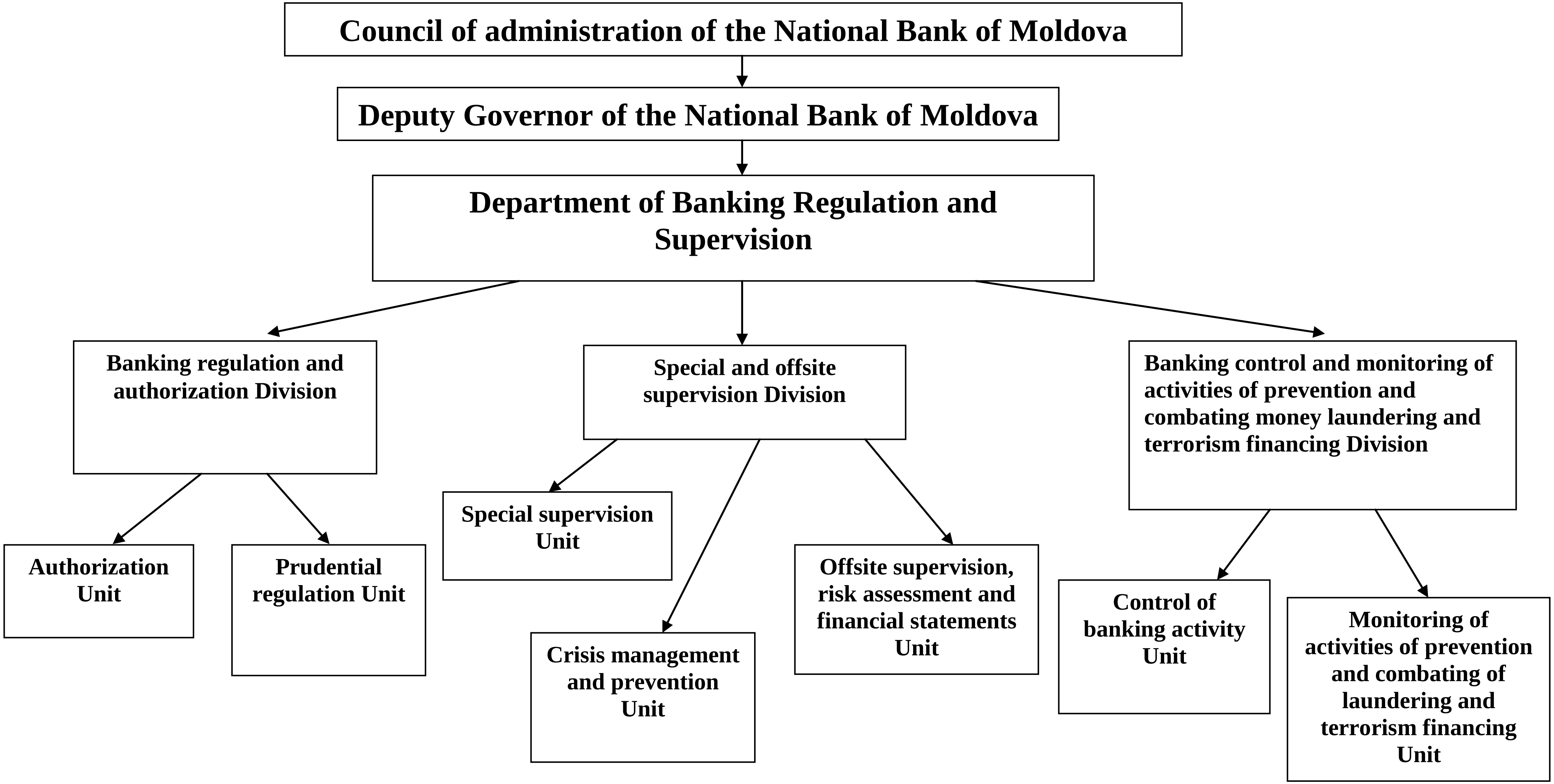
The presence of an adequate capital requires the ability of the bank to cushion the negative impact of risks arising from the activity. According to international practice, reserves from the revaluation of unrestricted securities, whose issuers have rating not less than rated A-/A3 assigned by at least one of the agencies Standard & Poor's, Moody's and Fitch-IBCA may be qualified as part of the capital.

Qualification of revaluations of the unrestricted securities as part of bank capital is in line with the provisions of the document "International convergence of capital measurement and capital standards" of 1988 (for Basel I) and 2006 (for Basel II), which specifies that the reserves from revaluation and other differences from the revaluation of bank assets may be included in the calculation of Tier II capital as an additional capital at the discretion of the supervisory authority.

Thus, given that these securities have high liquidity, it was provided for the possibility of including the value of the reserves in the calculation of Tier II capital. At the same time, the issuer-companies are subject to the obligation of being simultaneously residents of countries with the ratings mentioned above. If the rating assigned to an issuer varies from one agency to another, the rating agency that assigned the lowest rating shall be taken into account.

The amendments above have led to the amendment of the Instruction on preparing and presenting the reports by banks for prudential purposes, as regards the calculation of total regulatory capital ratio, which is drawn up taking into account the Regulation on risk-weighted capital adequacy.

ORGANIZATIONAL STRUCTURE OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

During 2014, in order to further develop the domestic banking system, including improvement of the prudential regulations and of the banking supervision mechanism, the National Bank of Moldova has collaborated with a number of international organizations, such as: IMF, World Bank, European Commission, European Bank for Reconstruction and Development, U.S. Department of the Treasury and the Group of Banking Supervisors from Central and Eastern Europe

In order to achieve an adequate exchange of information related to the banks' licensing, the National Bank of Moldova has cooperated with other central banks, and namely: the National Bank of Romania, the National Bank of Ukraine, the Bank of Albania, the National Bank of the Republic of Macedonia, the National Bank of the Kyrgyz Republic.

In 2014 the National Bank of Moldova has signed a Memorandum of Understanding on cooperation in the field of banking supervision with the Federal Financial Supervisory Authority of Germany (BaFin). The signing of this Memorandum is the first step in creating the necessary framework to enhance bilateral cooperation in order to facilitate the exchange of information necessary for efficient supervision of banking institutions licensed by both authorities. Also, the National Bank of Moldova has cooperation agreements with banking supervisors from other countries, such as: Romania, Russia, Kazakhstan and Belarus. Currently, other cooperation agreements are negotiated with supervision authorities from Italy, France and Austria.

In order to improve prudential regulation and banking supervision instruments, in 2014, the National Bank of Moldova has benefited from training organized by the Polish Financial Supervision Authority.

COOPERATION WITH OTHER SUPERVISORY BODIES

According to the legal framework in force and the existent agreements, the National Bank of Moldova cooperates with other supervision authorities from the Republic of Moldova. Thus, in 2013, in order to fulfill efficiently its functions, the National Bank of Moldova has worked based on the concluded agreement with the National Anticorruption Center, National Commission of Financial Market, the State Chamber of Registration, the State Enterprise „Cadastru”, and Office of the General Prosecutor.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

During 2014, the International Monetary Fund and World Bank conducted a Financial Sector Assessment Program in the Republic of Moldova (Financial Sector Assessment Program - FSAP). During the program, experts of the mission carried out a thorough and detailed examination and analysis of the financial sector of the country.

As a result, after the last FSAP assessment from 2007, among the progress achieved by the Republic of Moldova experts pointed out the following: significant improvement in regulation and supervision of financial sector, formation of institutional and legal framework for crisis management. However, the experts stressed the need to continue the efforts aimed to diminish the main risks and vulnerabilities in the financial sector of the country by improving the quality of financial sector supervision, strengthening the management of financial crises and strengthening the depositors protection system.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	10	10	10
Branches of foreign credit institutions	4	4	4
Cooperative banks	-	-	-
Banking sector, total:	14	14	14

Ownership structure of banks on the basis of assets total (at year-ends)

Type of financial institution	2012	2013	2014
Public sector ownership	6.52	3.82	4.94
Other domestic ownership	43.42	48.97	44.55
Domestic ownership total	49.94	52.79	49.49
Foreign ownership	50.06	47.21	50.51
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	48.76	75.85	0.119
Branches of foreign credit institutions	13.59	14.73	0.007
Cooperative banks	-	-	-
Banking sector, total:	48.75	75.85	0.126

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	4.26	9.39	5.86
Cooperative banks	-	-	-
Banking sector, total:	4.26	9.39	5.86

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	80.22	82.99	85.27
Branches of foreign credit institutions	19.78	17.01	14.73
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

* Only branches of foreign banks.

The structure of assets and liabilities of the banking system (%) (at year-end)

Assets	2012	2013	2014
Cash	4.20	3.69	3.58
Due from banks and NBM, net	16.03	21.43	15.11
Net loans and financial leasing	56.93*	53.86*	55.84*
Government securities, net	7.27	5.36	4.72
Other, net	15.57	15.66	20.75
Total assets	100.00	100.00	100.00
Liabilities	**2012**	**2013**	**2014**
Deposits of households	43.81	41.15	36.83
Deposits of corporates (nonfinancial)	17.99	18.37	15.87
Other	20.99	25.48	34.13
Shareholder capital	17.21	15.00	13.17
Total liabilities and shareholder capital	100.0	100.0	100.0

* Calculated according to IFRS.

Capital adequacy ratio of banks

Type of financial institution	2012	2013	2014
Commercial banks	24.38*	23.38*	13.92*
Cooperative banks	-	-	-
Banking sector, total	24.38*	23.38*	13.92*

(* - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking system (%)

Loan classification	2012	2013	2014
Standard	48.32	47.22	55.18
Supervised	37.18	41.20	33.09
Substandard	4.97	3.70	3.04
Doubtful	6.36	2.96	3.22
Losses	3.17	4.92	5.47
Total	**100.0**	**100.0**	**100.0**
Specific reserves	10.65	9.68	10.37

The structure of deposits and loans in 2014 (%)
(at year-end)

	Deposits	Loans
Non-financial sector, including:	95.68	96.52
Households	66.87	16.92
Corporate	28.80	79.62
Government sector	1.36	0.16
Financial sector (excluding banks)	2.97	3.32
Total*	**100.0**	**100.0**

*Bank deposits and loans were excluded from the total

P&L account of the banking sector (at year-end, in mln. EUR)

P&L account	2012	2013	2014
Interest income	276.16	265.24	292.73
Interest expenses	138.56	149.35	153.90
Net interest income	137.60	115.89	138.84
Net fee and commission income	50.51	47.53	49.90
Other (not specified above) operating income (net)	-59.93	-11.63	-51.39
Gross income	381.25	367.38	406.51
Administration costs	93.49	87.07	85.90
Depreciation	14.19	12.29	11.53
Provisions	128.67	133.17	111.37
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	35.81%	13.14%	41.18%
Profit (loss) before tax	37.89	64.04	47.95
Net profit (loss)	27.17	56.73	37.55

As of December 31, 2014, 1 EUR=18.9966 MDL.

Total own funds in 2014 (in mln. EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	474.50*	-	457.25*	19.77*	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	474.50*	-	457.25*	19.77*	-

(* - for Basel I; ** - for Basel II; *** - for Basel III)
As of December 31, 2014, 1 EUR=18.9966 MDL.

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2014 DEVELOPMENTS IN THE MONTENEGRIN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The preliminary Monstat[25] data on quarterly **GDP trend** showed positive rates in all three quarters of 2014, whereas the Q1 growth amounted to 1.5%, Q2 growth amounted to 0.3%, and Q3 growth was 1.3%.

Inflation declined in 2014. The annual rate amounted to a negative 0.3% in December 2014, whereby prices from the category *transport* (-4.7%) reported the highest annual decline in 2014, which included the highest decline in prices of fuels and lubricants (11.1%).

Lending activity of banks was not satisfactory. The annual decline in both total and new loans was recorded in 2014. On the other hand, the NPL trend was positive in the observed period that reflected in the decline in NPLs and their share in total loans.

Budget of Montenegro reported deficit in 2014 in the amount of 102.6 million euros or 3% of GDP. It declined by 113.2 million euros compared to the 2013 deficit. Both the dynamics of the public debt growth and total amount of public debt represent a concern. The concern has been increased also by the expectation that the public debt will grow in the following period due to the realisation of planned infrastructure projects.

Unemployment rate published by the Employment Agency of Montenegro amounted to 14.95% in December 2014, which is a y-o-y increase by 0.07 percentage points.

According to the Monstat data, **average wage** in Montenegro amounted to 723 euros in 2014 and it declined y-o-y by 0.4%. Average wage without taxes and contributions amounted to 477 euros, and it declined y-o-y by 0.4%.

Balance of payment current account increased during 2014. It mainly resulted from negative trends at the account of goods and primary and secondary revenues. According to the preliminary data, balance of payment current account amounted to 520.4 million euros which represented a y-o-y growth of 6.9%. Positive trends were recorded at the account of services, which resulted in surplus of 690.4 million euros or 20.3% of GDP or 5.7% more than in 2013.

FDI inflows increased in 2014. The 2014 preliminary data showed net inflows of FDI in the amount of 353.9 million euros, which represented a y-o-y increase of 9.3%. Total FDI inflows amounted to 498.1 million euros and it increased y-o-y by 3.9%.

[25] Data are preliminary until the publication of final GDP for 2014 in September 2015.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

Key balance sheet positions grew in one-year period. Total assets grew at a rate of 5.98%; banks' total deposits also grew at a rate of 9.89%, while total capital grew at a rate of 11.62%. Banks' liquid assets have increased by 17.88%.

Banks continued with the prudent lending policy in 2014 and they relied mainly on own liquid funds. Banks' deposits exceeded the level of lending activities which resulted in loan to deposit ratio of 95%.

Banks' total loans and receivables have kept a negative trend during 2014, which represented annual decline of 1.25%. All asset quality indicators recorded improvement during 2014. Banks' liquidity was good. Banks' total liquid assets amounted to 697.2 million euros, while liquid assets to total assets ratio amounted to 22.23%. Daily and ten-day liquidity indicators were above the prescribed minimum.

Aggregate financial result was positive at 23.8 million euros. Ten banks in the system reported profit, while two banks reported negative financial result at the end of the year. Total capital of Montenegrin banks amounted to 444 million euros at end-2014 and it recorded a y-o-y increase by 46.2 million euros or 11.62%. Aggregate capital adequacy ratio was 16.18% at end-2014, which was substantially above legally prescribed minimum of 10%. Banks' total own funds amounted to 315 million euros, while total capital required for all risks the banks were exposed to amounted to 1.947.2 million euros.

Total loans and receivables from banks and clients impaired by value adjustments (net loans and receivables) amounted to 2.213.2 million euros at end-2014. Long-term loans accounted for 70.76% in maturity structure of total net loans and receivables, while short-term loans made up 29.24%.

Total deposits of banks and clients (increased by funds at escrow accounts and prepayments and interest value adjustments) amounted to 2.327.7 million euros at end-2014, and they increased y-o-y by 9.89%.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS.
LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN MONTENEGRO

Large interest of domestic and foreign investors, legal and natural persons, for founding new banks was evident in 2014. One bank was licensed, while another three banks and one MFI are under the licensing procedure. The deadline for making decision under these applications expires in the first half of 2015.

Bank and MFI supervision has been intensified during 2014, which was realised through 11 regular and three extraordinary targeted on-site examinations. The examinations covered 11 banks in the system.

Due to the disclosed irregularities, the CBCG imposed measures against three banks in 2014 for removing irregularities in their work, in the form of warning for two banks and in the form of agreement for one bank. Due to violation of the provisions of the Law on Consumer Credits governing the manner of informing the client prior to the conclusion of the contract, the CBCG imposed a measure of interim prohibition of lending until irregularities are removed.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

Strategic objectives of the Central Bank are largely determined by the position of Montenegro in the negotiation process for the EU accession. A set of laws and enabling regulations that the Central Bank is obliged to prepare or adopt by end-2017 was defined, inter alia, in the negotiation position for Chapter 9 Financial Services that the Government of Montenegro established in October 2014.

The Central Bank initiated drafting of the most complex regulations in the banking area. Thus, documentation basis was prepared in 2014 and the work on the new Banking Law and the Decision on Bank Capital Adequacy has started. These documents will transpose Directive 2013/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and the Regulation 575/2013 EU of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms into the national legislation. New Basel Capital Accord and liquidity standards (Basel III) will be implemented through the adoption of the aforesaid regulations and other regulations enabling the implementation of the Banking Law. They are aimed at strengthening capital requirements for banks and establishing framework for new regulatory requirements concerning liquidity and additional capital requirements for the systemically important financial institutions.

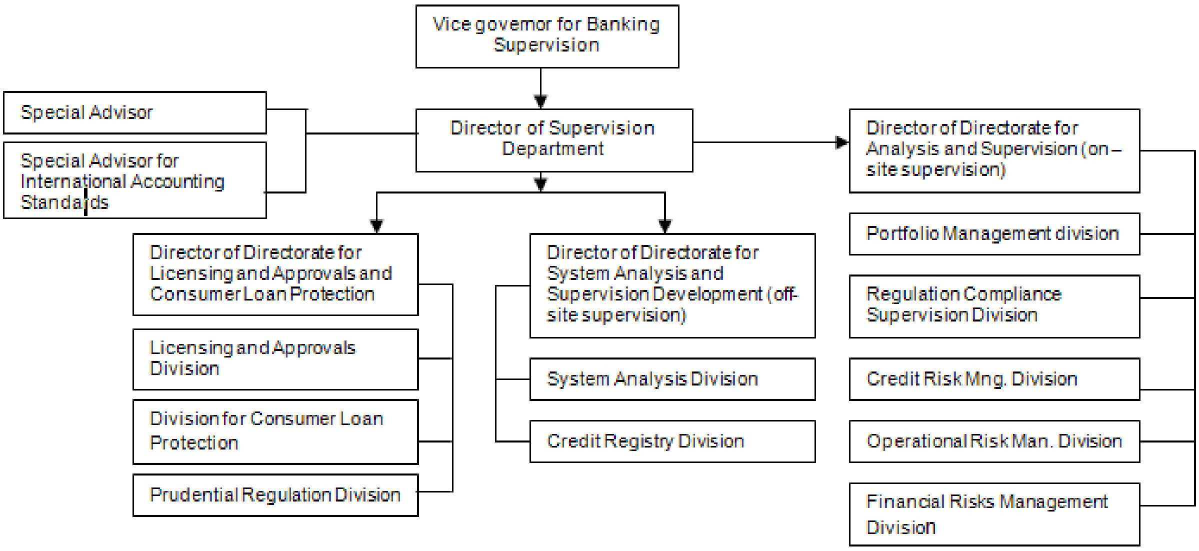
THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

The Central Bank adopted a Decision amending the Decision on uniform manner of calculating and reporting effective interest rates on loans and deposits (OGM 53/14) at end-2014. The Commission Directive 2011/90 amending Part II of Annex I to Directive 2008/48/EC was implemented through the adoption of this decision, which fully complied this decision with the prevailing EU legislation regulating the effective interest rate on consumer loans under the supervision of the Central Bank of Montenegro.

In accordance with the Examination Schedule, 11 targeted regular on-site examinations were performed in 2014 which covered 11 banks in the system. In addition, three extraordinary targeted on-site examinations of banks in the area of the prevention of money laundering and terrorist financing were performed. New bank that was licensed in May 2014 was not subject to on-site examination. The operations of this bank and its risk profile were monitored based on off-site examinations in 2014, i.e. based on the analysis of reports the banks submitted to the Central Bank.

In accordance with the risk based supervision, full scope examinations were not performed during 2014. Instead, the focus was on the examinations of capital, credit risk, functioning of the internal controls system, earnings, compliance with regulations, prevention of money laundering and terrorist financing. Focusing on targeted examination contributed to the strengthening of supervision and developing the concept of risk based supervision, where the dominant role is placed on the portfolio management approach in the bank supervision. The supervision of the banking sector was focused on the supervision of banks from the risk areas assessment perspective.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

Further progress in the negotiation process on Montenegro accession to EU has been made, in particularly with regard to the opening of larger number of chapters. With regard to the negotiating chapters from the CBCG competence, negotiations on Chapter 4 Free Movement of Capital and Chapter 32 Financial Supervision were opened at the Intergovernmental Conference held in Luxembourg on 24 June 2014. The Chapter 18 Statistics was opened at the meeting of the Intergovernmental Conference held between Montenegro and the EU on 16 December 2014 in Brussels.

The Central Bank of Montenegro continued its work on harmonising its regulation with the EU Acquis, which was evaluated also in the European Commission Report, which states that high level of compliance of the legislation with the EU regulation has been made.

The CBCG participated for the first time in the preparation of the National Economic Reform Programme (NERP) that replaced recent Pre-accession Economic Programme (PEP). It implies the change of dialogue and improvement of reporting aimed at defining clear reform guidance that should provide long-term growth and competitiveness.

The CBCG representatives participated in the work and drafting of the materials for the bodies established under the Stabilisation and Association Agreement (SAA). In 2014, the CBCG participated and prepared materials under its competence for meetings of the Sub-Committee for Internal Market and Competition, Sub-Committee for Economic and Financial Issues and Statistics, and the Stabilisation and Association Committee.

The CBCG delegation participated in the High Level Policy Dialogue organised by the ECB once a year in Frankfurt with the central banks of the candidate countries for joining EU that started the negotiation process.

A Programme of Technical Cooperation with the Central Bank of Montenegro for its preparation to access the European System of the Central Banks (ESCB) started in September. This programme is realised by the European Central Bank in cooperation with ten partner national central banks of the Eurosystem.

As a result of successful long lasting cooperation, an International Banking Forum was organised in March 2014 by the Central Bank of Montenegro and the International Monetary Fund. The CBCG, Ministry of Finance, banks operating in Montenegro, representatives of their parent banks, representatives of home supervisors and international institutions (IMF, World Bank, EBRD, and ECB) participated at the forum.

The CBCG delegation participated at the IMF/WB Spring and Annual Meetings (11-13 April and 9-12 October) in Washington. The CBCG had a series of meetings with the representatives of these institutions. It also participated at regular annual meeting of the Belgium-Netherlands Constituency held from 30 May to 1 June in The Hague, the Netherlands. In 2014, Montenegro officially requested from the IMF and WB the participation in the Financial Sector Assessment Programme (FSAP. The request was accepted and the FSAP mission is planned for the second half of 2015.

With regard to the cooperation with the international financial institutions and organisations, the CBCG continued intensive and close cooperation with the central banks in the region, European Central Bank and other financial organisations. International meeting of the supervisors was particularly important in this area because it was organised by the CBCG as a continuance of regional cooperation in attaining joint interest in the area of bank supervision[26]. The main objective was to further define joint approach to international institutions, organisations and associations.

COOPERATION WITH OTHER SUPERVISORY BODIES IN MONTENEGRO

With an aim to reduce the level of non-performing loans in banks, the World Bank, Ministry of Finance and the Central Bank of Montenegro, during 2014 undertook a series of activities regarding project named "Podgorica model".

The Ministry of Finance, in cooperation with the Central Bank, prepared a Draft Law on voluntary financial restructuring of debts, which was established by the Government of Montenegro and submitted it to the Parliament of Montenegro

[26] Besides Montenegro, the meeting was attended by the following non-EU countries: Albania, Bosnia and Herzegovina, Kosovo, Macedonia, Serbia and Republika Srpska.

in late July 2014. The law is currently in the parliamentary debate and expected to be adopted during 2015.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	11	11	12
Branches of foreign credit institutions			
Cooperative banks			
Financial institutions, total	**11**	**11**	**12**

Ownership structure of banks on the basis of assets total

Type of financial institution	2012	2013	2014
Public sector ownership	-	-	-
Other domestic ownership	-	-	-
Domestic ownership total	10	10	20.5
Foreign ownership	90	90	79.5
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	46.86	68.20	1,198
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total	46.86	68.20	1,198

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	-18.32	0.49	5.35
Cooperative banks	-	-	-
Banking sector, total:	-18.32	0.49	5.35

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	100	100	100
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2012**	2013**	2014**
Commercial banks	14.71	14.44	16.18
Cooperative banks	-	-	-
Banking sector, total:	**14.71**	**14.44**	**16.18**

(* - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector
(share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non financial sector*	97.32	98.42	97.49
- households	19.40	23.26	24.29
- corporate**	73.78	74.35	71.32

*excluding government sector and financial institutions; share of total NPL
**state companies, private companies and entrepreneurs; share of total NPL

The structure of deposits and loans of the banking sector in 2014 (%)
(at year-end)

	Deposits	Loans
Non-financial sector, including:	94.3	76.8
Households	57.2	38.3
Corporate	30.7	36.7
Government sector	5.2	6.2
Financial sector	0.5	17.0
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2012	2013	2014
Interest income	189451	179149	173072
Interest expenses	83472	74895	61983
Net interest income	105979	104253	111091
Net fee and commission income	25660	33863	34969
Other (not specified above) operating income (net)	46026	17652	12083
Gross income		252119	242127
Administration costs	-112756	96091	99593
Depreciation		9640	9471
Provisions	120510	44036	21117
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	-55599	3555	25222
Net profit (loss)	**-56527**	**2049**	**23787**

Total own funds in 2014 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	316002	-	282872	44427	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	316002	-	282872	44427	-

(* - for Basel I; ** - for Basel II; *** - for Basel III)

2014 DEVELOPMENTS IN THE POLISH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Macroeconomic situation in 2014 in Poland remained stable – the GDP grew by 3,4% while the unemployed rate was decreasing and reached 8,1 % (Labour Force Survey). The EUR/PLN exchange rate was quite stable over the year and stayed within the band around 4,05-4,25. In case of pair USD/PLN situation was however a bit different as the Polish zloty was steadily weakening. The exchange rate rose from around 3 PLN per 1 USD at the beginning of the year to around 3,6 at the year's end. The exchange CHF/PLN rate, which is important for the Polish banking sector (about half a million households have outstanding CHF denominated mortgage loans) also remained relatively stable moving within the band 3,33-3,60 PLN per CHF. 2014 was a year of continuous easing of the monetary policy which resulted in a record low interest rate benchmark for Polish financial market – the WIBOR reached the levels of around 2% (remaining however much higher than benchmarks for major EU currencies which were around 0% and were converging towards negative values). In 2014 in Poland deflation was observed for the first time since 1990. Situation of public finance was stable, however one has to remember that this was due to a major reform of pension funds from 2013 which effected in a non-recurrent budget transfer equal to around 9% of GDP. Nevertheless, this will allow only a short term improvement in public finance, which will still be one of the main challenges for the Polish economy in coming years.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

In 2014 the situation of the banking sector remained stable. As of the end of December 2104, in Poland were active 38 commercial banks, 28 branches of credit institutions, 565 cooperative banks and 50 credit unions. Assets of commercial banks accounted for 80% of GDP, cooperative banks 9% and credit unions 0,95% of GDP respectably .

The situation of capital base remained strong and at the end of 2014 capital adequacy ratios were at considerably high levels. Banks are expected to maintain their capital base. The situation as regards the liquidity was stable, too. Only 8 small banks (out of 631) did not fulfill one or more liquidity measures. The level of non-performing loans decreased slightly second year in a row.

One of the issues that raise concerns about Polish banking sector remains quite high share of FX loans in banks' portfolios, especially after rapid increase in CHF exchange rate in January 2015. Fortunately, almost all of loans were (and are) granted by Polish banks at flexible interest rate and any depreciation of PLN is partially traded off by change in currency parity so that the instalments of such loans remain relatively moderate. As long as FX lending risk is not eliminated, both borrowers and banks will be under constant pressure related to exchange rates and will be exposed to a number of risks. Responding to current situation

PFSA (KNF) offered a solution, which can solve the CHF loans problem. Additionally, according to PFSA recommendations there are no new FX loans granted by banks to clients (except for FX earners)

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2014, the binding "BION Methodology" ("BION" stands for "Supervisory Review and Assessment") was modified with regard to the provisions of the CRD IV legislative package. BION process rules were reviewed and updated in the scope of:

- types of risk subject to risk-based supervision,
- bank's business model analysis,
- application of the principle of proportionality to the categorization of banks according to their systemic importance.

As a result, the "BION Methodology" introduced framework for the assessment of risk to capital and capital adequacy which is consistent with the scope of supervisory review and evaluation process (SREP) laid down in the EBA Guidelines. This will enable to achieve the compliance with binding standards on reaching joint decision on the capital and liquidity adequacy of cross-border EU banking groups in 2015.

In 2014 in total 605 BION analyses were carried out, including 565 in cooperative banks, 2 in associating banks and 38 in commercial banks.

In 2014 the KNF carried out 5 complex inspections and 23 targeted inspections both in commercial and cooperative banks. Targeted inspections were focused on the areas of bank's activity considered to generate the highest risk.

In 2014 KNF merged domestic stress tests with pan-European stress testing exercise, which was coordinated by EBA. Stress tests were conducted for all commercial banks operating in Poland (cooperative banks and branches of credit institutions were excluded from the sample). For 15 significant banks results were published. Aim of the exercise was to determine the potential impact of the shock on the financial standing and capital position of the Polish banking sector. Results showed strong resilience of the domestic banking sector, although for two banks projected capital shortage below 100 mln EUR in total. Banks raised additional capital or covered shortage with retained profits.

Another important issue is a development of credit unions sector, which was not supervised by the KNF before October 2012. The most of credit unions do not have sufficient own funds and overall economic performance of the sector was poor. In 2014 one credit union merged with the other one, next 2 credit unions have been acquired by the banks, while activity of 2 credit unions has been suspended (court declared bankruptcy of one of them in 2014 and the second one in 2015). Active credit unions reported nett loss in 2014 in the total amount of 129,4 million PLN comparing to 61 million PLN in 2013. It should, however, be stressed that these results have not been verified by the auditors yet. Entire credit unions' sector (including bankrupted credit unions) reported in 2014 the loss in the amount of 768,9 million PLN comparing to 128,2 million in 2013.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN POLAND

The organization, scope and purpose of supervision over the financial market are regulated by the Act of 21 July 2006 *on Financial Market Supervision*. According to the above, the supervision over the financial market comprises of the:

1) banking supervision,
2) pension supervision,
3) insurance supervision,
4) capital market supervision,
5) supervision over electronic money institutions,
6) supervision of payment institutions and payment service offices,
7) supplementary supervision,
8) supervision over credit unions and their national association.

The supervision over the financial market, in the scope mentioned above, is exercised by **the Polish Financial Supervision Authority (KNF)**. As far as the banking sector is concerned, KNF is in charge of microprudential supervision since 2008. Regulatory powers of KNF have been narrowed to powers strictly specified in the Banking Act. It shares its regulatory powers with the Ministry of Finance and the National Bank of Poland.

The **objective of the supervision** is to ensure:

1) the safety of funds held on bank accounts,
2) compliance by the banks with the provisions of the present Banking Act, the Act on the National Bank of Poland, their articles of association, and the decision on granting authorization to establish those banks.
3) compliance of banks' activity carried out in accordance with Art. 70 para. 2 of the Act on Trading in Financial Instruments of July 29, 2005 with provisions of that Act, this Act and the articles of association.

Moreover, the tasks of the KNF includes the:

a) undertaking measures aimed at ensuring regular operation of the financial market,
b) undertaking measures aimed at development of financial market and its competitiveness,
c) undertaking educational and information measures related to financial market operation,
d) participation in the drafting of legal acts related to financial market supervision,
e) creation the opportunities for amicable and conciliatory settlement of disputes which may arise between financial market actors, in particular disputes resulting from contractual relations between entities covered by KNF supervision and recipients of services provided by those entities,
f) carrying out other activities provided for by acts of law.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

The main strategic task of the Polish Financial Supervision Authority (KNF) is to support the stable functioning and secure development of the financial market. The financial sector in Poland is one of the safest and most promising in Europe. The net profit of the banking sector in 2014 totaled PLN 16.23 bn. The main strategic objectives of the KNF (as a banking supervisory authority) in 2014 were aimed at strengthening soundness and profitability of banks in Poland. Main activities in these field were :

- asset quality review and stress tests in the Polish banks. The scale and scope of the AQR was fully compliant with ECB methodology
- issuance of Recommendation U on bancassurance to improve the quality of cooperation standards between banks and insurance companies, mainly in the field of PRIIPs sales
- adoption of principles for Recommendation W on internal models at banks
- CRD IV/CRR package implementation.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

Apart strategic objectives listed above the KNF undertook may other activities which were also very important for the stability and development of the financial system The application for establishing new mortgage bank was approved and other banks are also working on similar projects to support obtaining long-term funding. In 2014, the following issues were added to the common dividend policy: principles of corporate governance for supervised institutions and standardized supervisory review and evaluation process (SREP) methodology. The KNF adopted guidelines on IT and an increased interest in mediation as an alternative way of dispute resolution. We also built our own Data Processing Centre (CPD) that meets the highest safety standards. The KNF also triggered recovery plans for credit unions, which were aimed at stabilizing situation in this sector. Unfortunately, the costs of remedying credit unions are borne by banks through contributions to the Bank Guarantee Fund (‘BGF’) and, indirectly, by bank customers and taxpayers. For the first time in history, the Polish Financial Supervision Authority prohibited exercising voting rights attached to shares, and ordered the sale of the bank’s shares, which was a consequence of defaulting on investor obligations.

ORGANIZATIONAL CHART OF THE SUPERVISORY AUTHORITY

INTERNATIONAL ACTIVITIES OF THE AUTHORITY

Today key legal acts determining the framework for the functioning of the financial institutions in Europe are not drafted in individual countries but rather on the EU level. Thus, active participation of KNF in negotiations on an international stage is necessary to safeguard the interests of the domestic financial system.

KNF is an active member of relevant international supervisory bodies on the EU as well as on an international level including among others EBA, ESMA, EIOPA, ESRB, IOSCO IAIS and IOPS. In 2014 KNF participated in 15 supervisory colleges for cross-border banking groups.

KNF maintains close contact with supervisors from other countries. Bilateral cooperation is facilitated by agreements on cooperation and exchange of information, which KNF has already signed with supervision authorities from 29 jurisdictions (excluding multilateral agreements within IOSCO and the IAIS).

In November 2014 the European Central Bank took over supervision of major banking groups in the euro area in the framework of the Single Supervisory Mechanism (SSM). As a result, KNF has taken measures to formally shape its relations with the SSM in accordance to the regulation establishing the Mechanism. Practical issues such as the flow of information, ECB inspections of Polish banks owned by international groups or cooperation on validation of internal models still required some further agreements.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

KNF is the only authority in Poland responsible for supervising financial sector. Division of tasks within KNF is mostly sector wise. But KNF maintains close relations with other institutions responsible for financial stability, i.e. the Ministry of Finance (regulations), National Bank of Poland (macroeconomic analyses) and the Bank Guarantee Fund (bank resolution). The statutory tasks of KNF include as well participation in the process of drafting laws regulating supervision over the financial market. KNF acts as an advisor and gives opinions to authorities and agencies which, under separate legal regulations, initiate and conduct legislative work. Furthermore to that, in order to deal with emergency situations, Financial Stability Committee has been established - it encompasses KNF, Ministry of Finance, National Bank of Poland and the Bank Guarantee Fund and is responsible for an overall stability of the financial system.

STATISTICAL TABLES

Number of financial institutions (at year-end)

Type of financial institution	2012	2013	2014
Commercial banks	45	41	38
Branches of foreign credit institutions	25	28	28
Cooperative banks	572	571	565
Banking sector, total:	**642**	**640**	**631**

Ownership structure of banks on the basis of assets total

Type of financial institution	2012	2013	2014
Public sector ownership	22.9	22.3	24.1
Other domestic ownership	13.5	14.4	14.4
Domestic ownership total	36.4	36.8	38.5
Foreign ownership	63.6	63.2	61.5
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	37.3	52.1	797
Branches of foreign credit institutions	61.7	70.9	1776
Cooperative banks	8.6	11.4	57
Banking sector, total:	**34.7**	**48.5**	**661**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2012	2013	2014
Commercial banks	11.16	10.13	10.18
Cooperative banks	11.13	7.84	7.48
Banking sector, total:	**11.16**	**9.99**	**10.00**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	91.6	90.9	91.0
Branches of foreign credit institutions	2.1	2.3	2.1
Cooperative banks	6.3	6.9	6.8
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%)
(at year-end)

Assets	2012	2013	2014
Claims from			
Financial sector	7.9	8.4	8.5
Nonfinancial sector	60.0	59.6	58.4
Government sector	6.8	6.6	6.1
Other assets	25.3	25.4	27.0
Claims due to			
Financial sector	25.1	24.7	23.4
Nonfinancial sector	53.6	55.2	55.7
Government sector	4.4	3.9	4.0
Other liabilities	6.0	5.3	6.0
Capital	10.9	10.9	**10.9**

Capital adequacy ratio of banks

Type of financial institution	2012**	2013**	2014***
Commercial banks	14.8	14.2	14.6
Cooperative banks	13.8	13.4	15.7
Banking sector, total:	14.7	14.1	14.7

(Please, mark for each item: * - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector
(share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non financial sector	8.9	8.5	8.1
- households	7.4	7.1	6.5
- corporate	11.8	11.6	11.2

The structure of deposits and loans of the banking sector in 2014 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	87.6	87.2
Households	62,2	60.3
Corporate	23.5	30.9
Government sector	6.2	9.5
Financial sector (excluding banks)	6.2	3.9
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2012	2013	2014
Interest income	71 269	61 896	58 840
Interest expenses	35 785	27 196	21 671
Net interest income	35 484	34 699	37 170
Net fee and commission income	14 337	13 434	13 786
Other (not specified above) operating income (net)	8 030	6 576	5 577
Gross income	58 773	55 469	57 700
Administration costs	27 785	27 587	27 185
Depreciation	2 590	2 654	2 727
Provisions	1 151	458	713
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	8 243	7 790	8 263
Profit (loss) before tax	19 200	18 510	20 154
Net profit (loss)	15 467	15 175	15 981

Total own funds* in 2014 (in EUR m)**

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	29 694	27 147	27 155	2 539	-
Cooperative banks	2 422	2 228	2 251	171	-
Banking sector, total:	32 116	29 376	29 406	2710	-

(Please, mark for each item: * - for Basel I; ** - for Basel II; *** - for Basel III)

2014 DEVELOPMENTS IN THE ROMANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2014, real GDP increased by 2.8 percent, thus placing Romania, for the second consecutive year, among the top five EU28 countries. A contribution to this outcome made the 2.6 percent growth seen in 2014 Q4, which was attributed solely to domestic absorption and supported by all economic sectors. The favorable impact of domestic absorption on real GDP dynamics (3.5 percentage points, the most pronounced in 2014) was eroded by external demand, as the negative differential between the annual growth rates of exports and imports of goods and services generated a net contribution of -0.8 percentage points. The annual inflation rate in 2014 was placed at low levels, moving most of the year below the lower limit of the variation of the target (2.5 percent ± 1 percentage point). The modest growth in consumer prices was ascribable to the persistence of the demand deficit and declining inflation expectations, factors to which was added the reduction in commodity prices in the second half of 2014 (mainly energy and agriculture).

During 2014, the NBR also lowered the minimum reserve requirement ratios on RON-denominated liabilities of credit institutions (by 3 percentage points in January 2014 and 2 percentage points in September 2014, to 10 per cent.), and on their foreign currency-denominated liabilities (in three steps of 2 percentage points in January, July and November 2014, to 14 per cent.). Both measures were aimed at supporting a sustainable rebound in lending and continuing to bring the minimum reserve requirements mechanism into line with ECB standards.

DEVELOPMENT IN THE BANKING SYSTEM

The number of credit institutions remained unchanged in 2014, the Romanian banking system comprising 31 banks, Romanian legal entities (including the credit cooperative organization) and 9 branches of foreign banks at the end of year. Significant for 2014 was the beginning of a new tendency on the market consisting in the consolidation of the banking system through the mergers between banking and non-banking institutions.

The NBR closely monitors banking system developments taking measures for an appropriate supervision and adequate management of risks faced by the banks. Risks to the banking sector were also countered by efforts of credit institutions such as consolidation of solvency, provisioning and liquidity levels.

In the context of the measures taken by NBR to improve the banking assets quality, the sales of loans and supervisory measures determined the decline in non-performing loans and the NPLs ratio (13.9% in December 2014 against 21.9% in December 2013). Credit risk continued to be adequately covered as a result of a prudent approach of credit institutions, encouraged by the proactive prudential actions of the central bank. Firstly, the degree of NPL coverage with IFRS provisions remained at a comfortable level of 69.9% at end-

December 2014. Secondly, both the level and the quality of own funds have remained satisfactory: (i) the total capital ratio (former solvency ratio) stood at 17.6% in December 2014, considerably above the minimum regulated level of 8%, (ii) own funds consist overwhelmingly of high loss-absorbency capacity components (with a Tier 1 capital ratio of 14.6% in December 2014 and Core Tier 1 ratio of 14,6%). This was mainly due to significant capital increases made by shareholders in terms of cash contribution (i.e. EUR 111 million in 2012, EUR 190 million in 2013 and an additional contribution of EUR 394 million in 2014). The adverse effects of the deleveraging process in European banking groups had not significantly impacted Romania in 2014, due to the balanced macroeconomic policies. Parent banks continued to provide capital to support their subsidiaries in the local market, and capital contributions have been made by shareholders without any recourse to public funds. In 2014, the deleveraging process has continued at a relatively similar rate, reflecting the adjustment in the banks' business model in the context of the new prudential framework that sets stricter capital and liquidity requirements. The loan-to-deposits ratio fell further to 91.3% in December 2014. Implementation of Basel III not led to requirements of additional, large capital increases by credit institutions in Romania. The high share of Tier 1 capital in total capital and the lack of hybrid capital instruments cushion the impact of Basel III on capital requirements for local entities.

The banking sector recorded a net loss at the end of 2014 (RON -4.7 billion) due to the banks' efforts to reduce their nonperforming loans but returned in positive territory in 2015. Thus, since August the sector showed losses, under the adverse impact of growth resuming of net expenses with IFRS loan losses.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS.
LEGAL COMPETENCE OF THE ROMANIAN BANKING SUPERVISORY AUTHORITY IN ROMANIA

Credit institutions are mainly regulated by the Government Emergency Ordinance No. 99/2006 on credit institutions and capital adequacy, as subsequently amended and supplemented and by Regulation No. 575 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 and, among others, by the Law No. 85/2014 regarding the procedures for the prevention of insolvency and the insolvency procedures. As regards the transposition of CRD IV provisions into the national legal framework, Romania observed the implementation timetable set at EU level by adopting Government Emergency Ordinance No. 113/2013 on some budgetary measures and on amending and supplementing Government Emergency Ordinance No. 99/2006, as amended and supplemented, which contains provisions envisaging the strengthening of the legal framework on credit institutions and investment firms in areas such as corporate governance, prudential supervision and sanctions. The Government Emergency Ordinance No. 113/2013 was approved by Law No. 29/2015 and published in the Official Journal Part I no.171/12.03.2015.

Starting with the CRD IV/CRR implementation, credit institutions are required to observe the EC's implementing regulations laying down technical standards, directly applicable in all Member States, including also those related to the reporting field.

At the beginning of 2012, the Romanian banking system implemented IFRS as its accounting basis and for the drawing up of individual financial statements. At present, the FINREP, approved by the European Banking Authority, is governed by the (EU) Regulation no.680/2014, being directly applicable to the EU credit institutions. In order to ensure the optimal conditions for the unitary application of the FINREP individual reporting framework by the Romanian credit institutions, as well as the correlation thereof with the new FINREP consolidated reporting framework, this framework was also adapted for solo reporting purposes and NBR Order no.6/2014 was issued.

At EU level, the efforts to strengthen the prudential supervision framework continued, significant progress being made in completing the architecture of the Banking Union. Specifically, the Union's first pillar, the Single Supervisory Mechanism (SSM), became operational in 2014. Non-euro area Member States may also join the SSM on a voluntary basis, through a close cooperation agreement between the national competent authorities and the ECB, whose tasks in such a case are limited to preparing instructions, guidelines and requests intended for the national authorities and regarding the entities subject to prudential supervision. Romania declared its intention to enter a close cooperation agreement with the ECB, after clarifying the technical aspects, as well as the economic and legal implications linked to the complex process of joining the SSM.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

The main objective of NBR was linked to the main goal which is to assure the stability of the Romanian banking system, attributable to its capacity to act as a monetary and supervisory authority.

Having in view the banking system exposure to credit risk, NBR set up a strategy for the reduction of fully provisioned uncollectible NPLs on commercial banks' balance sheets. Among the most important supervisory measures took by NBR in 2014 in order to reduce the NPL level there were: i) a recommendation addressed to credit institutions to remove from on balance sheet of all the exposures representing uncollectible loans fully covered by provisions; ii) a recommendation to fully cover with provisions the exposure from debt service over 360 days without initiation of legal proceedings to recover debts, followed by their removal once provisioned for; iii) a recommendation to establish provisions in order to cover exposures against borrowers in insolvency and followed by their removal from the balance sheet; iv) carrying out of an external audit on the IFRS provisions established by banks to cover losses for the existing loans at the end of June 2014, and also on the banks' collateral.

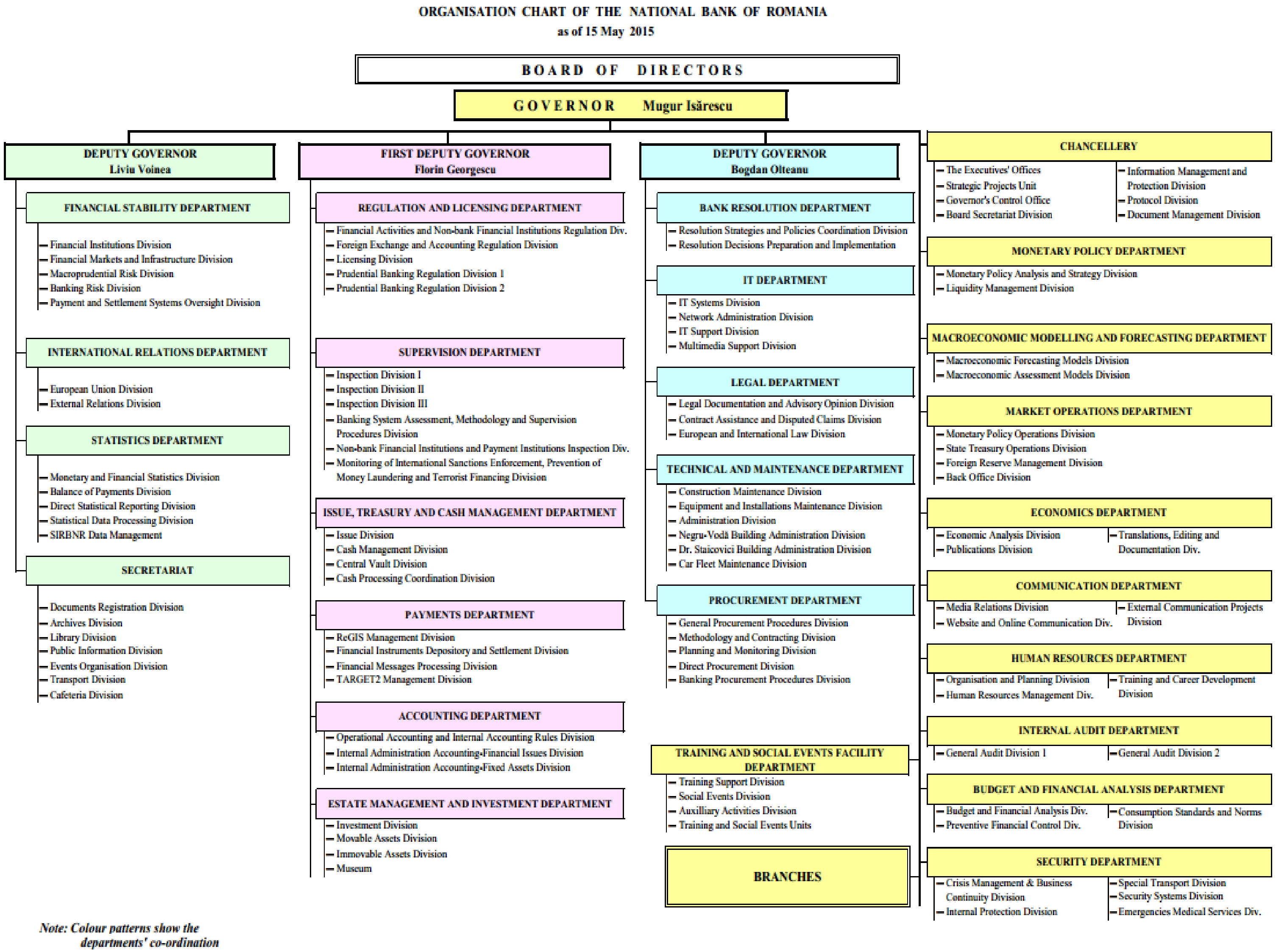
From the regulatory perspective, one of the key objectives of the NBR was to continue the harmonization process of national regulations with the guidelines and standards issued by EBA.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2014

During 2014, NBR carried out 36 on-site inspections according with the annual supervision program, of which 29 banks and seven branches of foreign banks. The on-site actions aimed mainly: overall risk profile; banks' financial situation; business strategy; responsibilities and organization management structures; organization and functioning of the internal control system; analysis of significant risks; ICAAP oversight.

Additionally, there were performed 24 actions on specific topic, such as asset quality; non-performing asset management (volume and structure, coverage with provisions of non-performing exposures, measures to reduce non-performing assets, risk management of the bad loans portfolio); restructured loans; NPLs restructuring policies; NPL recovery strategies; adequacy of IT systems for managing impaired assets; liquidity and financing; operational and reputational risk exposure; performance indicators used to measure operational risk and reputational events associated to outsourced activities; qualifying holdings; the implementation of the recommendations and measures taken by the NBR.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF NBR

From the date of Romania membership of the European Union, the National Bank of Romania, through its representatives in the EU structures, actively participate in the formulation of positions, both to establish at European level of prudential regulation strategies, and to draw up the text of the new directives / regulations / technical standards. The NBR was actively involved in the finalization of legislation process at European level, the most important being the transposition of Directive 2014/59/UE establishing a framework for the recovery and resolution of credit institutions and investment firms and Directive 2014/49/EU on deposit guarantee schemes.

In the supervision of cross-border banking groups, the NBR cooperate with other supervisors through supervisory colleges, a structure that ensures both optimum dissemination of information and the adoption of joint decisions on capital adequacy and liquidity, and since 2015 on the recovery plans of credit institutions. So far, the NBR signed multilateral cooperation agreements with 19 international bank groups. Apart from participating in the meetings of the supervisory colleges, the NBR, in its capacity as supervisory authority, also had representatives in certain EBA groups and sub-groups such as: Standing Committee on Oversight and Practices, Joint Committee on Financial Conglomerates (JCFC), Task Force on the Impact of the New Capital Framework (TFICF), Subgroup on Operational Risk (SGOR), Sub-committee on Accounting, Reports and Auditing (SCARA), Standing Committee on Regulation and Policy and Board of Supervisors.

Throughout 2014 and in the first part of 2015, the NBR was involved in the preparation of the twinning project dedicated to the National Bank of Moldova for strengthening the latter’s capacity in the field of banking regulation and supervision. The NBR entered a consortium with De Nederlandsche Bank (DNB) and the project will be implemented over a 24-month period.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

In December 2012, the Romanian Government approved, by way of emergency ordinance, the establishment of the Financial Supervisory Authority (FSA). From 30 April 2013, the FSA took over the responsibilities of the National Securities Commission (NSC), the Insurance Supervisory Commission (ISC) and the Private Pension System Supervisory Commission (PPSSC), thus overseeing the capital markets and the insurance and private pension markets.

National Bank of Romania collaborates institutionally with FSA with regard to the regulation of banking and non-banking financial market. The NBR meetings with FSA and the Ministry of Public Finance are held in an institutional framework, at regular intervals, and refer to the harmonization of regulation and supervision of banking and non-banking financial market, according to the European supervisory mechanisms.

Before the establishment of FSA, the institutional discussions for the insurance, capital market, and private pensions sectors were held with representatives of NBR by the former ISC, NSC and PPSSC, within the National Committee for Financial Stability. The National Committee for Financial Stability (NCFS) set up according to the provisions of multilateral agreement signed between Ministry of Public Finance, National Bank of Romania and Financial Supervisory Authority, held regular meetings and promotes a steady and efficient information exchange between the sectorial financial supervisors and the Ministry of Public Finance.

During the ordinary meeting of the NCFS that took place on December 23rd, 2013 the members analyzed the provisions of the CRD IV Directive regarding the capital buffers that can be imposed on credit institutions and financial investment companies, alongside with the minimum requirements for the own funds with a view to increasing their capacity to bear the losses that can occur as a consequence of materializing the idiosyncratic and systemic risks.

NCFS members will periodically issue recommendations on the implementation of capital buffers in Romania.

STATISTICAL TABLES

Number of financial institutions
(at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	31	30	30
Branches of foreign credit institutions	8	9	9
Cooperative banks	1	1	1
Banking sector, total:	**40**	**40**	**40**

Ownership structure of banks on the basis of assets total (%)
(at year-ends)

Type of financial institution	2012	2013	2014
Public sector ownership	8.4	8.5	8.7
Other domestic ownership	1.8	1.5	1.4
Domestic ownership total	10.2	10.0	10.1
Foreign ownership	89.8	90.0	89.9
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions
(at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	42.7	60.2	942
Branches of foreign credit institutions	90.1	96.8	3575
Cooperative banks	-	-	-
Banking sector, total:	38.4	54.2	797

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	-6.85	-0.66	-14.15
Cooperative banks	1.97	1.33	1.05
Banking sector, total:	**-5.92**	**0.13**	**-12.45**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	91.1	90.4	89.9
Branches of foreign credit institutions	8.7	9.4	9.8
Cooperative banks	0.2	0.2	0.3
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%)
(at year-end)

	2012	2013	2014
Claims from	**100.0**	**100.0**	**100.0**
Financial sector	18.1	20.5	20.1
Nonfinancial sector	58.8	55.9	54.3
Government sector	-	-	-
Other assets	23.1	23.6	25.6
Claims due to	**100.0**	**100.0**	**100.0**
Financial sector	29.0	23.3	18.7
Nonfinancial sector	57.3	63.2	67.9
Government sector	-	-	-
Other liabilities	3.3	3.1	3.8
Capital	10.4	10.4	9.6

Capital adequacy ratio of banks

Type of financial institution	2012**	2013**	2014***
Commercial banks	14.9	15.4	17.5
Cooperative banks	32.4	31.7	30.7
Banking sector, total:	**14.9**	**15.5**	**17.6**

(* - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector
(share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non financial sector	18.2	21.9	14.0
- households	12.3	13.5	7.9
- corporate	23.6	29.2	20.0

*from FINREP- F18.00

The structure of deposits and loans of the banking sector in 2014 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	77.9	67.8
Households	49.2	33.4
Corporate	28.7	34.4
Government sector	17.0	27.9
Financial sector (excluding banks)	5.1	4.3
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends) (in million RON)

P&L account	2012	2013	2014
Interest income	23,389.0	20,193.7	17,381.5
Interest expenses	11,467.0	8,854.0	6,311.9
Net interest income	11,922.0	11,339.7	11,069.6
Net fee and commission income	3,833.5	3,957.6	3,938.2
Other (not specified above) operating income (net)	3,373.8	3,976.8	3,895.0
Gross income	**19,129.3**	**19,274.1**	**18,902.8**
Administration costs	10,227.1	9,943.6	9,627.8
Depreciation	1,005.1	955.0	862.6
Provisions	780.4	688.8	2,744.2
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	9,866.6	8,174.0	10,275.7
Profit (loss) before tax	**-2,749.9**	**-489.2**	**-4,641.4**
Net profit (loss)	**-2,341.9**	**48.6**	**-4,667.1**

Total own funds in 2014 (in million EUR)

Type of financial institution	Total own funds***	Core Tier 1***	Tier 1***	Tier 2***	Tier 3
Commercial banks	7,110.7	5,884.7	5,884.7	1,226.0	-
Cooperative banks	55.7	50.0	50.0	5.7	-
Banking sector, total:	7,166.4	5,934.7	5,934.7	1,231.7	-

(* - for Basel I; ** - for Basel II; *** - for Basel III)

2014 DEVELOPMENTS IN THE RUSSIAN BANKING SYSTEM

MACROECONOMIC SITUATION

In 2014, the Russian economy was seriously challenged by geopolitical problems amid the exhaustion of traditional sources of economic growth started in the previous years. The private capital outflow from Russia increased both due to the purchase of foreign cash by households and corporates, and external debt repayment by the Russian private sector whose refinancing possibility was limited by the imposed sanctions.

In 2014, the international reserves of the Russian Federation contracted by 124.1 billion US dollars to 385.5 billion US dollars as of 1 January 2015. The adequacy of the international reserves of the Russian Federation, calculated in accordance with the international standards in terms of the number of months of import coverage of goods and services was 10.8 months (previous year - 13 months).

In early 2015, the external debt of the Russian Federation was estimated at 597.3 billion US dollars, in 2014 it contracted by 18% (the previous year it increased by 15%).

The GDP growth fell to 0.6% in 2014. The unemployment rate remained low (slightly over 5%, seasonally adjusted) in 2014. In December 2014, the annual consumer price growth amounted to 11.4%.

DEVELOPMENT IN THE BANKING SECTOR (INCLUDING THE ASSETS TOTAL / GDP)

The key macroeconomic indicators of the Russian banking sector are close to the benchmarks set by the Banking Sector Development Strategy of the Russian Federation for the period until 2015 (hereinafter – the Strategy), or exceed them. Measures to increase capitalisation of Russian banks taken by the Government of the Russian Federation and the Bank of Russia will help to achieve the target capital to GDP ratio of 14-15% set by the Strategy.

The bank assets to GDP ratio rose from 86.8% to 108.7%. The total value of loans to the economy (non-financial institutions and households) increased over 2014 by 25.9% (in 2013 – by 17.1%) to 40.9 trillion rubles; these loans grew over the year by 12.9%, excluding foreign exchange revaluation. The share of these loans in banking sector assets decreased from 56.5% to 52.6%. The ratio of the total loan portfolio to GDP increased significantly: from 49.0% to 57.2%.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN RUSSIA

In compliance with the Federal Law on the Central Bank of the Russian Federation (the Bank of Russia Law), the Bank of Russia is the banking regulation and banking supervision authority. The principal objectives of banking regulation and banking supervision are to maintain stability of the Russian banking system and protect interests of depositors and creditors. The Bank of Russia exercises ongoing supervision over the compliance by credit institutions and banking groups with Russian legislation, Bank of Russia regulations and required ratios.

The Bank of Russia analyses the activity of bank holding companies and uses the received information for the purposes of banking supervision over credit institutions and banking groups integrated into bank holding companies.

The Bank of Russia sets rules, binding for credit institutions, banking groups and bank holding companies, for compiling and presenting accounting (financial), statistical and other statements required for consolidated risk assessment and supervision of credit institutions.

To fulfil its functions, the Bank of Russia is entitled to request information on the activities of credit institutions, banking groups and bank holding companies, including data on the members of banking groups and bank holding companies other than credit institutions.

The Bank of Russia sets requirements for risk and capital management and internal controls of credit institutions and banking groups, and also assesses the quality of these systems.

The Bank of Russia is entitled to assess the remuneration system of a credit institution as regards the results of risk management and to send the credit institution a direction on eliminating violations.

The Bank of Russia is entitled to set qualification and business reputation requirements for chief accountants (and their deputies), heads of branches, members of the board of directors (supervisory board), large shareholders (participants) of credit institutions, and qualification requirements for the head of the risk management service, the head of the internal audit service and the head of internal controls of credit institutions or the parent credit institution of a banking group. The Bank of Russia is entitled to demand the replacement of persons holding the specified positions if they fail to comply with qualification and business reputation requirements.

To ensure stability of credit institutions the Bank of Russia may establish the following required ratios (also valid for banking groups):

- the maximum size of property (non-monetary) contributions to the authorised capital of a credit institution, and the list of non-monetary property that may be contributed as payment for the authorised capital;
- the maximum risk per borrower or a group of related borrowers;
- the maximum amount of high credit risks;
- the liquidity ratios of a credit institution;
- the own funds (capital) adequacy ratios;
- the amount of currency, interest rate and other financial risks;
- the minimum risk provisions;

- the ratios for a credit institution to use its own funds (capital) to acquire shares (stakes) of other legal entities;
- the maximum amount of loans, bank guarantees and sureties provided by a credit institution (banking group) to its shareholders (members).

The Bank of Russia establishes the methodology for calculating capital and required ratios of a credit institution (banking group), taking account of international standards and consultations with credit institutions and banking associations and unions. The Bank of Russia is entitled to establish different ratios and methods for calculating them for various types of credit institutions. The Bank of Russia sets requirements for bank risk management methods and quantitative risk assessment models, applied by credit institutions and banking groups for evaluating assets, calculating capital adequacy ratio and other required ratios.

In order to exercise its regulatory and supervisory functions, the Bank of Russia conducts examinations of credit institutions (their branches), sends them binding orders to eliminate violations that have been revealed in their operations, and applies sanctions specified in the Bank of Russia Law with respect to violators.

The Bank of Russia is entitled to inspect the activity of credit institutions participating in banking groups and bank holding companies and located on the territories of foreign states. Banking supervisory authorities of foreign states may gain access to information on the activity of credit institutions located on the territory of the Russian Federation as members of banking groups whose parent organisations are foreign banks upon a written consent of the credit institutions participating in banking groups. Supervisors shall inform the Bank of Russia about the results of such inspections.

If a credit institution violates federal laws or Bank of Russia supporting regulations and orders, fails to provide information, or provides incomplete or inaccurate information, the Bank of Russia is entitled to demand that the credit institution should eliminate the revealed violations, to impose a fine of up to 0.1% of the minimum authorized capital, or restrict the credit institution from engaging in certain operations for up to six months, including operations with the parent credit institution of the banking group, the parent organisation of the bank holding company, participants of the banking group, participants of the bank holding company or persons related to the credit institution.

The Bank of Russia is entitled to revoke a credit institution’s banking licence on grounds stipulated in the Federal Law on Banks and Banking Activities. The procedures for revoking a banking licence are established in Bank of Russia regulations.

The Bank of Russia analyses the performance of credit institutions (banking groups and bank holding companies) in order to identify situations threatening the legitimate interests of their depositors and creditors and the stability of the Russian banking system.

Under the risk-focused supervision of systemically important credit institutions the Bank of Russia appoints its authorised representatives to credit institutions supported by the state, and to credit institutions whose assets total 50 and more billion roubles and (or) the funds raised from individuals under bank deposit and bank account agreements total 10 and more billion roubles. The procedure for the appointment of authorised representatives, the performance of their functions and the termination of their activities is established by the Bank of Russia.

Since 2013, the Bank of Russia is a regulatory, controlling and supervisory authority on financial markets over non-credit financial institutions and (or) the area of their activities in compliance with federal laws.

The Bank of Russia cooperates with credit institutions, non-bank financial institutions, their associations and unions and self-regulatory organizations, holds consultations with them before taking the most important decisions relating to legislation, gives the necessary explanations and considers proposals on issues relating to banking and financial market regulation.

Banking legislation of the Russian Federation (including Bank of Russia regulations) in the area of banking supervision is being changed in order to maintain its effectiveness due to the development of the national banking system and regulatory practices, taking account of the international banking supervision practice.

In order to strengthen the resilience of the Russian banking sector, the Bank of Russia enhances banking regulation practices following the recommendations of the Financial Stability Board and the Basel Committee on Banking Supervision (BCBS). Basel III minimum capital requirements came into force for Russian banks as prudential requirements starting from 1 January 2014 (in line with the initial date of the introduction of these requirements by the EU and the US).

The Bank of Russia requires maintaining a higher level of the total capital adequacy ratio than the BCBS – at 10% of risk-weighted assets. Stricter rules are applied also to the minimum Common Equity Tier 1 requirement (CET 1), which is set at 5%. Tier 1 minimum capital requirement is set in line with Basel III given the phase-in arrangements (5.5% – since 1 January 2014, 6% – since 1 January 2015).

To implement the new liquidity standards according to Basel III, the Bank of Russia has published for comment a draft regulation on calculating the liquidity coverage ratio (LCR) and a draft LCR reporting template. In 2014, Russian banks started calculating the LCR for monitoring purposes. According to the internationally agreed timeline for Basel III implementation, the LCR initially was expected to come into force in Russia as a prudential requirement starting from 1 January 2015 then its implementation was postponed to 1 July 2015.

In late 2014, in order to create conditions for the banking sector to adapt to sharp fluctuations in the foreign exchange and financial markets (price and yield of securities) mostly resulting from the external factors, the Bank of Russia decided to temporary ease some prudential requirements.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

In 2014, principal efforts of the banking supervision continued to focus on developing risk-based approaches for assessing soundness of credit institutions under supervisory arrangements for protecting interests of depositors and creditors and maintaining the stability of the banking sector. The key task of supervision was an early identification of negative trends in bank operations. The important supervisory goals were the increasing transparency of credit institutions' activity and the adequate record of risk exposure in financial statements.

The Bank of Russia paid close attention to the largest banks of federal and regional importance, banks with financial strains and banks involved in large scale dubious operations.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2014, the Bank of Russia adopted regulations to improve banking regulation and supervision. The policy of rehabilitation and strengthening of the banking sector was continued, including measures to further intensify the banking supervision, ensure maximum transparency of banks' operations to the regulator, and understand the business model of the bank.

For the purpose of early detection of problems in credit institutions' operations the Bank of Russia continued to implement the risk-based approach to the banking supervision, assuming the priority of content over the form of asset valuation.

The Bank of Russia gave more attention to the quality of internal controls in credit institutions and the compliance of banks' internal control rules with the regulatory requirements.

Under the supervision framework the Bank of Russia applied methods of consolidated supervision over banking groups to reduce the concentration of bank risks in the owners' business.

Among the bank risks, the credit risk traditionally calls for special supervisory attention. Amid vigorous build-up of loan portfolios by banks in 2014 more attention was paid to the actual business performance of the borrower as the source of funds to service the loans and to the quality and adequacy of collateral used to adjust the value of created provisions.

The Bank of Russia gave additional attention to the situation in the market of unsecured consumer lending that experienced considerable risk accumulation in recent years. As a result of the adopted regulatory measures (including statutory restrictions on the total cost of consumer loans) and the undertaken supervision efforts some banks adjusted their development strategy, focused on risk management systems, and pursued the policy of gradual replacement of old portfolios with higher quality new ones.

The Bank of Russia continued to analyse the credibility of banks' assessment of certain types of assets, including shares of closed-end unit investment funds and real estate.

In 2014, dramatic changes in the foreign exchange market led to significant structural changes in balance sheet indicators and leaps in market interest rates increased the cost of credit institutions' funding. The supervisory practice monitored the impact of movements in the foreign exchange rates and interest rates on the income and capital of banks with a sizeable share of assets and liabilities denominated in foreign currencies.

The establishment of a mega-regulator offered additional opportunities for the banking supervision to obtain information on the interactions of banks with other financial market participants.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

The Supervisory Authority of the Bank of Russia head office includes the Banking Supervision Department, the Banking Regulation Department, the Credit Institution Licensing and Financial Rehabilitation Department, the Systematically Important Banks Supervision Department, the Financial Monitoring and Foreign Exchange Control Department and the Bank of Russia Chief Inspection. The main objectives of these divisions are to provide methodological and organisational support to the Bank of Russia statutory functions of banking supervision under the framework of the entire supervisory cycle: from licensing credit institutions, establishing regulatory requirements, exercising the on-going supervision of their activities and conducting on-site inspections to financial rehabilitation of credit institutions and implementation of measures to liquidate financially unviable credit institutions, if necessary.

The supervisory divisions are managed by the Bank of Russia Banking Supervision Committee headed by the Bank of Russia First Deputy Chairman in charge of this area. The Committee is responsible for making decisions on banking supervision policies.

The Bank of Russia carries out its banking supervision policies through its regional offices in the constituent entities of the Russian Federation.

The Bank of Russia supervisory divisions employ 5,038 executives and specialists, of which 42.6% work at the head office, and 57.4% are engaged in the regional branches. Most specialists (98.2%) hold a university degree, are aged 30-50 y.o. (61.8%), and have over three year experience in the banking system (87.0%).

INTERNATIONAL ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2014, the Bank of Russia continued to take part in the activities of the Basel Committee on Banking Supervision (BCBS) and its working groups and sub-groups on standards implementation, capital and liquidity issues, macroprudential supervision and supervisory colleges. The Bank of Russia also participated in the mutual assessment of the compliance of the BCBS member countries with BCBS standards and documents.

In 2014, it also worked to prepare information and other material at the request of the Secretariat of the BCBS Group of Bank Supervisors from Central and Eastern Europe (BSCEE).

In May 2014 the Bank of Russia hosted BSCEE Seminar on the topic «Basel III and Systemic Stability Policy».

The Bank of Russia pays much attention to cooperation and exchange of information with banking supervisory authorities of foreign countries. It has signed 37 cooperation agreements (memorandums of understanding) with foreign bank supervisors. In 2014 draft cooperation agreements (memorandums of understanding) were discussed with banking supervisory authorities of several foreign countries.

In this regard aiming at enhancing cross-border cooperation the Bank of Russia continued to inform foreign supervisory authorities about the latest legislative amendments concerning its powers to provide information which constitutes banking secrecy, to conduct on-site inspections of cross-border establishments of banking groups and banking holdings, as well as about guarantee of the higher protection of information provided to the Bank of Russia by foreign supervisors.

In 2014, the Bank of Russia held bilateral meetings on key issues of banking supervision and banking regulation with supervisory authorities of China and Hungary.

In order to coordinate the activities of authorities supervising banking groups' cross-border establishments and to determinate the mode of supervision of credit institutions participating in banking groups, as well as to ensure transparency of international banking operations, the Bank of Russia cooperates with foreign supervisors in multilateral colleges. In particular, the Bank of Russia representatives participated in supervisory colleges held by supervisory authorities of Austria, Hungary and the Netherlands.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The Bank of Russia has developed cooperation with Ministries and governmental agencies of the Russian Federation within the framework of inter-agency agreements and arrangements with the Ministry of Finance, Russian Federal Treasury, the Federal Financial Monitoring Service, the Federal Anti-Monopoly Service, the Federal Tax Service, the Federal Customs Service, Pension Fund and other federal agencies.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

Despite slower economic growth in Russia, the banking sector developed quite intensively: over the year assets of credit institutions increased by 35.2% (adjusted for exchange rate dynamics – by 18.3%) to 77.7 trillion rubles (in 2013 – by 16.0%).

The recent downward trend in the number of credit institutions continued in 2014: it decreased by 89 to 834 during the reporting year.

During 2014, the resource base of banks was formed amid the actual closing of foreign markets and the slowdown of economic growth. Russian banks expanded the resource base mainly due to the corporate funds and borrowing from the Bank of Russia. High rates of the resource base nominal growth were largely determined by the exchange rate dynamics.

In 2014, the access to external funding sources for Russian banks was almost completely closed, which encouraged the banking sector to use domestic sources more intensively; whereas the structure of these sources changed significantly.

In the reporting period, the amount of funds in customer accounts increased by 25.4% (in 2013 – by 16.0%) to 43.8 trillion rubles; the share of these funds in the banking sector liabilities decreased over the year from 60.8% to 56.4%.

Amid slower growth of household deposits and restricted access to external funding, the value of borrowing from the Bank of Russia increased over the year more than twofold to 9.3 trillion rubles; deposits placed with banks by the Federal Treasury increased sixfold (to 0.6 trillion rubles). As a result, the share of funds raised from the Bank of Russia in banks' liabilities increased over the year from 7.7% to 12.0%, and of funds raised from the Federal Treasury – from 0.2% to 0.7%.

The total value of loans to the economy (non-financial institutions and households) increased over 2014 by 25.9% (in 2013 – by 17.1%) to 40.9 trillion rubles; these loans grew over the year by 12.9%, excluding foreign exchange revaluation. The share of these loans in the banking sector assets decreased from 56.5% to 52.6%.

The value of loans and other placed funds provided by banks to non-financial organisations increased by 31.3% in the reporting period (in 2013 – by 12.7%); adjusted for the foreign exchange factor, the increase was 13.0%. The corporate loan portfolio reached 29.5 trillion rubles, and as of 1 January 2015 its share in the banking sector assets amounted to 38.0% (in early 2014 – 39.2%). Despite the increased needs of companies to refinance their foreign debt, demand for loans at the year-end was held back by higher cost of borrowing.

Household lending increased over the year by 13.8% (in 2013 – by 28.7%) and as of 1 January 2015 the portfolio reached 11.3 trillion rubles; adjusted for exchange rate dynamics, the increase was 12.5%. During 2014, the growth rate of household loans predictably declined mainly due to the dramatic reduction in the unsecured consumer lending (as of 1 January 2015, the annual growth rate in this segment declined during the year nearly threefold and amounted to 8.9%). In early 2015, the debt on unsecured consumer loans amounted to 6.4 trillion rubles.

In 2014, bank profits totalled 589 billion rubles (in 2013 – 994 billion rubles). Credit institutions' return on assets amounted to 0.9%, return on equity – 7.9% (in 2013 – 1.9% and 15.2% respectively).

Over the year the capital adequacy ratio decreased across the entire banking sector from 13.5% to 12.5%. The decline was caused by high growth of risk-weighted assets.

STATISTICAL TABLES

Number of financial institutions
(at year-ends)

Type of financial institution	2012	2013	2014
Banks	897	859	783
Non-bank credit institutions	59	64	51
Banking sector total	**956**	**923**	**834**

Ownership structure of banks on the basis of assets total (%)
(at year-ends)

Type of financial institution	2012	2013	2014
State-controlled banks	50,6	51,5	58,9
Other banks controlled by residents	31,5	33,2	31,3
Banks controlled by residents, total	82,1	84,7	90,1
Foreign-controlled banks (banks with non-resident interest in excess of 50%)	17,9	15,3	9,9
Banking sector (excluding non-bank credit institutions), total	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions
(at year-end)

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Banks	46,4	53,8	0,109
Non-bank credit institutions	82,4	91,2	0,344
Banking sector, total	46,3	53,6	0,108

Return on Equity (ROE) by type of financial institutions*

Type of financial institution	2012	2013	2014
Banks	18,1	15,1	7,8
Non-bank credit institutions	58,2	48,1	21,8
Banking sector total	**18,2**	**15,2**	**7,9**

* Calculated as the ratio of the current years balance sheet profit to the average chronological value of capital over the accounting period

Distribution of market shares in balance sheet total*
(at year-ends, %)

Type of financial institution	2012	2013	2014
Banks	99,7	99,7	99,6
Non-bank credit institutions	0,3	0,3	0,4
Banking sector total	**100,0**	**100,0**	**100,0**

* Share in aggregate banking sector assets

The structure of assets and liabilities of the banking sector (%)
(at year-ends, %)

Assets	2012	2013	2014
Financial sector	16,5	15,7	16,3
Nonfinancial sector	56,0	56,5	52,6
Government sector (including the Bank of Russia)	7,5	7,0	7,4
Other	20,0	20,7	23,7
Liabilities	**2012**	**2013**	**2014**
Financial sector (including credit institutions)	13,5	12,6	12,4
Nonfinancial sector	49,2	49,6	44,5
Government sector (including the Bank of Russia)	7,1	8,6	13,4
Capital (profits, funds)	11,9	11,5	8,9
Other	18,3	17,7	20,8

Capital adequacy ratio of banks

Type of financial institution	2012	2013	2014
Banks	13,7	13,4	12,4
Non-bank credit institutions	36,9	34,8	63,4
Banking sector, total	**13,7**	**13,5**	**12,5**

Asset portfolio quality of the banking sector
(share of non-performing loans, %)

Asset classification	2012	2013	2014
Non financial sector	6,9	6,8	7,9
households	6,5	7,5	9,9
corporate (including individual entrepreneurs)	7,0	6,5	7,2

The structure of deposits and loans of the banking sector in 2014
(at year-end, %)

	Deposits and other funds raised by credit institutions	Loans, deposits and other funds provided by credit institutions
Non financial sector, including:	**92,5**	**94,8**
Households	52,2	25,2
Non financial institutions	40,3	69,6
Government financial authorities and off-budget funds*	2,9	2,3
Financial sector (excluding banks)	4,60	2,9
Total	100,0	100,0

P&L account of the banking sector in EUR
(at year-ends)

P&L account	2012	2013	2014
Interest income	89 018 905	98 091 365	77 426 441
Interest expenses	43 512 634	48 595 053	40 352 148
Net interest income	45 506 272	49 496 312	37 074 293
Net commission income	14 052 923	14 546 949	10 610 076
Other (not specified above) income (net)	7 537 236	9 475 488	10 981 474
Gross income	67 096 431	73 518 749	58 665 843
Administration costs	36 814 528	37 779 667	27 994 920
Depreciation	n/a	n/a	n/a
Loan loss provisions	5 102 870	13 635 682	22 027 437
Impairement on financial assets not measured at fair value through profit and loss| Provisions on financial assets (loans, …)	n/a	n/a	n/a
Profit (loss) before tax	25 179 033	22 103 401	8 643 486
Profit (loss) after tax	20 101 727	17 906 761	7 553 571

Total Own Funds in 2014 (in EUR)

Type of financial institution	Total own funds (capital)	Core capital	Additional capital
Banks	114 971 462	82 734 547	32 236 916
Non-bank credit institutions	1 038 562	938 008	100 554
Banking sector, total	**116 010 024**	**83 672 555**	**32 337 470**

2014 DEVELOPMENTS IN THE SERBIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Economic activity in 2014 was under a strong impact of negative effects of the floods which hit Serbia in May, and the slowdown in external demand. The floods inflicted the greatest damage on the energy and mining sectors, whereas the diminished activity in manufacturing was largely due to slower growth in our main foreign trade partners, which all together negatively contributed to GDP by 1.5 pp. Lower activity was also recorded in trade sector. On the other hand, increased activity in transport, agriculture, information and communications, and construction sectors partially offset the annual GDP fall of 1.8%.

On the expenditure side of GDP, economic activity in 2014 was mainly under the influence of a decline in private consumption and lower private investments. Net exports provided mild negative contribution as the slowdown in exports influenced both by the floods and dented external demand, was almost compensated by slower growth in imports due to fiscal consolidation measures. However, in late 2014 first signs of economic activity began to emerge – in the last quarter of 2014, GDP grew by 0.6% in seasonally-adjusted terms.

In contrast to 2013 when earlier investments in automobile and oil industries gave their full effect on exports, movements in 2014 were under a strong impact of the floods. However, the current account deficit was by 5.4% lower compared to 2013 despite the flood effects. Its share in GDP fell to 6.0%, down by 0.1 percentage point compared to 2013. Contribution to CAD reduction came from the shrinking trade deficit caused by greater export growth relative to import and the larger surplus in the services account. This created a sounder footing for a sustainable external position and more stable exchange rate of the dinar. The net FDI and portfolio investment inflow came at EUR 1.2 bln and EUR 368.9 mln, respectively, but it is still below the pre-crisis level as a consequence of slower global recovery and increased risk aversion to emerging economies. Net outflow regarding foreign financial loans by residents came at EUR 756.7 million. Even though they declined from end-2013, foreign exchange reserves remained at an adequate level. At end of year, they amounted to EUR 9.9 bln and covered more than six months of imports of goods and services.

Low inflationary pressures, which marked 2013, weakened further in 2014. In addition to monetary policy measures and reduced aggregate demand, low inflationary pressures were also aided by factors with a temporary effect – the unusually low growth in administered prices, falling prices of primary agricultural commodities and a vigorous fall in global oil prices in the second half of the year. These factors with a temporary disinflationary effect provided the strongest influence on inflation's moving below the lower bound of the target tolerance band (4±1.5%) throughout the major part of the year. Namely, year-on-year inflation fell from 3.7% in January to 1.7% in December.

Disinflationary pressures in 2014 were diminished by monetary policy easing through cuts in the key policy rate by 150 bp and dinar's depreciation against the euro in the second half of 2014, which is why Serbia managed to avoid deflation, unlike the majority of other countries in the region. Monetary policy was pursued with caution due to risks emanating from the international environment and unfavorable fiscal trends, particularly in the first half of the year.

The first half of 2014 saw an underperformance in collection of tax revenues. Fiscal trends were more favorable in the second half of 2014, mainly owing to the effects of undertaken fiscal consolidation measures in curbing grey economy and tax evasion, as well as of the cuts in pensions and public sector wages. Consolidated fiscal deficit, that also includes guarantees and costs of capital increase of banks and majority state-owned enterprises, reached 6.7% of GDP in 2014, of which 3 pp related to interest payments. In addition to keeping public sector wages and pensions subdued over the next two to three years, the fiscal strategy also envisages public sector rightsizing, cuts in subsidies and the reform of public enterprises. All these measures aim to narrow consolidated budget deficit to 3.8% of GDP by 2017, stabilize the public debt to GDP ratio around 80% and pave the way for its gradual reduction.

Key macroeconomic indicators

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Q1 2015
Real GDP growth (in %)[1)]	5.5	4.9	5.9	5.4	-3.1	0.6	1.4	-1.0	2.6	-1.8	-1.8
Consumer prices (in %, relative to the same month a year earlier)[2)]	17.7	6.6	11.0	8.6	6.6	10.3	7.0	12.2	2.2	1.7	1.9
NBS foreign exchange reserves (in EUR million)	4,922	9,020	9,634	8,162	10,602	10,002	12,058	10,915	11,189	9,907	10,515
Exports (in EUR million)[3)]	5,329	6,948	8,110	9,583	8,043	9,515	11,145	11,469	13,937	14,451	3,527
- growth rate in % compared to a year earlier	19.1	30.4	-	18.2	-16.1	18.3	17.1	2.9	21.5	3.7	6,7
Imports (in EUR million)[3)]	9,612	11,970	15,468	18,267	13,099	14,244	16,487	16,992	17,782	18,096	4,432
- growth rate in % compared to a year earlier	0.7	24.5	-	18.1	-28.3	8.7	15.7	3.1	4.7	1.8	7.1
Current account balance[3)] (in EUR million)	-1,778	-2,356	-5,474	-7,126	-2,032	-2,037	-3,656	-3,671	-2,098	-1,985	-450
as % of GDP	-8.4	-9.6	-18.6	-21.1	-6.6	-6.8	-10.9	-11.6	-6.1	-6.0	-6.2
Unemployment according to the Survey (in %)	20.8	20.9	18.1	13.6	16.1	19.2	23.0	23.9	22.1	18.9	
Wages (average for the period, in EUR)	209.7	260.0	347.1	400.5	337.4	330.1	372.5	364.5	388.6	379.3	344.0
RS budget deficit/surplus (in % of GDP)[4)]	0.5	-1.7	-1.6	-1.7	-3.2	-3.4	-4.0	-5.9	-5.2	-6.4	-2.4
Consolidated fiscal result (in % of GDP)[4)]	1.2	-1.5	-1.9	-2.6	-4.4	-4.6	-4.8	-6.8	-5.5	-6.7	-2.4
RS public debt, (central government, in % of GDP)	50.2	35.9	29.9	28.3	32.8	41.8	45.4	56.2	59.6	71.0	75.0
RSD/USD exchange rate (period average)	66.87	67.03	58.39	55.76	67.47	77.91	73.34	88.12	85.17	88.54	108.15
RSD/USD exchange rate (end of period)	72.22	59.98	53.73	62.90	66.73	79.28	80.87	86.18	83.13	99.46	111.42
RSD/EUR exchange rate (period average)	82.99	84.11	79.96	81.44	93.95	103.04	101.95	113.13	113.14	117.31	121.50
RSD/EUR exchange rate (end of period)	85.50	79.00	79.24	88.60	95.89	105.50	104.64	113.72	114.64	120.96	120.22
MEMORANDUM: GDP (in EUR million)[5)]	21,103	24,435	29,452	33,705	30,655	29,766	33,424	31,683	34,263	33,075	7,221

1) At constant prices of previous year.

2) Retail prices until 2006.

3) Starting from 2007 data on exports and imports of goods and services are shown in accordance with BPM6. Data for 2005 and 2006 are shown according to BPM5. Due to methodological incomparability, exports and imports growth rates are not shown. As of 1 January 2010, the Serbian Statistical Office applies the general trade system of registration of exports and imports which is a broader concept and includes all goods entering/exiting country's economic territory, apart from goods in transit. The Statistical Office has published comparable data for 2007, 2008 and 2009. Previous years are disseminated using the special trade system. Trade with Montenegro is registered within relevant transactions as of 2003.

4) Includes below-the-line items (payment of called guarantees, bank recapitalisations and debt takeover) in line with IMF methodology, as of 2008 on RS budget level and as of 2005 on consolidated level.

5) According to ESA 2010.

Notes:

1. Data are subject to corrections in line with the official data sources.
2. Source for the data on unemployment: Labour Force Survey, Statistical Office
3. Source: MoF for public debt and NBS for estimated GDP.

DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

The banking sector, as the largest portion of the financial system of Serbia (92.0%), has been relatively successful in overcoming the negative spill-over effects of the global financial crisis. Reasons lie in the previously accumulated liquidity and solvency buffers, timely support of parent banks and measures taken by the NBS and Government of the RS for alleviating negative effects of the global financial crisis on Serbia. Banking sector is adequately capitalized and liquid, still, non-performing loans seem to be the main issue in Serbian banking sector.

At the end of December 2014, there were 29[27] banks operating in Serbia. All banks in Serbia are operating as independent legal entities, no branching is allowed. 21 banks were in majority foreign ownership, 2 banks were in majority ownership of domestic natural persons and legal entities, while 6 banks were in majority ownership of the Republic of Serbia. Foreign-owned banks are members of banking groups from 11 countries and the most significant foreign banks are from Italy and Austria (24.9% and 14.8%, respectively), followed by banks from Greece (14.1%), France (10.2%) and other countries (10.5% share in total). In Serbia, overall financial intermediation by banks is still on relatively low level in comparison to more developed markets. The share of banking sector assets to GDP amounted to 76.6% at the end of December 2014.

Total balance sheet assets of the banking sector in Serbia reached 24.5 bln EUR at the end of 2014 which is a decrease of 1.1% since the end of 2013.

With a large number of banks holding small shares in total assets, lending, deposits and income, the Serbian banking sector is fragmented. The market share of the top five banks in Serbia is 53.5% for assets, 53.9% for lending and 52.5% for deposits.

At the end of December 2014 total net value of loan portfolio was at the level of EUR 13.7 billion which is a decrease of 7.1% compared to the end of 2013. Loans to corporate sector (both private and public sector companies) made 52.4% of total loans with EUR 7.2 billion, at the end of 2014. During 2014 loans to corporate sector have decreased by 3.6%. The growth rate of total household loans was 2.9% during 2014 and at the end of December 2014 they amounted to EUR 4.9 billion and made 36.0% out of total loans.

At the end of December 2014, the share of NPL's in total loans granted was 21.5% gross (11.1% net), while in absolute terms, their level reached 3.5 bln EUR gross. Despite the relative size of the non-performing share of lending portfolios in Serbia's banking sector, significant provisioning has been established both by means of International Financial Reporting Standards ("IFRS") rules (59.0% of NPL's was provisioned) and local asset classification rules (114.5%).

Total banking sector deposits at the end of December 2014 stood at the level of EUR 15.6 bln with an increase of 3.8% in 2014. Household deposits made 57.9% of total deposits with increase of 1.5% in 2014. Savings deposits are most prominent in both household and total deposits with EUR 8.5 billion at the end of December 2014. Approximately, one fifth of all deposits were related to corporate sector with a EUR 3.2 billion at the end of 2014 which is an increase of 1.7% compared to the previous year.

[27] NBS issued operating licence to Mirabank on 16 December 2014 and the bank started its operations in April 2015.

The growth rate of own funding sources was sufficient to maintain the proportion of own funds to total liabilities of 20.7% as of 31 December 2014. The capital adequacy ratio was 19.96% at the end of December 2014, which is significantly above the regulatory minimum of 12%.

The average regulatory liquidity ratio for the Serbian banking sector in December 2014 was 2.16, indicating that liquid assets (core and receivables maturing in the next 30 days) were twice as large as liabilities without maturity and liability maturity within 30 days. Liquid assets comprised 37.1% of total assets and 58.6% of total short-term liabilities.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN SERBIA

The broader regulatory framework in the field of banking supervision consists of two laws of systemic importance: The Law on the National Bank of Serbia, and the Law on Banks.

Within one of its main objectives - contribution to the safeguarding and strengthening of the stability of the financial system, the National Bank of Serbia is responsible for issuing and revoking operating licenses for banks, as well as carrying out prudential supervision of safety, soundness and legality of bank's operations, and performs other activities in accordance with the Law on Banks.

During 2012, amendments to the Law on the National Bank of Serbia were adopted with the aim of increasing the quality of supervision of the Serbian financial system. In accordance with these amendments, which came into force in August and November 2012, The Administration for Supervision of Financial Institutions (hereinafter: the Supervision Administration) was formed. The Supervision Administration is an organizational unit within the National Bank of Serbia and does not have a legal personality.

The Supervision Administration was set up to perform activities related to the supervision of banks, insurance companies, financial leasing companies and voluntary pension fund management companies. Supervision Administration can propose to the Executive Board by-laws and issuance of licenses to financial institutions, and must deliver a report to the Council of the Governor each quarter. The Director of the Supervision Administration is appointed by the National Assembly on proposal of the Assembly committee in charge of finance for a six-year renewable term of office, and the Director is a member of the Executive Board of the NBS. Supervision Administration and its mandate are in more detail regulated by the NBS by-law.

Prudential regulatory framework in Serbia is based on regulations which implement Basel II standards to a large extent, and which are effective as of 31st December 2011.

During 2014, the National Bank of Serbia continued to develop its regulatory framework in line with the development of international standards of supervision, while taking into account macroeconomic developments and characteristics of the local banking sector. In that period, draft amendments and supplements to the Law on the National Bank of Serbia and the Law on Banks were prepared, with the aim of improving bank recovery and resolution framework in line with principles and rules set out in the Directive 2014/59/EU (BRRD). Those amendments and supplements were adopted in February 2015.

Besides major changes to the Law on Banks in February 2015, during 2014, the NBS adopted several by-laws. At its meeting held in May 2014, the NBS Executive Board adopted the Decision Amending the Decision on Capital Adequacy of Banks. The change concerns the extension of deadline – from 1 January 2015 to 1 January 2018, by which banks may assign 0% credit risk weight to all exposures to the Republic of Serbia and the NBS (including exposures that are not denominated and funded in dinars), as well as to exposures to central governments and central banks of EU Member States whose credit assessment is associated with credit quality step 3 or above and which are denominated and funded in the domestic currency of any Member State.

The decision to extend the deadline for the application of a more favorable credit risk weight was made after careful consideration of the regulatory treatment of exposures to governments and central banks under the EU regulations that implement Basel III standards and envisage the same type of a more favorable treatment until 31 December 2017.

The Decision on Bank Reporting Requirements was adopted to harmonize the reports prescribed by the Decision with a set of accounting regulations published in the RS Official Gazette, No 71/2014, as well as to upgrade individual reports that banks submit to the NBS.

The Decision on Disclosure of Data and Information by Banks introduces four standard forms for banks to disclose data on their capital and main features of financial instruments which are included in capital calculation, data on the reconciliation of regulatory capital items with capital items from bank balance sheets, and data on capital adequacy. The Decision aims to ensure greater transparency in bank operation and to provide the broadest public with a set of simple, comparable and easily accessible data and information on bank capital, which should facilitate business decision making and assessment of banks' risk profile.

At its meeting of 12 December 2014, the NBS Executive Board adopted the Decision Amending the Decision on the Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items. The amendments mark an improvement on the current provisions regulating the recognition of prime and adequate collateral. Furthermore, receivables from a natural person borrower on whom the bank does not have an updated credit record, instead as currently in the E category, are now classified one category below the category where they would otherwise be classified. This should preclude unjustified provisioning for reserves by banks in respect of accounts of clients who regularly settle their obligations. This however would not diminish the bank's obligation to appropriately assess the creditworthiness of these persons and thereby ensure adequate credit risk management. In addition, provisions on credit records of debtors – farmers and entrepreneurs have been aligned with amended regulations on taxation of income from independent business activities.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

As part of its efforts to continuously improve the regulatory framework for banking operations in line with international standards and EU regulations, the NBS Executive Board in its meeting of 17 December 2013 adopted the Strategy for Implementation of Basel III Standards in Serbia, which covers relevant issues under the new set of standards and envisages three phases of Basel III implementation:

- a preparatory phase to conduct a gap analysis between domestic regulatory framework and Basel 2.5 and Basel III standards, and a comparative analysis of the dynamics of the introduction and implementation of Basel III standards by EU member states and neighboring countries, and to draw up an operational plan for Basel III implementation;
- an impact assessment phase which includes setting of the timeframe for implementation of particular elements of Basel III; and
- a legislation drafting phase, i.e. drafting of regulations implementing Basel 2.5 and Basel III standards.

At the meeting in December 2014, the NBS Executive Board adopted the changes of the Strategy for Implementation of Basel III Standards in the Republic of Serbia in a way to achieve the phase approach in conducting quantitative impact study and legislation drafting. The phase approach is an appropriate manner to implement Basel III standards in the banking sector of the Republic of Serbia, which will ensure shorter time distance between the periods of impact assessment and the implementation through regulation.

It should be mentioned that the first phase, envisaged by the Strategy for Implementation of Basel III Standards in the Republic of Serbia, was successfully finished with the completion of gap analysis. The impact assessment for capital and leverage standards is in its finishing stages, while the QIS for liquidity standards will take place in the second half of the year. Drafting of regulations that comply with the Basel III standards i.e. with corresponding EU legislation is underway and is planned to be finished by the end of 2015. The final timeframe for introduction of individual elements of Basel III will be determined when the impact of these amendments has been thoroughly assessed.

Given the scope and complexity of all duties that are expected from the National Bank of Serbia in its banking supervisory role, the NBS is constantly focused on strengthening and improving the capacity of its Bank Supervision Department. This is mainly done through a continuous process of training and education of employees.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

13 on-site supervisions were conducted in 2014: 9 supervisions of safety and soundness and legality of bank's operations from the aspect of risk management, 1 target control (liquidity risk, interest rate risk and market risk) and 3 follow-up on-site supervisions of bank's operations. Further, 14 on-site supervisions were conducted in 2014 regarding the AML/CTF issues, supervision of payment transactions and supervision provisions of Financial Services Consumer Protection Law: 10 targeted control (6 related to AML/CTF issues and supervision of payment transactions, 2 related to AML/CTF issues and 2 related to supervision provisions of Financial Services Consumer Protection Law) and 4 follow-up on-site supervisions of bank's operations related to AML/CTF issues and supervision of payment transactions.

AML

National bank of Serbia, as supervisory body in the field of Prevention of Money Laundering and Financing of Terrorism continued participation in the Project against Money Laundering and Terrorist Financing in Serbia ("MOLI-Serbia"), which successfully ended in May 2014. The MOLI-Serbia project, with an estimated cost of approximately EUR 2.37 million, was primarily funded by the EU through IPA funds (as defined herein), with minimal additional contributions from the Council of Europe and from the Budget. The aim of the project was to improve prevention of money laundering and terrorist financing within Serbia, including through legislation, professional training and supervisory and operative capacities.

As part of the MOLI-Serbia project, after completing a comprehensive assessment of money laundering risk, Serbia, with the significant role of National bank of Serbia, finished Terrorist Financing National Risk Assessment (TFNRA), as same as National Strategy for Prevention of Money Laundering and Terrorist Financing for period 2013 – 2018.

National bank of Serbia representatives continued to take part in Plenary meetings of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism-MONEYVAL.

Measures Against Banks

During 2014, National Bank of Serbia – Banking Supervision Department took following measures against banks: 12 letters of warning, 6 ordering letters, 7 resolutions with orders for banks to undertake certain measures, 3 resolutions on temporary measures and 1 resolution on revoking banks' operating licenses. Further, National Bank of Serbia – Banking Supervision Department rendered 7 resolutions on imposing fines to banks and/or a member (members) of the banks' managing and/or executive board, 5 reports against banks and responsible persons for commercial offences and 8 requests for initiation of the proceedings for commercial misdemeanors against banks and responsible persons.

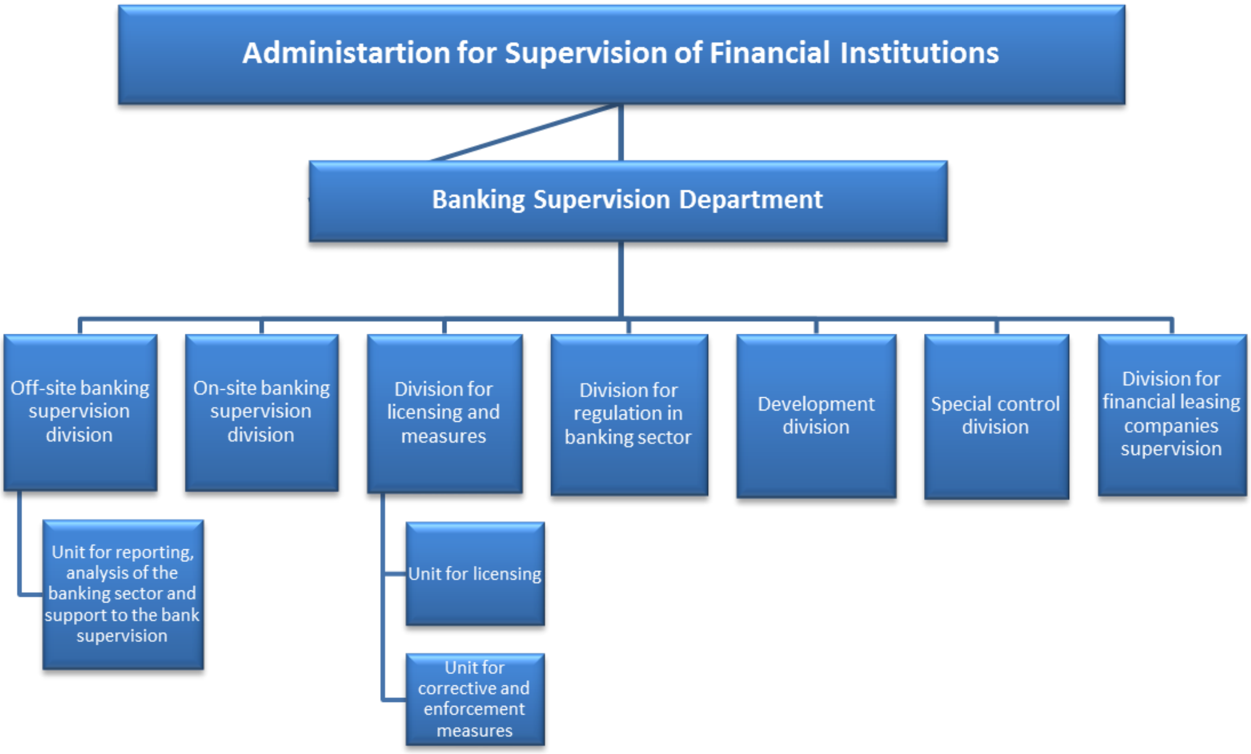
Licensing and Approvals regarding Banks

In 2014, National Bank of Serbia – Banking Supervision Department granted 1 preliminary bank founding permit and 1 bank operating license, approved 13 requests for amendments of banks' founding acts and their articles of association. Also, 97 procedures regarding appointment of managing and executive board members (93 requests were approved, 4 procedures were terminated) and 8 procedures of direct acquisiton of ownership in banks in Serbia (6 requests for acquisiton of an ownership in banks in Serbia were approved and 2 procedures were terminated) were initiated.

Futhermore, 2 requests for distributing bank's profit through payment of dividends to its shareholders were approved, 1 application for approval for acquisition of subordinated company in financial sector was approved, 2 banks were permitted not to include a subsidiary in consolidated financial statements.

The National Bank of Serbia – Banking Supervision Department processed 143 notifications from banks regarding externalization of their business activities and processed 7 notifications from banks about their intent to include subordinated obligations into the supplementary capital.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

NBS has signed Memorandums of Understanding with banking supervision authorities of following countries: Austria, Belgium, Bosnia & Herzegovina and Republika Srpska, Cyprus, France, Germany, Greece, Hungary, Italy, Macedonia, Montenegro, Russia, Slovenia and several multilateral Memorandums of Understanding relating to supervisory colleges of banking groups.

However, even before the conclusion of mentioned memorandums and agreements, the NBS has already established very successful practical cooperation with all of the home supervisors of banks with subsidiaries in Serbia. Beyond signing formal agreements on understanding, cooperation and coordination, cooperation is extended through active participation of the NBS' representatives at Supervisory Colleges.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

In that respect and regarding its supervisory task NBS has signed Memorandums of Understanding with following domestic bodies and authorities:

- Deposit Insurance Agency,
- Securities Commission,
- Administration for the Prevention of Money Laundering,
- Tax Administration,
- Commission for Protection of Competition,
- Association of Serbian Banks and
- the Belgrade Stock Exchange.

The NBS successfully cooperates with all before mentioned supervisory authorities whenever there is a need for sharing information in accordance with MoUs signed. The cooperation with domestic regulatory authorities has been additionally enhanced by conclusion of the multilateral Agreement on cooperation and data exchange between the NBS, Ministry of Finance, Serbian Business Registers Agency, Central Securities Depository and Clearing House and Securities Commission in 2013.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

In Serbia, as well as in other countries in the CEE region, there is relatively high level of NPLs. In addition to introducing regulatory measures aimed at resolving the problem of high NPLs in Serbia, the NBS has continued to analyze various topics related to the monitoring of NPLs and loan loss provisioning.

The NBS has developed and in April 2015, sent to the banks a Survey on indentifying obstacles to solving the problem of NPLs (hereinafter: Survey). The main objectives of the Survey are: identifying the main steps and activities that banks conduct when faced with difficulties in collection of receivables, as well as when the client defaults, the effects of their implementation, as well as the main problems that banks face in that process; identification of the main problems that banks face in the process of assignment of NPLs to other legal entities, as well as the problems that exist in the tax treatment of NPL write-offs; identification of problems in the collection of NPLs and determining the main causes that led to the rapid growth of NPLs in the previous period. NBS is currently in the process of analyzing the results of the Survey and they will be used in in the process of making decisions about future steps that need to be taken in order to resolve the problem of high level of NPLs.

The IMF-NBS financial sector agenda agreed in MEFP is built around several pillars with diagnostics of banks' balance sheets being one of the fundamental. In view of the current uncertain economic environment, **National Bank of Serbia undertakes a program of special diagnostic studies of banks** operating in the Republic of Serbia, in line with similar initiatives in many EU countries. The diagnostic studies commenced in the April 2015 and will be completed by end-September 2015.

These diagnostic studies, largely similar to asset quality reviews conducted in EU countries, will help verify the health of the banking system, dispel uncertainty about banks' asset quality, and guide regulatory and supervisory policies. By specific design of the SDS, intention of the NBS is to shed more light on banks' collateral valuation practices, assessment of the adequacy of provisioning (particularly focusing on the aspect of proper IFRS application), and providing better information for combating vulnerabilities. In parallel, the NBS will further enhance the supervisory and regulatory frameworks by leveraging standards and requirements contained in the EU's Single Rule Book, international best practices, and the insights drawn from the diagnostic studies.

NBS will use the studies to foster conservative implementation of IFRS accounting standards and disclosure practices and in addition diagnostics will be guided, to the extent possible, by strengthened collateral valuation standards and minimum requirements for appraisers. Moreover, NBS will use the experiences obtained thorough this exercise to strengthen its prudential framework and supervisory approach.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	32	30	29
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**32**	**30**	**29**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2012	2013	2014
Public sector ownership	18.1	18.7	19.2
Other domestic ownership	6.8	6.9	6.3
Domestic ownership total	24.9	25.6	25.5
Foreign ownership	75.1	74.4	74.5
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	38.5	53.5	793
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**38.5**	**53.5**	**793**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	4.7*	-0.4	0.6
Cooperative banks			
Banking sector, total:	**4.7***	**-0.4**	**0.6**

* Data without Razvojna banka Vojvodine (licence revoked in April 2013)

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%) (at year-end)

	2012	2013	2014
Claims from			
Financial sector	7.1	10.0	17.0
Nonfinancial sector	55.7	51.9	49.3
Government sector	14.8	16.4	21.9
Other assets	22.4	21.7	11.8
Claims due to			
Financial sector	12.3	10.4	11.0
Nonfinancial sector	61.3	62.7	60.4
Government sector	3.5	4.1	6.3
Other liabilities	2.4	1.9	1.6
Capital	20.5	20.9	20.7

Capital adequacy ratio of banks

Type of financial institution	2012**	2013**	2014**
Commercial banks	19.9	20.9	20.0
Cooperative banks			
Banking sector, total:	**19.9**	**20.9**	**20.0**

(* - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans)

Type of financial institution	2012	2013	2014
Non financial sector			
- households	8.49	9.43	10.30
- corporate	21.19	27.10	26.70

The structure of deposits and loans of the banking sector in 2014 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	89.9	87.4
Households	61.8	41.0
Corporate	21.1	44.5
Government sector	7.4	11.6
Financial sector (excluding banks)	2.7	1.0
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2012	2013	2014
Interest income	200,683	195,940	183,028
Interest expenses	83,611	77,029	58,309
Net interest income	117,072	118,911	124,719
Net fee and commission income	35,543	34,797	34,826
Other (not specified above) operating income (net)	16,528	9,982	11,540
Gross income	169,143	163,690	171,085
Administration costs	103,375	98,776	101,187
Depreciation	8,462	8,099	7,733
Provisions	0	0	0
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	45,652	58,931	58,649
Profit (loss) before tax	11,654	-2,118	3,516
Net profit (loss)	8,446	-3,493	2,283

Total own funds in 2014 (in EUR)

Type of financial institution	Total own funds	Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	2,804,453	N.A.	2,470,224	334,229	
Cooperative banks					
Banking sector, total:	**2,804,453**	**N.A.**	**2,470,224**	**334,229**	

(* - for Basel I; ** - for Basel II; *** - for Basel III)

2014 DEVELOPMENTS IN THE SLOVAKIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Slovakia's annual economic growth increased to 2.4% in 2014, from 1.4% in the previous year. The economy maintained steady momentum during the year, as is evident from the constant rates of quarter-on-quarter GDP growth. Therefore the temporary stalling of the euro area's recovery in the second and third quarters did not have an immediate adverse impact on the domestic economy.

For the first time since the financial crisis, the main driver of Slovakia's GDP growth was household final consumption, following a marked increase in households' real disposable income. The purchasing power of households was boosted both by accelerating nominal wage growth and, significantly, by the lack of change, on average, in consumer prices. Another factor was the increase in consumer confidence.

Although total exports for 2014 as a whole increased in comparison with the previous year, their quarter-on-quarter trend after the first three months was downward. By contrast, investment demand picked up, owing significantly to investment in publicly-funded infrastructure projects. The increase in fixed capital formation was probably related to a turn in the corporate credit cycle.

Economic growth during the period under review was sufficient to have a positive impact on labor market indicators. Employment increased by 1.1% year-on-year, which translated into the net creation of 25,000 jobs. Employment growth was spread across a wide range of sectors, but not construction. This development was reflected in the average unemployment rate, which fell from 14.2% to 13.3%.

In line with the situation in the rest of the euro area inflation decelerated in Slovakia in 2014. The average annual rate of consumer inflation during the year was at -0.1% even slightly negative.

Outlook for Slovak economy is rather positive. GDP growth is expected to accelerate to 3.2% in 2015 and 3.8% in 2016. Alongside domestic demand, this should be driven again by higher net exports.

DEVELOPMENT IN THE BANKING SECTOR (INCLUDING THE ASSETS TOTAL / GDP)

The annual rate of growth of the volume of retail loans continued to accelerate during 2014 and reached 12.2% as at end-December. As the result of this, the growth rate kept to belong between the highest dynamics among EU countries. Significant growth rate was observed in both main categories of loans, housing loans and consumer loans. Demand was mainly driven by significantly decreasing interest rates together with growing average salaries and stagnating real estate prices. NBS Recommendation No 1/2014 was issued as the reaction on these trends in October 2014.

Development in the corporate sector continued to be shaped by the uncertain macroeconomic condition, however can be seen favorable in some respects. During 2014, the annual rate of change in the outstanding amount of corporate loans became less negative and eventually turned positive in the second half of the year. However, developments in the total volume of loans were influenced considerably by lending to state-owned enterprises. Positively can be seen gradually decreasing decline of the loan volume of the private enterprises.

The declining trend in investments in domestic government bonds continued also in 2014. Nevertheless, share of these bonds as a percentage of total assets of the banking sector remained one of the highest in EU.

Given abovementioned trends, the Total assets-to-GDP ratio increased from 85% at the end of 2013 to 87% at the end of 2014.

The credit quality of both, retail and corporate sector remained without significant changes.

Customer deposits, which represent dominant and stable form of financing continued to grow in 2014. Loan-to-Deposit ratio increased to 89% as a result of higher growth rate of loans, but still remained below average in comparison with EU countries.

Profitability of banks operating in Slovakia remained without significant changes in year-on-year terms, but the structure of profit changed considerably in 2014. Changes were driven largely by growing interest income in retail and by increase in commission and fee income in corporate sector. Growing amount of credit risk costs, taxes and levies had negative impact on profitability.

The degree of resistance of domestic banking sector to potential adverse development remained high, as capital adequacy ratio was 17.3% at the end of 2014 and average leverage ratio stayed at satisfactory level slightly exceeding 8%.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN SLOVAKIA

Národná banka Slovenska (NBS – National Bank of Slovakia) performs supervision of the financial market.

As part of its supervision of the financial market, NBS shall perform supervision of banks, branch offices of foreign banks, securities dealers, branch offices of foreign securities dealers, stock exchanges, central depositories, asset management companies, branch offices of foreign asset management companies, mutual funds, foreign collective investment undertakings, insurance companies, reinsurance companies, branch offices of foreign insurance companies, branch offices of foreign reinsurance companies, branch offices of insurance companies from another state, branch offices of reinsurance companies from another state, pension asset management companies, pension funds, supplementary pension insurance companies, supplementary pension companies, supplementary pension funds, payment institutions, branch offices of foreign payment institutions, rating agencies, electronic money institutions, branch offices of foreign electronic money institutions, independent financial agents, financial advisers, the Deposit Protection Fund, the Investment Guarantee Fund, the Slovak Bureau of Insurers, consolidated groups, subconsolidated groups, financial holding institutions, mixed financial holding companies, financial conglomerates, also over other persons, other property associations with a designated purpose and over groups of persons and property associations with a designated purpose.

The Single Supervisory Mechanism (SSM) is a new system of financial supervision that officially entered into operation on 4 November 2014. It comprises the European Central Bank and the national competent authorities (NCAs) of mainly euro area countries, including Slovakia. The basis of the SSM is cooperation between the European Central Bank (ECB) and NCAs, with NBS operating as the NCA in Slovakia. For the purposes of the SSM, banks (credit institutions) are categorised into "significant" and "less significant" institutions, with the ECB directly supervising significant banks, while NCAs are in charge of the supervision of less significant banks. The criteria used to assess whether a credit institution falls within the significant or less significant institution category are set out in the respective EU legislation.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

Apart from making a comprehensive assessment of banks, the main priorities for the year under review were the monitoring of banks' liquidity, credit risks, capital adequacy, and the protection of banks and branches of foreign banks against money laundering and terrorist financing.

NBS participated in the preparation of the Single Supervision Mechanism (SSM), which constitutes the first pillar of the Banking Union under which the European Central Bank (ECB) has taken on responsibility for the supervision of significant institutions. The SSM, which started functioning officially on 4 November 2014, comprises the ECB and the competent national authorities of the participating Member States. When the SSM was introduced, one of its crucial tasks was to carry out a comprehensive assessment of all significant banks, in which NBS also took an active part.

Another important task in 2014 was to establish Joint Supervisory Teams (JSTs) as basic SSM units for the supervision of bank groups at the highest level of consolidation. NBS is a member of nine JSTs. The staff members of NBS representing supervision over local banks in these JSTs are commissioned to act as sub-coordinators. Their task is to coordinate the conduct of supervision activities at local level in accordance with the rules of supervision at the highest level of consolidation.

The completion of the first pillar of the Banking Union in 2014 was followed by the implementation of its second pillar, i.e. the Single Resolution Mechanism (SRM). A legislative framework for the SRM was established in 2014. The second half of August 2014 saw the coming into force of a regulation stipulating uniform rules and procedures for the recovery and resolution of credit institutions and investment firms within the scope of the SRM and the establishment of a Single Resolution Fund (SRF) for bank resolution within the euro area, after an intergovernmental agreement was signed in May 2014 on the transfer and mutualisation of contributions to the SRF. These legal documents, along with the Bank Recovery and Resolution Directive (BRRD) represent the basic legislative pillars of the SRM. The year under review also witnessed the preparatory phase of SRM implementation.

To accomplish the key tasks of bank recovery and resolution in Slovakia, a national resolution authority has been established, namely the Resolution Council, with effect from 1 January 2015. Professional and organisational conditions for the Council to exercise its powers are ensured by NBS through its newly established Resolution Section, which is part of the Regulation Department of the Financial Market Supervision Unit (since 1 September 2014). This organisational arrangement ensures the Resolution Section's operational independence and conflict of interests prevention between the functions of this Section and those of the FMS Unit's other organisational units, the competence of which includes the supervision of credit institutions and investment firms.

In 2014, the NBS representatives were involved in the work of the team in charge of the transposition of the BRRD into the Resolution Act in the Financial Market. This Act was passed by Parliament on 26 November 2014 so that it could enter into force on 1 January 2015 in accordance with the relevant provisions of the BRRD. With the adoption of the Resolution Act, a new framework has been introduced for the prevention and resolution of possible crisis situations in the financial market of Slovakia. The objective of this framework is to deploy an efficient crisis management system suitable for ensuring the financial stability and continuity of the financial system's critical functions. The main task is to protect the depositors of any institution or group that has run into difficulties.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2014, NBS conducted a total of 79 authorisation proceedings in regard to the banking sector. Four of these proceedings were commenced in 2013 and 68 were completed with the issuance of a final decision. Most proceedings concerned the granting of prior approval to appoint new members to the boards of directors or supervisory boards of banks, managerial employees, and heads of the internal control and internal audit units of banks. Within the competence of the ECB, four applications were submitted in the period from 4 November 2014 to the end of 2014 for the approval of new members of the boards of directors or supervisory boards of banks. One of the proceedings conducted in this matter came to an end in 2014 with the issuance of a final decision by the ECB.

In regard to the banking sector, two sanction proceedings were instituted in 2014. One of these proceedings was completed in the period under review with the issuance of a final decision to impose a penalty.

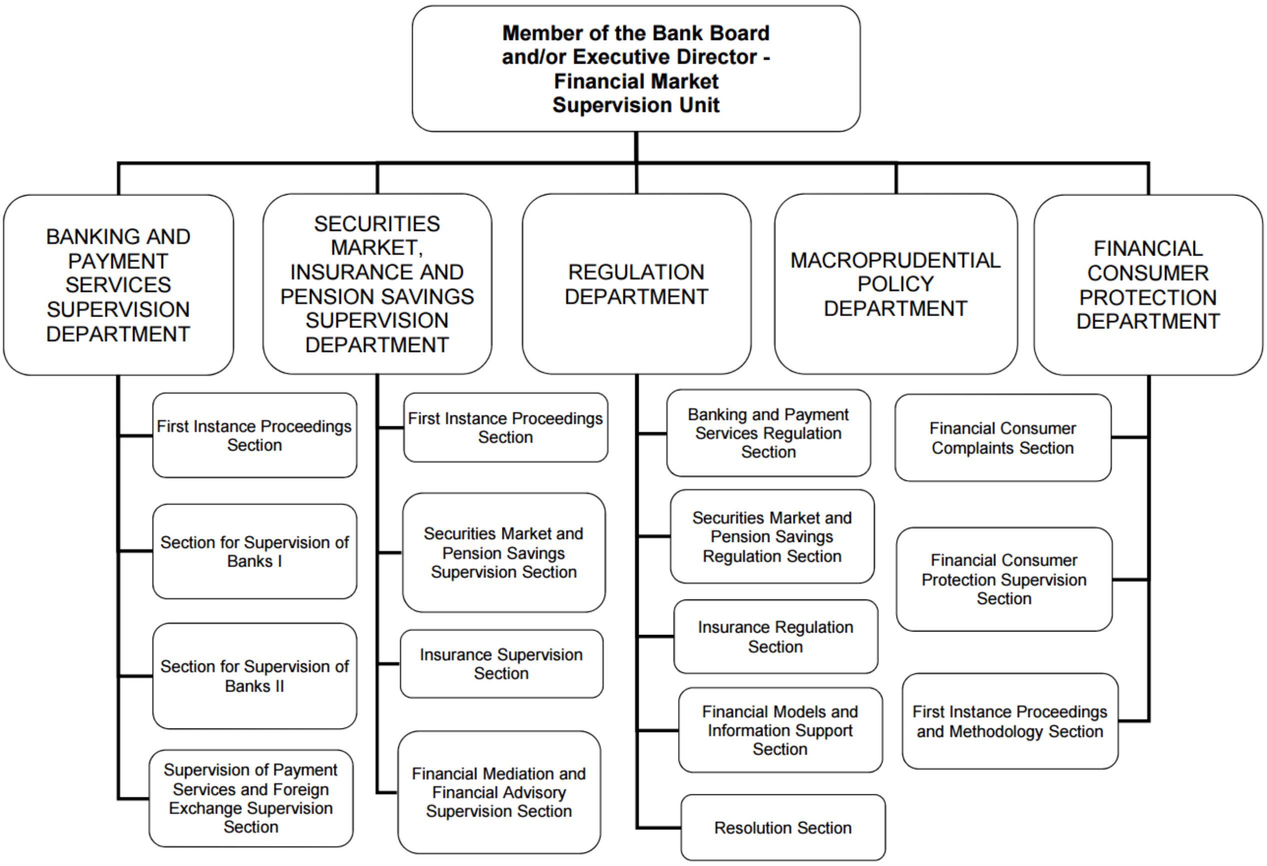
In 2014, NBS registered 18 foreign credit institutions that notified their intention to provide cross-border banking services in Slovakia, without establishing a branch.

Supervision in the banking sector in 2014 was exercised on the basis of the annual supervision plan. A total of nine thematic on-site inspections were commenced in banks and branches of foreign banks, five of which were formally completed in the same year. Within the scope of these inspections, the FMS Unit examined four applications for the use of, or for a change in, an internal risk measurement model for capital requirement calculation for credit risk or for operational risk. One of the top priorities of on-site inspections was to assess the risk management system's effectiveness, mainly for credit risk, market risk, operational risk, and liquidity risk. In addition to this priority, on-site inspections also focused on the provision of investment and payment services, the evaluation of banks' internal systems of administration and management, and of their protection against money laundering and terrorist financing.

Regarding off-site supervision, the FMS Unit conducted monthly evaluations in 2014 on the basis of the statements and reports of banks and branches of foreign bank, quarterly analyses of the risk profiles of individual banks, and comprehensive annual assessments of banks, including a risk profile assessment, internal capital adequacy assessment, and own funds adequacy assessment.

Before assuming responsibility for prudential supervision, the ECB, working closely with the national supervisory authorities, carried out a comprehensive assessment of the three largest banks, focusing on the quality of their assets and capital adequacy, with a view to strengthening the balance sheets of these banks through the imposition of corrective measures designed to eliminate the shortcomings revealed, increasing the banks' transparency by improving the quality of available information about their condition, and strengthening the confidence of all parties concerned by assuring them that, after the adoption of corrective measures, the banks will have sufficient capital adequacy. The assessment was preceded by a preparatory phase, i.e. risk assessment.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

The representatives of the Banking and Payment Services Supervision Department are members of the EBA Board of Supervisors. Several employees have been nominated as members of all working groups across the four Standing Committees and the EBA Review Panel.

Throughout the year 2014, the NBS activities in cooperation with the EBA focus within its various committees particularly on the development of technical and regulatory standards arising from the provisions adopted by the European legislation - Regulation CRR and CRD IV.

An essential part of the banking supervision constitutes the cooperation with supervisory bodies which supervise parent institutions of subsidiaries based in Slovakia. This cooperation is realized mainly through the colleges of supervisors for the respective banking group.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The Banking and Payment Services Supervision Department communicates with all relevant sector associations, especially within the processes of preparation of regulation, recommendations and guidelines. There is a close cooperation among the NBS, the Ministry of Interior and the Police Headquarters.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

The Concept of Financial Consumer Protection approved by the Government of the Slovak Republic was implemented in 2014, through the preparation of an amendment to the Financial Market Supervision Act, authorising NBS to act as a competent authority in charge of financial consumer protection (as from 1 January 2015). In this connection, NBS established a new department with effect from 1 September 2014, the Financial Consumer Protection Department, comprising three sections: the Financial Consumer Complaints Section (the former Financial Consumer Protection Section), the Financial Consumer Protection Supervision Section, and the First-Instance Proceedings and Methodology Section. This indicates that, starting from 2015, NBS will be authorised to verify whether entities subject to supervision meet their obligations arising from the legal regulations pertaining to consumer protection.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	14	13	13
Branches of foreign credit institutions	14	15	15
Cooperative banks	0	0	0
Banking sector, total:	**28**	**28**	**28**

Ownership structure of banks on the basis of assets total (%)

Type of financial institution	2012	2013	2014
Public sector ownership	0.8	0.8	0.9
Other domestic ownership	0.4	0.4	0.4
Domestic ownership total	1.2	1.2	1.3
Foreign ownership	98.8	98.8	98.7
Banking sector, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	62.8	81.6	1578
Branches of foreign credit institutions	73.6	85.7	2977
Cooperative banks	-	-	-
Banking sector, total:	**53.8**	**70.7**	**1221**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	9.65	11.69	10.30
Cooperative banks	-	-	-
Banking sector, total:	**9.65**	**11.69**	**10.30**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	92.1	85.9	85.8
Branches of foreign credit institutions	7.9	14.1	14.2
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking sector (%) (at year-end)

	2012	2013	2014
Claims from			
Financial sector	11.0	11.4	11.9
Nonfinancial sector	60.0	62.2	63.4
Government sector	22.8	20.9	19.2
Other assets	6.1	5.5	5.6
Claims due to			
Financial sector	12.1	10.4	10.9
Nonfinancial sector	63.5	64.8	64.0
Government sector	1.5	1.7	2.0
Other liabilities	8.7	8.5	8.9
Capital	14.2	14.6	14.2

Capital adequacy ratio of banks (%)

Type of financial institution	2012	2013	2014
Commercial banks	15.67**	17.23**	17.35***
Cooperative banks	-	-	-
Banking sector, total:	**15.67****	**17.23****	**17.35*****

(* - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-performing loans) (%)

Asset Classification	2012	2013	2014
Non financial sector	5.36	5.28	5.50
- households	**4.33**	**4.16**	**4.32**
- corporate	**7.63**	**8.13**	**8.61**

The structure of deposits and loans of the banking sector in 2014 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	89.3	95.1
Households	**61.2**	**54.7**
Corporate	**28.1**	**40.5**
Government sector	2.0	2.3
Financial sector (excluding banks)	8.7	2.5
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends in EUR thousands)

P&L account	2012	2013	2014
Interest income	2 486 004	2 399 937	2 396 875
Interest expenses	722 993	586 234	494 502
Net interest income	1 763 011	1 813 703	1 902 373
Net fee and commission income	426 328	439 043	469 860
Other (not specified above) operating income (net)	-281 368	-136 697	-219 458
Gross income	1 943 058	2 156 786	2 175 500
Administration costs	1 005 767	1 027 764	1 073 520
Depreciation	144 012	138 722	134 285
Provisions	170 025	219 041	198 032
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	1 528 511	1 593 930	1 544 198
Profit (loss) before tax	588 167	730 522	746 938
Net profit (loss)	491 366	549 369	560 224

Total own funds in 2014 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	5 235 711 000***	4 836 686 000***	4 836 686 000***	399 025 000***	-***
Cooperative banks	-	-	-	-	-
Banking sector, total:	**5 235 711 000*** **	**4 836 686 000*** **	**4 836 686 000*** **	**399 025 000*** **	**-*** **

(* - for Basel I; ** - for Basel II; *** - for Basel III)

2014 DEVELOPMENTS IN THE SLOVENIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Despite a slowdown in the final quarter, economic growth was relatively high last year, and its structure was favourable from the perspective of export orientation. Growth in exports and thus in industrial production strongly outperformed growth in foreign demand, and the contribution made by net trade to annual GDP growth of 2.6% amounted to almost 2 percentage points. Growth in gross fixed capital formation approached 5%, entirely as a result of a significant increase in public investment, as investment in machinery and equipment declined. government consumption also declined, albeit by considerably less than in 2013. The negative contribution made to GDP growth by austerity measures also declined correspondingly: it was just 0.1 percentage points, compared with around 0.3 percentage points in 2013. Growth in private consumption was weak compared with the developments on the labour market. Aggregate activity in private-sector services declined at the end of the year, which was the main factor in the slowdown in quarterly GDP growth to the level of the euro area average.

Total employment rose last year for the first time since the outbreak of the economic crisis. Employment of staffing agency workers has been classified under the latter, thereby clouding the actual picture of employment in individual sectors, industry and construction in particular.

Although unemployment began again falling in year-on-year terms in the middle of the year after almost two years, the number of unemployed remains one of the main macroeconomic problems. The number of registered unemployed recorded its largest fall of the last six years to end the year at slightly over 119,000. The registered unemployment rate also fell significantly, to 13%. The surveyed unemployment rate had also fallen by the end of the year, to 9.6%, below the euro area average. Wage developments were in line with economic growth, and wages have been increasing moderately for just over a year.

Inflation as measured by the HICP averaged 0.4% in 2014, down 1.6 percentage points on the previous year, and the same as the euro area average. Average core inflation in 2014 was also down significantly on the previous year. Average core inflation in Slovenia in 2014 was slightly below the euro area average.

The current account surplus approached 6% of GDP in 2014. In the wake of the gradual recovery in foreign demand, nominal growth in merchandise exports has been sharply strengthening since the second half of 2013, reaching close to 10% by the end of 2014. After three years of contraction, merchandise imports increased by 4.0% in 2014.

Slovenia was a net financer of the rest of the world in 2014 in the amount of EUR 3.4 billion, up a fifth on the previous year, and the largest figure to date. The sectors overall increased their claims from currency and deposits by EUR 6 billion, the private sector accounting for EUR 2.3 billion of this. The private sector made net repayments of liabilities to the rest of the world in the amount of EUR 1.6 billion, of which the banks and other sectors accounted for approximately equal amounts, while the government sector recorded net borrowing of EUR 259 million.

The largest net inflows in 2014 were recorded by net investments in securities, which were unchanged from 2013 in the amount of EUR 4 billion.

There was a net inflow of EUR 1.1 billion in FDI in 2014. The analytical disclosure of FDI in terms of direction reveals a net increase of EUR 1.2 billion in inward FDI in 2014, the second-largest annual increase since 2002.

Slovenia's net external debt stood at EUR 10.8 billion at the end of 2014, down EUR 1.8 billion or 14% over the year. The gross external debt increased by EUR 4.2 billion or 10% to EUR 44.4 billion, while gross external claims increased by EUR 6 billion or 22% to EUR 33.6 billion. Net borrowing increased in 2014, mostly in the government sector (EUR 5.6 billion) and in the corporate sector via direct equity links with non-residents (EUR 0.2 billion), while the remaining sectors made net repayments of debt (EUR 2.2 billion by the banking sector and EUR 1.9 billion by other sectors).

The general government deficit narrowed significantly in 2014, primarily as a result of the smaller scale of the measures to stabilise the banking system. It amounted to 4.9% of GDP, 10 percentage points less than in 2013. The measures to stabilise the banking system accounted for 0.9 percentage points of the deficit, compared with 10.1 percentage points in 2013. A one-off factor that widened the general government deficit in 2014 was the ruling by the European Court of Human Rights (ECHR) in connection with Ljubljanska banka savers in the amount of 0.7% of GDP, while the proceeds from the concession for the mobile telephony radio spectrum narrowed the deficit by 0.2% of GDP. After excluding the aforementioned measures to stabilise the banking system and other one-off factors, the general government deficit amounted to 3.5% of GDP, 0.7 GDP percentage points less than in the previous year (after bank recapitalisations, payments to erased residents and payments for wage disparities have been excluded). Interest expenditure was higher than in the previous year, by 0.7% of GDP. The general government deficit in 2014 was thus significantly wider than forecast in the Stability Programme update of April 2014 (4.1% of GDP), primarily as a result of the ECHR ruling. The structural deficit in 2014 stood at 2.5% of GDP according to the European Commission's estimates of February 2015, 0.6 GDP percentage points more than in the previous year.

General government revenues were up as a result of the improved economic situation and rises in certain taxes, while expenditure was notable for high growth in interest and public investment. General government revenues increased by 2.9%. Alongside the improvement in the economic situation, this was attributable to the rise in VAT (in mid-2013), the rise in excise duties and rises in health insurance contributions for certain groups of policyholders. The overall effect of all the revenue-side measures is estimated at around 0.9% of GDP. Indirect taxes thus increased by 2.9% in 2014, while direct taxes increased by 1.1% and social security contributions by 1.0%. General government expenditure was down 14.2%, although expenditure actually increased by 2.0% if the bank recapitalisations and aforementioned one-off effects are excluded from both years. The main factor in the increase in expenditure was the sharp growth in government investment and in interest. Expenditure on intermediate consumption was up 0.7%, while employee compensation was down 0.5%. Expenditure on subsidies was down almost a sixth. Disbursements of European funds increased again.

The general government debt increased, partly as a result of the pre-financing of principal maturing in the coming years. The general government debt amounted to EUR 30,133 million or 80.9% of GDP at the end of 2014, up EUR 4,706 million on a year earlier. The increase in the debt was primarily attributable to the financing of the general government deficit, the pre-financing of principal maturing in the coming years and the issue of Bank Asset Management Company (BAMC) bonds. The major bond issues were in February, April and November. The two bonds issued in February were denominated in US dollars, although the currency risk was also hedged. The nominal value of the 5-year bond was USD 1.5 billion, while that of the 10-year bond was USD 2 billion. These bond issues were followed by 7-year and 3.5-year bonds in April and 7.5-year bonds in November, each with a nominal value of EUR 1 billion. Issues of certain existing bonds were expanded in the total amount of EUR 317 million in connection with the recapitalisation of Abanka and Banka Celje. The BAMC issued two bonds in the total amount of EUR 552 million as a result of the transfer of non-performing claims from Abanka and Banka Celje. The assistance to euro area countries in financial difficulties was also a factor in the increase in debt, albeit to a lesser extent than in previous years: this debt amounted to 4.2% of GDP at the end of the year. The government also borrowed by issuing treasury bills of various maturities and by raising loans.

The stock of guarantees and sureties changed over the year, on account of the measures to stabilise the banking system. It amounted to EUR 8,276 million at the end of the year, or 22.2% of GDP, up EUR 18 million on the end of 2013.. It first declined in the middle of the year as guarantees were called in connection with the resolution of the two banks undergoing orderly wind-down. The two banks have now gradually begun paying back the called guarantee to the government. The stock of guarantees rose towards the end of the year as a result of the issue of the two BAMC bonds. Loans raised by DARS d.d. and the collateral for EFSF bond issues earmarked for assisting euro area countries in financial difficulties still account for approximately half of the stock of guarantees. Guarantees constitute contingent liabilities for the government, which it must meet if the guarantee is called. Called guarantees amounted to EUR 432 million in 2014, while repayments to the government from called guarantees amounted to EUR 27 million. Both were primarily related to the aforementioned resolution of the two banks undergoing the orderly wind-down process.

The required yield on long-term Slovenian government bonds and the premium on long-term Slovenian government bonds over the benchmark German bonds fell last year. The fall was the result of the implementation of the measures to resolve the Slovenian banking system at the end of 2013 and the consequent restoration of the financial markets' confidence in Slovenia. The favourable developments in yields were also attributable to the ECB's expansionary monetary policy, which was reflected in a fall in the required yields of government bonds of other periphery countries. At the end of the year the required yield on 10-year Slovenian government bonds was 2.1%, while the premium over the benchmark long-term German government bond was around 150 basis points.

Slovenia's key fiscal challenge in 2015 remains the elimination of the excessive deficit. In mid-October 2014 Slovenia sent the European Commission its draft budget plan for 2015, which the latter assessed as being broadly in line with its commitments. The principal measures for 2015 concern wage restrictions, which have been agreed with the trade unions, a reduction in expenditures on goods and services and on subsidies, and a rise in certain levies (e.g. a rise in the tax on financial and insurance services, higher taxation of student work). The continuation of gradual, growth-friendly fiscal consolidation is also important from the perspective of the sustainability of the debt.

DEVELOPMENTS IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

As at 31 December 2014 there were 17 banks operating in Slovenia (seven of which were direct subsidiaries of Eurosystem banks), three savings banks, and four branches of foreign (Eurosystem) banks. The banks have a market share of 95% of the banking system in terms of total assets. The number of credit institutions was up one (a branch) on a year earlier.

The government recapitalised two more banks in October and December 2014 on the basis of a decision on state aid, which slightly changed the ownership structure of the banking system. The measures were similar to those taken in December 2013 to stabilise the banking system. In October 2014 the government additionally recapitalised Abanka via Slovenian government securities, and the bank transferred some of its non-performing claims to the Bank Asset Management Company (BAMC) in exchange for BAMC bonds. In December the government recapitalised Banka Celje via securities and cash, and the bank transferred some of its non-performing claims to the BAMC in exchange for BAMC bonds. The bank's subordinated liabilities were terminated before the recapitalisation.

Following the recapitalisations there was a further change in the ownership structure of the banking system in 2014. As at 31 December 2014 there were seven subsidiary banks and four branches under full foreign ownership, seven banks under full domestic ownership, and three banks under majority domestic ownership. There had been a significant change in the ownership structure of the banking system in 2013, the government recapitalising five banks on the basis of a decision on state aid, after covering losses via the interests of existing owners, thereby becoming the sole owner. The proportion of the banking system held by non-residents as measured by equity stood at 30.3%, while the proportion under direct government ownership was 63%, and the proportion held by other domestic owners was 6.7%. The proportion of equity in the banking system held by the government increased by a further 3 percentage points in 2014, while the proportion held by non-residents declined by 1.6 percentage points and the proportion held by other domestic owners declined by 1.3 percentage points.

The banking system continued to contract in 2014. The banking system's total assets declined by EUR 1.6 billion last year to EUR 38.8 billion, down 3.9% on a year earlier. Last year saw the fifth consecutive annual decline in the banking system's total assets, taking the total decline to EUR 13.3 billion. The contraction in total assets also brought a reduction in the ratio of the total assets of banks and savings banks to GDP to 107%.

Deposits by the non-banking sector strengthened their position as Slovenian banks' most important source of funding. The stock increased by EUR 1.9 billion in 2014, which raised the proportion of total funding accounted for by deposits by the non-banking sector to 63%, as wholesale funding and the debt to the Eurosystem declined. Despite a halving of deposit rates, the increase in household deposits strongly exceeded the large withdrawals of household deposits from the banking system in 2013, which was attributable to various factors. First, the recovery of the banking system means that confidence is gradually being restored to Slovenian banks' operations. Second, as income stagnates, modest consumption and a fall in household investment are being reflected in an increased rate and amount of saving. Third, the increase in household deposits is also the product of households' proceeds from the privatisation of large firms. The proportion of total funding accounted for by household deposits had increased to 39% by the end of the year. A significant factor in determining whether Slovenian banks have a good long-term liquidity position will be their ability to maintain an appropriate, more-stable funding structure.

Slovenian banks' liquidity improved slightly further in 2014. This was reflected in a relatively high first-bucket liquidity ratio, in a high proportion of the pool of eligible collateral at the Eurosystem that is free, and in a higher proportion of total assets accounted for by marketable secondary liquidity. The improvement in these liquidity indicators was attributable to a decline in net liabilities to the Eurosystem, the issue of treasury bills and Slovenian government bonds, and the securities received in the implementation of the measures for the recovery of two banks in the final quarter of 2014. Given their cautious behaviour and the lack of interest in taking up additional risks, the banks directed their excess liquidity more towards safer investments or the repayment of liabilities than towards an increase in lending activity.

The banking system recorded another small loss in 2014. The banks were still exposed to a high level of income risk owing to the contraction in lending activity, the poor quality of the credit portfolio and low interest rates. The loss amounted to EUR 67.5 million at the end of the year. The banking system's gross income recorded a solid increase of 18%. As interest income declined by 11.5%, last year's growth in net interest income was attributable to the sharp decline of 37.5% in interest expenses, as a result of the sharp fall in deposit rates on deposits by the non-banking sector and the ongoing debt repayments to the rest of the world. The banks increased their stock of lower-risk but also less profitable investments, given their increased aversion to taking up risks. Growth in non-interest income was positive in 2014. Impairment and provisioning costs were down significantly on the previous year's high figure (caused by the AQR and stress tests). Impairment and provisioning costs in the banking system accounted for a half of the disposal of the banks' gross income. The banks continued improving their cost-efficiency in 2014, and further reduced operating costs.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS.
LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN SLOVENIA

With the introduction of the euro in Slovenia on 1 January 2007, the Bank of Slovenia became a part of the Eurosystem, which comprises the European Central Bank (ECB) and the national central banks (NCBs) of the euro area countries. The Governor of the Bank of Slovenia is a member of the General Council of the ECB, its third decision-making body, which meets four times a year. The General Council comprises the President and the Vice-President of the ECB and the governors of the national central banks of all EU Member States.

The financial market comprises three sectors and is supervised by three autonomous independent supervisory authorities:

- the banking sector (principally represented by banks and branches of foreign banks) supervision is under competence of the Bank of Slovenia,
- the capital market is supervised by the Securities Market Agency and
- the insurance sector with pension savings is supervised by the Insurance Supervision Agency.

Fundamental changes were made to banking supervision in 2014, both from the perspective of content and the implementation of activities, and from the perspective of organisation and human resources, as a consequence of internal audits and findings, and the introduction of the Single Supervisory Mechanism (SSM) under the aegis of the ECB (further description in section 7 International activities of the authority).

According to the Bank of Slovenia Act the central bank carries out supervision of credit institutions in order to maintain the stability and security of their operations and for the creation of confidence in the banking system, particularly among savers and depositors. In accordance with the statutory mandate the tasks of the Banking Supervision Department of the Bank of Slovenia include in particular the performance of licensing, authorisation and notification procedures for the work of these institutions, giving consent for members of boards of management to hold their offices in banks, and other authorisations and consents prescribed by The Banking Act, the performance of on-site inspection in banks, collecting and analysing quantitative and qualitative information from supervised entities and other sources, cooperate with other supervisors in the country and outside, participate actively at international supervisory forums, working groups and colleges.

Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (the CRR), which entails a significant step towards enforcement of a single European rulebook, began to be applied by Member States on 1 January 2014. For its practical implementation the Bank of Slovenia issued a regulation in January setting out the manner and scope of the exercise of options, discretions and other duties conferred on the competent supervisory authority by the EU regulation.

Other changes to secondary legislation were the Bank of Slovenia's response to practical findings in supervision. January saw the issue of a new Regulation on the documentation for demonstrating the fulfilment of conditions to perform the function of a member of the management board of a bank or savings bank, which updated the questionnaire used as one of the bases for assessing the reputation and experience of candidates for membership of the management board or supervisory board of a bank or savings bank within the framework of the licensing of board members.A new Regulation on the amounts of annual fees for supervision and fees for decisions on requests for the granting of authorisations was published in February, changing the amounts of individual fees and the ratios between individual fees paid by the banks in connection with the granting of various authorisations.

The regulation set out a definition of forborne financial assets to accord with the definition given by the technical standards for supervisory reporting, the types of forbearance that can be carried out by the banks, and the accounting framework for the two basic categories of financial assets created as a result of individual types of forbearance. Requirements were also prescribed for the classification of forborne financial assets into rating categories and in terms of their documentation or recording in books of account. In connection with write-offs a framework was put in place for the faster derecognition of non-performing financial assets from the statement of financial position when the bank judges that a financial asset will no longer be repaid or the conditions for derecognition under the IFRS have been met.

In March the new Guidelines on implementing the resolution on the assessment of credit risk losses by banks and savings banks updated the requirements with regard to the reporting of classified financial assets. It involves the reporting of individual transactions or counterparties to financial assets and the reporting of forborne financial assets.

Within the framework of the Bank of Slovenia’s efforts to speed up the restructuring of corporates that are over-leveraged yet have good prospects, the regulatory framework was upgraded with the aim of contributing to the practical implementation of Slovenian debt restructuring principles in the economy. A new Regulation on risk management and the implementation of the internal capital adequacy assessment process for banks and savings banks was published in April 2014, which emphasised significant elements that have to be taken into account in the financial restructuring of corporates with a large number of creditors. The risk management process at the banks also has to include an assessment of whether a collective approach to corporate resolution is reasonable, as a coordinated approach can minimise the losses of all creditors. A bank not opting to participate in a collective agreement with regard to the approach taken to a corporate in financial difficulty would have to refrain from actions that weaken the position of the other creditor banks in relation to the debtor, in accordance with best practice. A bank opting to participate is committed to upholding certain principles.

Other changes to secondary legislation in 2014 were aimed at harmonising with the requirements of EBA guidelines or derived from the requirements of domestic legislation. The Regulation on eligible assets and documentation for the granting of an authorisation to increase the share capital of banks and savings banks via a non-cash contribution was published in October 2014 to operationalise the new ZBan-1J, which in December 2012 introduced the option of the recapitalisation of a bank or savings bank via a non-cash contribution. The regulation sets out the types and criteria of eligible assets for the recapitalisation of a bank via a non-cash contribution, and defines the documentation that the bank must enclose in the request for an authorisation. Debt securities of central governments and central banks of Member States that meet the criteria for eligible collateral for Eurosystem claims and allow the bank the final, free and permanent disposal of the assets are classed as eligible assets for this purpose. Amendments to the Regulation on the books of account and annual reports of banks and savings banks, and to the guidelines for its implementation were adopted in December. The purpose of the amendments was the harmonisation of the scheme of financial statements intended for publication or for inclusion in the annual report with the FINREP section of the technical standards for supervisory reporting. The banks took account of the amended regulation and guidelines when compiling their annual reports for the 2014 financial year.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

The Bank of Slovenia will devote most attention to supervisory activities, through which it aims to encourage better management of non-performing exposures. These notably include:

- **Preparation of individual plans to reduce non-performing exposures.** The Bank of Slovenia is planning to resolve issue within the framework of monitoring individual plans to reduce non-performing exposures drawn up by the individual banks.
- **Optimisation of restructuring processes at the banks with eliminating** collective and individual deficiencies in the organisation of the restructuring processes at the banks, and to apply standardised best practice in the organisation of the restructuring processes.
- **Creation of EWSs for monitoring exposures** In light of the importance of the EWS as a preventive tool, the Bank of Slovenia will issue guidelines on the minimum requirements for the creation of an EWS on the basis of best banking practice and the results of the analysis.
- **Overhaul of reporting to the Bank of Slovenia on progress in restructuring.** To reduce the reporting workload on the banks and to improve the quality and usefulness of existing reports on progress in restructuring, the Bank of Slovenia will overhaul the reporting methods used to date.
- **Establishment of guidelines for fundamental restructuring that is sustainable in the long term.** The financial restructuring of a large number of firms that are over-leveraged yet have good long-term prospects has stabilised the situation to a considerable extent. Now the need is for operational and ownership restructuring, for firms to be able to invest more significantly in their development and in expanding turnover. Given that a large number of stakeholders are involved in these processes, the guidelines will help to make the process faster and more effective.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

Upon the establishment of the SSM certain supervisory powers were transferred from the national level to the European level. The ECB required a comprehensive assessment of the bank's financial position to be conducted at all significant banks.

Credit risk is by far the most significant risk at European banks, for which reason a thorough and wide-ranging asset quality review was the central part of the entire activity. Slovenian banks (NLB, NKBM and SID banka) were reviewed as part of the ECB's comprehensive assessment. After the review of credit risk had been conducted, additional impairments were primarily required for claims against highly indebted corporates, affiliates and restructured corporates. Restructuring measures were taken at the two banks with a small capital shortfall, and the effects of the restructuring improved profitability in 2014 to the extent that the identified capital shortfalls were covered by retained earnings.

The Banking Supervision Department was involved in the comprehensive assessment of the three largest Slovenian banks throughout the year. The Bank of Slovenia organised its work in the execution of this extensive task on a project basis, where its main role was in coordinating all the participants, guiding the banks and clarifying the methodology, conducting quality controls, drawing up reports and submitting data to the ECB.

Ordinary annual reviews and risk and capital assessments at all the banks were conducted in parallel with the activities of the comprehensive assessment of significant banks. The assessment took account of events, developments and results until mid-2014, and the results of the stress tests conducted at all the banks under the standard methodology and scenario of the European Banking Authority (EBA). After the implementation and results of the comprehensive assessment, the significant banks were subject to a follow-up review and risk and capital assessment in conjunction with or under the aegis of the SSM, and on this basis capital plans were drawn up to meet the requisite capital levels for significant banks determined in the comprehensive assessment process and the SREP.

The Bank of Slovenia conducted 27 different inspections and reviews in 2014, within the framework of which 30 different areas at 14 banks were examined. The following areas were examined:

- 13 reviews in the area of credit risk at 11 banks, encompassing a thorough review of credit risk at the three largest banks as part of the comprehensive assessment during the activities to transfer the supervision of significant banks to the ECB, a review of procedures and credit files of eligible collateral for loans at the ECB within the framework of ordinary monetary operations at six banks, and four regular reviews of credit risk at three banks;
- a review in the area of liquidity risk was conducted at two banks;
- two reviews in the area of operational risk, one of which was related to changes in the advanced measurement approach to measuring and managing operational risk at the bank;
- six procedures were opened in the area of governance at five banks, of which one relates to the governance of the group, while the others relate to procedures against members of the management boards. In these procedures a caution was imposed on two management board

members, in one case the management board member resigned from his position before the procedure was completed, and at two banks members of a special administration had their terms of office extended;
- the area of strategic governance was reviewed at two banks;
- the area of money laundering and terrorist financing was reviewed at two banks;
- reviews were conducted at two banks of the monitoring of the compliance of the restructuring programme with a European Commission decision on state aid;
- a review of the determination of the bank's liquidation value was conducted at one bank in conjunction with external auditors.

After organisational and process changes made in the second half of 2014, further changes in supervision will be required in supervision, which will be set out by the SSM. The largest changes are currently in progress or in implementation in the following areas:
- participation in procedures to assess the capital and liquidity adequacy of significant banks in Slovenia and cross-border groups where members are banks in the Slovenian banking system, and the adoption of the Joint Risk Assessment and Decision (JRAD);
- continual monitoring of banks for reason of the daily submission of information;
- coordination in the selection of banks for review, the scope of reviews and the composition of teams;
- the envisaged communication with banks.

Close monitoring of the implementation of strategic/business plans and related activities to raise capital and maintain capital adequacy, particularly at the banks with capital weaknesses. This includes continual monitoring and supervision of:
- bank restructuring plans within the framework of European Commission measures in relation to state aid,
- the effects of agreed corporate restructuring,
- the bank restructuring procedures via the transfer of non-performing claims to the BAMC;
- ownership consolidation in the banking system;
- from the perspective of market discipline, the focus in reviews will be on prevention of money laundering and terrorist financing.

Activities of the banking supervisory are also described in section International activities of the authority.

LICENSING

The Bank of Slovenia issued 13 authorisations in 2014, mostly authorisations to hold office as a member of the management board of a bank. In 2014 the Bank of Slovenia conducted 16 procedures, and issued 11 authorisations to hold office as a member of a bank's management board, one authorisation to provide financial services and one authorisation for a demerger. In 2014 the Bank of Slovenia issued cautions to two members of a bank's management board, and initiated two procedures to revoke the authorisation to hold office as a member of a bank's management board that resulted in a resignation.

One authorisation to acquire a qualifying holding was issued in 2014.

The Bank of Slovenia received 13 notifications in 2014 of the direct provision of services in Slovenia by banks of Member States.

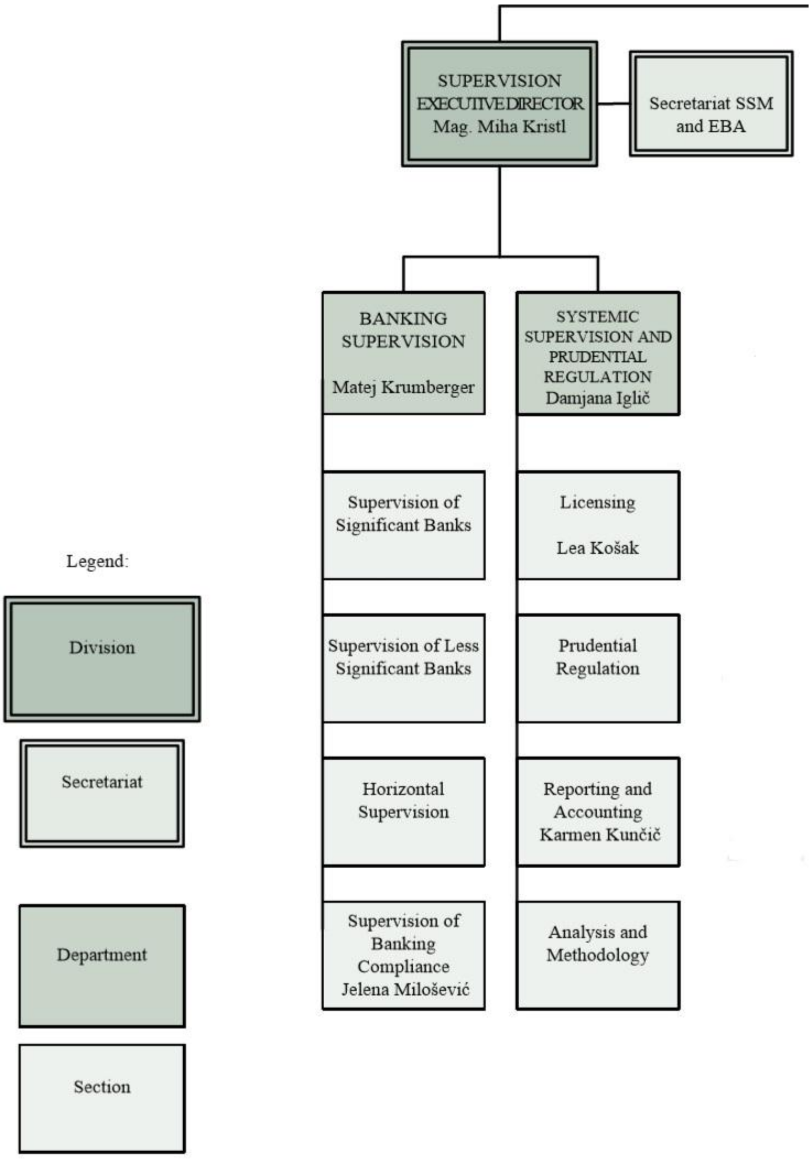
The establishment of the SSM changed the Bank of Slovenia's powers in connection with making licensing decisions. The SSM took full effect for banks in the euro area on 4 November 2014, when the ECB assumed powers and responsibilities for conducting banking supervision, one year after the entry into force of the Regulation No 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions. Although the power and responsibility for the supervision of all credit institutions in the euro area lies formally with the ECB, the decentralised supervision system means that the Bank of Slovenia still executes its existing duties (and certain others). There have been significant changes to the Bank of Slovenia's decision-making powers in the supervision of banks and savings banks and in connection with licensing in this context. There have consequently been changes to the procedures for making decisions on:

- the issue of an authorisation to provide banking services;
- the revocation of an authorisation to provide banking services;
- the issue of an authorisation to acquire a qualifying holding in a bank;
- the issue of an authorisation to hold office as a member of a bank's management board at a significant financial institution;
- notifications of the cross-border provision of banking services.

The ECB is responsible for issuing and revoking the authorisation to provide banking services.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

Under the influence of and in response to changes in the environment, major changes in internal organisation and HR in the conduct of supervision were carried out in 2014. There were new organisational arrangements in supervision, primarily as a result of the introduction of the SSM at all significant banks in the euro area, in parallel with a complete reorganisation of the Bank of Slovenia. During a broader reorganisation at the level of the entire institution, the Banking Supervision Department was renamed the Supervision Division in November 2014, and placed under the leadership of an executive director. The Supervision Division consists of two departments, the Banking Supervision Department (BSD) and the Systemic Supervision and Regulation Department (SSRD).



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

The SSM Regulation adopted on 3 November 2013 gave the ECB a mandate to put in place a functioning single supervisory mechanism within one year as the first of three pillars of the European Banking Union established as a European policy response (June 2012) to the crisis, with the aim of better preventing and overcoming difficulties in the banking system and consequently in the entire economic system.

The SSM Regulation transfers certain powers directly to the ECB, which is responsible for deciding on the issue or withdrawal of authorisations to provide banking services or to acquire qualifying holdings, the misdemeanours system, etc. All European banks were classed according to certain criteria either as systemically important (significant) banks, or as less significant banks whose turnover is smaller and more regionally focused. The powers and methods of supervision differ between the two categories. Supervision of significant banks is the direct responsibility of the ECB. A major role in conducting supervision at the operational level at the significant banks belongs to the Joint Supervisory Team (JST) of ECB coordinators and representatives of the national supervisor. The national supervisory authority participates directly in all supervisory activities at significant institutions, but does not take decisions at the national level. Supervision at less significant banks is conducted in accordance with the SSM rules and methodology, supervisory data is also regularly submitted to the ECB for less significant banks, briefings are given of the supervisory findings of the national supervisor, consultations can be held on the issue of measures with a material impact on a bank, but the final decision rests with the national supervisory authorities, unless it is a case of violations in which the measure of the withdrawal of the authorisation to provide banking services or the replacement of the bank's senior management is imposed. The SSM rules allow these banks to be transferred into direct supervision by the ECB at the proposal of the national supervisor or the ECB in the event of the possible occurrence of a systemic crisis or a failure to conduct adequate supervision at the national level.

Before taking over the supervision of significant banks the ECB wanted to obtain a clear picture in particular of the quality of the investments and the adequacy of capital coverage in the event of a deterioration in business conditions at each significant bank or banking group. To ensure that standard procedures were applied in the comprehensive assessment at all significant banks in the euro area, a detailed standard methodology for asset review and valuation was drawn up and stress tests were centrally formulated for each country with regard to the various macroeconomic circumstances. The entire project consisted of three parts: an asset quality review, stress tests, and the determination of risk-based capital requirements in light of the results of the two preceding phases of the assessment. The results of the comprehensive assessment were simultaneously published for all the banks at the end of October, just before the SSM entered into force on 4 November 2014.

More than half of the Slovenian banking system is under the direct supervision of the ECB. According to the criterion of the three largest banks in terms of total assets, three Slovenian banks (NLB, NKBM and UniCredit Banka Slovenija) were classed as significant and were therefore included in direct supervision by the ECB, and underwent the comprehensive assessment in 2014. In addition to these three banks, there are five other Slovenian banks that are members of banking groups established in euro area countries that are also classed as significant. These banks were included in the comprehensive assessment on a consolidated basis within the framework of their corresponding parent banks in 2014. The other ten Slovenian banks are classed as less significant, and their supervision remains the responsibility of the Bank of Slovenia.

COOPERATION WITH OTHER DOMESTIC SUPERVISORY AUTHORITIES

The adoption of the Macro-Prudential Supervision of the Financial System Act (the ZMbNFS) in late 2013 created the legal basis for the implementation of macro-prudential supervision in Slovenia.

The Financial Stability Committee (FSC) was established in 2014 pursuant to the ZMbNFS. The FSC formulates macro-prudential policy in conjunction with three independent national authorities responsible for the supervision of relevant institutions in their respective parts of the financial system: the Bank of Slovenia, the Securities Market Agency and the Insurance Supervision Agency. The eight-person FSC consists of two representatives from each of the supervisory authorities, and two representatives from the Ministry of Finance who do not have voting rights. The purpose of the FSC is to help protect the stability of the entire financial system, including the strengthening of its resilience and the reduction of accumulated systemic risks, thereby ensuring that the financial sector is able to make a sustainable contribution to economic growth.

The FSC formulates macro-prudential policy by issuing guidelines to the supervisory authorities. The guidelines are issued in cases when the need to prevent or reduce systemic risk has been identified, or when it is assessed that the warnings and recommendations of the ESRB need to be implemented. The guidelines are aimed at the supervisory authorities responsible for the area with the identified disruption. In implementing macro-prudential policy the supervisory authorities are responsible for the macro-prudential supervision of financial corporations, which are supervised pursuant to the sectoral laws governing their respective areas.

In accordance with Recommendation ESRB/2011/3, the ZMbNFS confers the lead role on the FSC on the Bank of Slovenia. The lead role entails the Governor of the Bank of Slovenia being appointed the president of the FSC with the power to convene and chair ordinary sessions, and the Bank of Slovenia being given the power to provide the FSC’s support staff. The latter provides analytical, administrative and logistical support to the FSC in the exercise of its duties. The FSC held three ordinary sessions in 2014, which took place on Bank of Slovenia premises.

Guidelines for macro-prudential policy were drawn up in 2014 for the purpose of putting in place an operational framework for macro-prudential policy and the macro-prudential supervision of the banking system.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

Around EUR 22 billion of securities of Slovenian issuers were on the list of eligible collateral in 2014, of which government securities accounted for the vast majority (88%). The pool of eligible collateral at the Bank of Slovenia, into which Slovenian banks transfer their assets as collateral for Bank of Slovenia loans, averaged EUR 5.8 billion over 2014.

At two banks where a procedure to close down the banks was initiated and a special administration was appointed in 2013, in accordance with legislation the Bank of Slovenia takes the role of the supervisory board and the general meeting. In this role it actively monitors the procedure to wind down the banks, which in accordance with a European Commission decision must cease trading by the end of 2016.

Within the framework of the efforts to introduce harmonised multi-purpose collection of detailed credit data in euro area countries, work on the definition of the attributes for reporting continued in the ESCB in 2014. A draft regulation was drawn up, and is expected to be adopted in June 2015. At the same time the Bank of Slovenia continued its preparations for establishing a multi-purpose single credit register. Apart from the attributes and certain aspects that will have to wait for the adoption of the ECB regulation, there has been discussion of the functionality of the register, the technical requirements and the legal, organisational and financial aspects. Talks have also been held with the banks about the appropriate incorporation of the Sisbon system.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks[1]	20	20	20
Branches of foreign credit institutions	3	3	4
Cooperative banks	0	0	0
Banking sector, total	**23**	**23**	**24**

Ownership structure of the financial institutions on the basis of registered capital (%) (at year-ends)

Type of financial institution	2012	2013	2014
Public sector ownership	22.9	54.9	55.6
Other domestic ownership	38.3	12.6	10.3
Domestic ownership total	61.2	67.5	65.9
Foreign ownership	38.8	32.5	33.8
Banking sector, total	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	42.7	56.4	0.0739
Branches of foreign credit institutions	100	100	0.7738
Cooperative banks	/	/	/
Banking sector, total	**41.7**	**55.1**	**0.0972**

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	-19.2	-97.4	-2.56
Cooperative banks	/	/	/
Banking sector, total	-19.0	-97.3	-2.69

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	98.3	97.8	97.3
Branches of foreign credit institutions	1.7	2.2	2.7
Cooperative banks	/	/	/
Banking sector, total:	**100.0**	**100.0**	**100.0**

The structure of assets and liabilities of the banking system (%) (at year-end)

	2012	2013	2014
Claims from			
Financial sector	12.8	12.9	15.2
Nonfinancial sector	63.3	56.3	51.0
Government sector	14.8	20.7	24.9
Other assets	9.1	10.0	9.0
Claims due to			
Financial sector	23.2	19.1	16.1
Nonfinancial sector	45.2	51.7	57.0
Government sector	6.6	4.1	6.0
Other liabilities	17.0	15.8	10.8
Capital	8.1	9.3	10.0

Capital adequacy ratio of banks

Type of financial institution	2012	2013	2014
Commercial banks**	11.9	14.3	19.28
Cooperative banks	/	/	
Banking sector, total**	11.9	14.3	19.28

(* - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector[1] (share of impaired receivables / share of non-preforming loans[1])

Type of financial institution	2012	2013	2014
Non financial sector	14.4	13.3	11.9
- households[2]	4.9	4.1	5.3
- corporate	24.0	20.4	17.7

The structure of deposits and loans of the banking sector in 2014 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	80.9	81.3
Households	61.8	38.7
Corporate	19.1	42.6
Government sector	9.6	8.4
Financial sector (excluding banks)	9.5	10.3
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)

P&L account	2012	2013	2014
Interest income	1,944,092	1,504,051	1,327,869
Interest expenses	1,057,784	792,983	495,703
Net interest income	886,310	711,070	832,165
Net fee and commission income	339,436	339,486	346,281
Other (not specified above) operating income (net)	302,558	39,494	55,807
Gross income	1,565,693	1,090,051	1,230,900
Administration costs	658,268	640,262	611,890
Depreciation	84,411	79,644	74,972
Provisions	-30,100	123,057	104,966
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	1,629,502	3,600,558	545,157
Profit (loss) before tax	-776,375	-3,353,475	-106,087
Net profit (loss)	-754,031	-3,490,414	-114,058

Total own funds in 2014 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	3,981,039,000	3,812,402,000	3,806,612,000	168,638,000	/
Cooperative banks	/	/	/	/	/
Banking sector, total:	3,981,039,000	3,812,402,000	3,806,612,000	168,638,000	/

(* - for Basel I; ** - for Basel II; *** - for Basel III)

2014 DEVELOPMENTS IN THE TURKISH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2014 GDP increased by 2.9% at constant prices in the first quarter of 2014 in line with the growth expectations. The current account deficit, which is considered as the main macroeconomic issue for the Turkish economy, was $64.3 billion (-8% of GDP) by January 2014 and decreased to $45.8 billion (5.8% of GDP) by December 2014. Main reasons for this progress were; lower commodity prices, lower trade balance and macro prudential measures which decrease demand on imported goods by putting pressure on domestic demand.

The unemployment rate, which was estimated to be 9.0% at the end of 2013, realized as 9.9% as of December 2014. Consumer Price Index increased by 8.17% during 2014. General government nominal debt stock to GDP ratio (EU definition) was realized as 33.5% in 2014.

DEVELOPMENT IN THE BANKING SECTOR (INCLUDING THE ASSETS TOTAL / GDP)

As of end 2014, there are 49 banks operating in Turkish banking sector (TBS). The total asset size of TBS is around 2 trillion TL which overpassed GDP. The total asset/GDP ratio is at 114%.

The main investment item in assets is loan portfolio which has a 60% share in total assets. As of December 2014, the loan portfolio has reached to 1.24 trillion TL. The share of FX loans in loan portfolio is around 8% and the share of FX indexed loans is approximately 5%. NPL ratio is at 2.85% which is comparatively low when compared to other emerging markets. Securities are another important investment item. Total share of securities in the balance sheet is 15% and the amount of securities is nearly 300 billion TL.

The main funding source is deposit (52.6% of total liabilities). As of end 2014, total deposit in TBS has reached to 1.05 trillion TL. FX deposit constitutes 37% of total deposits.

TBS's capital base is strong. CAR is at 16.3% which is significantly higher than 12% target CAR. Tier I CAR is nearly 14%.

TBS has high and sustained profitability ratios. As of December 2014, ROA is at 1.7%. The FX position of banking sector is very limited. There is a short position in the balance sheet but banks balance their short position by using off-balance sheet instruments such as derivatives which yields a fully hedged fx position.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN TURKEY

In Turkey, Capital Markets Board of Turkey (CMB) is the regulatory and supervisory authority in charge of the securities markets. General Directorate of Insurance (GDI) and the Insurance Supervisory Board under Secretariat of Treasury is responsible for insurance sector. Banking Regulation and Supervision Agency (BRSA) with the authority given by Banking Law Nr. 5411 regulates and supervises banks (commercial-deposit banks, investment and development banks and participation banks and the branches in Turkey of such institutions established abroad), financial holding companies, financial leasing companies, factoring companies, consumer financing companies and asset management companies, payment institutions and e-money institutions. Moreover, BRSA authorizes independent audit, rating, valuation and outsourcing firms that give service to supervised institutions.

Within the scope of the Law on Bank Cards and Credit Cards, the institutions willing to establish card systems, issue bank cards and credit cards, exchange information on card holders, and engage in clearing and settlement activities are also regulated by BRSA. In addition, BRSA is empowered to authorize and terminate the activities, temporarily or permanently, of institutions that performs the independent audit, valuation, rating and outsourcing activities for banks.

BRSA is a public legal entity with administrative and financial autonomy. The independence of the BRSA gives autonomy in three main areas: i) autonomy in regulation and supervision, ii) autonomy in Agency administration, iii) autonomy in using financial resources.

With the enactment of the Banking Law Nr. 5411, regulatory and supervisory framework of the banking system has been reshaped in a more systematic way in the light of international best practices. Banking Law in force gives the BRSA all the powers to regulate, enforce and ensure the implementation of the establishment, activities, management and organizational structure, merger, disintegration, change of shares and liquidation of banks and monitor and supervises enforcement of them. BRSA uses its powers through regulatory transactions and specific decisions taken by its Board. Banking Regulation and Supervision Board is authorized to revoke the operating permissions of failing banks or to transfer the shareholder rights except dividends and the management and supervision of the banks to the Savings Deposit Insurance Fund (SDIF), for the purposes of transferring, selling or merging them partially or fully. The banks whose operating permissions have been revoked are liquidated as subject to the provisions of Banking Law by SDIF.

Besides, according to the Bank Cards and Credit Cards Law Nr. 5464, BRSA is also responsible for authorization, regulation and supervision of card system organizations, card issuing organizations, organizations entering into merchant agreements, information exchange and clearing/settlement organizations. Furthermore, with the Law Nr. 6493 enacted in 2013, authorization, regulation and supervision of payment institutions and electronic money institutions were also incorporated into the scope of authority.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

"Strategic Plan 2013-2015" adopted in 2013 includes four main strategic objectives: (1) enhancing corporate structure; (2) strengthening the efficiency of regulation, supervision and enforcement framework; (3) boosting confidence, stability and competitiveness in financial markets; and (4) raising awareness among financial consumers, protecting them at the maximum level and improving financial inclusion.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2014, 4 new regulations and 4 new communiqués were published; 14 regulations and 10 communiqués were amended. Furthermore in order to make banks to operate in a more efficient way and to manage their risks in a more prudent way BRSA issued 8 guidelines, including credit management guideline, interest rate risk guideline, operational risk guideline and market risk guideline.

Throughout the audit activities, a total of 333 reports were prepared. Reports about regulation compliance and complaints constitute the biggest portion of these reports. IT supervision of the supervised institutions has been carried out by both BRSA's employees and 3rd party independent auditors. In this respect 91 audit reports were prepared in 2014. In terms of oversight function, a total of 2,604 bank-level reports were prepared, including 137 monthly and 2,009 weekly reports. Furthermore, in order to enhance the efficiency of oversight function 162 industry-specific oversight reports, memos and presentations have been prepared. These reports mainly incorporate information regarding the overall market developments, key ratios, loans, derivatives and stress testing.

In 2014, 1 participation bank, 2 asset management companies and 1 financing company have been issued establishment permits. Moreover 1 participation bank, 2 asset management companies and 1 financing company have been issued operation permit. Apart from these 10 companies were authorized for real estate valuation.

In order to raise awareness among financial consumers, to protect them at the maximum level and to improve financial inclusion some actions were taken by BRSA. In this respect e-complaint system and a call center have been established, a new website was introduced and a new audit approach, consumer focused audit, which deals with the structural problems between consumers and financial institutions has been designed. 27,316 complaints, most of them are about commission and fees, loans and deposit were received throughout the year.

In 2013 Basel III rules started to be implemented to further strengthen the own funds structure of banking sector. In 2014 in order to achieve a better compliance with Basel III rules Regulation on Liquidity Coverage Ratio was issued. Furthermore the undergoing work regarding the preparation of the regulations about implementation of internal rating based approach to measure credit risk capital requirement and advanced measurement approach to measure operational risk capital requirement were completed. With respect to Pillar II of

Basel standards, ICAAP (Internal capital adequacy assessment process) was introduced to address the need of enhancing risk management skills of banks to maintain adequate capital against negative shocks. BRSA also strives for complying with FSB principles. With this regard several work which is mainly related to banks' resolution framework, remuneration policies and systemically important financial institutions have been undertaken in 2014.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

- **BANKING REGULATION AND SUPERVISION AGENCY**
  - **CHAIRMAN**
    - Advisery to the Chairmanship
    - Department of Legal Affairs
    - **VICE PRESIDENT**
      - Department of Enforcement I
      - Department of Enforcement II
      - Department of Enforcement III
      - Department of Enforcement IV
      - Department of Enforcement IV
    - **VICE PRESIDENT**
      - Department of Information Systems Compliance
      - Department of Data and System Management
      - Department of Corporate Communication and Foreign Relations
    - **VICE PRESIDENT**
      - Department of Regulation
      - Department of Access to Information
    - **VICE PRESIDENT**
      - Department of Audit IV
      - Department of Economic Assessments
      - Department of Strategy Development
      - Department of Support Services
        - * Board Affairs and Decisions Directorate
        - * Human Resources Directorate
        - * Training and Communication Directorate
        - * Administrative and Financial Affairs Directorate
    - **VICE PRESIDENT**
      - Department of Audit I
      - Department of Audit II
      - Department of Audit III
      - Department of Risk Management

INTERNATIONAL ACTIVITIES OF THE AUTHORITY

Efficient and timely exchange of information among supervisory bodies is essential for effective supervision, and is particularly critical for a strong financial market. In this context, the Article 98 of the Banking Law No. 5411 establishes the framework for instituting efficient international cooperation.

In this context BRSA has signed memorandum of understanding (MoU) with De Nederlandsche Bank in 24/1/2014 and the total number of countries with which BRSA has signed MoU reached 33 by year end 2014. Under the scope of close cooperation with other authorities, sharing of expertise and training activities also take an important part. In this regard BRSA has shared its experience on supervision with Kyrgyzstan and Kazakhstan by conducting trainings for these country authorities.

Banking Regulation and Supervision Agency's (BRSA) international relations have four dimensions. Agency have collaboration with foreign supervisory authorities related to consolidated supervision, close cooperation with European Union as a candidate country, strong links with multinational institutions and relations with other international and foreign institutions.

BRSA has also strong links with multinational institutions such as International Monetary Fund (IMF), World Bank (WB), Bank for International Settlements (BIS) and Organization for Economic Cooperation and Development (OECD).

On May 2009, BRSA became a member of Basel Committee on Banking Supervision (BCBS). BRSA also became a member of Islamic Financial Services Board (IFSB) which conducts studies on ensuring standardization in Islamic financial services on December 2010. In this regard the BRSA attended the 25th meeting of the council in the capital city of Malaysia on 10-11st December 2014. BRSA closely follows the work done by BCBS, IFSB and other international standards and best practices on banking supervision and participates in different studies that are conducted by these institutions globally.

BRSA has been the country coordinator of Working Group of Banking and Finance of Black Sea Economic Cooperation Organization since 2009 and the period has been extended in 01/07/2013 for two years.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

Based on Article 98 of Banking Law, views were exchanged and information was shared with Undersecretariat of Treasury, Capital Market Board (CMA), Savings Deposit Insurance Fund (SDIF) and CBRT in order to ensure coordination and cooperation among authorities in executing monetary, credit and banking policies.

Financial Sector Commission, which is responsible for ensuring coordination, cooperation and exchange of information among the related authorities and associations, raising joint policy recommendations and conveying comments on matters concerning the future of the sector, in order to improve confidence and stability in the financial markets pursuant to Banking Law, convened two times in 2014 May and November. The meetings focused particularly on evaluations regarding the developments in the financial sector, Istanbul Financial Center Project and measures for boosting domestic savings.

The Coordination Committee (CC) consisting of the presidents and vice presidents of BRSA and SDIF, pursuant to Banking Law, is in charge of ensure that maximum cooperation be established between the BRSA and the SDIF when it is necessary to carry out transactions in the competency of the SDIF, and exchange of information. During 2014 CC met four times in February, May, September and December. During the meetings held in 2014, information was exchanged about the general status of the banking system, measures to be taken based on the results of audits at credit institutions, calculation of risk-based insurance premiums and the cases in which action needs to be taken by SDIF. The protocol of CC was updated in 2014.

Financial Stability Committee, established through Decree-Law no. 637 published in 2011 is chaired by the Minister for Undersecretariat of Treasury and consists of Undersecretary of Treasury, CMB, BRSA and SDIF Presidents. While the primary function of the Committee is to develop proposals for measures and policies to identify, monitor and mitigate systemic risks that may involve financial system as a whole, the Committee is also responsible for planning, policy development, monitoring and coordination of systemic risk management activities. Systemic Risk Evaluation Group (SREG) which consists of representatives from Undersecretariat of Treasury, BRSA, SDIF, CBRT and CMB held three meetings in 2014 April, July and October.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

BRSA continues to its activities for full compliance to international standards. In this regard BRSA published new regulations for Basel II and III compliance. In 2014 regulations for liquidity coverage ratio is published. Also in order to apply the Pillar II requirements of Basel, II BRSA published a regulation on ICAAP and SREP. In addition to these regulations BRSA published a series of risk management guidelines as best practices documents. Some of which are guidelines on; credit management, ICAAP report, stress testing, management of interest rate risk in the banking book, management of country risk, management of operational risk, management of market risk and management of counterparty credit risk. Also in 2014 regulations for advanced approaches of Basel II for credit risk and operational risk were published. Banks are expected to apply for using their internal models for the calculation of capital requirements for credit risk and operational risk in 2015.

In addition to regulations about Basel II and III, BRSA published a regulation where the procedures and principles on fees which will be received from financial consumers, are defined. BRSA also established a call center for consumer complaints in 2014.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks[28]	30	31	33
Branches of foreign credit institutions	6	5	5
Cooperative banks	-	-	-
Banking sector, total:	**49**	**49**	**51**

Ownership structure of banks on the basis of assets total[29]

Type of financial institution	2012	2013	2014
Public sector ownership	30.1	30.8	31.3
Other domestic ownership	53.0	51.3	49.5
Domestic ownership total	**83.1**	**82.1**	**80.8**
Foreign ownership	**16.9**	**17.9**	**19.2**
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions[30]

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	35.3	54.7	785
Branches of foreign credit institutions	0.2	0.21	0.02
Cooperative banks	-	-	-
Banking sector, total:	**35.3**	**54.7**	**789**

[28] There are no cooperative banks in Turkey. Commercial banks are defined as deposit taking institutions, therefore investment & development banks are excluded. We have, as of year-end 2014, investment & development banks (13), private, public and participation (4) banks.
[29] Turkish Banking Sector General Outlook, 2012, 2013, 2014.
[30] Commercial bank shares include branches of foreign credit institutions excluding only investment &development banks.

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	16.7	15.0	12.7
Cooperative banks	-	-	-
Banking sector, total:	**15.7**	**14.2**	**12.3**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	95.9	95.7	95.5
Branches of foreign credit institutions	0.21	0.29	0.22
Cooperative banks	-	-	-
Banking sector, total:[31]	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2012**	2013**	2014**
Commercial banks	17.1	14.5	15.6
Cooperative banks	-	-	-
Banking sector, total:	**17.9**	**15.3**	**16.3**

(* - for Basel I; ** - for Basel II; *** - for Basel III)

Asset portfolio quality of the banking sector
(share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non-financial sector, including			
- households	2.9	2.9	3.4
- corporate	2.6	2.4	2.3
-SME[32]	3.2	3.1	3.3

[31] Remaining shares belong to investment &development banks.
[32] Current data classification of loans excludes SME loans from corporate loans.

The structure of deposits and loans of the banking sector in 2014 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:		
Households	59.6	28.7
Corporate[33]	35.7	69.5
Government sector	4.7	1.8
Financial sector (excluding banks)	-	-
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends) (billion TL)

P&L account	2012	2013	2014
Interest income	109.9	110.6	138.7
Interest expenses	57.6	53.3	73.1
Net interest income	52.3	57.3	65.6
Net fee and commission income	15.9	18.8	20.7
Other (not specified above) operating income (net)	-13.9	-17.9	-20.9
Gross income	138.5	144.9	173.7
Administration costs	25.6	32.8	35.9
Depreciation	1.9	2.1	2.6
Provisions[34]	4.5	5.0	4.1
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)[35]	3.5	3.4	3.2
Profit (loss) before tax	30.1	31.1	31.5
Net profit (loss)	23.5	24.7	24.6

[33] Including SME loans.
[34] Provisions consist of special provisions for non-performing loans, provisions for general loan losses, termination indemnities, securities impairment, affiliates, subsidiaries and joint ventures impairment.
[35] Other provisions.

Total own funds in 2014 (in EUR)

Type of financial institution (million EUR)	Total own funds ***	Core Tier 1***	Tier 1***	Tier 2***	Tier 3
Commercial banks	87	74.2	73.3	14.2	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	95.8	82.5	81.8	14.6	-

(* - for Basel I; ** - for Basel II; *** - for Basel III)

2014 DEVELOPMENTS IN THE UKRAINIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2014, in Ukraine, the economic situation, worsened considerably due to a number of negative factors. Among key factors that contributed to negative economic trends in 2014 were: military actions in the east of the country, rupture of interregional ties due to annexation of AR Crimea, narrowing both external and internal demand for production of domestic manufacturers, needed fiscal consolidation measures, deterioration of financial performance of enterprises etc. At the same time, large crops of grains harvested by agrarians in the year under review and liberalization of domestic goods access to EU markets positively influenced the economy of the country.

In 2014, indicators decreased in almost all economic sectors of Ukraine. As a result, the real GDP decreased by the year end by 6.8%. Nominal GDP in the reporting period made UAH 1 5667 billion (USD 131 billion). By IMF estimate GDP per capita based on PPP fell to USD 8 668 compared with USD 9 143 in 2013.

The slowdown of real wage growth in the context of consumer demand decline and high inflation led to narrowing of domestic consumer demand and as a result retail trade turnover decreased by 8.6%.

In 2014, the nominal household income, calculated on the basis of ILO Methodology, increased as compared with the previous year by 3.6% and made UAH 1 531.1 billion. At the same time, the real disposable income decreased by 8.4%.

Headline inflation made 24.9% (eop). The producer price index grew by 31.8%.

The core inflation rate for 2014 made up 22.8% (eop).

In 2014, net inflow of foreign direct investment made USD 410 million. Net investment outflow was registered in January – May, while in June – December net inflow made USD 1.5 billion and was mainly channeled in the real sector.

DEVELOPMENT IN THE BANKING SYSTEM

As of 1 January 2015, 182 banks were registered in the State Register of Banks, 162 of which had banking licenses (including three state banks - OSCHADBANK JSC, Ukreximbank JSC, Derzhzembank PJSC) and one (RODOVID BANK JSC) had the license of a remedial bank. The number of banks with foreign capital, which were operating in Ukraine, increased by 2 banks, and made 51 banks, 19 of which were banks with 100% foreign capital. Banks had 133 operating branches (out of 141 registered), 15 245 bank offices and 14 representative offices of Ukrainian banks, 7 of which were in the territory of Ukraine. 14 banking groups were operating at year end in Ukraine, two of which were recognized in 2014.

Among main challenges of the banking sector of Ukraine during the reporting year were considerable outflows from the banking system, worsening of the quality of banks' loan portfolios and loss-making. Increase of the banking sector key performance indicators at the end of 2014 took place only due to exchange rate adjustments of banks' assets and liabilities following hryvnia depreciation to main foreign currencies.

According to annual grouping of banks by size of assets, in 2014, 15 banks were put to the 1st group, 20 banks - to the 2nd group, 23 banks - to the 3rd group and 122 banks - to the 4th group.

In 2014, the assets, capital and liability concentration process was in progress in banks of the 1st group, where 73% of total assets of Ukrainian banks, 74.5% of capital and 72.8% of total amount of liabilities were concentrated as of 1 January 2015.

The banking system of Ukraine has completed the year 2014 with the following trends:

- In a year, total assets were up by 8%, to UAH 1 521 billion (EUR 79 billion);
- Lending to economic entities increased by almost 15%, to UAH 803 billion (EUR 42 billion);
- Bank's liabilities grew by 8%, to UAH 1 169 billion (EUR 61 billion);
- Household funds decreased by 4%, to UAH 416 billion (EUR 22 billion);
- Legal entities' funds were up by about 12%, to UAH 288 billion (EUR 15 billion);
- Banks' regulatory capital decreased by almost 8%, to about UAH 189 billion (almost EUR 10 billion). Banks' authorized capital decreased by almost 3%, to UAH 180 billion (EUR 9 billion);
- The banking system loss made of about UAH 53.0 billion (EUR 2.8 billion) in 2014.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS, NEW DEVELOPMENTS.
LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN UKRAINE

Banking in Ukraine is regulated by the following fundamental laws:

- On Banks and Banking;
- On the National Bank of Ukraine;
- On Households Deposit Guarantee System;
- On Financial Services and State Regulation of Financial Markets;
- On Joint Stock Companies;
- On Prevention and Counteraction of Legalization (Laundering) of the Proceeds from Crime or Terrorism Financing.

Under the National Bank of Ukraine Law and the Banking Law, the National Bank of Ukraine is responsible for banking regulation and supervision in Ukraine.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2014

During 2014 the National Bank of Ukraine actively participated in implementation of the measures used as the basis of reformation program in the financial sector. This program was carried out in close cooperation with the IMF, World Bank, EU, EBRD and other IFIs and financial donors. The goal of such measures was to support stability and appropriate functioning of the domestic banking system, improvement of its ability to counteract existing challenges. The measures were implemented on the directions of capitalization of the banks, establishment of the banks important for the system, strengthening of corporate governance at the banks, saving their liquidity, improving the loan portfolio quality, reducing the share of nonperforming loans and ensuring appropriate supervision over banking activity.

Also, the National Bank of Ukraine started the elaboration of the Comprehensive Program for the development of the banking system of Ukraine in 2015 - 2020 in order to make structural reforms in the banking sector systemic.

BANKING SUPERVISORY AUTHORITY ACTIVITIES IN 2014

In 2014, the National Bank of Ukraine activities focused on further improvement of legal framework for banking regulation and supervision.

The NBU amended a number of regulatory documents, in particular:

- Early July 2014 the Verkhovna Rada of Ukraine enacted the Law of Ukraine "On Amendment of Some Legislative Acts of Ukraine on Preventing Negative Impact on Stability of the Banking System", which had been developed on the initiative of the National Bank of Ukraine and the Deposit Guarantee Fund. In particular, this Law provided for peculiarities of withdrawing of insolvent banks corresponding to the established requirements from the market with the participation of the state (represented by the Ministry of Finance of Ukraine or state bank). The same Law also increased minimum amount of the authorized capital of newly incorporated banks up to UAH 500 million.
- According to Amendments to the Instructions on the Procedure for Regulation of Banks Activities in Ukraine, the standard value of the minimum amount of regulatory capital of the bank (N1) is increased UAH 120 million to UAH 500 million. For the banks which commenced their activities before 11 July 2014 a stage-by-stage bringing of the regulatory capital to the established level is provided for a period of ten years.
- To strengthen financial capability of the banking system of Ukraine and improve the level of trust to it the Verkhovna Rada of Ukraine enacted the Law of Ukraine developed by the National Bank of Ukraine "On the Measures Designed for Facilitation of Capitalization and Restructuring of Banks" late December 2014. Among other things this Law enacted simplified procedure for capitalization and reorganization of the banks, and also established peculiarities of capitalization of the banks subject to participation of the state.

- Resolution "On Approval of the Regulations for the Identification of Systemically Important Banks" was amended for identifying the systemically important banks. According to the resolution such banks shall be identified on annual basis subject to application of a multi-factor model based on the criteria of importance for the system. Methodological basis for identifying the systemically important banks were drafted using the recommendations of the Basel Committee on Banking Supervision regarding the principles of work with domestic systemically important banks, as well as relevant provisions of EU law.
- National Bank of Ukraine developed and approved Regulations on Organization of Internal Control at the Banks of Ukraine, which set out minimum requirements to organization of internal control at the banks.

Also, on initiative of the National Bank of Ukraine the Verkhovna Rada of Ukraine made amendments to the Law of Ukraine "On Banks and Banking" in terms of establishment of peculiarities of corporate governance at the banks, which:

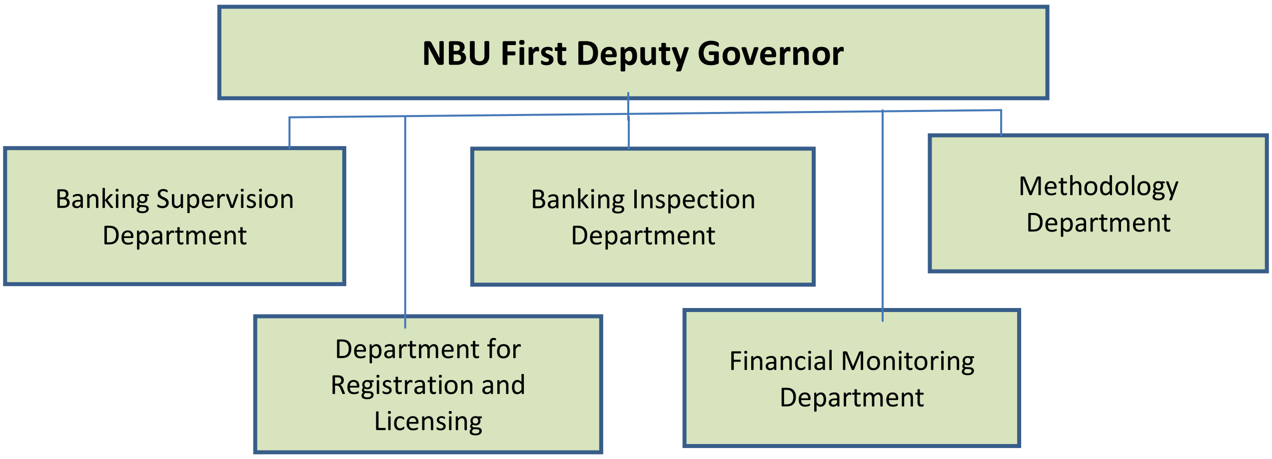
- improved requirements to organization of corporate governance at the banks;
- increased liability of the bank's management personnel, namely, council of the bank for the results of its activities;
- set the requirements to building adequate and efficient risk management and internal control systems.

In addition to the aforementioned the National Bank of Ukraine also took all measures provided for in the Action Plan for 2014 developed jointly with the Government on prevention and counteraction to legalization (laundering) of the proceeds of crime or terrorist financing.

For the purpose of raising sustainability of the banking system of Ukraine and protection of investors' and creditors' interests, and as the execution of obligations accepted by Ukraine against the IMF, the National bank diagnosed 35 largest banks of Ukraine in the accounting year in order to assess quality of the assets, adequacy of the regulatory capital, establishment of required volumes of additional capitalization for a period till the end of 2016. Diagnostic study was done in two stages: 15 top banks of group I were studied before 31 July 2014, and the following 20 largest banks were inspected before 30 September 2014. According to its findings it was determined that 17 banks required additional capitalization for a total of UAH 57.9 billion.

Further to the above, in 2014 there were established Criteria to banks that can serve the reason for the state to participate in their statutory capital, Conditions for the state possible participation in recapitalization of the bank and Principles to be followed in the design of the framework for the use of public funds to restructure undercapitalized or insolvent banks.

ORGANIZATIONAL STRUCTURE OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES

In 2014 the National Bank of Ukraine continued its cooperation with International Financial Institutions including in the Banking Supervision. In particular, new Stand-by Program for Ukraine by IMF Executive Board which was approved on 29 April 2014, included measure directed at strengthening the Ukrainian Banking Sector and improvement the banking supervision regulatory framework. Besides, the National Bank of Ukraine cooperated with the World Bank, EBRD and others for development of the financial sector of Ukraine within the WB Programmatic Financial Sector Development Policy Loan and technical assistance projects.

Two Ukrainian Financial Fora under Vienna Initiative 2 were held in Kyiv and Brussels and July and November correspondently.

Moreover the National Bank of Ukraine continued the work on ensuring bilateral international cooperation with foreign supervisory authorities under Memoranda of Understanding on Cooperation in the Area of Credit Institutions Supervision and Multilateral Cooperation and Coordination Agreements on the Supervision.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

As a banking supervisor, the National Bank of Ukraine has been cooperating with other supervisory authorities of the country, in particular: The National Commission for State Regulation of Financial Service Markets and the National Securities and Stock Market Commission, with whom the National Bank of Ukraine has signed the respective agreements on exchange of information.

STATISTICAL TABLES

Number of financial institutions (head offices/branches) (at year-ends)

Type of financial institution	2012	2013	2014
Commercial banks	176	180	163
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**176**	**180**	**163**

Ownership structure of banks on the basis of assets total (%) (at year-ends)

Type of bank	2012	2013	2014
Public sector ownership	15.4	15.5	22.1
Other domestic ownership	46.1	51.7	20.3
Domestic ownership total	61.5	67.2	42.4
Foreign ownership	38.5	32.8	57.6
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	35.2	43.5	0.0564
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	-	-	-

Return on Equity (ROE) by type of financial institutions (%)

Type of financial institution	2012	2013	2014
Commercial banks	3.03	0.81	-30.46
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	3.03	0.81	-30.46

Distribution of market shares in balance sheet total (%)

Type of financial institution	2012	2013	2014
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2012	2013	2014
Commercial banks	18.06*	18.26*	15.60*
Cooperative banks	-	-	-
Banking sector, total:	**18.06***	**18.26***	**15.60***

(* - for Basel I; ** - for Basel II)

Asset portfolio quality of the banking sector
(share of impaired receivables / share of non-performing loans)

Asset classification	2012	2013	2014
Non financial sector	16.5*	12.9*	19.0*
- households	**6.2**	**4.6**	**7.1**
- corporate	**10.3**	**8.3**	**11.9**

(*Classification of loans is carried out according to a new methodology which provides for an integral assessment of an asset (i.e. including accrued income))

The structure of deposits and loans of the banking sector in 2014 (%) (at year-end)

	Deposits	Loans
Households	58.9	20.2
Government sector	0.5	0.5
Corporate	35.1	76.9
Other (excluding banks)	5.5	2.4
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends) (in EUR million)

P&L account	2012	2013	2014
Interest income	11.156	11.767	7.864
Interest expenses	6.451	7.325	5.052
Net interest income	4.705	4.442	2.812
Net fee and commission income	1.710	1.901	1.216
Other (not specified above) operating income (net)	-700	-653	-285
Gross income	14.229	15.295	10.929
Administration costs	3.524	3.683	2.320
Depreciation	366	370	214
Provisions	2.215	2.533	5.371
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-	-	-
Profit (loss) before tax	499	278	-2.878
Net profit (loss)	463	130	-2.754

Total own funds in 2014 (in EUR billions)

Type of financial institution	Total own funds (for CAR)	Tier 1	Tier 2	Tier 3
Commercial banks	10.09	7.06	3.03	-
Cooperative banks	-	-	-	-
Banking sector, total:	**10.09**	**7.06**	**3.03**	**-**

MAIN GROUP EVENTS OF THE YEAR 2014

27th Annual BSCEE Members' Conference

Yerevan, Armenia, June 12 – 14, 2014

The Chairmanship of the BSCEE Group in 2014 was held by Central Bank of Armenia and Mr. Mher Abrahamyan, Head of Financial System Regulation Department of the Central Bank of the Republic of Armenia was entrusted the position of the Chairman. Therefore, the 27th Annual BSCEE Members' Conference was hosted by the Central Bank of the Republic of Armenia on June 12 - 14, 2014 in Yerevan.

The two day conference was entitled *Financial Stability as a Cornerstone for Sustainable Growth.* The main themes that were discussed during the Conference refer to: *Basel III: Implementation challenges for SIBs regulatory framework* and *Liquidity requirements; Macro-prudential regulatory issues.*
It was attended by around forty representatives of the central banks and supervisory institutions from twenty one countries from Central and Eastern Europe, and other institutions for banking supervision. International experiences, among others, were presented by the representative of the Bank for International Settlements (BIS) from Basel and the representative of the International Monetary Fund.

The National Bank of Slovakia volunteered to hold the 2015 BSCEE Chairmanship as well as host the 28th Annual Conference and the Member countries accepted this candidature by acclamation.

FSI – BSCEE Regional Seminar

Tula, Russia, May 13 – 15, 2014

The Central Bank of the Russian Federation in cooperation with the Financial Stability Institute and the BSCEE Secretariat organized a regional seminar for BSCEE member countries on *Basel III and Systemic Stability Policy.* The emphasis of the seminar was to provide a forum for supervisors to hear from experts on the latest regulatory reforms and to share experiences and issues in implementing Basel III and policies relating to systemic stability. The programme for the seminar covered the topics of:

- Basel III framework
- Liquidity risk
- Macroprudential policies for systemic stability
- G-SIBs: assessment methodology and higher loss absorbency requirement
- Policy framework for D-SIBs

XVIII ICBS, Tianjin, China, September 22 – 25, 2014
BSCEE Regional Meeting, September 22, 2014

The XVIII International Conference of Banking Supervisors was hosted by the China Banking Regulatory Commission (CBRC) and coorganized by the Basel Committee on Banking Supervision. The main themes were the *Post-Basel III Agenda* and the *Role of Financial System in Promoting Growth*.The panel discussions focused on *Balancing simplicity, comparability and risk sensitivity* and *The role of the financial system in promoting growth: Making financial services safe and affordable for the real economy*. It has provided an excellent opportunity for supervisors worldwide to deepen the supervisory dialogue on measures to strengthen the long-term resilience of the global financial system.

During the event, on September 22, the BSCEE Regional Meeting took place and focused on one of the topics of the Conference: *Post-Basel III reforms.*

BSCEE CONTACT LIST

Supervisory Authorities of the Member Countries	Address	Web-site address
Bank of Albania	*Sheshi Skënderbej No. 1* *Tirana, Albania*	www.bankofalbania.org
Central Bank of Armenia	*6, Vazgen Sargsyan str.* *PO Box 0010, Yerevan* *Republic of Armenia*	*www.cba.am*
Austrian Financial Market Authority	*Otto-Wagner-Platz 5* *1090 Wien* *Austria*	www.fma.gv.at
National Bank of the Republic of Belarus	*Nezavisimosty Ave. 20* *Minsk 220008* *Republic of Belarus*	www.nbrb.by
Banking Agency of Federation of Bosnia and Herzegovina	*Kosevo 3, Sarajevo 4000* *Bosnia and Herzegovina*	www.fba.ba
Banking Agency of Republika Srpska, Bosnia and Herzegovina	*Vase Pelagića 11 A* *78000 Banja Luka* *Republika Srpska*	www.abrs.ba
Bulgarian National Bank	*1 Knyaz Alexander I Square* *Sofia 1000, Bulgaria*	www.bnbank.org
Croatian National Bank	*TRG Hrvatskih velikana 3* *Zagreb 10002, Croatia*	www.hnb.hr
Czech National Bank	*Prague 1,Na Prikope 28* *115 03 Czech Republic*	www.cnb.cz
Estonian Financial Supervision Authority	*Sakala 4* *Tallinn 15030, Estonia*	www.fi.ee
National Bank of Georgia	*2 Sanapiro Street* *0114 Tbilisi, Georgia*	www.nbg.gov.ge
Central Bank of Hungary	*Krisztina krt. 39* *1013 Budapest, Hungary*	www.mnb.hu
Financial and Capital Market Commission	*Kungu iela 1* *Riga, LV-1050, Latvia*	www.fktk.lv
Bank of Lithuania	*Zirmunu St 151* *Vilnius, LT-09128 Lithuania*	www.lbank.lt

National Bank of Macedonia	*Kuzman Josifovski Pitu Blvd 1 Skopje, 1000 Macedonia*	www.nbrm.mk
National Bank of Moldova	*1 Grigore Vieru Ave. Chisinau, MD-2005 Moldova*	www.bnm.org
Central Bank of Montenegro	*Bulevar Svetog Petra Cetinjskog 7 Podgorica, Montenegro*	www.cb-cg.org
Polish Financial Supervision Authority	*Plac Powstańców Warszawy 1 00-950 Warsaw, Poland*	www.knf.gov.pl
National Bank of Romania	*25, Lipscani str. Bucharest 1, Romania*	www.bnro.ro
Central Bank of the Russian Federation (Bank of Russia)	*12 Neglinnaya str. 103016 Moscow, Russia*	www.cbr.ru
National Bank of Serbia	*Kralja Petra 12 11000 Belgrade, Serbia*	www.nbs.rs
National Bank of Slovakia	*Imricha Karvasa 1 813 25 Bratislava, Slovakia*	www.nbs.sk
Bank of Slovenia	*Slovenska 35 1505 Ljubljana , Slovenia*	www.bsi.si
Turkish Banking Regulation and Supervision Agency	*Atatürk Bulvarı 191 B Blok 06680 Kavaklidere Ankara, Turkey*	www.bddk.org.tr
National Bank of Ukraine	*Institutska str. 9. 01601 Kiev, Ukraine*	www.bank.gov.ua
BSCEE Secretariat	*Plac Powstańców Warszawy 1 00-950 Warsaw, Poland*	www.bscee.org