BSCEE

Review

2013

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 four member institutions from twenty three 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 and Ukraine. In 2013 the Banking Regulation and Supervision Agency of Turkey has applied for the BSCEE membership and has been accepted to the Group. Turkey will officially join the BSCEE Group as the twenty fifth member in 2014.

The Chairmanship of the BSCEE Group rotates on annual basis. In 2013 Mr. Zlatko Barš, Director of the Banking Agency of the Federation of Bosnia and Herzegovina 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 2013. 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 26th Annual Members' Conference was organized by the Banking Agency of the Federation of Bosnia and Herzegovina and Banking Agency of Republika Srpska of Bosnia and Herzegovina in Sarajevo on June 12 – 14, 2013.

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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2013 DEVELOPMENTS IN THE BANKING SYSTEM OF THE MEMBER COUNTRIES

2013 DEVELOPMENTS IN THE ALBANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Aggregate demand and economic growth remained at low levels during 2013; inflation fluctuated around Bank of Albania's lower targeted band, while the budget deficit and public debt increased sharply due to the unfavorable economic environment, both in the country and abroad. Consumption and investments continue to suffer from low confidence and tight lending terms. Fiscal policy is faced with a high public debt level, which has limited the possibilities for macroeconomic stimulus. On the other hand, the external environment was characterized by ongoing euro-area problems, hence limiting our export growth and making financial markets pursue conservative policies in terms of lending to developing economies. However, 2013 saw positive developments as well. Financial markets were characterized by improved liquidity and downward interest rates, in response to Bank of Albania's easing monetary policy. Also, the introduction of new financial agents and instruments has further deepened these markets. The banking system remains solid and well-capitalized, regardless of the increase in non-performing loans. The current account deficit has dropped, creating better premises for a sustainable external position of the economy and stable exchange rate. These developments have contributed to maintaining macroeconomic stability. Average annual inflation reached 1.5% in the fourth quarter, remaining unchanged from the third quarter. Based on the economic outlook and aiming to boost aggregate demand, the Bank of Albania lowered the key interest rate by 0.5 percentage points, to 3.0% in the fourth quarter of 2013. Also, Bank of Albania's monetary policy decisions were associated with ongoing liquidity injections and orientations toward the future monetary policy stance. This policy has managed to keep liquidity premia and inflation in check, by contributing to lowering the interest rates in the interbank, government debt securities, lek loan and deposit markets. However, the lending rates in lek did not fully reflect our monetary policy, indicating the presence of high risk premia and containing the monetary stimulus transmission to the economy. These risk premia were also reflected in other lending terms, which are unrelated to the lending rates and appear tighter as compared to their historical performance.

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

At the end of 2013, the ratio of financial system assets to the GDP grew by 3 percentage points reaching 99.1 % . The banking sector owns 91.4 % of financial system assets (90.6 % of GDP). Total banking sector assets reached 1,234.3 billion ALL, at an annual growth rate of 3.9 %. 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 shrank by 1.8 %. This decrease in the stock of credit is significantly influenced by the sale of non-performing loans from banks and write-offs. At the end of the year, nonperforming loans to total loans reached 23.5 % , compared with 22.5 % at the end of 2012. Deposits amounted to 1,013.5 billion ALL, increasing by 3.6 % from a year ago. The Loan to deposits ratio stood at 55.6 %. The banking system recorded a positive financial result with net profits reaching 6.6 billion ALL, compared with 3.8 billion ALL a year ago. By the end of 2013, the banking system's capital adequacy ratio stood at 18 %.

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 2013, the regulatory and supervisory framework was reviewed intensively, 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 amendment of legal acts.

Regulatory acts fully revised and approved during 2013:

- Regulation on licensing and activity of non-bank financial institutions, which stipulates the terms and conditions, requirements, documentation and procedures for licensing non-bank financial institutions to extend licensing requirements to electronic money institutions;
- Regulation on management of risk to non-bank financial institutions' activity, which sets forth the rules for managing the operational risk of non-bank financial institutions to extend regulatory requirements to electronic money institutions;
- Regulation on electronic payment instruments, which sets forth rules about transparency in the framework of electronic money activities;
- Guideline on managing the interest rate risk in banking books, which sets forth the rules and procedures for managing the interest rate risk position in the banking book;
- Regulation on capital adequacy ratio, which, in accordance with the Basel II standards, presents new approaches for risk measurement and a more calibrated calculation that the banks need to hedge against risk;
- Regulation on prevention of money laundering and terrorist financing. Regulatory acts partially amended during 2013;
- Regulation on capital adequacy ratio - partial amendments to the existing regulation in the framework of the package of measures to improve lending in Albania;
- Regulation on credit risk management - partial amendments to create necessary stimuli for banks in carrying out the credit restructuring

process, as an effective way to prevent further deterioration in the loan portfolio quality;

- Regulation on liquidity risk management - partial amendments to revise the level of some liquidity indicators, in line with the changes in the banking system liquidity situation;

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2013

Introduction of a new capital adequacy regulation in line with EU directives

The draft capital adequacy regulation developed during 2012 based on the EU directives was approved by the Supervisory Council of the Bank of Albania, and it shall enter into force on January 2015. The COREP reporting standards that shall accompany this new regulation were also discussed with the banking industry, and a parallel reporting based on both existing and new standards shall start during 2014.

FSAP and fulfilment of the mission's recommendations

On October-November 2013, the Albanian financial system and its oversight were subject to an assessment by the International Monetary Fund (IMF) and the World Bank (WB). This assessment included all the segments of the financial system, the way of overseeing them, approximation to international standards, the public authorities' ability to identify and manage various risks and inter institutional cooperation. The mission assessed that in spite of unfavorable and challenging economic environment due to the international financial crisis, the Bank of Albania demonstrates a high level of compliance with the Basel Core Principles for Effective Banking Supervision. The work and improvements of concepts for full implementation of risk-based supervision were also assessed as positive. On the other hand, the mission put forward recommendations for further improving and completing the initiated processes, which have been translated into detailed work plans for the respective institutions, including the Bank of Albania. Carrying them out in due time and quality assumes special importance.

Criteria for the development policy loan

Criteria for the Development Policy Loans (DPL)' is a World Bank instrument for setting some important development objectives to extend supportive loans to the Albanian government. The DPL objectives have derived from some conclusions of the FSAP mission and the Bank of Albania has the most important role in meeting these criteria. They aim at making legal and regulatory amendments to improve the functioning and soundness of the financial system. The Bank of Albania is strongly committed to meet these criteria, closely cooperating with the involved institutions for their entry into force within 2014.

Managing the non-performing loans legacy

Further to a number of legal and regulatory initiatives to decrease the level of nonperforming loans and boost lending to the economy, the Bank of Albania has undertaken a specific initiative, in cooperation with the World Bank's FinSAC project, to improve the loan restructuring process. The purpose of this platform is to use the international experience for drafting recovery and resolution plans about non-performing borrowers or those who are showing problems in individual bank portfolios. For this purpose, the Bank of Albania is closely cooperating with FinSAC experts. In addition, two guidelines were drafted for the loan restructuring process - one for businesses and one for households. Their purpose is to orient banks and borrowers in the loan restructuring process, as a very important phenomenon under the current economic situation. They were drafted following the market driven need for comprehensively reviewing the lending relationships under Albania's current economic conditions and the difficulties of businesses and households to settle their liabilities to banks. Also, a third guideline on real-estate assessment issues was drafted to define some core principles for orienting the assessment of real estates pledged as collateral for the disbursed loans. This guideline sets forth minimum standards that would enable comparative assessments not only within a financial institution but also within the overall financial system. It also identifies more accurately the level of specific credit risk and the overall loan portfolio.

Cooperation with foreign banking supervision authorities

The Bank of Albania considers cooperation with foreign banking supervision authorities as a crucial factor in ensuring a healthy banking activity under the circumstances of a high presence of foreign banks in the country. In this context, the BoA has aimed at enhancing coordination with EU home supervisory authorities in the context of the Vienna Initiative and the Working Group on the Banking Union and Emerging Countries.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2013

The Bank of Albania is the supervisory authority of banks, branches of banks and non-bank financial institutions. It carries out its supervisory role pursuant to the Law "On banks in the Republic of Albania" aiming to ensure a sound banking activity by developing and implementing policies and an appropriate regulatory framework, flexible and in line with the dynamics of development in the country, safeguard the stability of the banking and financial system, prevent crises in the banking sector, and protect depositors.

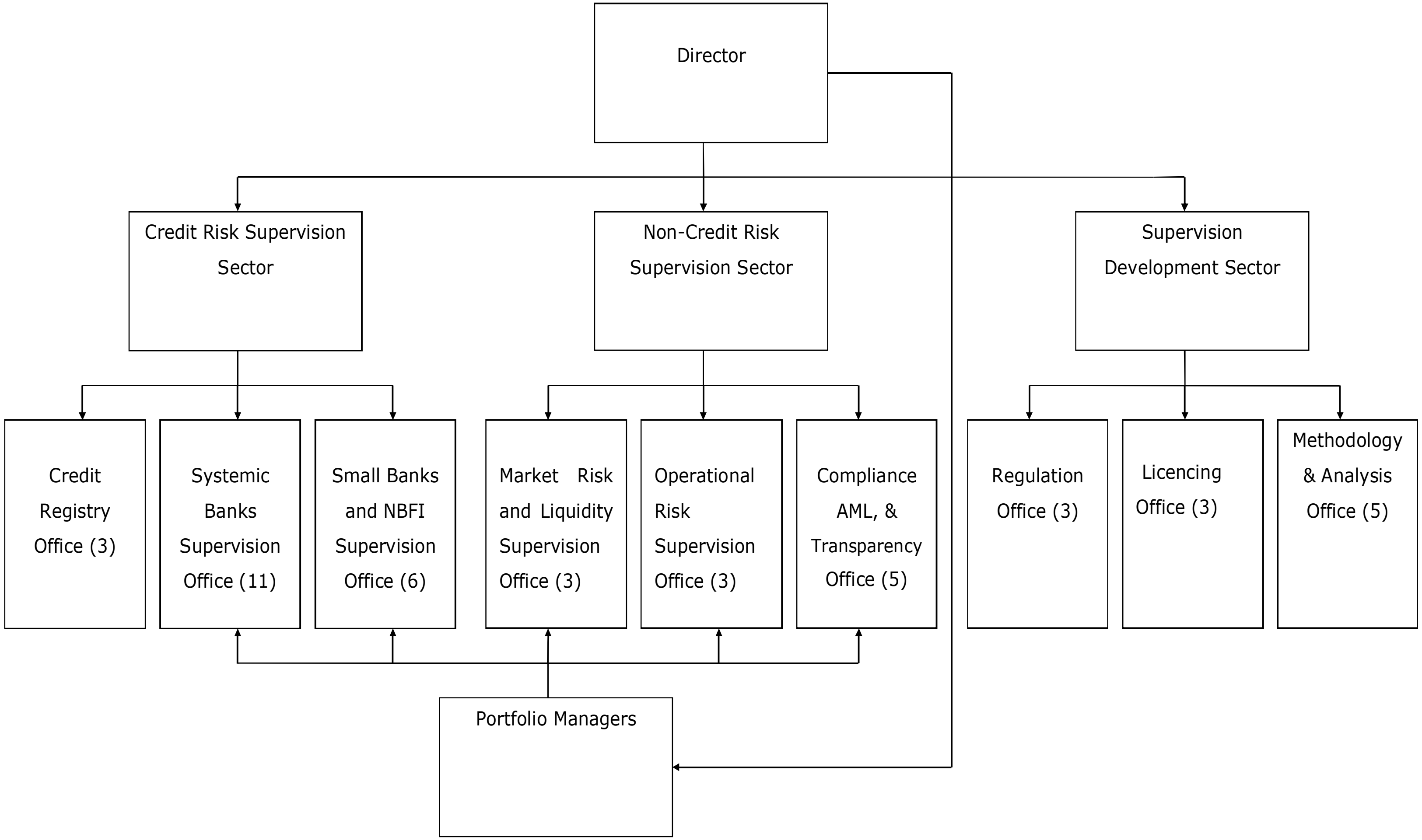
In terms of licencing activity, during 2013, two applications were approved, under bank licence annexes, for conducting additional activities: one for intermediation in insurance and reinsurance and one for providing guarantees and taking commitments, trading for the account of clients, and foreign exchange transactions in a self-organised market of transferrable securities. During the year, banks submitted applications for expanding or reducing their branches or agencies in the country. During 2013, five new bank branches/agencies were opened and 14 existing agencies/branches closed, hence leading to contraction in the banking network by nine branches/agencies on a year earlier. In 2013, the number of entities operating in the non-bank financial market did not change, since three new licences were granted for factoring and financial leasing and three other licences were revoked. Licensing foreign exchange bureaus continued in 2013, albeit at a slower pace than a year ago. Specifically, 18 foreign exchange bureaus were licensed and seven were revoked the licence.

On-site examinations, as an important part of the supervisory process, have aimed at closely inspecting and assessing the risk profile of entities licensed by the Bank of Albania. The planning and organisation is based on the following pillars: switching to risk-based supervision, ensuring institutions' compliance with effective legal and regulatory framework, and enhancing the efficiency of the supervisory instruments. During 2013 the Bank of Albania has conducted eight full-scope examinations and three partial examinations of banks; two examinations of non-bank financial institutions and one examination on the savings and loan associations union. During these examinations, cooperation was in place with other supervisory authorities, such as the General Directorate for Prevention of Money Laundering and the Financial Supervisory Authority.

The Bank of Albania has further increased the number of entities reporting borrower's data to the Credit Registry. During 2013, two more non-bank financial institutions and one savings and loan association became part of the Credit Registry. This brings the number of reporting institutions to 29, including banks and other financial institutions. The information that these entities report to the Credit Registry serves the Bank of Albania for credit risk assessments.

BANK OF ALBANIA

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

Since 2013, the Governor of the Bank of Albania is a member of the Steering Committee of the Vienna Initiative 2. In this capacity, the Bank of Albania has aimed at leveraging this participation to present to the EU authorities the common concerns of non EU countries vis-à-vis home supervisory authorities. For this purpose, the Bank of Albania has strived to develop a common approach with other non EU countries on the most pressing issues concerning home-host cooperation, including deleveraging, participation in supervisory colleges, the signing of MoUs, information exchange between home-host authorities, and establishing an institutional coordination framework with the new supervisory authorities emerging under the Banking Union in the EU (SSM/ECB).

On the basis of cooperation agreements with several foreign supervisory authorities, for certain banks, whose subsidiaries perform banking activity in the Albania, necessary information has been exchanged. Also, following the initiative of the European Central Bank for the functioning of colleges of supervisors of the largest European banking and financial institutions, Bank of Albania representatives has been taking part in panels organized by Bank of Greece.

Cooperation with international financial institutions has been very important during 2013. Prior to the FSAP mission and the assessment conducted during the October-November period, an intensive exchange of information has been in place with the International Monetary Fund and World Bank, to prepare for the mission’s visit. Cooperation with the World Bank has also extended to fulfilling the criteria for obtaining the Development Policy Loan. On the other hand, technical assistance from FinSAC has been important in enhancing the efforts of the Bank of Albania to strengthen the loan restructuring process in the banking system.

COOPERATION WITH OTHER SUPERVISORY BODIES IN ALBANIA

Over the past two years, the inter-institutional cooperation on consulting the policies of addressing and assessing the systemic risk has made headway, upon the institutionalization of the Financial Stability Advisory Group. This group consists of the Minister of Finance presiding it, the Governor of the Bank of Albania, and the Chairperson of the Albanian Financial Supervisory Authority. The Group regularly invites the General Director of the Deposit Insurance Agency and is supported by a Secretariat, which is directed by the Bank of Albania. The purpose of this advisory structure is to discuss and harmonize policies and actions for preventing and managing risks, and for maintaining financial stability. In its regular meetings, participating authorities have discussed the state of the financial system, assessment of risks to related segments, and have provided information on actions taken to address relevant issues.

During 2013 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 is not limited 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, joint activities in order to expand the supervisory capacity and exchange different professional experiences, training of other subjects etc. During 2013, there have one inspection in joint collaboration with FIU in one bank and 2 joint training tables in Tirana, for banks. On the other hand, cooperation with various institutions which monitor specific activities of the financial market, such as Financial Supervision Authority and Deposit Insurance Agency has continued to be effective during 2013. The cooperation has been focused in the exchange of information and data and on carrying out joint inspections.

STATISTICAL TABLES

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

Type of financial institution	2011	2012	2013
Commercial banks	14	16	16
Branches of foreign credit institutions	2	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	2011	2012	2013
Public sector ownership	0	0	0
Other domestic ownership	9.7	10.2	9.7
Domestic ownership total	9.7	10.2	9.7
Foreign ownership	90.3	89.8	90.3
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	56.1	72.3	0.14
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	56.1	72.3	0.14

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

Type of financial institution	2011	2012	2013
Commercial banks	6.94	3.78	6.43
Cooperative banks	n/a	n/a	n/a
Other	n/a	n/a	n/a
Banking sector, total:	**0.76**	**3.78**	**6.43**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	90.4	100	100
Branches of foreign credit institutions	9.6	n/a	n/a
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	2011	2012	2013
Financial sector	12.52	17	16.07
Nonfinancial sector	45.5	42.37	38.58
Government sector	36.75	35.22	40.86
Other	5.24	5.4	4.49
Liabilities	**2011**	**2012**	**2013**
Financial sector	3.91	3.4	3.35
Nonfinancial sector	82.03	83.0	82.11
Government sector	2.9	2.4	2.14
Capital	8.67	8.57	8.37
Other	2.49*	2.63*	4.03*

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Commercial banks	15.6 *	16.2*	17.91*
Cooperative banks	N/A	N/A	N/A
Banking sector, total:	15.6 *	16.2*	17.91*

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

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

Asset classification*	2011	2012	2013
Non financial sector**	18.77	22.5	23.49
- households	15.84	17.2	16.71
- corporate	20.80	24.4	27.69

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

	Deposits	Loans
Households	87.33	26.39
Government sector	2.16	4.69
Corporate	10.51	68.92
Other (excluding banks)	n/a	n/a
Total	**100.0**	**100.0**

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

P&L account	2011	2012	2013
Interest income	73,324.06	76,731.57	74,310.07
Interest expenses	33,689.43	36,960.64	34,778.01
Net interest income	39,634.64	39,770.93	39,532.06
Net fee and commission income	6,110.92	6,294.80	6,471.66
Other (not specified above) operating income (net)	3,830.21	3,616.35	3,010.11
Gross income*	**49,575.76**	**49,682.08**	**49,013.83**
Administration costs	24,490.67	25,930.61	26,223.19
Depreciation	n/a	n/a	n/a
Provisions	22,912.21	18,591.47	14,890.39
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	2,262.07	5,160	7,900.25
Net profit (loss)	706.26	3,768.57	6,563.95

* In million ALL

Total own funds in 2013 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	821.33	680.57	140.76	n/a
Cooperative banks	n/a	n/a	n/a	n/a
Banking sector, total:	821.33	680.57	140.76	n/a

In million EUR

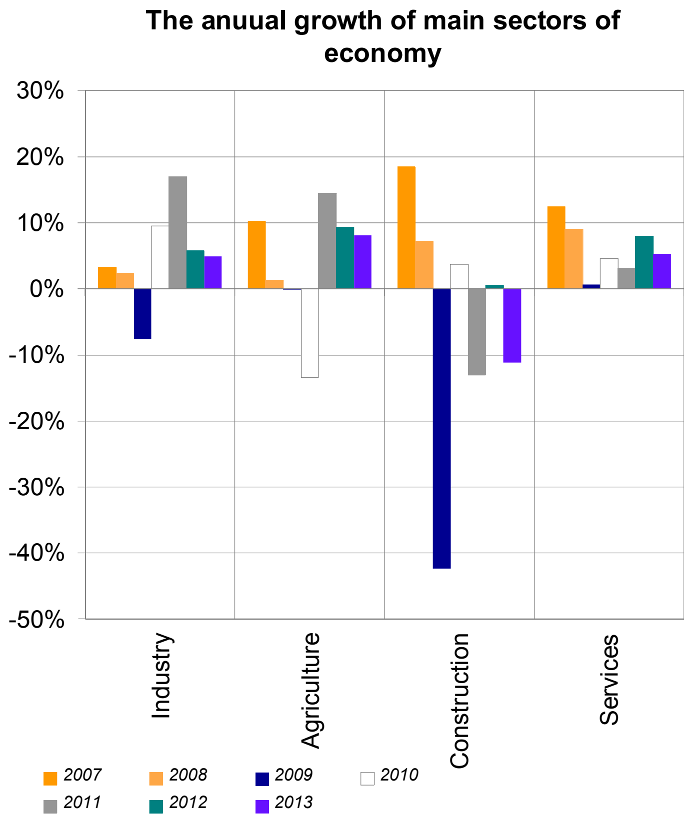
2013 DEVELOPMENTS IN THE ARMENIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The economic growth of Armenia in 2013 amounted to 3.5% (7.2% previous year). *The main economic developments and trends were different in the first and second halves of 2013. Though the first half of the year was characterized by pessimistic expectations and negative trends, the second half saw more positive developments and optimistic expectations of the market.*

The value added of industry reported a 4.9% growth in 2013. The growth rate was especially high in mining and processing industries. Agriculture value added showed an 8.1% growth. The value added of construction reported an 11.2% decline as compared to the previous year, mainly due to reduction of volumes of construction financed by companies. Meanwhile, the volume of households-funded construction has increased. The growth of service sector value added has been 5.3% in 2013.

Taking into account the appreciation of food products and services, particularly energy prices increase from July, a high inflationary environment was shaped in 2013. The 12-month inflation rate was 5.6% in December, thus stepping aside the confidence band.



The private consumption recorded a 1.8% increase, according to the National Statistics data, which was more than 5 times lower than in previous year. The lower pace of growth of private consumption was a consequence of high level of prices, a drop-off in lending growth volumes and a growth slowdown recorded in agriculture. Meanwhile, government expenditure posted a higher growth; 13.4%.

According to Armenia's Ministry of Finance data, public debt of Armenia has increased by 5.0% compared to the previous year and amounted to 44.0% of GDP. The major part of the public debt - the external debt - has increased by 4.4% and amounted to 37.5% of GDP. The share of loans with floating rate continued to show a downward trend of about 13.1% in comparison to the previous year and was 22.2% of the total volume of debt. Though the qualitative indicators of the external debt have mainly increased during 2013, Armenia is still considered a less indebted country.

The expenditures (including PIU funds) grew by 8.2%. In view of accelerated growth of revenues as compared to expenditures and government's contractionary fiscal policy, the budget deficit is reduced by 73.0% and the budget deficit to GDP ratio was 0.4% in 2013 instead of 1.5% in the previous year.

2013 was highlighted by the introduction of a new instrument for financing the budget deficit, that is government bonds issued in foreign currency /Eurobonds/ with an amount of USD 700 million, 6.25% yield and a 7-year term. Meanwhile, a high demand in international capital market was in part due to upsurge of investors' interest towards government bonds of developing countries. As a result, an average reduction of 4.5 percentage points[1] was recorded in dram denominated government bonds yield. This action of the government creates opportunities for the private sector to attract more funds available with low interest rates from the global financial markets.

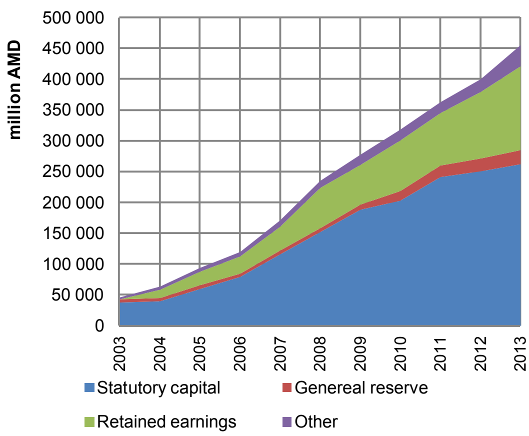
DEVELOPMENT IN THE BANKING SYSTEM (INCLUDING THE ASSETS TOTAL / GDP)

As of 31 of December, 2013, 21 commercial banks and one development bank (Panarmenian Bank OJSC) operated in Armenia. During 2013, 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 6.8 pp., constituting 69.0%, as compared to the previous year. The ratio of loans to economy to GDP was 40.1%, pushing the ratio up by 1.5 pp. The deposits to GDP ratio has also increased by 7.3 pp., and reached 35.7 percent.

Banking system capital

During the year, total capital of the banking sector has grown by 13.8% (AMD 55.3 billion, EUR 101, 6 million); and total assets by 18.8% (AMD 465.9 billion, EUR 85,46 million). As a result, the leverage ratio (capital to assets ratio) has dropped by 0.7 pp. to 15.5 percent. The capital increased due to AMD 38.2 billion net profit and replenishment of AMD 11.4 billion statutory capital. 4 banks replenished statutory capital completely by foreign sources. Consequently, compared to the end of the previous year, the share of non-resident investors' participation in the statutory capital of the banking sector has increased by 1.3 pp. to 74.6% at the end of the year.

The structure of total capital of the banking system



Compared to the end of the previous

[1] Data according to Armenia's Ministry of Finance.

year the total regulatory capital of the banking sector has grown by 16.2 percent and reached AMD 428.5 billion at the end of the year. In terms of total regulatory capital quality structure, the share of regulatory Tier 1 capital in total regulatory capital is still high, constituting 86.6%. (As of 31.12.2012 the ratio was 90.7%).

As compared to the previous year, net asset loss provisions to assets ratio increased by 0.3 percentage points to 1.2%. Net interest margin decreased by 0.6 percentage points to 4.5%.

In 2013, gross revenues of the banking system have grown by 24.7 percent and reached AMD 514.2 billion. Gross expenditures have grown by 30.0%, amounting to AMD 464.9 billion. The shares of assets loss provisions and recoveries in the structure of revenues and expenditures grew. In the structure of banks' revenues the share of interest income declined, meanwhile in the expenditure structure non-interest expenditures decreased. These structural changes are mainly due to relative high fluctuation of NPLs in total loan portfolio during 2013.

During current year significant growth of accessibility of financial services was observed. The number of bank branches increased by 11 and at year end was 485.As a result, the number of bank branches per100 000 adult population increased by 0.9 percentage points and totaled 19.8 percent

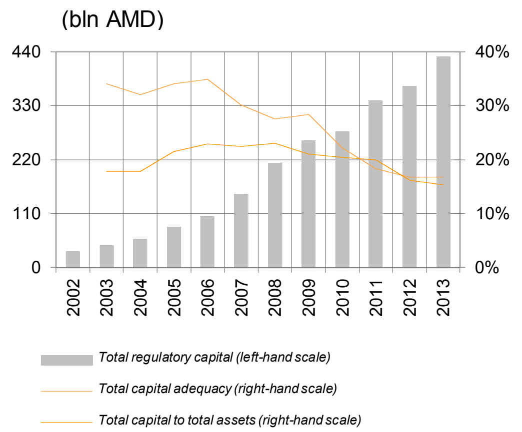
The number of bank employees (including service personnel) increased by 4.2 percent and at year-end reached 11 438. Compared with previous year the share of managerial staff in total number of employees decreased by 0.4 percentage points and at year-end amounted 16.1 percent

Banking system capital adequacy

The capital adequacy ratio remained fairly unchanged due to slower pace of lending growth and amounted to 16.7% (16.8% as of 31.12.2012). All the banks maintained capital adequacy ratio within the required prudential threshold, and no cases of violation of regulatory capital adequacy ratios were recorded during the year.

The share of credit, market and operational risks in the structure of risk weighted assets was respectively 91.1, 5.9 and 3.0 percent (as of 31.12.2012 the indicators were respectively 92.4, 4.8 and 2.8 percent). In this context the credit risk is still considered as a major risk factor for the banking system.

Banking system capital adequacy

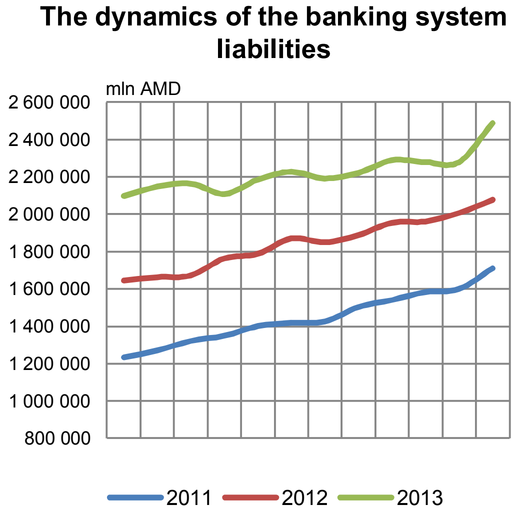


Banking system liabilities

In 2013, total liabilities of the banking system increased by 19.8 percent (AMD 410.6 billion) and at the end of the year totaled AMD 2 trillion 488 billion.

Dram liabilities increased by 23.2 percent and foreign exchange liabilities increased by 17.9 percent. As a result, the share of foreign exchange liabilities decreased by 1.0 percentage points and at the end of the year totaled 63.9 percent.

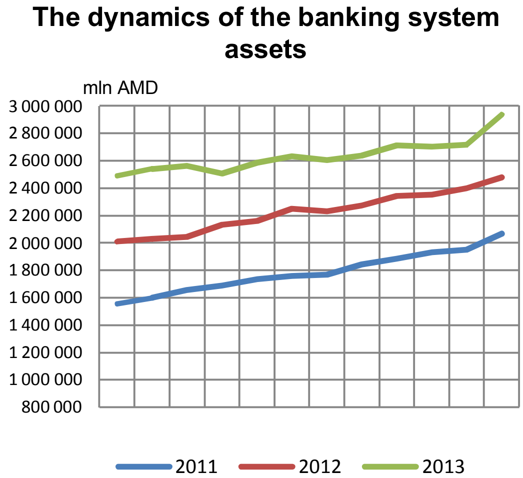
The growth of liabilities was mainly driven by the growth of deposits from natural and legal persons.



Banking system assets

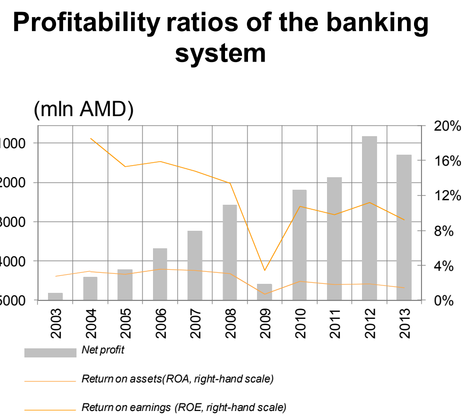
Over 2013, total assets of the banking system increased by 18.8 percent (by AMD 466 billion), and totaled AMD 2 trillion 944 billion at the end of the year. Growth of assets was mainly driven by the growth of loans to economy and increase of correspondent accounts held in the Central Bank.

Compared with previous year the loans to economy increased by 11.2 percent and totaled AMD 1 trillion 709 billion. Loans to legal entities and natural persons grew respectively by 7.4 and 17.2 percent totaling AMD 1 trillion and 708 billion at the yearend.



Banking system financial performance

In 2013 the net profit of the banking system, calculated in accordance with the Central Bank supervisory reports, amounted to AMD 38.2 billion. During the year, 16 banks operated at a profit and 6 banks at a loss. Compared with the previous year, return on assets (RoA) and return on equity (RoE) of the banking system have decreased by 0.5 pp. and 2.2 pp. and amounted to 1.4% and 9.2%, 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 a 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 48.1 billion, while the return on assets (RoA) was 1.6 percent and return on equity (RoE) 10.0 percent.

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

In 2006 the Central Bank was given the authority to regulate and supervise activities of all participants of the financial sector. So, the Central Bank took on the function of mega-regulator along with responsibility for maintaining financial stability.

Ongoing developments in real and financial sectors suppose also corresponding adjustments in regulatory framework. In 2013 enhancements of regulatory framework of financial sector were continued.

In 2013 amendments were made to Minimum requirement of Internal Controls for banks, according to which banks should have an ICAAP process, as well as separate functions responsible for risk management and compliance.

Three amendments and addenda were introduced to the Law on "Funded Pensions". Mentioned changes were driven by the fact that until the changes to the law it didn't regulate number of issues related with the accounting of the mandatory pension contributions, which rose during the development of the corresponding IT solutions.

According to the decree of the Central Bank board Amendments and addenda were introduced in Regulation No 1 "Registration and Licensing of Banks and Branches of Foreign banks, Registration of Bank Branches and Representative Offices, Qualification and Registration of Heads of Banks and Branches of Foreign Banks".

Amendments and addenda were introduced in Regulation No 2 "Regulation of Banking; Prudential Requirements for Banking". The amendments were aimed at the enhancement of the regulatory prudential framework of banking activities and compliance with the level of risks taken by the banks.

Amendments and addenda were introduced to Regulation No 3 "Banks' Reports; Submission and Publication of Banks' Reports" in order to comply with the shifts in regulatory framework. Amendments were introduced to the procedure on selecting an independent auditor by commercial banks operating in the territory of the Republic of Armenia.

Changes have been made to Procedure on Creation of Credit Registry of Banks, Credit Organizations, Foreign Bank Branches Offices operating in the territory of the Republic of Armenia and Participation in the Credit Registry.

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:

a. license banks, as well as other entities, in case if envisaged by law, and regulate and supervise activities thereof,
b. provide loans to the banks as a last-resort-lender,
c. 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 2013

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 2013 on-site and offsite inspections of the Central Bank in the financial institutions were focused on the following areas: legal compliance, risk management system, asset quality assessment, internal control 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.

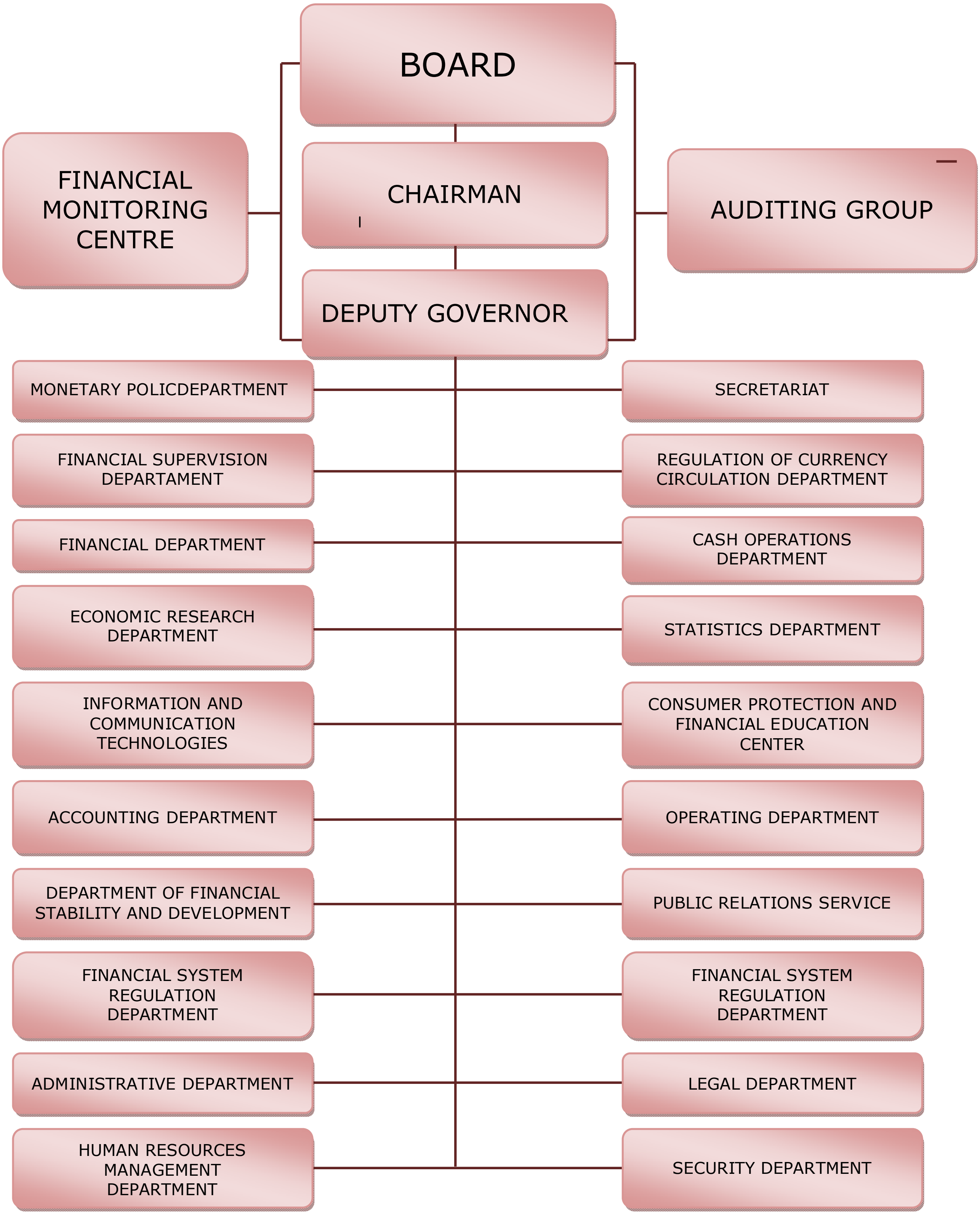
THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY LAST YEAR

In 2013, the Financial Supervision Department of the Central Bank performed both off-site and 211 on-site inspections

Compared with previous year, in 2013 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 Central Bank of Armenia



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In 2013, 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, central bankers training center at Bank of England, member countries of Eurasian Economic Community, International Organization of Securities Commissions and other institutions. Topics covered in training courses, conferences and seminars conducted by the above mentioned institutions are mainly related to financial stability and contemporary issues related to banking, insurance, securities market participant regulation and supervision. Several specialists from the Central Bank attended online training courses arranged by the Financial Stability Institute (FSI).In 2013, highly experienced supervision specialists of the Central Bank continued to organize training courses for younger colleagues for sharing their experience and knowledge with latter.

In 2013, Central Bank continued multilateral and bilateral cooperation with international and foreign organizations.

Within the framework of the technical assistance by the International Monetary Fund and World Bank the Central Bank hosted number of IMF missions on banking supervision and financial operations, accounting, monetary policy and statistics. In March 2013 the Central Bank hosted World Bank private sector development mission headed by Marcin Piatkowski, and in April delegation headed by Peter Holzer visited Armenia within Pension Reform programme.

Financial Sector Assessment Program IMF/WB mission headed by Jennifer Eliot and John Pollner. On March 11-14 2012 the International Monetary Fund executive director Menno Snel (responsible for activities with Armenia) visited the Central Bank.

The Central Bank organized number of business meetings, working sessions, a “round tables” and conferences. The Central Bank in cooperation with Financial Stability Institute and Banking Supervisors from Central and Eastern Europe group organized regional seminar on Revised Core Principles and Basel III.

Inter alia are worth mentioning the following events: Annual meeting of European Fund for Southeast Europe group, meeting of the Board of Governors and Audit Committee of the Black Sea Trade and Development Bank, management board meeting of the Pension Reserve Fund, annual meeting of Financial Consumer Protection Network, meeting of advisory group of Financial Stability Board in CIS, global forum on private pension systems organized by Organization of Economic Co-operation and Development and International Organisation of Pension Supervisors, 16th meeting of the council of heads of securities market state regulatory bodies of the CIS countries and 17th meeting of the council of heads of securities market state regulatory bodies of the EurAsEC member countries, GITEX week conference exhibition, annual meeting of the Boards of Governors of the IMF and the World Bank Group, 38th annual conference of International Organization of Securities Commission, 83rd annual general meeting of Bank of International Settlements, 26th Banking Supervisors from Central and Easter Europe annual conference, annual meeting of Dutch Group of WB/IMF, meeting of supervisory board of German-Armenian fund.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

In 2013, Central Bank of Armenia has been cooperating with the supervisory bodies of Belarus, China, Cyprus, Egypt, Georgia, Iran, Kyrgyzstan, Lebanon, Germany, Russia and Ukraine. Also MoU signing is in process with, France, UAE and Kazakhstan.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN THE COURSE OF LAST YEAR

During the last year one of the main objectives of the development of regulatory framework was the compliance with newly introduced international standards. Particularly, work on implementation of Basel III standards is underway. The main efforts were directed towards the definition of capital and the quality of its components, as well as the development of criteria for identification of D-SIBs.

STATISTICAL TABLES

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

Type of financial institution	2011	2012	2013
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	2011	2012	2013
Public sector ownership	3.2	3.1	3.0
Other domestic ownership	24.1	23.6	22.4
Domestic ownership total	**27.3**	**26.7**	**25.4**
Foreign ownership	**72.7**	**73.3**	**74.6**
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	30.3	47.6	0.0699*
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	30.3	47.6	0.0699

*HHI of assets (min0, max 1)

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

Type of financial institution	2011	2012	2013
Commercial banks	9.8%	11.2%	9.07%
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	9.8%	11.2%	9.07%

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
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)

Assets	2011	2012	2013
Financial sector	32.43	30.97	34.51
Nonfinancial sector	61.21	64.86	60.89
Government sector	6.84	7.13	7.56
Other	10.3	6.48	6.20
Liabilities	**2011**	**2012**	**2013**
Financial sector	10.45	10.84	10.31
Nonfinancial sector	34.22	36.75	37.18
Government sector	3.82	2.73	2.00
Capital	16.61	15.86	15.41
Other	**8.08**	**4.20**	**3.89**

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Commercial banks**	18.3%	16.8%	16.7%
Cooperative banks	n/a	n/a	n/a
Banking sector, total:**	18.3%	16.8%	16.7%

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

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

Asset classification	2011	2012	2013
Non financial sector	3.8 %	3.9%	4.6%
- households	**3.5%**	**3.7%**	**5.5%**
- corporate	**3.9%**	**4.0%**	**4.3%**

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

	Deposits	Loans
Households	68.78	38.35
Government sector	0	0
Corporate	20.81	56.84
Other (excluding banks)	10.35	4.82
Total	**100.0**	**100.0**

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

P&L account	2011	2012	2013
Interest income	351 868	424 652	468 567
Interest expenses	-163 343	-208 863	-248 327
Net interest income	188 524	215 789	220 240
Net fee and commission income	46 140	47 619	56 853
Other (not specified above) operating income (net)	224 489	303 092	535 556
Gross income	586 097	775 364	**944 983**
Administration costs	-78 695	-84 499	**-93 518**
Depreciation	-18 789	-20 568	-21 710
Provisions	-173 210	-281 602	-57 261
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-44 531	-63 314	-78 844
Profit (loss) before tax	85 923	102 376	90 676
Net profit (loss)	66 538	79 709	70 171

Total own funds in 2013 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	824 350	761 479	62 871	
Cooperative banks				
Banking sector, total:	824 350	761 479	62 871	

2013 DEVELOPMENTS IN THE AUSTRIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Austria's economy performed fairly well in 2012 and 2013, considering that the euro area was in recession. Real GDP growth was admittedly very subdued in Austria, but nevertheless positive, whereas output declined in ten euro area countries at least in one of the two years. However, the recovery is increasingly gaining a foothold across the globe.

The Austrian economy remained sluggish throughout the first half of 2013. Declining net real wages and flat consumer confidence dampened consumer spending. In the second half of 2013, Austria's economy overcame stagnation and slowly began to recover moderately in the wake of the revival of global activity. Real GDP growth ran to 0.4% in 2013 (in real terms, seasonally adjusted). Austria's growth differential to the euro area contracted visibly in 2013, but still came to +0.8 percentage points.

Labor market conditions were ambivalent in 2013. Economic activity was weak, but employment augmented markedly – as did unemployment. Whereas payroll employment enlarged from 3.47 million to 3.48 million persons in 2013 (+0.5%), unemployment surged from just under 261,000 to about 287,000 (+10.2%). This development can be explained by the increase in labor supply, in particular of labor from abroad. Although unemployment clearly expanded, the unemployment rate as measured by Eurostat increased by only 0.6 percentage points (from 4.3% in 2012 to just 4.9% in 2013).

Austrian HICP inflation sank perceptibly in 2013 (annual average: 2.1%), declining from 2.9% in the fourth quarter of 2012 to 1.6% in the last quarter of 2013 (year on year in both instances). This drop hinged on the easing of prices in global commodity markets, the moderate development of prices for imported goods, and slightly falling wage cost growth.

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

In 2013 the consolidated return on assets (after tax) of Austrian banks was negative for the first time in years at –0.04%. The decrease in the net result after tax and minority interests by EUR 4 billion to EUR –1.04 billion was due to several reasons: On the one hand, the operative business was characterized by the low interest rate environment, which led to a decline of the consolidated net interest income – the most important source of income – by 3.4% to EUR 18.6 billion. On the other hand, the net result was pressured by write-downs of goodwill of subsidiaries in CESEE as well as losses at one bank under restructuring. Furthermore, the results for 2012 had benefited from one-off effects resulting from a buyback of supplementary and hybrid capital. Profitability in the Austrian market remained weak and further contributed to a dependence on profits generated in the foreign market.

Since 2008 the aggregated capitalization of Austrian banks has increased steadily, but it remains low in an international comparison. A further improvement in capitalization is necessary, given the current risk profile (e.g. high exposure of Austrian banks to CESEE, volume of foreign currency loans), the generally challenging environment, higher market expectations with respect to capitalization as well as higher regulatory requirements. In addition, well capitalized banks are more attractive for investors contributing to better funding conditions. At the end of 2013, the banking system's overall solvency ratio stood at 15.4%, while the tier-1 capital ratio came to 11.9%.

The liquidity conditions of Austrian banks improved further in 2013. On an aggregate basis the cumulative net financing gap narrowed as banks increased their counterbalancing capacity by increasing their liquidity buffers. Austrian banks have already repaid about three quarters of the funds raised through the ECB's longer-term refinancing operations.

Foreign currency loans of domestic households and nonfinancial corporations have been decreasing by 39% since autumn 2008, which reflects the success of the initiatives of the Austrian supervisory authorities – most recently the revised minimum standards on risk management and new lending in foreign currency from early 2013. At the end of 2013 Austrian banks had a volume of EUR 40 billion of foreign currency loans outstanding vis-à-vis all domestic nonbanks, corresponding to a share of foreign currency loans of 12% (mainly in Swiss francs).

Total assets of the Austrian banking system (on a consolidated level) decreased in 2013 by 6.4% yoy to 1,089.7 bn EUR. This corresponds to 345% 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 amongst others responsible for the supervision of credit institutions and payment institutions. Further tasks in the field of banking supervision include combating the unauthorized provision of financial services and taking preventive action against money laundering and terrorist financing. The FMA is an integral part of the European System of Financial Supervisors (ESFS) and represents Austria in the relevant European institutions, closely cooperating with the network of supervisors and actively contributing to its work.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2013

- The banking supervision department of the FMA has set the following objectives for the year 2013:
- 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).
- Focuses on the supervision of credit institutions undergoing a restructuring process are set.
- FMA-Priorities concerning the developments of European regulatory and supervisory initiatives are set and acted on.
- The IMF-FSAP survey concerning banking supervision is prepared in a professional manner and successfully completed.
- The international cooperation with banking supervision authorities in the context of Consolidating Supervision is further intensified.
- A common management culture in order to strengthen motivation and employee engagement is in place.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

Licensing processes

In 2013, no new licences pursuant either to the Federal Banking Act (BWG) or to the Payment Services Act (ZaDiG) were granted. There was an increase in the number of approved licence extensions, from a total of three in 2012 to nine in 2013. 18 licences were declared expired or revoked.

33 credit institutions and 66 payment institutions from other Member States provided "passive" notification of being active in Austria. 53 Austrian credit institutions provided "active" notification via the FMA to other Member State supervisory authorities.

Obtaining of information for supervisory purposes

To enable the FMA and OeNB 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 433 instances of information being obtained or of documentation being inspected in 2013. 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 47 audit engagements to the OeNB in 2013. 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: twelve on-site activities related to model approval took place in 2013.

Additionally, the FMA conducts regular structured talks with the management of the credit institutions. In 2013, 62 such meetings took place.

General and official supervisory measures

In accordance with its statutory mandate, the FMA is charged with monitoring credit institutions´ compliance with statutory provisions pertaining to banking, with ascertaining facts in cases involving the endangering of creditors´ interests and with introducing appropriate remedial measures where necessary. The FMA ordered such measures (specified in Article 70 para. 2 BWG) in two cases in 2013. A capital add-on (according to Article 70 para. 4a BWG) was required once during the year under review. 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 also introduce measures (specified in Article 70 para. 4 BWG). On seven occasions in 2013 the FMA ordered credit institutions, under threat of a coercive penalty, to establish compliance with statutory provisions within an appropriate period of time.

A further general supervisory measure designed to enforce compliance with the statutory provisions is specified in Article 97 BWG – 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. Interest was charged in 16 such cases in 2013.

Consolidating Supervision and Colleges

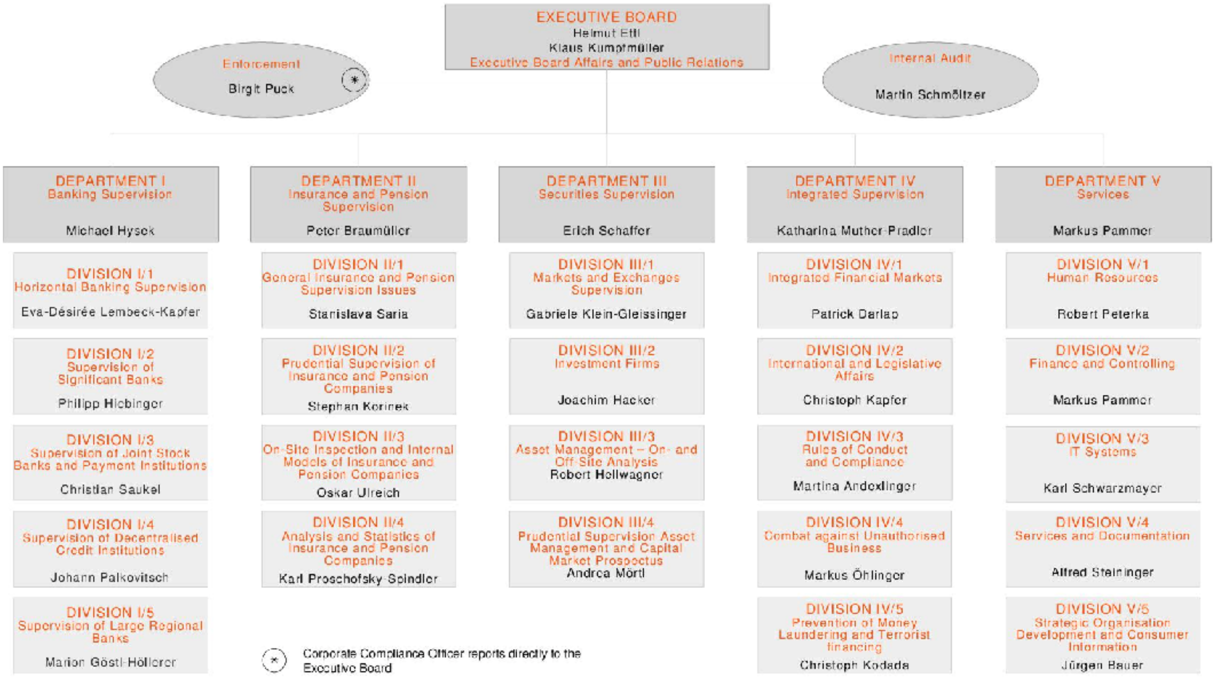
In view of the special significance of the CESEE region for Austrian banking industry, and as a means of promptly assessing the economic situation of a group of credit institutions at the consolidated level, on-site inspections of credit institutions are being conducted with greater frequency in that region within the framework of consolidated supervision. Priority is also given to discussing the risk situation in the context of management talks involving the major banking groups with a strong CESEEE commitment.

As of the end of 2013, the FMA has also 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 ten supervisory colleges with a more flexible structure existed.

Combating money laundering and terrorist financing

The FMA´s responsibilities and powers in combating money laundering and terrorist financing were significantly expanded in 2010. The FMA has been granted comprehensive and sole responsibility for ensuring that preventive systems and measures are in place. In 2013, 10 on-site inspections and 18 company visits at credit institutions were carried out within the new framework of combating money laundering and terrorist financing.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY[2]



INTERNATIONAL ACTIVITIES OF THE AUTHORITY AND COOPERATION WITH OTHER SUPERVISORY BODIES

Apart from the European Cooperation regarding the ESFS and the *Single Supervisory Mechanism* (SSM), the FMA has further intensified bilateral and multilateral cooperation. The FMA attended the Integrated Financial Supervisors Conference (IFSC) in Copenhagen and also attended meetings of the Basel Consultative Group (BCG), a subgroup of the BCBS. Bilateral visits were paid to the banking supervisory in Russia and Poland, while a delegation from the Russian central bank visited Vienna in December 2013.

[2] Please note that the FMA is an integrated supervisory authority, therefore banking supervision is one of five departments in the FMA. A reorganisation of the departments of the FMA took place in 2013 – the above organisation chart shows the current organization of the FMA.

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 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.

In line with the macro-prudential measures set out in the CRD IV, the new national institutional body Financial Market Stability Board has been established in 2013 (date of entry into force 1st 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 (Article 13 Financial Market Authority Act). In accordance with the 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

IMF and World Bank Financial Sector Assessment Program (FSAP)

In light of the global financial crisis, the IMF has identified 25 countries worldwide with a global systemically important financial sector - Austria ranks amongst them. Therefore, in 2013, the FASP country assessment took place in Austria. The Austrian financial sector, its basic legal parameters and its long-term strategic positioning were assessed. In accordance with the Article IV mission of the IMF the FSAP findings were presented in July 2013. They stated that Austria´s banking system is stable and that the FMA and OeNB collaborate effectively.

<u>New Bank Restructuring Regime</u>

The Banking Intervention and Restructuring Act (BIRG) has been passed by the Austrian legislator in 2013 (date of entry into force 1st January 2014). It is a first step at national level towards establishing a single European regime for the restructuring and resolution of banks. 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 now able to get involved at an early stage as soon as signs begin to emerge that a bank has a problem.

<u>Single Supervisory Mechanism (SSM)</u>

With effect from November 2014, banking supervision in the euro area will be overhauled. As of this date, responsibility for the supervision of individual institutions within the euro area as part of the SSM will pass to the ECB. With appointed date May 2014 six Austrian groups of credit institutions will be subject to direct supervision by the ECB.

STATISTICAL TABLES

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

Type of financial institution	2011	2012	2013
Commercial banks	197	192	190
Branches of foreign credit institutions	30	29	30
Cooperative banks	597	584	570
Banking sector, total:	**824**	**809**	**790**

Source: OeNB, unconsolidated data.

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

Type of financial institution	2011	2012	2013
Public sector ownership	10.6	10.1	9.7
Other domestic ownership	68.1	66.8	66.7
Domestic ownership total	78.7	76.9	76.3
Foreign ownership	21.3	23.1	23.7
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	39.9	48.5	745
Branches of foreign credit institutions	68.5	76.8	3,280
Cooperative banks	49.0	62.5	1,156
Banking sector, total:	28.8	36.0	386

Source: OeNB, unconsolidated data.

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

Type of financial institution	2011	2012	2013
Commercial banks	-0.1	3.4	-5.3
Branches of foreign credit institutions	4.3	5.2	4.7
Cooperative banks	-	-	-
Banking sector, total:	1.6	4.2	-1.2

Source: OeNB, unconsolidated data.

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	61.3	62.6	62.5
Branches of foreign credit institutions	1.2	1.3	1.5
Cooperative banks	37.5	36.1	36.1
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	2011	2012	2013
Financial sector	n.a.*	n.a.	n.a.
Nonfinancial sector			
Government sector			
Other			
Liabilities	**2011**	**2012**	**2013**
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	2011	2012	2013
Commercial banks**	13.4	13.9	15.4
Cooperative banks**	13.7	14.7	15.3
Banking sector, total:**	**13.6**	**14.2**	**15.4**

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	2011	2012	2013
Non financial sector	4.5	4.7	4.1
- 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 2013 (%)
(at year-end)

	Deposits	Loans
Households	70.3	42.6
Government sector	4.7	8.4
Corporate	17.4	43.1
Other (excluding banks)	7.6	5.9
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	2011	2012	2013
Interest income	28.2	25.6	21.2
Interest expenses	18.6	16.8	12.4
Net interest income	9.6	8.8	8.8
Net fee and commission income	3.8	3.8	4.1
Other (not specified above) operating income (net)	5.8	6.5	6.1
Gross income	**19.2**	**19.1**	**19.0**
Administration costs	10.0	10.4	10.8
Depreciation	0.5	0.5	0.5
Provisions	5.7	2.5	6.6
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	2.2	4.3	0.2
Net profit (loss)	1.2	3.2	-0.9

Source: OeNB, unconsolidated data in EUR bn.

Total own funds in 2013 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	53.4	41.6	11.3	0.5
Cooperative banks	35.6	21.7	8.0	0.5
Banking sector, total:	**89.0**	**68.8**	**19.3**	**0.9**

Source: OeNB, consolidated data in EUR bn.
Total own funds before deductions; Tier capital after deductions

2013 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF BELARUS

MACROECONOMIC ENVIRONMENT

In 2013 the economic situation in the Republic of Belarus was characterized by slowing down economic growth. The slowdown of the external demand for Belorussian products led to deterioration of the foreign trade balanced state and decreasing industrial output growth alongside with building up finished product stocks. High import capacity, excess of real earnings over rise in labor productivity, insufficient level of direct foreign investments affected the sustainability of the economy.

High level of consumer demand and recovery of investment activity ensured maintenance of economic growth in 2013.

In 2013, GDP increased in comparable prices by 0.9% on the previous year (in 2012 – by 1.7%). Consumer prices gain in 2013 stood at 16.5%, compared with 21.8% in 2012.

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

As of January 1, 2014, the banking sector of the Republic of Belarus included 31 operating banks (in 2012- 32 banks). The number of branches fell in 2013 from 105 to 94 owing to the streamlining by banks of their regional structures. At the same time, the total number of banks' organizational units (branches, banking services centers, settlement and cash centers, and exchange offices) in the territory of the country grew by 15, 5%, amounting as of January 1, 2014 to 4,686. Foreign banks ran 8 representative offices in the territory of the country.

Foreign capital participated in the authorized capital of 27 banks, including 22 banks with more than 50% of foreign participation in authorized capital and 7 wholly-foreign owned banks. As of January 1, 2014, the non-residents' share in the aggregate authorized capital of the Belarusian banks stood at 19.56%, including the share of Russian capital in the authorized capital of the banks amounting to 10.88%. As of January 1, 2014, the share of the State Committee on Property of the Republic of Belarus in the authorized capital of 9 banks stood at 72.6% of the aggregated authorized capital of the banking sector.

In 2013, aggregate registered authorized capital in the banking sector grew by 6.6%, amounting to BYR31.8 trillion, or EUR2.4 billion in equivalent, as of January 1, 2014.

In the period under review the regulatory capital increased by 19.3%, amounting to BYR53.6 trillion (EUR4.1 billion in equivalent). The regulatory capital/GDP ratio stood at 8.4% in 2013 as of January 1, 2014 (8.5% as of January 1, 2013).

In 2013 banks' assets increased by BYR74 trillion, or by 23%, and reached BYR395.2 trillion as of January 1, 2014(EUR30.2 billion in the equivalent). The banks' assets/GDP ratio stood at 62.1% as of January 1, 2014 (60.6% as of January 1, 2013).

In 2013, banks' profits amounted to BYR6.8 trillion, or EUR0.5 billion in equivalent, exceeding the 2012 level by 26, 5%. Return on the banking sector's assets totaled 1.87% (as of January 1, 2013 – 1.82%); return on the regulatory capital – 13.77% (as of January 1, 2013 – 12.74%).

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

During 2013 legal and regulatory framework covering banking supervision was further improved and amended in compliance with international standards and experience of practical application.

With a view of raising awareness of population and organisations on banking activities risks the volume of information, covered by banks and head organizations of banking groups and/or bank holding companies in media, on internet websites, in answers for requests from interested users, was expanded and specificated.

Within continuous work on improving banking activities regulatory mechanisms the procedure of considering the entitlements of banks and non-bank credit and financial organisations was defined. Besides, the procedure of acquiring permition from the National Bank for acquisition of stocks was updated. In addition, the single requirement for a minimal authorized fund amount of a non-bank credit and financial organisation, equivalent to EUR1million, as well as differential requirements to the minimal amount of regulatory capital depending on a type of banking transactions, carried out by a non-bank credit and finance organization, were set.

The National Bank improved banking activities quality parameters ensuring the ability of banks to confront internal and external destabilizing effect and adequately fulfill their functions in economics. In pursuing these aims the approaches to risk assessment on foreign exchange credits during calculation of regulatory capital adequacy parametres by banks were toughened.

According to the plan of introduction of Basel III international standards, concerning capital, leverage and liquidity, measures aimed at improving and raising of efficiency of the liquidity management process and liquidity risk in banks were taken.

During 2013 corporate governance, risk management and internal control were further improved. Particularly, changes and emendments, connected with considering processes of revealing conditions for conflict of interests and measures aimed at conflict avoidance, as well as indentification of certain types of operational risk, were made to the legal and regulatory framework regulating corporate governance organisation, risk management and internal control systems.

In 2013 a range of measures was taken in the sphere of default risk minimization for credits given within instant lending to natural persons. Expanding of requirements for the capital on retail credits for natural persons provided at increased interest rates was stipulated since January 1, 2014. Besides, the amount of allocations to special reserves for coverage of possible losses on credits for consumer needs was increased.

LEGAL COMPETENCE OF THE BANKING SUPERVISION AUTHORITY

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

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

- development of secure functioning regulations and other prudential requirements to the banks to ensure the banking system's stability and soundness;
- state registration of banks and licensing of banks' activities;
- monitoring of financial stability;
- 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 and evaluation of its operational risks;
- detection of violations of banking legislation;
- monitoring of the banking sector's risks;
- setting the rules of 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 natural persons' deposits guarantee fund is built up at the expense of monthly irrevocable contributions of banks licensed to accept deposits from natural persons that are further accumulated by the Agency on the Guaranteed Repayment of the Natural Persons' Deposits.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2013

In 2013, the goals and objectives 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 improvement of prudential requirements and supervisory procedures and an increase in the level of all components of the supervisory process (pre-supervision on the stage of state registration of banks and licensing of banks' activities; current supervision, including off-site, inspection and macroprudential supervision).

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2013

During 2013 the National Bank conducted continuous monitoring of banks' compliance with standards of secure operating and other prudential norms and limitations. Shaping equal conditions of operating for all the banks and ensuring fair competition was continued. Nevertheless, it was not possible to fully reject the preferences provided on condition that banks meet certain prudential requirements, which is mainly caused by the necessity of serving governmental programs and adaptation of banks to significant changes in banking legislation.

In 2013 the National Bank made a focused effort on strengthening documentary supervision in improvement of the banking activities indicators analysis and compliance of the banks with the standards of secure operation, revealing adverse trends and crisis phenomena on the early stages. With a view to automation and, thus, accelerating data processing in financial and other reporting of banks, further work on improvement of information and analytical system of the National Bank was continued.

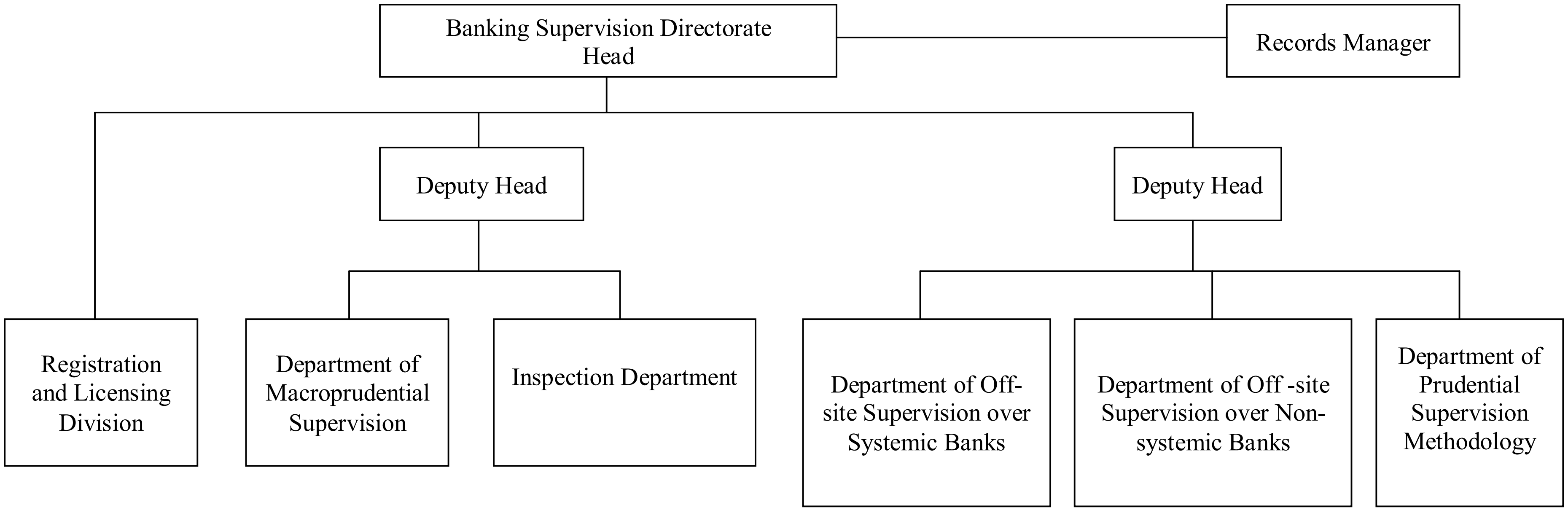
With a view to discontinuing the adverse trends and eliminating (preventing) situations posing a threat to depositors' and other creditors' interests, the National Bank (based on the analysis of reports and other information obtained) on the basis of reasoned judgement applied to banks relevant measures of the supervisory response, including submittal of the instructions on eliminating the revealed violations and application of adequate measures, as well as carried out the meetings with executive bodies of banks and submitted letters to them.

The practice of meaningful interaction between the National Bank, audit organizations and the Association of Belarusian banks was continued.

In 2013 the National Bank conducted 10 scheduled inspections of banks. In connecion with revealing breaches of legislation and drawbacks in systems of corporate governance, internal control and risk management the results of the inspections of certain banks were considered on the meeting of the Board of the National Banks.

In 2013 macroscenary stress testing of the banking sector sustainability in 2014 was implemented. The assessment of loss in banking sector depending on the extrenal conditions deterioration degree and situation development in the foreign exchange market was conducted. In 2013 methodology of bank systemic significance assessment was developed. The index of systemic risk was build up for risk assessment and monitoring on the scale of the whole banking sector. Besides, the methodology of the bank capital countercyclical buffer assessment was developed in accordance with Basel III.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

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

In 2013, the cooperation agreement in banking supervision with the Central Bank of Turkmenistan was signed. In 2013 17 bilateral agreements with foreign banking supervision bodies 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	2011	2012	2013
Commercial banks	31	32	31
Branches of foreign credit institutions	-		
Cooperative banks	-		
Banking sector, total	31	32	31

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

Type of financial institution	2011	2012	2013
Public sector ownership	64,9	65,3	64,3
Other domestic ownership	1,1	1,0	1,0
Domestic ownership total	66,0	66,3	65,3
Foreign ownership	34,0	33,7	34,7
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	68,0	79,5	0,21
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**68,0**	**79,5**	**0,21**

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

Type of financial institution	2011	2012	2013
Commercial banks	14,87	12,74	13,77
Branches of foreign credit institutions	-		
Cooperative banks	-		
Banking sector, total:	**14,87**	**12,74**	**13,77**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
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 system (%) (at year-end)

Assets	2011	2012	2013
Claims on general government	5,5	4,9	6,3
Claims on economic entities*	48,1	55,9	57,8
Claims on natural persons	12,6	12,8	13,9
Claims on the National Bank	22,2	17,6	13,8
Claims on banks	3,0	2,3	1,9
Claims on non-residents	7,3	4,2	3,5
Other assets	1,3	2,4	2,7
Liabilities	**2011**	**2012**	**2013**
Central government funds	7,1	9,4	9,9
Local government funds	7,3	3,7	3,2
National Bank funds	26,1	26,2	21,8
Economic entities' funds*	19,5	25,1	26,9
Natural persons' funds	3,1	2,4	2,0
Banks' funds	19,3	16,3	19,7
Funds received from non-residents	17,6	16,9	16,5
Other liabilities	14,1	14,5	14,1
of which own capital	5,5	4,9	6,3

* Economic entities - non-bank financial institutions, commercial and non-profit non-financial enterprises and organizations, individual entrepreneurs.

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Commercial banks	24,7%**	20,8%**	15,5%**
Cooperative banks	-		
Banking sector, total:	**24,7%**	**20,8%**	**15,5%**

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

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

Asset classification	2011	2012	2013
Non financial sector	3,68%	5,82%	4,68%
- households	4,59%	7,16%	5,67%
- corporate	0,47%	0,40%	0,93%

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

	Deposits	Loans
Households	59,3	20,8
Government sector	11,1	47,4
Corporate	26,1	30,6
Other (excluding banks)	3,5	1,2
Total	**100,0**	**100,0**

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

P&L account	2011	2012	2013
Interest income	2126,7	3690,7	3460,2
Interest expenses	1481,5	2666,7	2470,7
Net interest income	**645,2**	**1024,0**	**989,5**
Net fee and commission income	**280,5**	**515,9**	**560,8**
Other operating income (net)	**-415,7**	**-727,1**	**-829,7**
Net provision assignments	**364,6**	**409,0**	**221,9**
Net other income	**203,7**	**151,2**	**124,4**
Gross income	7517,0	9594,2	11283,9
Profit (loss) before tax	**349,1**	**555,0**	**623,1**
Income tax	63,2	79,3	101,5
Net profit (loss)	**285,9**	**475,7**	**521,6**

Total own funds in 2013 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	4098,8	3054,9	1057,6	0,0
Cooperative banks	-	-	-	-
Banking sector, total:	**4098,8**	**3054,9**	**1057,6**	**0,0**

2013 DEVELOPMENTS IN THE BANKING SYSTEM OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

MACROECONOMIC ENVIRONMENT

According to the preliminary estimates[3], the nominal value of the 2013 GDP in Bosnia and Herzegovina (BiH) was 26.259 billion BAM. According to the estimate made by the Central Bank of Bosnia and Herzegovina, GDP/ per capita in 2013.was 6,85ths. BAM for Bosnia and Herzegovina. The GDP growth in 2013 was 2,1%.

In the third quarter of 2013, there were no considerable changes in macroeconomic trends. The increased

industrial output and deflationary pressures in the country still did not contribute to the increase of domestic demand through the increase of welfare of citizens. Given the annual basis, the growth of the industrial production indicates a recovery in industrial production in 2013. The analysis of the industrial production (2013 /2012) shows that in BiH there was a increase of the industrial production by 6,4%.

The average inflation rate in 2013 in BiH was -0,1%. In comparison to 2012 the average inflation rate was 2,1%. The annual inflation rate by the end of 2013 was -1.2%. Compared to the previous year, inflation was a 1,8 %. The number of employees in BiH at the end 2013 amounted to 689.270 persons; out of that number 438.593 are employed in the FBiH, 240.305 in RS (September 2013).

The ceiling for insured deposits scheme under the auspices of the Deposit Insurance Agency was 50 ths. BAM and it applied exclusively to physical persons, with 25 banks participating in the deposit insurance.

At the end of the 2013, the total deposits were 14.25 billion BAM. The annual growth rate of the total deposits amounted to 6,9% in 2013. The share of government sector in total deposit structure was 8,2%, and the share of households deposit was 58,7 % in total deposits.

The data on the average weighted interest rates for 2013 show that there were no significant changes in trends of interest rates compared to the previous year. There were no large oscillations in the average weighted interest rates in the previous year. The data on the average weighted lending interest rates indicate that the largest part of loans was agreed with variable interest rates, and fixed interest rates only for one year period, and that a very small part of loans was extended at the fixed interest rate for a period longer than a year.

Since the largest part of new loans to households was related to consumer loans, the interest rates on this kind of loans in BAM with and without the currency clause were used as lending interest rates and interest rates on new term-deposits in BAM with and without currency clause on periods longer than two years as deposit interest rates, in order to show their difference. Difference between lending and deposit interest rates of households was between 4 to 5 p.p

[3] Estimates of Central Bank of Bosnia and Herzegovina which are in use as preliminary data till publishing of BH Agency of statistics official GDP.

but the difference was even higher if interest rates with shorter maturity periods were included in deposit interest rates as well.

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

Over the past years, as affected by the economic and financial crisis, the banking sector was characterized by stagnation, along with slight changed among key banking categories: balance sheet total, deposits, cash funds, loans and total capital. Still, as opposed to the last three years, the 2013th saw some positive trends, i.e. growth of the balance sheet total as a result of a deposits increase, thus positively reflecting upon cash funds. Loans, as sources of financing, mostly refer to credit lines by foreign credit institutions and are steadily declining as a result of debt reduction, i.e. payment of liabilities due and weak inflow of new investments from abroad. The lending segment continues to display a positive trend of slight growth over the course of the past three years.

As of 31.12.13, there were 17 banks (16 banks with majority private ownership and one bank with majority of state ownership) holding the banking license in the FBiH. This number is lower than as at 31.12.2012. considering a revocation of the banking license and initiation of liquidation proceedings of one bank. As of 31.12.2013, the number of employees in the banks declined by 1% in comparison to 2012.

The balance sheet total of the banking sector as of 31.12.2013 amounted to 15.4 billion BAM, posting an increase by 3.1% or 458 million BAM compared to the last two years. Loans, being the largest assets item in banks also show a slight growth of 1.7% or 186 million BAM and reached an amount of 10.9 billion BAM, thus representing 70% of the balance sheet total of banks in the FBiH. As for their structure, retail and corporate loans hold an equivalent share of 47.9% or 5.2 billion BAM. Total non-performing loans stand at 1.6 billion BAM and hold a share of 14.6% among total loans.

Capital position in FBiH banks as of 31.12.13. stood at 2.3 billion BAM. In 2013, capital rose by 6% or 128 million BAM, thus including a minor change in its structure (80% core capital and 20% supplementary capital). Core capital increased by 8% or 138 million BAM, while supplementary capital dropped by 2% or 10 million BAM. The core capital increase mostly refers to the transfer of one part of profit earned in 2012 from supplementary to core capital, as well as to the capital increase of two banks of altogether 34 million BAM, reserve payment by one bank of 97 million BAM and posting of audited profit earned in 2013 regarding one bank. Capital adequacy rate of the banking system as of 31.12.13. was 18.0%, which is still quite above the legal minimum (12%) and represents a satisfactory capitalization rate of the overall system considering the existing level of risk exposure and poses strong basis and foundation for preservation of its safety and stability.

Cash funds amount to 4.4 billion BAM and represent 28.6% of the balance sheet total of banks in the FBiH, thus posting an increase of 11.5% or 455 million BAM in comparison to 2012. This increase is chiefly attributable to deposits going up by 5.1% or 563 million BAM, but can also be seen to stem from a very modest credit growth.

Within the structure of sources of financing of banks, deposits amount to 11.5 billion BAM and represent 74.6% of such sources, thus still being the key financing source for banks in the FBiH. Savings deposits are the main and the largest segment of deposit and financial potential of banks. They have maintained a positive growth trend and amounted to 6.2 billion BAM as of 2013. This is 7.7% or 445 million BAM more than as at 2012.

According to unaudited income statement for 2012, banks in the FBiH have posted a loss of 228 ths BAM. Out of all banks, 14 have achieved positive financial result of altogether 140 million BAM, as was also the amount of total loss posted by three banks.

Despite the evident negative trends, liquidity of the banking system in the FBiH is still seen as sound, having satisfactory share of liquid assets in total assets, as well as very good maturity matching of financial assets and financial liabilities, plus a trend of moderate improvement starting from the end of 2010.

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) LAWS (new developments in 2012)

1. Amendment to the Law on bank (Official Gazette of the FBiH No. 66/13).

B) REGULATION ISSUED BY FBA (new development in 2013)

1. Decision on amendments to the decisions on minimum standards for credit risk management and asset classification of banks (Official Gazette of FBiH, No: 15/13);
2. Decision on amendments to the decisions on reporting forms banks deliver to the Banking Agency of the Federation of Bosnia and Herzegovina (Official Gazette of FBiH, No:15/13);
3. Decision on temporary restrictions and minimum requirements for dividends and discretionary bonus disbursement and repurchase of own shares by banks (Official Gazette of FBiH, No:15/13);
4. Decision on diligent behavior of members of bank's bodies (Official Gazette of FBiH No:60/13);
5. Decision on suitability assessment of bank's bodies (Official Gazette of FBiH No:60/13);
6. Decision on the remuneration policy and practice for bank employees (Official Gazette of FBiH No:60/13);
7. Decision on minimum standards for currency exchange operations (Official Gazette of FBiH No:95/13 and 99/13);
8. Decision on examination of currency exchange operations (Official Gazette of FBiH No: 95/13);
9. Decision on conditions and manner of executing international payments (Official Gazette of FBiH No:95/13);
10. Decision on examination of foreign currency operations in banks–payment transactions (Official Gazette of FBiH No. 95/13);
11. Instruction on change condition for forming, recording and reporting for loan loss provisioning (January 2013);
12. Instruction on condition of reporting for provisional administrator for banks business operation under provisional administration (July 2013);
13. Instruction on condition and manner for additional banks reporting under provisional administration (July 2013);
14. Instruction on condition for reporting Provisional administrator of process of liquidation in bank (July 2013).

Legal competences of FBA:

1. Issuing licenses for establishment of banks, micro-credit organizations and leasing companies, issuance of license for changes of organizational system of banks, micro-credit organizations and leasing companies, type of activity and approvals for appointment of their managing staff;

2. Supervising banking, micro-credit, leasing operations and foreign exchange offices, and undertaking appropriate measures in accordance with law;
3. Revoking banking, micro-credit organizations and leasing companies licenses in accordance with law;
4. Appoints provisional and liquidation administrators of banks, conducts supervision of provisional administration and liquidation of banks, monitors liquidation of micro-credit organizations and submits request to initiate bankruptcy process in banks and micro-credit organizations;
5. Declaring sub-legal acts regulating the work of banks, micro-credit organizations, leasing companies and foreign exchange offices;
6. Performing evaluation of conditions and issues approvals to banks, micro-credit organizations, leasing companies, and foreign exchange offices in accordance with laws from those areas and sublegal acts;
7. Supervising and evaluating compliance of banks, micro-credit organizations and leasing companies to the anti-money laundering and terrorism financing standards;
8. Supervising and evaluating implementation of measures by banks, micro-credit organizations and leasing companies in order to prevent the funding of activities which are, or which threaten to be, obstructive of 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;
9. Taking all such actions as may be appropriate, which may include the blocking of customer accounts in any bank or banks within the jurisdiction of the FBA, in order to prevent the funding of activities which are, or which threaten to be, obstructive of the peace implementation process as pursued under the aegis of the General Framework Agreement for Peace in Bosnia and Herzegovina and requiring the Central Bank of Bosnia and Herzegovina to open a special reserve account; requiring the banks in which accounts are blocked under item, aforesaid and transfer criminal funds to the safe keeping of the Central Bank of Bosnia and Herzegovina, or one of its main units and undertake numerous actions related to above mentioned issues including revocation of banking licenses and other kinds of authorizations;
10. Evaluating and promoting the consumers protections rights and interests, with the aim to facilitate that the disputes and conflicts occurred between the banking system institutions and the users can be rightfully and promptly resolved by the independent parties, with a minimum formality through reconcilement, negotiation or other peaceful manner.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2013

The focus of FBA in 2013 was to maintain its stability as priority task in the current stress conditions, as well as its progress and development. The prior tasks were:

1. Continue with activities within its competencies to consolidate the supervision function on a state level;
2. Take measures and actions within its competencies to overcome and mitigate effects of the global financial crisis on the banking sector in the FBiH;
3. Maintain continuous supervision of banks through on-site and off-site examinations, placing an emphasis therein on dominant risk segments of the banking business and aiming to improve efficiency by means of:
   - persist on capital strengthening of banks, especially those recording outstanding assets growth,
   - continue permanent monitoring of banks, primarily those with systemic importance to development of credit activities with the highest concentration of savings and other deposits in order to protect depositors,
   - continue a systematic monitoring of bank`s activities in prevention of money laundering and terrorism financing and improve cooperation with other supervisory and examination institutions,
   - maintain continuity in payment system examinations,
   - continue working on further development of regulation for the financial sector, which refers to the action, the status and operations of banks, microcredit organizations, leasing companies, foreign exchange offices,
   - continue working on further development of regulation based on the relevant EU directives, Basle Principles, as part of BiH's preparation to join the European Union,
   - establish and expand cooperation with home country supervisors of the investors present in the banking sector of the FBiH, and other countries in order to have more effective supervision,
   - continue improving cooperation with the banking, microcredit and leasing Association in all banking, microcredit organization and leasing companies performance segments organization of counseling and professional assistance in the area of implementation of laws and regulations, advancement of cooperation in regard to professional development, proposed changes of all legislative regulations.
   - Continuously improve operational information system that will enable early warning and preventive action to eliminate weaknesses,
   - Further strengthening capital and solvency levels in proportional with growth of assets and risk, higher profitability, consistent implementation of adopted policies and procedures to prevent money laundering and financing of terrorism, and the safety and security of the financial sector, in accordance with the law and regulations;
4. Continuous education and training of staff.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2013

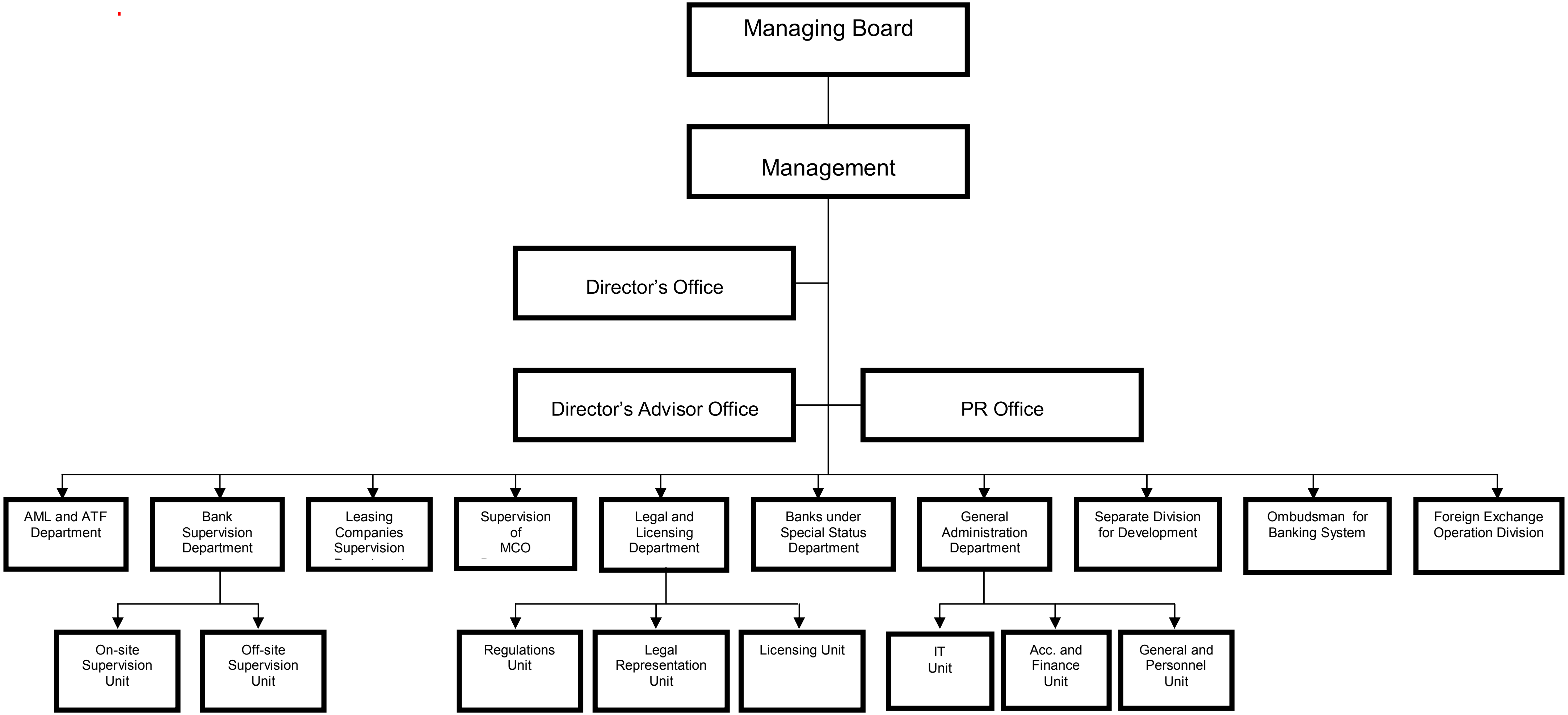
The activities of FBA, in 2013, among other things, implemented the following activities:

1. Continuous monitoring through a continuous process of on-site and off-site examination, monitoring of financial condition of banks in order to synchronize and coordinate activities to preserve the stability of banking sector;
2. Taking measures anticipated by laws and other regulations within the scope of its authority;
3. Activities continued regarding implementation of the Strategy that entailed a prudent and gradual transition to the new regulatory framework in BiH, starting from simple and going towards more complex approaches to calculating capital requirements to cover for risks inherent with bank operations. The Strategy reflects a commitment to direct alignment with the regulatory framework of the EU, starting from the new global regulatory framework CRD IV/CRR. In cooperation with the Banking Agency of the RS and the Association of Banks in BiH, FBA has implemented a preliminary QIS encompassing a standardized approach to calculation of the credit risk capital requirement (standardized approach). A general conclusion after implementation of the QIS is that this would lead to an increased capital adequacy rate at the level of the FBiH banking system. In the 2013th completed activities related to preliminary draft regulatory framework under Pillar 1 in terms of standardized approaches for credit, market and operational risks.
4. Key changes introduced regarding existing regulatory framework for bank`s operations refer to enactment of new Decision on Temporary Measures for Dividends and Discretionary Bonus Disbursement and Repurchase of Own Shares by Banks, as well as to the corporate governance segment – decisions on the remuneration policy and practice for bank employees, suitability assessment of members of bank's bodies (fit & proper criteria) and duty of care by members of bank's bodies.
5. Development and advancement of the regulatory framework in accordance with the law, development trends of generally acceptable international principles and standards;
6. Strengthening of banks capital, enhancement of their lending policies and their consistent implementation in practice, raising prudency to the highest possible level;
7. The focus of supervision was on dominant risk segments such as credit risk, liquidity risk, asset quality, process control of the regulatory framework of international accounting standards 39/37;
8. Further cooperation with domestic and foreign global and other institutions, as the International Monetary Fund (IMF),European Central Bank (ECB), the World Bank, Group of Banking Supervisors of Central and Eastern Europe (BSCEE) and others, as well as with supervisory authorities from home countries of parent banks that in the FBiH have their banks-subsidiaries;
9. In cooperation with the IMF, the Central Bank of Bosnia and Herzegovina and Banking Agency of RS continued project implementation of macro

stress tests to assess the level of banking sector resilience to stress, and have been considered assumptions used for macro stress tests. In first quarter of 2013th Central Bank of BiH, together with the entity banking agencies adopted "Guidelines for the development of stress tests and the use of prudential instruments", which formalizes the development of stress tests between the institutions listed.

10. At the state level in order to define macro prudential policies and strengthening financial stability, made list of systemically significant banks in BiH, in accordance with the guidelines of the IMF, the International Committee for Financial Stability and the Guidelines of the Bank for International Settlements on forming a list of systemically important banks, that are tailored to the specific characteristics of the banking system in BiH.
11. FBA has drafted Contingency Plan, which represents a set of measures to be taken alone or with other members of the Standing Committee for Financial Stability BiH, as well as with other regulatory institutions to ensure preventive action to avoid crisis situations, and manage and take preventive action if a crisis situation arises.
12. FBA is in the process of developing Early Warning System as additional supervisory tools that will be used to evaluate banking institutions for the purpose of early identification of financial and operational inefficiencies and / or negative trends in the business of individual banks.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

During the 2013, the FBA in cooperation with the Central Bank of Bosnia and Herzegovina, continued efforts to strengthen and improve international cooperation with international financial institutions, regional and other organizations, as well as bilateral and multilateral cooperation with banking regulators from other countries. In the framework of bilateral cooperation, the FBA has cooperated, through the regular exchange of information and supervision of banks - members of foreign banking groups that have their subsidiaries in both BiH Entities, with the banking regulators of the following countries: Slovenia (participation in the Supervisory Colleges), Turkey (through regular exchange of information with the banking regulator in Turkey), Austria (regular exchange of information on a quarterly basis, information on banking groups and their subsidiaries in the FBiH, as well as the annual reports of the supervisory controls and evaluation process), Serbia (joint supervision with the regulator from Serbia), Montenegro (bilateral meetings).

MOU with the relevant banking supervisors from Italy and Austria were prepared. FBA has re- launched the initiative in the direction of the signing of the MoU. FBA has sent letters to the European Central Bank and the European Banking Authority (EBA) in order to define further steps with regard to the signing of the MoU with banking supervisors from the EU. At the end of January 2014th ECB has reviewed made amendments which are consistent with part of the EU regulations relating to confidentiality. The modalities of cooperation between the countries of the Western Balkans and the single control mechanism in terms of supervision will be discussed by the Supervisory Board of the Single EU monitoring mechanism in the 2014.

COOPERATION WITH OTHER SUPERVISORY BODIES IN BOSNIA AND HERZEGOVINA

The FBA has established cooperation with many supervisory bodies and other institutions in our country (e.g. Memorandum of Understanding with: Central Bank of Bosnia and Herzegovina, Deposit Insurance Agency of BiH, Insurance Companies Supervision Agency, Intelligence-Security Agency of BiH and other relevant domestic institutions).

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

The FBA was the host of two events of great importance in 2013:

- Cross-border banking forum in cooperation with the Central Bank of BiH, Banking Agency of RS and technical assistance of the IMF, with the participation of representatives of all banking groups operating in Bosnia and Herzegovina, its subsidiaries and regulators as well as international institutions (World Bank, IMF, ECB and EBRD);

- Chairing of the XXVI annual conference of the BSCEE groups which took a place in June 2013.

STATISTICAL TABLES

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

Type of financial institution	2011	2012	2013
Commercial banks	19	18	17
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**19**	**18**	**17**

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

Type of financial institution	2011	2012	2013
Public sector ownership	1,3	1,4	1,6
Other domestic ownership	7,7	7,6	7,4
Domestic ownership total	9,0	9,0	9,0
Foreign ownership	91,0	91,0	91,0
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	57,5	71,6	1.465
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	57,5	71,6	1.465

*Whole percentages are used.

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

Type of financial institution	2011	2012	2013
Commercial banks	4,8	6,2	-0,0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	4,8	6,2	-0,0

*Return on average equity (ROAE).

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
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	2011	2012	2013
Commercial banks	17,0*	17,3*	18,0*
Cooperative banks	-	-	-
Banking sector, total:	17,0*	17,3*	18,0*

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

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

Asset classification	2011	2012	2013
Non financial sector*	12,0	13,3	14,8
- households	10,8	10,5	10,0
- corporate	13,2	15,9	19,4

*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 2013 (%) (at year-end)

	Deposits	Loans
Households	60,6	47,9
Government sector	5,4	1,3
Corporate	26,1	50,4
Other (excluding banks)	7,9	0,4
Total	**100.0**	**100.0**

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

P&L account	2011	2012	2013
Interest income	866.684	809.424	781.045
Interest expenses	294.557	269.769	239.302
Net interest income	572.127	539.655	541.743
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*	887.169	848.628	858.965
Administration costs	250.783	243.133	246.087
Depreciation	n/a	n/a	n/a
Provisions	190.499	144.750	230.103
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	96.605	127.190	17.726
Net profit (loss)	81.242	110.356	-228

*Net interest income and gross operational income.

Total own funds in 2013 (in EUR)

Type of financial institution	Total own funds (for CAR)	Tier 1	Tier 2	Tier 3
Commercial banks	1.102.354	951.347	233.684	-
Cooperative banks	-	-	-	-
Banking sector, total:	1.102.354	951.347	233.684	-

2013 DEVELOPMENTS IN THE BANKING SYSTEM OF REPUBLIKA SRPSKA OF BOSNIA AND HERZEGOVINA

MACROECONOMIC ENVIRONMENT

The beginning of 2013 brought the economic recovery of Republika Srpska. In fact, under the conditions of favorable global business and overall economic trends, the economic activity of RS, measured by the real growth rate of GDP, marked the inter-annual quarterly growth rates of 1,9% in Q1, 2,4% in Q2, 1,9% in Q3, 2,0% in Q4 2013, respectively.

The primary impulse of the domestic economic recovery arises from good industrial results, and especially in the segment of textile and wood processing industry. Hence, the volume of entire industrial production increased for 4,1% in 2013. At the same time, the export from RS has been increasing at the rate of 9,0%, i.e. the import at 1,4%. In the circumstances of more dynamic increase of export when compared to the dynamics of import increase, the total foreign trade deficit decreased for nearly 150 million BAM.

During 2013, positive trends were recorded in civil engineering of RS, which generated the increase of value of works performed of 0,8% at the international level. Additionally, the job market shows signs of recovery: the number of person registered at the Employment Institute decreased for 1,3%, while the number of employees was higher for 1,4% in September when compared to the number in March 2013.

In the conditions of moderate decrease of interest rates for short-term and long-term borrowing, during the first nine months of 2013, the total net loans in the banking system of RS increased for 4,7% (the same period of the previous year). In the same period, led by the growth of deposits in the household sector (+14,7%), the total deposits in domestic banks increased for 6,2%. As a part of wider regional trend of deceleration of inflationary trends, the average consumer prices in RS in 2013 also remained the same when compared to their level in previous year, 2012.

In 2014, the continuation of economic growth is expected, both globally and in the context of domestic economy. In fact, according to the RS Government expectations, stated in the document Economic Policy of Republika Srpska for 2014, the RS economy will have a growth at a real rate of 2,0%, which, according to the IMF assessment, should be also the amount of total economic growth of Bosnia and Herzegovina in 2014.

DEVELOPMENT IN THE BANKING SYSTEM

Taking into account the results realized in 2013 regarding, it can be stated that the banking sector of Republika Srpska, despite the challenges it encountered, as a whole has remained stable and liquid, hence it withstands the risks arising from the global financial and economic crisis.

Although somewhat slower, the increase of bank loans has been continued, which is very important in the conditions of somewhat difficult business operations of numerous business entities. Additionally, the increase of total deposits has been continued, which is particularly expressed in household deposits. However, the continuous increase 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 Agency of Republika Srpska (hereinafter: the BARS) continued requesting from banks not to allocate the generated profit to dividend payment, but to use it to strengthen their own capital bases.

The banking sector of Republika Srpska has a total of 10 banks, out of which 9 having majority private capital dominated by foreign private capital and 1 state owned bank.

Basic indicators of the banking sector operation as of 31/12/2013:

- Total balance sheet amount was EUR 3,8 billion with a growth rate of 5% if compared to the balance as of 31/12/2012.
- Cash funds (EUR 0,7 billion) were 20% out of total assets with a decrease rate of 3% in comparison with the previous year. Out of total banks' cash funds, 26% was on accounts abroad (foreign currency current accounts and the funds termed up to 30 days).
- Total gross loans (EUR 2,5 billion) increased by 7%, as well as loans to households (EUR 0,9 billion) in comparison to the end of 2012.
- Share of non-performing loans in the total loan portfolio increased by 2.11 percentage points in comparison to the end of 2012 (from 14.12% to 16.23% as of 31/12/2013). The NPLs level and trend call for a continuous attention. An important factor in maintaining the RS banking sector safety was the strengthening of capital of the RS banks in 2013 (in 2013, the shareholders capital of banks increased by EUR 44,8 million or 16% in comparison to the end of 2012).
- Total calculated reserves for the coverage of potential credit and other losses under regulatory requirement increased by 16% in comparison with the previous year, while the coverage rate of classified assets by reserves amounted to 11.6% (as of 2012, the rate of coverage amounted to 10.8%).
- 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 31.6 million (as of the end of 2012 amounted to EUR 33.5 million).
- Average coverage rate of classified assets by the value adjustments under IAS amounted to 8.9% (as of 31/12/2012 amounted to 7.5%).
- Deposits (EUR 2,4 billion) were a basic source of funding banks' operation, with the share of 70%. Since 2011, deposits have had a trend of increase. As of 31/12/2013, deposits increased by 6% in comparison with the previous year.
- Trend of growth in households' deposits continued also in 2013 and as of 31/12/2013 increased by 15%. Share of households' deposits in total deposits increased from 44% to 48%.
- Banks' total capital (EUR 0,4 billion) increased by 8% if compared to the condition as of 31/12/2012.

- 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 82%, while domestic capital was 18%.
- Tier 1 capital (EUR 0.36 billion) increased by 15% in comparison with the previous year, and represents the legally defined parameter for measuring a maximum exposure of banks to loan and other risks concentrations.
- Average capital adequacy rate improved significantly and amounted to 17.42%, as of 31/12/2012 it was 16,23% (legally required minimum is 12%).
- Banking sector of Republika Srpska is liquid and able to meet all its obligations in due terms, although one bank faced difficulties in maintaining current liquidity position in the first quarter of 2013.
- At the level of total banking sector as of 31/12/2013, the loss amounted to EUR 18.4 million (as of 31/12/2012, net profit amounted to EUR 8 million). Two banks operated with a loss amounting to EUR 40,9 million, while eight banks generated a profit in the amount of EUR 22.5 million.

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

Legal and Institutional framework (new developments in 2013)

The following laws were amended:

- Law on Banking Agency (Official Gazette of Republika Srpska, number: 59/13) Amendments were done in order to meet the EU minimum standards on confidentiality and professional secrecy;
- Law on Banks (Official Gazette of Republika Srpska, number: 44/03, 74/04, 116/11, 05/12, 59/13) was amended primarily with the aim to improve the procedures for temporary administration, liquidation and bankruptcy of a bank.

The new prudential regulation issued by the BARS:

- Decision on temporary limitation and requirements for bank payment of dividends and discretionary bonuses (Official Gazette of Republika Srpska, number: 18/13, 90/13). The temporary limit on dividends and bonuses payout, as well as the shares buyback options was introduced in case that regulatory capital is not at least 14,5% of RWA and Tier 1 capital is not at least 8,5% of RWA;
- Decision on remuneration policies and practices for employees in banks (Official Gazette of Republika Srpska, number: 80/13). This decision introduces obligation on banks to introduce remuneration policies;
- Decision on the assessment of suitability of members of the bank's management body (Official Gazette of Republika Srpska, number: 80/13). This decision introduces criteria and procedures for the

evaluation of proposed and elected or appointed members of the body of a bank;
- Decision on diligence of members of the bank management body (Official Gazette of Republika Srpska, number: 80/13). This decision defines the code of practice for members of the bank management body, the principles of corporate governance in banks, criteria for determining conflicts of interest, as well as the requirements for the establishment of policies for managing conflicts of interest and the establishment of specific specialized committees, appointed by the supervisory board.

In order to comply with the IAS/IFRS and best international practices, the amendments to Decision on Minimum Standards for Banks' Credit Risk Management and Assets Classification and Decision on Minimum Standards for Banks' Risk Concentration Management were adopted.

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 2013

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;
- 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 LAST YEAR

In 2013, two microcredit organizations and two saving credit organizations had their licenses revoked by the BARS, hence the banking system of Republika Srpska as of 31/12/2013 consists of 10 banks, 5 microcredit organizations and 2 leasing companies.

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 continious supervision of banks, microcredit organizations, saving credit organizations and leasing companies.

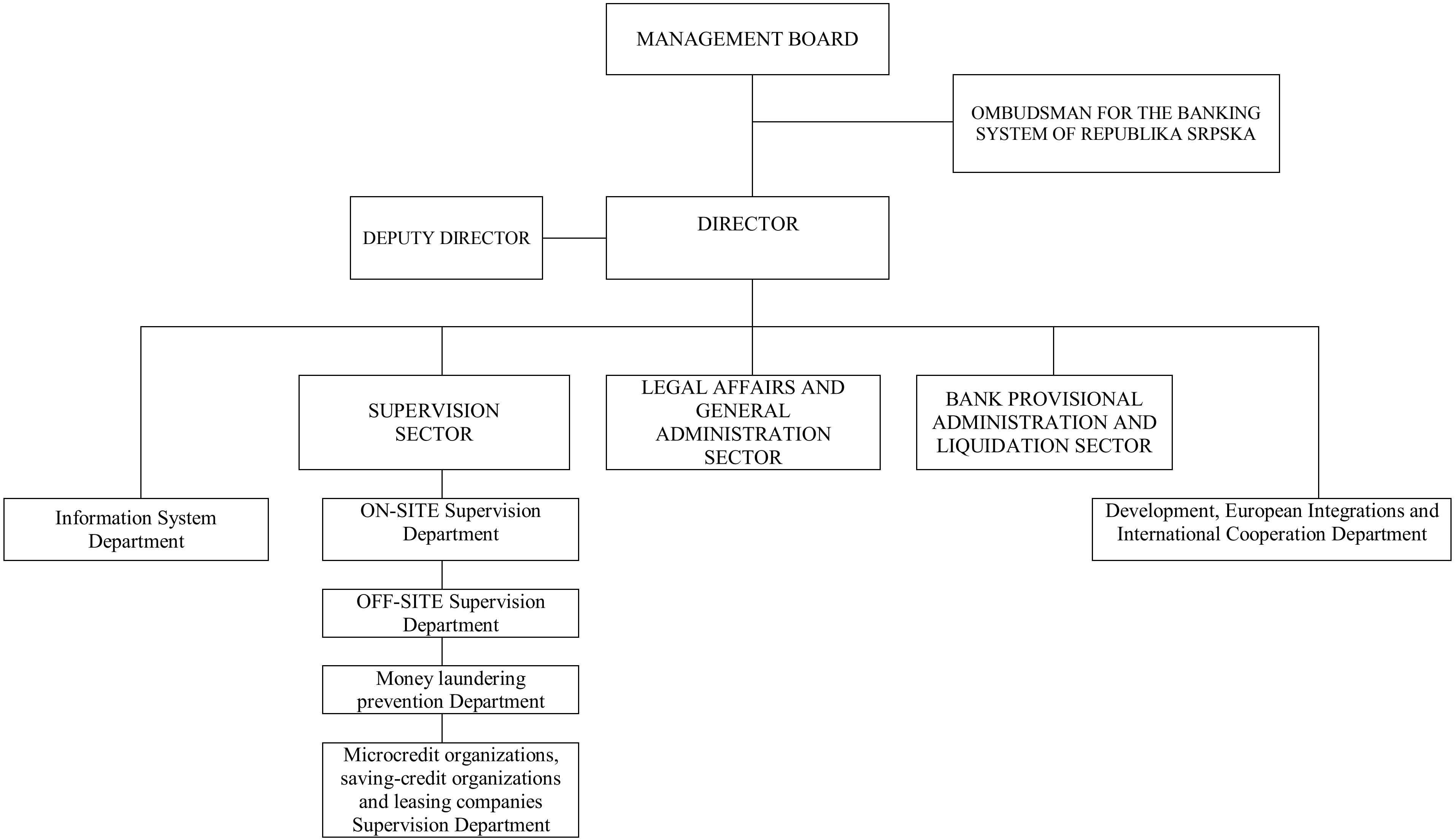
The BARS has continuously controlled the operations of financial organizations through the off-site and on-site supervision, primarily by means of monitoring the solvency, liquidity, capitalization and profitability of all individual financial organizations, as well as the system as a whole. The BARS 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, 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 engagement in the USAID PARE project of technical assistance to the financial sector has been continued, according to the BARS adopted Strategy for Introducing Basel II and in accordance with the BARS Plan of Actions, 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). Quantitative study of the impact of application of standardized approach for calculating capital requirements for credit risk has been carried out, and additionally draft decisions covering market, credit and operational risk have also been made.
- in cooperation with the Central Bank of Bosnia and Herzegovina and the Banking Agency of Federation of Bosnia and Herzegovina, Methodology for determination of systemicaly important banks in Bosnia and Herzegovina was developed.
- the BARS was actively involved in preparation of amendments to legislation governing the operations of financial organizations.
- further development and advancement of the 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 2013, 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, International Monetary Fund, World Bank, EBRD, BSCEE, KfW, EFSE, 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 Agency has regularly submitted data on the condition and trends of the RS banking system to the representatives of International Monetary Fund (IMF) and World Bank (WB) missions. Additionally, the BARS has, together with the representatives of IMF regarding the fulfillment of obligations under Stand-by arrangement, regularly (on a quarterly basis) reviewed and analyzed the impact of global economic and debtor crisis on domestic banking and financial sector, trends in the banking sector, capitalization of banks in Republika Srpska, results of stress tests for the banking system in Republika Srpska as well as for separate banks, etc.

Within the cooperation with the BSCEE group of banking supervisors, the BARS and Banking Agency of the Federation of Bosnia and Herzegovina hosted the 26th annual conference of banking supervisors, which was held in June in Sarajevo. Also, the BARS's representatives took part in other events organized by the BSCEE in cooperation with other international institutions or members of the BSCEE group (High level Meeting for Central and Eastern Europe in Basel, Seminar on Core Basel Principles and Capital buffers in Yerevan, etc.).

In February 2013, the Agency became a full member of the OECD International Network on Financial Education (INFE), and the Agency's representatives participated in numerous meetings organized by the INFE/OECD.

With the aim to support the banking system in overcoming negative impacts of global economic and financial crisis and to maintain the stability of the banking system, the cooperation within so-called "Vienna Initiative" has been continued. The Agency's representatives attended the conference „Full Forum – Vienna 2.0 Initiative" – so-called Vienna Initiative 2, organized by the EBRD in cooperation with the IMF, WB, European Investment Bank and European Commission in Brussels, as well as other meetings organized by the host supervisors with the aim to establish better coordination between home and host supervisors.

The billateral cooperation with other supervisory authorities is primarily based on the signed Memoranda of Understanding (MoU). The BARS has, together with the Central Bank of Bosnia and Herzegovina and the Banking Agency of Federation of Bosnia and Herzegovina, signed a multilateral agreement with the supervisors of South Eastern Europe countries including Albania, Greece, Macedonia, Romania, Bulgaria, Serbia, Montenegro and Cyprus, as well as the MoUs on Cooperation in the Area of Banking Supervision with the Republic of Slovenia, Republic of Croatia, Republic of Serbia, Montenegro and the Republic of Turkey. The of the MoUs on Cooperation in the Area of Banking Supervision with the banking supervisors from Austria and Italy have been drafted.

The forms of information exchange and other forms of bilateral cooperation with home bank supervisors in 2013 included:

- Bank of Slovenia: exchange of quarterly Supervisory Newsletter for NLB Group, delivering annual comprehensive analysis of business operations, as well as submitting other information upon the request of the Bank of Slovenia.
- National Bank of Serbia: exchange of semi-annual Supervisory Newsletter on business operation of the Komercijalna banka Group, delivering annual comprehensive analysis of business operations, attendance of the representatives of the Agency at the college of supervisors organized by the National Bank of Serbia in Belgrade, as well as submitting other information upon the request of the National Bank of Serbia.
- Financial Market Authority (FMA): exchange of quarterly Supervisory Newsletter for Hypo and SBER Groups, delivering annual comprehensive analysis of business operations, holding bilateral meetings, as well as submitting other information upon the request of the FMA.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

In 2013, 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 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 Memoranda of Understanding, intensive bilateral cooperation with 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 2013.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN THE COURSE OF LAST YEAR

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	2011	2012	2013
Commercial banks	10	10	10
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**10**	**10**	**10**

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

Item	2011	2012	2013
Public sector ownership	-	-	4,1
Other domestic ownership	5,2	5,7	7,2
Domestic ownership total	5,2	5,7	11,3
Foreign ownership	94,8	94,3	88,7
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	58,4	81,2	1.498
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Financial institutions, total	58,4	81,2	1.498

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

Type of financial institution	2011	2012	2013
Commercial banks	8,2	2,0	-4,4
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Financial institutions, total	8,2	2,0	-4,4

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Other*	-	-	-
Financial institutions, total	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Commercial banks	18,1*	16,2*	17,4*
Cooperative banks	-	-	-
Financial institutions, average	18,1*	16,2*	17,4*

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

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

Asset classification	2011	2012	2013
Non financial sector	11,5	14,1	16,2
- households	**11,7**	**13,1**	**13,0**
- corporate	**11,3**	**14,7**	**18,2**

*Note: NPL coverage ratio

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

	Deposits	Loans
Households	55,2	37,0
Government sector	11,1	13,9
Corporate	24,6	47,5
Other (excluding banks)	9,1	1,6
Total	**100.0**	**100.0**

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

P&L account	2011	2012	2013
Interest income	166.190	177.705	176.735
Interest expenses	62.877	65.028	68.973
Net interest income	103.313	112.677	107.762
Net fee and commission income	-	-	-
Other (not specified above) operating income (net)	-	-	-
Gross income	**166.176**	**176.408**	**178.486**
Administration costs	**104.078**	**108.143**	**120.831**
Depreciation	-	-	-
Provisions	-	-	-
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	20.073	47.243	63.200
Profit (loss) before tax	34.131	12.161	-15.240
Net profit (loss)	29.812	7.993	-18.351

Total own funds in 2013 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	427.932	356.019*	103.716	-
Cooperative banks	-	-	-	-
Financial institutions, average	427.932	356.019	103.716	-

2013 DEVELOPMENTS IN THE BULGARIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The gradual improvement of the external economic environment in 2013 positively affected the economic activity in Bulgaria. In 2013 the real GDP growth rate rose to 0.9% (0.6% in 2012). The net exports had a main contribution to the growth and the exports of goods and services increased by 8.9% while imports grew with a lower rate than that of exports (5.7%) because of weak domestic demand.

The remaining unfavourable situation in the labour market and the prolonged uncertainty about future income contributed to the continued high rate of savings of households.

In 2013 fixed capital investments declined by 0.3 % in real terms and by 3.2% in nominal terms. As a result of the weak domestic demand and somewhat decreased expectations about future economic activity companies maintained their conservative policy about investment spending.

After having a relatively weak growth during the first half of the year, during the second half of 2013, the gross value added in the economy accelerated and in real terms the total growth for the year was 1.1%.

In 2013 the situation in the labour market for the whole economy remained unfavourable.
According to data from the Labour Force Survey of the National Statistical Institute in 2013, the unemployment level increased slightly and the average rate of 12.3% for 2012 reached 12.9%.

Consumer price inflation fell considerably compared to the previous year, and during the period August - December 2013 it was negative[4]. At the end of the year HICP shrank by 0.9% y-o-y (having a 2.8% inflation at the end of 2012) and the average annual inflation slowed down to 0.4% (2.4% in 2012).

In 2013 the surplus of the total balance of the current and capital account of the balance of payments was EUR 1,217.7 million (3.0% of GDP) compared to a surplus of EUR 207.1 million in 2012 (0.5% of GDP). A main contribution had the current account surplus, in which there was a significant contraction in the trade balance deficit. The trade deficit amounted to EUR 2,353.3 million in 2013 (EUR 3,460.3 million deficit in 2012). The trade deficit contracted due to both external and internal factors.

According to preliminary data from the balance of payments, in 2013 foreign direct investments in the country amounted to EUR 1,092.4 million (2.7 % of GDP) against EUR 1,070.3 million (2.7 % of GDP) in 2012.

In 2013 the financial account of the balance of payment was at a deficit of EUR 1,465.6 million compared to a surplus of EUR 1,466.2 million in 2012. The flows of the financial account during the period were influenced mainly by the

[4] Analysis based on HICP data

financial transactions of banks[5], foreign direct investments in the country and emissions during November of corporate bonds of EUR 900 million[6].

In 2013, gross external debt decreased by EUR 441.3 million and as of December amounted to EUR 37.3 billion (93.5% of GDP).

According to the balance of payments data, international reserves of BNB decreased by EUR 599.2 million for the period January - December 2013 (valuation adjustments excluded) as a result of all external current, capital and financial transactions. Taking into account the change in international foreign reserves on the BNB Issue department balance sheet, including revaluation adjustments, they decreased by EUR 1,126.6 million.

DEVELOPMENT IN THE BANKING SYSTEM

Development in the banking system

In 2013 the banking system remained under the influence of the processes and factors determined by the internal and external economic environment. Throughout the year the lending activity remained weak. The attracted funds continued to grow as a result of the increase in savings of households. The share of funding from domestic sources continued to increase while the liabilities to parent banks - decreased. The monthly dynamics of the segments of the loan portfolio were diverse. For the first time since 2009 a slight increase was reported in the consumer loans. The downward annual growth rate of the housing mortgage loans resulted in a decrease in 2013 of this financial product. Idle banking resources were invested in securities. The management of credit risk contributed to the decrease in the amount of classified exposures. The profitability remained under the influence of diminishing net interest income and continued impairment of loans.

Asset quality

Throughout the year classified exposures shrank by 1.2% due to sales of loan portfolios as well as writing off of loans. The classified share of corporate loans decreased by 1.2% whereas that of retail exposures - by 0.4%. Annual growth rate of gross loans past due more than 90 days slowed down to 2.7% (from 14.6% a year earlier) but their growth rate was higher than the one of the credit portfolio, therefore their share in the gross loans (excluding those to credit institutions) increased compared to last year to 16.9% (16.6% in 2012). Their net (balance) sheet value[7] decreased to 10.1% (10.6% in 2012) as a result of the growth in impairment costs. The impairment costs increased during the year. The specific provisions for credit risk decreased. The activities which were undertaken to manage credit risk contributed to the increase in the rate of provisioning of the classified exposures. As of end 2013 the Loan to Value ratio was 63.14% and the coverage with all collaterals of the corporate loans was almost three times – 280.38%.

[5] In 2013 the banks increased their foreign assets by EUR 1861.8 million (total portfolio and other investments) and decreased their liabilities by EUR 631.8 million (total portfolio and other investments).

[6] In November 2013 "Bulgarian telecommunications company" and "Bulgarian energy holding" issued corporate bonds of the amount of EUR 400 million and EUR 500 million respectively.

[7] The value of net loans past due more than 90 days is derived from deducting the impairment costs incurred from their gross amount.

Profitability

By 31 December 2013 the audited profit of the banking system was EUR 258 million (by EUR 11 million less compared to December 31, 2012). The ROA was 0.60% (0.66% in December 2012). The decrease was due to the growth of assets. ROE was 4.90% (5.29% in December 2012) and the decrease was influenced by the growth in the amount of own funds. The processes which influenced banks' ability to generate operating income in 2013 were connected to the change in the balance sheet structure of the credit institutions. In 2013 the pressure on profitability caused by impairment costs was significantly reduced compared to last year. Net income from financial instruments shrank as a result of smaller profits of interest rate instruments and foreign exchange trading in 2013. Net fee and commission income increased mainly due to higher fee and commission income linked to securities transactions.

Solvency

Total capital adequacy of the banking system increased from 16.6% at the end of 2012 to 17.0% at the end of 2013. The capital surplus (the excess of capital over the regulatory minimum) which provides additional resources for covering classified exposures also increased and as of end December amounted to EUR 1.4 billion (3.5% of GDP). Positive effects on the amount of own funds had the increase in issued capital, share premium, reserves, hybrid instruments and also the smaller amount of the specific provisions for credit risk. A reducing effect on the capital of credit institutions had the decrease in the amount of reserves of revaluation of real estate and that of subordinated debt. Tier 1 ratio increased from 15.1% in 2012 to 16.0% in 2013. As a result of the increase in registered and paid in capital, share premium, reserves and hybrid instruments the share of Tier 1 capital increased and as of end December 2013 covered 94.3% of the structure of own funds.

Liquidity

In 2013 the liquid assets ratio was within the levels of 25-27% and at the end of the year reached 27%. Liquid assets increased by 8.8% (EUR 0.8 billion) to EUR 10 billion. The decrease during the year of cash was fully compensated by the increase in resources in current accounts mainly of non-residents. Tradable debt securities issued by institutions also increased. The sum of liabilities (cash outflow) increased throughout the year.

Market structure

In 2013 there were 30 credit institutions and compared to end 2012 the total assets of the banking system increased by EUR 1.6 billion (3.9%). The ratio of the total amount of assets to GDP as of end 2013 was 109.5%. The five largest banks had a share of 49.6% of the total assets.

Foreign presence

A major contribution to the growth of assets during the year had domestic banks and they increased their market share to 30.2%.[8] There was also a growth of the assets of EU subsidiaries but their share in the total assets of the banking system decreased to 62.1%. A decrease was also registered in the share of EU

[8] With an order from September 18, 2013 of the BNB Deputy Governor in charge of the Banking Supervision Department the acquisition by First Investment Bank of 100% of the shares of Unionbank was approved. The calculated market share of domestic banks as of December 31, 2013 includes Unionbank.

bank branches (to 5.5%). Banks and bank branches outside the EU did not make a significant change of their market share (2.1%).

Products and distribution channels

At the end of 2013 there are 52 points of sale (branches, offices, representative offices and remote workstations), 80 ATMs and 1015 POS terminals per 100 000 population.

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

The BNB policy in banking supervision in 2013 was closely related to implementation of the so called EU legislative package of CRD IV/CRR, which replaced the existing Capital Requirements Directive with two new pieces of legislation: Directive 2013/36/EU determining the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, and Regulation (EU) № 575/2013 laying down prudential requirements for their activity[9]. Both legal acts comprise the requirements of the Third international agreement of the Basel Committee on Banking Supervision on capital standards and measures, so called Basel III. The new framework has been applicable since 1st January 2014 and aims to strengthen bank capital requirements, introduces a mandatory capital conservation buffer and a discretional countercyclical buffer, envisages new regulatory requirements for liquidity and leverage, as well as additional capital surcharges for systemically important banks.

As technical rules and requirements collected in CRR apply directly, certain changes in the national legal framework should be undertaken, enabling credit institutions and BNB to follow their tasks and obligations in reporting, and supervisory review and assessment respectively. The most important of them were changes in the Law on Credit Institutions (LCI) and Ordinance № 11 of the BNB on the Management and Supervision of Liquidity in Banks. Several BNB regulations were repealed, i.e. Ordinance № 8 on the Capital Adequacy of Credit Institutions, Ordinance № 7 on the Large Exposures of Banks, and Ordinance № 9 on the Evaluation and Classification of Risk Exposures of Banks and the Allocation of Specific Provisions for Credit Risk. New requirements related to risk management in banks were implemented, e.g. on capital buffers, leverage, net stable funding ratios, etc. Furthermore, novelties or amendments in prudential supervision introduced with Directive 2013/36/EU, also found their place in the form of amendments to the LCI.

[9] This package of acts was published in the "Official Journal of the European Union" - OJ L176/1, 27.4.2013, p. 1.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2013

The BNB's main strategic objectives in the field of banking supervision for 2013 were:

- Maintenance of and strengthening the stability of the banking system through further development of policies, standards and tools of supervision;
- Update of the national regulatory and supervisory framework for credit institutions and investment firms to ensure harmonisation with the EU reform in this field, and also to identify and effectively mitigate risks to financial stability;
- Monitoring and supervision of individual credit institutions with emphasize on credit risk and corporate governance with banks, and ensuring that effective crisis management tools are in place;
- Further development of national and cross border cooperation with relevant competent authorities.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

As the Financial crisis put a severe pressure on credit institutions in EU and revealed fragmentation in banking market, BNB continues its policy of maintaining adequate levels and quality of capital and liquidity positions of banks operating on the local market. Resources of the supervisory department were allocated not only to amendments and further improvement of the legal framework, but also to intensive and thorough monitoring of the activities and financial state of credit institutions, operating in Bulgaria.

Parallel to the ongoing monitoring, the state of micro indicators and risk profile of credit institutions, mainly by drawing up regular off-site risk profiles, the main focus of on-site inspections for the last year was placed on the impact of the current economic developments on the credit performance of banks, i.e. on the assets' impairment policies, the management of non-performing loans, the effectiveness of their collection, the internal policies for restructuring and renegotiation, collateral evaluation, etc. Assessments of liquidity, profitability, capital management with banks, etc. were also subject of particular attention over the supervisory review process. A total of 17 on-site inspections, including analysis and valuation of internal models, were carried out throughout the year. Quality reviews on banks' annual internal capital adequacy analysis ware also carried out in 2013, focusing on its adequacy for covering current and potential banking risks.

In some cases, the Bulgarian National Bank issued recommendations to banks, applying internal models for the assessment of credit and operational risks, for improving internal control mechanisms for operational risk management (incl. mechanisms for reporting and control of risk operations).

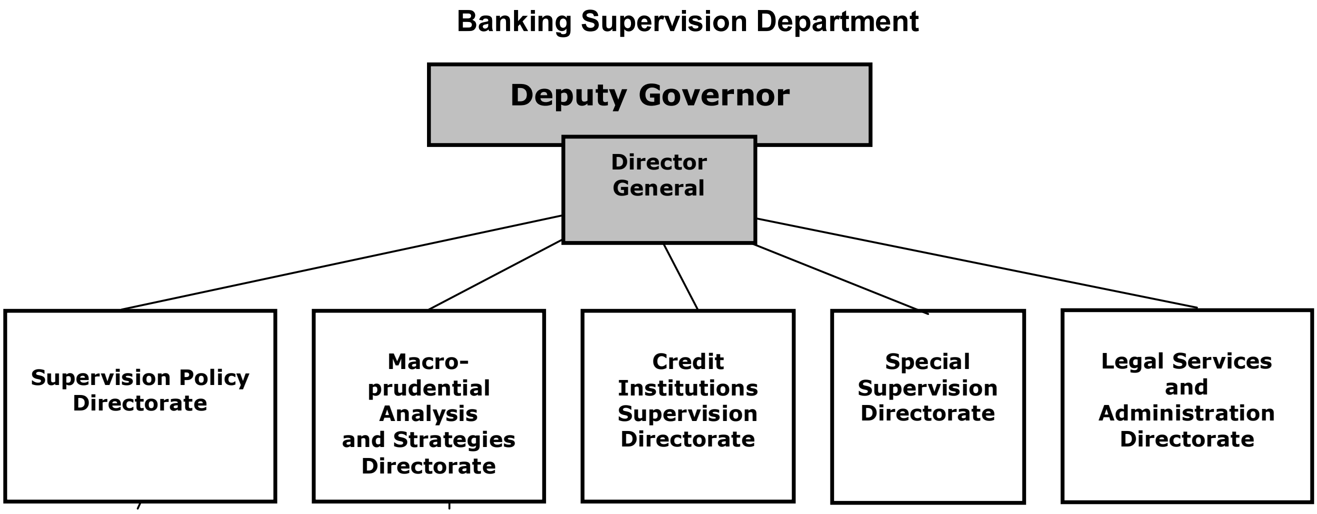
In addition to its periodical analysis of the financial parameters of credit institutions, in order to ensure the stability and resilience of the banking system as whole, the Banking Supervisory Department also monitored the structural and dynamic characteristics of the banking system. New areas and topics were added to the regularly conducted survey on the banks' expectations for development of key financial indicators in 2013. A research was made on the steps undertaken by credit institution for credit risk management in response to effects of the continuous economic uncertainty.

The BNB made further efforts in carrying out stress tests to check sensitivity of the banking system and individual credit institutions to different real or hypothetic scenarios. In some cases results were taken into account where supervisory actions were necessary.

In 2013, additional efforts were placed on periodic publications or press releases with supervisory or financial information in order to strengthen the public awareness on developments in banking.

The BNB continued also its activities in enhancing resilience of banks against money laundering and terrorism financing activities. The outcomes of the inspections in credit institutions carried out over the year confirmed that their internal control mechanisms are largely to fully compliant with the national AML/CFT legislation and the relevant BNB guidelines for mitigating the money laundering and terrorism financing risk. The preventive measures are duly implemented in the banks' day-to-day operations and checks.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES

The participation in various banking supervisory fora within the European Union, as well as the cooperation with competent authorities of other member states, continues to be an important part of the activities of the BNB.

With regard to the new capital framework (CRR/CRD IV) BNB experts continued in 2013 collaboration at standing committees and working groups within the EBA in elaboration and implementation of technical supervisory standards with respect to regulatory requirements and reporting, supervisory process and assessment, as well as exchange of information and cooperation between the relevant competent authorities. A number of quires and self assessment questionnaires were carried out jointly with experts from other NCAs within the various EBA fora. These activities are aimed at sharing experience and information on approaches used and ways of implementation of the new framework.

Experts and senior staff of the National Bank participated also in activities and meetings of the General Board of the ESRB and its substructures. They took part in discussions and preparation work of the ESRB Handbook on Operationalising Macro-prudential Policy in the Banking Sector, and the Flagship Report on Macro-prudential Policy in the Banking Sector and in the process of their approval. Views on systemic risks identified in the EU financial system, and possible measures for dealing with them were exchanged.

2013 was a crucial year for the adoption of a series of legislative acts of the EC for regulation of the financial sector, including the negotiations on some main elements of the Banking Union in EU, the Single Supervisory Mechanism (SSM), which will get operational in 2014, and the Single Resolution Mechanism (SRM) that should be effective in 2015, after a SRM Regulation (on functioning of the Resolution Board) is adopted, and an Intergovernmental Agreement (IGA) on the Single Resolution Fund is signed. Throughout the last year, leading experts and senior staff members of the BNB took part in the process of discussion and negotiation of their legal basics and options. Backing up a consistent position, Bulgaria won't join the SSM before a membership in the Euro zone, trying in this way to keep balance between current national supervisory powers on the one side, and lacking direct access to mechanisms and tools of liquidity and capital support within the Euro zone – on the other. However, BNB should further admit the indirect impact of international cooperation within supervisory colleges when following its commitments with respect to supervision of foreign bank subsidiaries operating on the local market.

As regards the SRM and the Directive on the Bank Resolution and Recovery respectively, the BNB supported a decision for a flexible framework, where each member country should be within the discretion to assign its authorities of resolution and recovery of credit institutions. However, the Bulgarian position on two other issues was not respected, i.e. on keeping a balance between harmonisation and flexibility of the bail-in instrument, and on the date of entry of the instrument. A declaration thereon was attached to the discussion papers enabling a further consideration, if possible, in the course of legislation.

The BNB also took part in the discussions on European practices with regard to non-regulated credit activities (shadow banking). A number of researches were carried out on new banking products and services issues, as well as loan servicing issues. The BNB published EBA's warning to customers regarding possible risk deriving from buying, holding and trading virtual currencies, such as Bitcoins.

The Bulgarian National Bank continued its participation as a host authority in 13 supervisory colleges. In this respect supervisory teams at BNB carried out and sent risk assessments, as well as ICAAP assessments of the subsidiaries of internationally active banking groups, operating in Bulgaria, as part of the joint risk assessment and joint decision process within the colleges.

The Bulgarian National Bank continued its policy of wide cooperation with central banks of the countries from the Western Balkans, supporting them in their negotiations with the EC. Experts from BNB provided technical expertise and help to the National Bank of Serbia (NBS) in matters financial stability and bank resolutions. The topics were among the subjects of a 2-year Project of the ECB for technical cooperation, i.e. "Strengthening the institutional capacity of the NBS", which was finished in late 2013.

In June 2013, the BNB hosted a visit of representatives from the National Bank of Ukraine dedicated to share experience in applying the new recommendations of the Financial Action Task Force (FATF) in AML/CFT.

COOPERATION WITH OTHER SUPERVISORY BODIES IN BULGARIA

The BNB continued its communication policy and cooperation with other relevant national authorities. It regularly provides the Advisory Council for Financial Stability (ACFS) with information and assessments on the condition of the national financial sector, as well as on topical issues of the current developments and risks in the banking sector of the EU, on the Single Supervisory Mechanism (SSM), etc. Members of the ACFS are the Minister of Finance, the Governor of BNB and the Chair of the Financial Supervision Commission that meet regularly, and upon the Council's agenda inform one another on issues of mutual concern.

In the recent years, money lending companies took an advantage of a notified retreat of banks from active credit activity due to the financial crisis across Europe. Money was lent to considerably higher interest rates than loans by banks which led to an increased number of complaints by borrowers, who were not in the capacity to repay their debs. For this reason, the exchange of information and cooperation between the BNB and the Commission of Consumer Protection were intensified enabling the latter to take timely examination of complaints. Legislative initiatives for changes in the Law on Consumer Credit were publicly discussed and have been adopted by the Parliament. It is expected that they should improve the consumer protection.

The cooperation with the Ministry of Foreign Affairs was on-going throughout the year on matters with regard to the EU Regulations and Decisions, as well as the UN resolutions in respect of the status of some countries, individuals, entities and organisations, which are under a restrictive regime.

Within the inter-institutional cooperation a draft plan on the implementation of the national strategy for combating money laundering has been proposed. With respect to inquiries for collecting evidence in cases of violation of the Law, joint inspections with the Specialised Administrative Directorate "Financial Intelligence" of the State Agency of National Security were carried out.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2011	2012	2013
Commercial banks	24	24	24
Branches of foreign credit institutions	7	7	6
Cooperative banks			
Banking sector, total:	**31**	**31**	**30**

Ownership structure of banks on the basis of assets total

Type of financial institution	2011	2012	2013
Public sector ownership	2.44	2.04	2.08
Other domestic ownership	21.06	24.38	28.15
Domestic ownership total	23.50	26.42	30.23
Foreign ownership	76.50	73.58	69.77
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	33.89	49.61	
Branches of foreign credit institutions	5.73	6.32	
Cooperative banks			
Banking sector, total:			721.60

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

Type of financial institution	2011	2012	2013
Commercial banks			
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**4.93**	**5.29**	**4.90**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	95.46	93.23	93.66
Branches of foreign credit institutions	4.54	6.77	6.34
Cooperative banks			
Other			
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2011	2012	2013
Cash in hand, balances with central banks	9.92	11.47	10.39
Loans and advances to credit institutions	10.83	8.36	11.25
Loans and advances to customers	67.73	64.62	62.32
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	8.60	10.11	10.68
Tangible assets and Intangible assets	2.06	2.37	2.41
Residual assets	0.84	3.07	2.95
Total assets	**100.00**	**100.00**	**100.00**
Liabilities	**2011**	**2012**	**2013**
Amounts owed to credit institutions	12.74	12.86	10.41
Amounts owed to customers	69.31	69.96	73.11
Debts evidenced by certificates	0.67	0.55	0.58
Residual liabilities	0.54	0.65	0.60[10]
Provisions	0.11	0.10	0.11
Subordinated liabilities	2.54	2.12	1.76
Equity (including valuation adjustments)	13.47	13.12	12.84[11]
Profit or loss for the financial year	0.62	0.64	0.59
Total liabilities and equity	**100.00**	**100.00**	**100.00**

[10] The line "Residual liabilities" has been revised to indicated the residual level of liabilities excluding all other indicated liabilities

[11] The line "Equity (including valuation adjustments)" has been revised to indicate the level of equity in line with the reported values according to the standardised EU-wide framework for reporting financial (accounting) data (FINREP)

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Commercial banks	17.55**	16.64**	16.97**
Cooperative banks			
Banking sector, total:	**17.55****	**16.64****	**16.97****

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

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

Asset classification	2011	2012	2013
Net Non-performing loans past due over 90 days (excl. those to credit institutions) as a % of net loans (excl. those to credit institutions)	9.60	10.57	10.06

Note: Total loans of banks are Net loans (gross loans minus impairment expenses).

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

	Deposits[6]	Loans[7]
Households[1]	51.84	24.88
Government sector[2]	3.11	0.78
Corporate[3]	21.24	46.77
Foreign[4]	16.23	14.10
Other[5]	7.58	13.47
Total	**100.0**	**100.0**

[1] Data refer to ESA'95 sectors S.14 Households and S.15 Non-profit institutions serving households.
[2] Data refer to ESA'95 sector S.13 General government (S.1311 Central government, S.1313 Local government and S.1314 Social security funds).
[3] Data refer to ESA'95 sector S.11 Non-financial corporations.
[4] Data refer to ESA'95 sector S.2 Rest of the world.
[5] Data refer to ESA'95 sector S.12 Financial corporations (monetary financial institutions, other financial intermediaries, financial auxiliaries, insurance corporations and pension funds).
[6] In accordance with the requirements of Regulation ECB/2008/32, in the liability side, instrument *deposits* also includes loans and repurchase agreements.
[7] In accordance with the requirements of Regulation ECB/2008/32, in the asset side, instrument *loans* includes also claims on deposits and repurchase agreements.
Source: Other monetary financial institutions.

Note: Due to the revision of data for 2012 we have also included a revised table for 2012 below:

The structure of deposits and loans in 2012 (%)
(at year-end)
Monetary statistics data

	Deposits[6]	Loans[7]
Households[1]	49.53	25.73
Government sector[2]	2.82	0.38
Corporate[3]	20.48	48.23
Foreign[4]	19.38	10.64
Other[5]	7.80	15.01
Total	**100.0**	**100.0**

[1] Data refer to ESA'95 sectors S.14 Households and S.15 Non-profit institutions serving households.
[2] Data refer to ESA'95 sector S.13 General government (S.1311 Central government, S.1313 Local government and S.1314 Social security funds).
[3] Data refer to ESA'95 sector S.11 Non-financial corporations.
[4] Data refer to ESA'95 sector S.2 Rest of the world.
[5] Data refer to ESA'95 sector S.12 Financial corporations (monetary financial institutions, other financial intermediaries, financial auxiliaries, insurance corporations and pension funds).
[6] In accordance with the requirements of Regulation ECB/2008/32, in the liability side, instrument *deposits* also includes loans and repurchase agreements.
[7] In accordance with the requirements of Regulation ECB/2008/32, in the asset side, instrument *loans* includes also claims on deposits and repurchase agreements.
Source: Other monetary financial institutions.

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

P&L account	2011	2012	2013
Interest income	2,572,113	2,462,428	2,360,922
Interest expenses	1,104,396	1,120,371	1,063,130
Net interest income	1,467,718	1,342,057	1,297,792
Net fee and commission income	401,789	399,644	418,797
Other (not specified above) operating income (net)	134,379	209,861	178,864[12]
Gross income	**2,003,886**	**1,951,562**	**1,895,453**
Administration costs	**887,673**	**898,313**	**912,301**
Depreciation	115,921	116,724	103,602
Provisions	10,003	1,696	7,328
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans)	711,964	633,729	576,011
Profit (loss) before tax	279,296	301,651	287,531
Net profit (loss)	242,277	268,496	257,702

Total own funds in 2013 (EUR'000)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks				
Cooperative banks				
Banking sector, total:	4,800,862	4,528,994	271,868	

[12] 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 all residual income, not specified in the here indicated categories

2013 DEVELOPMENTS IN THE CROATIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Unfavourable economic trends marked the year 2013. The fall in economic activity and domestic consumption continued into the fifth consecutive year. Gross domestic product in the Republic of Croatia fell in 2013 in real terms by 1%, leading to a cumulative fall in economic activity in the country of 12% from 2008. The fall in economic activity in 2013 was equally due to a fall in exports and aggregate demand. With small growth, only government consumption stood out, while all other components of aggregate demand declined. The fall in overall economic activity was mostly due to a fall in gross value added in manufacturing, while growth was seen in only a few service activities, mostly associated with the public sector. Exports also fell, despite growth in foreign demand and accession to the European Union in the second half of the year. Against such a background, inflation was subdued, and its fall was due to the spillover effects of the fall in global prices of food and other raw materials on the domestic prices. Further unfavourable trends in the economy led to a significant worsening in the risk premium and the country's loss of investment credit rating. The monetary policy responded to such unfavourable trends by supporting high system liquidity while at the same time maintaining the stability of the nominal exchange rate of the kuna against the euro, in the same way as in the previous years. Fiscal policy was also expansive pinpointing the importance of stronger implementation of structural reforms to improve economy's competitiveness and the general business climate.

DEVELOPMENTS IN THE BANKING SYSTEM

There were 35 credit institutions or 29 banks, one savings bank and five housing savings banks operating in the country at the end of 2013. On account of bankruptcy of one bank towards the end of September, the number of credit institutions fell by one in 2013, continuing the downward trend in the number of credit institutions present for the fourth consecutive year.

At the end of 2013, bank assets (one savings bank included) stood at HRK 398.1bn[13], or 121.3% of GDP. System concentration remained high, with the assets of the first five banks accounting for almost three quarters of the total assets of all banks and with the banks in foreign ownership dominating and accounting for almost 90% of the total bank assets.

In 2013 the banks again operated in a challenging economic environment. Bank assets declined slightly from the end of 2012 (0.5%), due to, among other things, the exit of one bank from the system and regulatory changes, particularly regulatory changes related to the classification of placements. The changes in the classification rules, made with a view to achieving a more objective estimate of the value of collateral and timely recognition of losses, together with growing

[13] Data for 2013 are based on the preliminary unaudited reports of credit institutions.

difficulties in loan repayments, resulted in a sharp increase in value adjustments and provisions. Bank pre-tax profits declined by almost 70% and at 0.3% and 1.3%, respectively, ROAA and ROAE reached the lowest recorded level since 1998 while as many as half of the banks reported losses.

Credit activity with the private sector was again slow in 2013, on account of increased caution of banks and subdued demand (particularly in the household sector) with increasing difficulties in loan collection. In the conditions of falling interest rates, this led to a considerable decline in interest income from loans. The banks mitigated these effects by generating savings on expenses, reducing operating costs and deleveraging on the financial market, made possible by moderate increase in household and corporate deposits. Thus, despite its decrease, operating profitability of banks remained very good. However, rising expenses on loss provisions weighted heavily on net income and have been the main cause of profitability being much lower than in the pre-crisis period. Due to migration of claims towards worse risk categories, it is likely that expenses on loss provisions will continue to affect significantly business results in the forthcoming period, particularly if the banks fail to take a more active stance towards the resolution of non-performing claims and if the long-awaited economic recovery fails to materialise.

In light of unfavourable economic developments, loan quality continued to deteriorate, and after three years of slower growth, the dynamics of growth of B and C risk category loans accelerated in 2013. The share of loans in these risk categories rose from 13.9% at the end of 2012 to 15.6% at the end of 2013, and it would have been considerably higher had it not been for one bank which, in the same way as in the previous year, had transferred a considerable amount of B and C category loans to a special purpose entity owned by the same parent. Corporate loans had the biggest impact on the fall in the quality of total loans, with B and C category loans accounting for 28.1% of these loans. In terms of the amount and rate of growth of these two loan categories, construction and manufacturing stood out in particular. The changes in classification rules raised the level of coverage of B and C category loans by value adjustments, primarily in segments where loans are generally well covered by real estate, such as construction, real estate business and residential real estate financing. Accelerated ageing of the household loans portfolio raised additionally the level of B and C loans in that sector, particularly in the case of home loans in Swiss francs. However, the quality of the household portfolio again rated much better than the average, with the share of B and C category loans standing at 11.1%.

After a considerable decline in 2012, in 2013, the sources of financing from majority foreign owners (received deposits and loans, hybrid and subordinated instruments) declined by a relatively small 7.7% with their share, after rising from the end of 2008, falling to the levels similar to those before the crisis already towards the end of 2012. At the end of 2013, they accounted for 15.7% of the total sources of financing. Foreign owners and other shareholders were paid somewhat bigger dividends in 2013 than in the year before and these dividends accounted for 85% of the profit generated in 2012. Nevertheless, the capital base remained strong and the capital adequacy ratio did not change and stood at 20.9% (compared to the minimum prescribed 12%), guaranteeing that the domestic banking system was well prepared for the implementation of new regulations in 2014 (CRR/CRD IV).

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

One of the tasks of the Croatian National Bank (hereinafter CNB), as regulated by the Act on the Croatian National Bank, is to issue authorisations and approvals to credit institutions which include banks, savings banks and housing savings banks and to withdraw these authorisations and approvals, as well as to carry out supervision and oversight of these institutions. The main acts governing the conditions for the establishment, operation and dissolution of credit institutions and credit unions and their supervision in 2013 were the Credit Institutions Act and the Credit Unions Act.

With amendments to the Credit Institutions Act and relevant subordinate legislation in the first half of 2013, the CNB introduced into the domestic legal framework some of the provisions of CRD III which concern areas in which these standards had not been implemented previously (employee compensation, broadening of the scope of consolidated supervision, etc.). With accession to the EU on 1 July 2013, the Republic of Croatia (hereinafter RC) was obligated to bring its legislative framework in line with the new rules (CRR/CRD IV) entering into force on 1 January 2014. With the new Credit Institutions Act, adopted towards the end of 2013, the RC transposed into the domestic legislative framework Directive 2013/36/EU, thereby further regulating the existing framework in the area of establishment, corporate management, macroprudential risks, and winding-up and bankruptcy of credit institutions. The new Act also takes account of the fact that from 1 January 2014, prudential requirements are governed by Regulation (EU) No 575/2013 which is directly applicable to EU Member States.

The supervision of credit institutions consists of a line of coordinated activities aimed at verifying compliance on the part of credit institutions with risk management rules, provisions of the Credit Institutions Act and regulations adopted under that Act, other laws and regulations governing the conduct of financial activities, their own rules, and rules and standards of the profession. 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 which regulate its competence for oversight.

The CNB exercises supervision of credit institutions by:

- collecting and analysing reports and information, ongoing monitoring of the operations of credit institutions,
- 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,
- giving opinions, authorisations, approvals and assessments of credit institutions.

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

Other supervisory authorities in the RC responsible for the supervision of the financial system are the Ministry of Finance and the Croatian Financial

Services Supervisory Agency. These two bodies are responsible for the regulation and supervision of non-banking financial services.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2013

As in the previous years, the main objectives of supervision exercised by the CNB are to maintain confidence in the Croatian banking system, and to promote and safeguard its safety and stability. To improve the quality and efficiency of supervision, the CNB continued to work on the process of harmonisation of the domestic regulatory framework with EU legislation and to improve other domestic legislation regulating the business of credit institutions. The most important feature of organisational changes which took place in the field of supervision was the uniting of on-site, off-site and licensing functions into single teams for the supervision of individual credit institutions. The focus of supervision was on management and control systems and alignment with legislative provisions, internal rules and supervisory requirements. Special attention was paid to credit risk management and adequacy of allocations for value adjustments and provisions for partly recoverable and fully irrecoverable placements. Heightened activities were also seen in the area of consumer protection to ensure adequate financial services availability and transparency.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY LAST YEAR

As regards banking regulations, strong efforts were made in 2013 to prepare legislative amendments, which will complete the introduction of the EU acquis communautaire in the field of banking into the Croatian legislation. Following adoption of the CRR/CRD IV and EU accession, intensive efforts were made towards timely adoption of the new Credit Institutions Act, the adoption of which completed alignment with Directive 2013/36/EU. At the same time, CNB employees actively participated in the work of EBA committees and subcommittees where proposals of technical standards for individual areas are made.

In 2013, the CNB again carried out the supervisory cycle of the assessment of the risk profile of credit institutions in relation to all the risks to which credit institutions are exposed or might be exposed in their business operations, an assessment of the adequacy of the process of assessment and 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 and monitoring of their execution, should the need for such measures arise. Internal Methodology for the risk assessment of credit institutions was used to assess the risk profile of credit institutions. This risk profile assessment is one of the tools used by the CNB to determine the scope of activities, the allocation of resources and priority credit institutions for the supervision in the forthcoming period. The supervisory cycle of the assessment of credit institutions in 2013 also included analyses of internal capital adequacy assessment reports (ICAAP reports).

The priority in 2013 was again on on-site examinations of credit institutions, which, in terms of scope, largely focused on the quality of assets and in particular on credit risk management and allocation of adequate value adjustments and provisions for partly recoverable and fully irrecoverable placements. On-site examinations in 2013 also paid special attention to the analysis of asset valuation in accordance with IAS and to the analysis of encumbered assets and issued instruments of collateral of banks in relation to counterparties in terms of banks' liabilities. As a result of all these activities, on-site examination identified considerable additional value adjustments in credit portfolios of almost all credit institutions that were subjected to on-site examination. Based on on-site examinations and violations, irregularities and weaknesses identified in reports, the CNB issued recommendations for the improvement of business processes and IT systems and imposed measures for the elimination of established violations and irregularities and improvement of the situation.

In the past several years, the CNB worked on the adjustment of the system of prudential reporting for supervisory purposes which involved Consolidated Financial Reporting Framework (FINREP), and Common Reporting Framework (COREP). The CNB continued to work on the reporting system adjustment in 2013 which involved in particular preparations for the receipt of new reports in 2014, defined by the implementing technical standard on supervisory reporting.

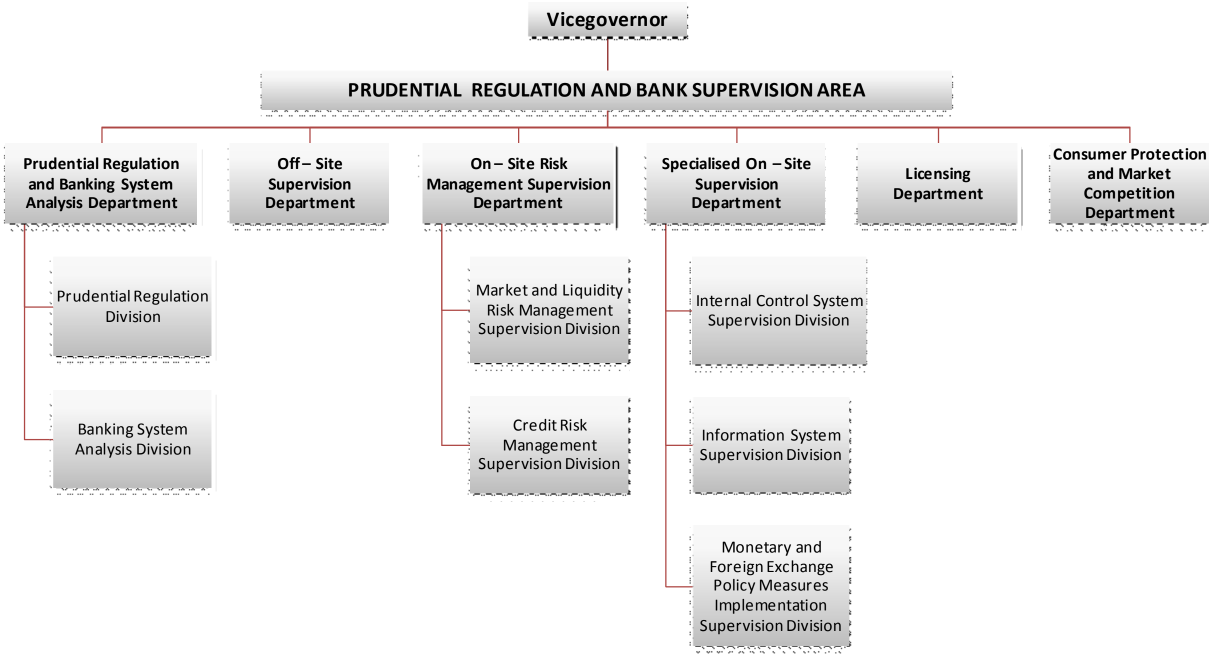
In the past several years, the CNB improved significantly the legislative framework and strengthened the activities aimed at better consumer protection, i.e. users of banking and financial services. Relevant amendments were also made in 2013 to the part of the Credit Institutions Act pertaining to consumer protection which entered into force in the second half of 2013. Difficulties with loan repayments resulting from job losses or falls in income were the main cause of dissatisfaction of a significant number of credit institutions' clients. As a result, the handling of consumer complaints, i.e. complaints of users of banking and financial services also required significant efforts in 2013.

In 2013, intense activities also took place in the area of information systems and models supervision with special organisational units being set up for these tasks in the second half of 2013. Until the date of accession of the RC to the EU, the CNB was responsible for the protection of market competition in banking and financial services market when these services are provided by credit institutions. From 1 July 2013, the responsibility for these activities was transferred to the Croatian Competition Agency.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

Supervisory activities in the first half of 2013 were organised in the framework of the Prudential Regulation and Bank Supervision Area, as shown in the chart below.

The organisational chart of the Prudential Regulation and Bank Supervision Area in the first half of 2013:

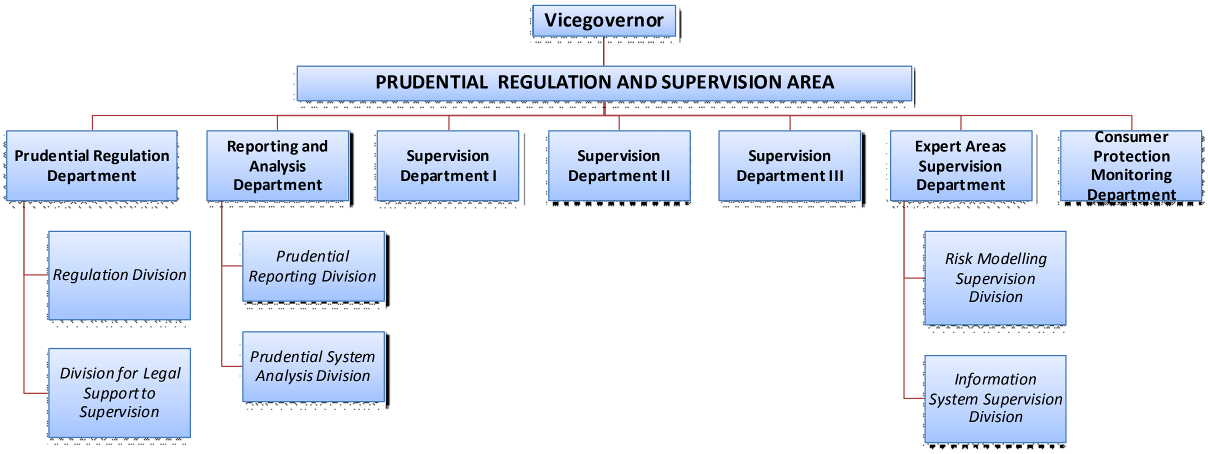


Since 1 July 2013, i.e. since accession of the RC into the EU, the organisation of supervisory tasks has been adapted to meet the new requirements. Three new organisational units now competent for the conduct of on-site and off-site examination are fully responsible for monitoring the business operations of individual groups of credit institutions (from licensing to taking supervisory measures). With the help of new IT support associated with the provision of analytical data on the business operations of credit institutions to supervisors, it is now possible to carry out successfully some of the business activities previously carried out in the course of on-site examinations, in the framework of off-site examinations, thereby increasing frequency and reducing costs of these examinations. At the same time, in addition to the existing specialist organisational units (prudential regulation and consumer protection monitoring), two new units have been set up which are responsible for:

- compilation of supervisory reports and preparation of internal and external publications on banking system analysis; and
- supervision of expert areas - models for risk management and information systems.

At the end of 2013, the Prudential Regulation and Supervision Area had a staff of 117 employees.

The organisational chart of the Prudential Regulation and Supervision Area in the second half of 2013:



INTERNATIONAL ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2013, the CNB continued to cooperate with foreign supervisors, particularly as regards joint risk assessments of banking groups and adequacy of the allocated amount of capital for individual group members. Based on valid memoranda of understanding, in 2013 CNB representatives took part in colleges of supervisors in relation to supervision of banking groups to which domestic credit institutions belong. In 2013, the CNB also prepared for all these colleges presentations on the risk profiles of credit institutions and the impact of the financial crisis on the business operations of credit institutions, the measures taken to reduce risk exposure and/or improve risk management and future business issues, particularly from the standpoint of adequacy of available eligible capital.

In 2013, the CNB delivered to consolidating supervisors the main findings, conclusions and recommendations of on-site examinations of domestic credit institutions that are members of banking groups. In the context of cooperation with foreign supervisors, the CNB is responsible for the compilation of a Supervisory Risk Report, i.e. for the annual risk assessment of domestic credit institutions which is used as an element in reaching a final Joint Risk Assessment Decision and a joint decision on the required amount of capital of banking groups.

COOPERATION WITH OTHER SUPERVISORY BODIES IN COUNTRY

In 2013, the CNB continued its cooperation with the Croatian Financial Services Supervisory Agency (hereinafter: 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 HANFA, resolve open issues on the exchange of data and arrange the coordination of supervisory activities. The Protocol on the exchange of information and the Rules of procedure were revised in 2013, to take account of changes in the legislative framework in which HANFA operates.

In 2013, the CNB participated in the work of the Standing Coordination Group for monitoring the implementation of international restrictive measures and in the work of the inner task force of the Inter-institutional Working Group for Preventing Money Laundering and Terrorist Financing. In addition, the CNB continued to cooperate with other government authorities such as the Ministry of Finance, the courts, the State Attorney's Office, etc.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

For more information on CNB supervisory activities and regulations governing CNB supervision, please visit CNB's website at: http://www.hnb.hr/.

STATISTICAL TABLES

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

Type of financial institution*	2011	2012	2013
Banks	31	30	29
Savings banks	1	1	1
Housing savings banks	5	5	5
Banking sector, total:	**37**	**36**	**35**

*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.
Note: Data for 2013 are preliminary unaudited data.

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

Type of financial institution	2011	2012	2013
Public sector ownership	4,5	4,8	5,2
Other domestic ownership	4,9	5,1	5,0
Domestic ownership total	9,4	9,9	10,2
Foreign ownership	90,6	90,1	89,8
Financial institutions, 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
Banks*	58,5	74,4	1 440,9
Housing savings banks	75,6	100,0	2 405,6
Banking sector, total:	**57,4**	**73,0**	**1 388,5**

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

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

Type of financial institution	2011	2012	2013
Banks	6,9	4,8	1,3
Housing savings banks	2,2	12,8	5,2
Banking sector, total:	**6,8**	**4,9**	**1,3**

*ROAE

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Banks	98,1	98,2	98,1
Housing savings banks	1,9	1,8	1,9
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2011	2012	2013
Financial sector	16,8	17,6	17,8
Nonfinancial sector	59,6	56,8	55,1
Government sector	16,1	18,1	18,6
Other*	7,4	7,5	8,6
Liabilities	**2011**	**2012**	**2013**
Financial sector	9,6	10,4	9,0
Nonfinancial sector	52,3	54,6	57,3
Government sector	2,1	2,1	2,1
Capital	13,6	14,2	13,9
Other*	22,4	18,6	17,7

*includes non-residents

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Banks	19,6	20,9	20,9
Housing savings banks	19,9	21,3	19,9
Banking sector, total:	**19,6**	**20,9**	**20,9**

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

Asset classification	2011	2012	2013
Non financial sector	14,1	16,4	18,7
- households	8,4	9,3	10,8
- corporate	20,1	24,9	28,1

*share of partly recoverable (risk category B) and fully irrecoverable (risk category C) loans
Note: 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 1/2009, 75/2009, 2/2010 and 89/2013).

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

	Deposits	Loans
Households	67,1	45,9
Government sector	2,3	16,7
Corporate	15,8	36,5
Other (excluding banks)*	14,8	0,9
Total	**100.0**	**100.0**

* includes non-residents

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

P&L account	2011	2012	2013
Interest income	2 938	2 922	2 637
Interest expenses	1 382	1 503	1 288
Net interest income	1 555	1 419	1 348
Net fee and commission income	408	389	395
Other (not specified above) operating income (net)	193	187	164
Gross income	2 156	1 996	1 907
Administration costs	904	879	898
Depreciation	118	108	97
Provisions	1	19	8
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	493	512	766
Profit (loss) before tax	640	478	138
Net profit (loss)	504	370	99

Total own funds in 2013 (in EUR*)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3**
Banks	6 941 824 196	6 629 645 761	312 178 434	-
Housing savings banks	84 066 122	73 285 851	10 780 271	-
Banking sector, total:	7 025 890 318	6 702 931 613	322 958 705	-

*HRK/EUR=7,637643
**As of 1 January 2012, it is not possible to include Tier 3 (for market risk coverage) in the calculation of own funds.

2013 DEVELOPMENTS IN THE CZECH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2013 the Czech economy experienced a period of decline. However, the decline moderated gradually during the year and economic activity returned to annual growth in the fourth quarter. A contraction in real GDP of 0.9% was recorded for the year as a whole. The adverse economic developments were mainly due to a decrease in gross fixed capital formation, and the contribution of net exports was also slightly negative for the year as a whole. By contrast, household and government consumption recorded slightly positive contributions to GDP growth.

Inflation fell considerably from a year earlier, reaching 1.4% on average in 2013. During 2013, headline inflation fell to the lower boundary of the tolerance band around the CNB's target and monetary-policy relevant inflation was well below this boundary.

The koruna depreciated overall against the euro in 2013 compared to 2012. This was due chiefly to a CNB Bank Board decision of 7 November 2013 to start using the koruna exchange rate as an instrument to further ease the monetary conditions. The average CZK/EUR exchange rate thus depreciated from 25.1 in 2012 to 26.0 in 2013. The average CZK/USD rate was 19.6, the same as in 2012.

The current account deficit decreased to 1.4% of GDP in 2013. In absolute terms it amounted to CZK 56.0 billion. The decrease in the current account deficit mainly reflected an increase in the trade surplus. In 2013 the financial account again ended in a surplus, which reached CZK 187.9 billion, up by CZK 113.6 billion on a year earlier.

Average unemployment as measured by the share of unemployed persons picked up compared to 2012, standing at 7.7%. Growth in the average nominal wage in the national economy almost halted in 2013, with wages rising by just 0.1%. The average real wage dropped for 2013 as a whole given a higher inflation rate than the increase in the nominal wage. Aggregate labour productivity recorded an annual decline of 1.8% in 2013.

Measures to reduce the public finance deficit and a decrease in government investment were reflected in a decline in the government deficit to 1.5% of GDP under ESA 95 methodology. As a result, the government debt-to-GDP ratio edged down to 46.0% in 2013.

The Czech National Bank had no room left to use interest rates to react to the anti-inflationary evolution of the economic environment and its forecast for the future. Therefore, it left its key interest rates, which were already at the zero lower bound, unchanged in the course of 2013. The two-week repo rate stayed at 0.05%, the discount rate also remained at 0.05% and the Lombard rate was also unchanged at 0.25%. In this situation, the CNB Bank Board decided to use the exchange rate as a monetary policy instrument with an intervention level close to CZK 27 to the euro. For the Czech Republic, as a small open economy with a long-term excess of liquidity in its banking sector, this is a more effective instrument for easing the monetary conditions than any other.

DEVELOPMENT IN THE BANKING SYSTEM

The Czech banking sector was sound and well capitalised in 2013 and continued to generate profit. It has sufficient funds and no liquidity problems.

As of 31 December 2013, the Czech banking sector consisted of 44 banks and foreign bank branches. The structure of the banking sector has long been stable.

The shareholder structure of the Czech banking sector is stable. Foreign capital has long dominated banks' capital.

Banks in the Czech Republic perform the important function of banking intermediation. The banking sector continued to grow in 2013. Total assets increased by 11.0% to CZK 5,143.2 billion.

Traditional banking based on collecting deposits and providing loans prevails in the banking sector. The total receivables of the banking sector grew slightly throughout 2013. The sector's receivables make up a large part of its balance-sheet assets. Domestic banks' total loans to clients rose by 6.5% year on year, to more than CZK 2,514 billion at the end of 2013. The rise in lending was chiefly due to loans provided to households (individuals and trades) and non-financial corporations. Loans to individuals are the biggest component of client loans. As of the end of 2013, bank loans to individuals amounted to more than CZK 1,092 billion. Household debt consists mostly of loans for house purchase, which account for more than 78% of all loans to individuals. Demand for loans for house purchase is concentrated in mortgage loans, which increased by another CZK 61.2 billion during 2013, to more than CZK 746 billion. Consumer credit, which also contributes to household debt, increased by CZK 0.7 billion in 2013. As of 31 December 2013, consumer credit provided to households totalled more than CZK 195 billion.

The Czech banking sector as a whole recorded very good financial results in 2013. It generated a net profit of CZK 61.2 billion, down by 4.8% compared to the previous year. The main source of net profit was again profit from financial activities (of more than CZK 168 billion), in particular interest profit accounting for almost 63% of profit from financial activities. Profit from fees and commissions accounted for almost 60% of non-interest profit. Total administrative expenses decreased by 1% year on year, to CZK 65.8 billion. The banking sector paid aggregate income tax of CZK 12.2 billion, which corresponded to the lower profit, and was CZK 0.2 billion lower than in 2012.

Credit risk remains the most serious risk undertaken by the Czech banking sector. The quality of the loan portfolio was stable in 2013. Non-default loans made up a large majority of the investment portfolio (94.8% as in 2012). The total value of default receivables rose by CZK 12.7 billion to CZK 161.4 billion owing to a reduced ability of non-financial corporations and individuals to repay their obligations. The share of default receivables in total investment portfolio receivables is still relatively low, 5.2% at the end of 2013.

Domestic banks are mostly local in nature and their activities are mostly focused on domestic clients. The shares of transactions with non-residents and foreign currency activities are relatively small. The exposure of the banking sector to territorial and foreign exchange risk in 2013 was again assessed as limited. Operations in foreign markets are usually executed by other units from the financial group to which the domestic bank belongs. Transactions with non-residents are significant mainly in the interbank market, particularly as regards derivatives transactions.

The liquidity of the Czech banking sector remains very good, the sector has enough liquid funds as usual. The liquidity sub-indicators were stable during 2013. Quick assets increased by more than 17% year on year to more than CZK 1,575 billion. Sufficient primary funds are available to finance the loans of the banking sector.

The capitalisation of the Czech banking sector is very good. The capital ratio increased and stood at 17.08% at the end of 2013. Regulatory capital rose by 14.8% during the year to more than CZK 368 billion. The value of Tier 1 increased by more than 16% to almost CZK 362 billion, mainly thanks to retained earnings and higher reserve funds. Partial repayment of subordinated debt in several banks led to a decline in supplementary capital (Tier 2). Tier 1 traditionally has a dominant position in the banking sector's capital, accounting for more than 98% of total regulatory capital. The capital requirements of the banking sector started to increase in line with the quality of the loan portfolio. They exceeded CZK 172 billion at the end of 2013, up by 10.3% year on year.

All banks were compliant with the set minimum capital ratio of 8% during 2013.

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. It stood at 132.4% at the end of 2013, 11.9 percentage points higher than in the same period of 2012.

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 authority performing financial market supervision in the Czech Republic. The CNB therefore 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 2013

The Czech National Bank endeavours to supervise the financial market and its institutions in accordance with international standards. 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:

- 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. In its supervisory activities, it effectively applies its legal powers, all the while pursuing its main objective, namely to safeguard the stability of the financial system of the Czech Republic.

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.

To ensure that supervision is transparent to the public, the Czech National Bank issues reports on supervisory activities (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 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 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 encompassing both publicly available and confidential information. The information obtained is subject to both regular and extraordinary (thematic) assessments based on analytical tools developed by the Czech National Bank. 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 using both formal and informal communication tools and follows up to check that corrective action has been taken.

Czech National Bank supervisors are in frequent contact with the senior management of systemically important institutions and communicate on an ongoing basis with middle management. The purpose of such contacts and communication is to develop a detailed knowledge of the strategy of the supervised institution and a general overview of its governance and relations with other members of the business group to which it belongs.

The Czech National Bank has 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. Supervised institutions are obliged to have internal mechanisms in place to ensure that the reported data are correct. Czech National Bank supervisors verify the reported data and request corrections where shortcomings are identified. The management of the supervised institution is responsible for the correctness of the information reported.

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. When performing consolidated supervision, the Czech National Bank requires these risks to be managed effectively.

In the context of 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 LAST YEAR

Banking supervision was performed under the standard regime in 2013. Owing to persisting problems in the global economy, attention was devoted primarily to the quality of credit portfolios, provisioning, sufficiency of capital to cover potential losses, and banks' liquidity and overall performance. Extraordinary monitoring of the current situation of building societies also continued in the wake of changes to the terms and conditions for building savings schemes.

In 2013, CNB off-site surveillance of the credit union sector concentrated in particular on assessing the current situation and developments in individual credit unions and on resolving their regulatory 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.

In addition, CNB supervision issues decisions relating to the assessment of the competence and integrity of proposed senior officers in banks, the approval of external auditors of banks and credit unions, the approval of the list of shareholders for the purposes of a bank's general meeting, consent to the inclusion of subordinated debt in Tier 2 capital and the approval of early repayment of subordinated debt.

Both comprehensive and partial examinations were conducted in the credit institution sector in 2013.

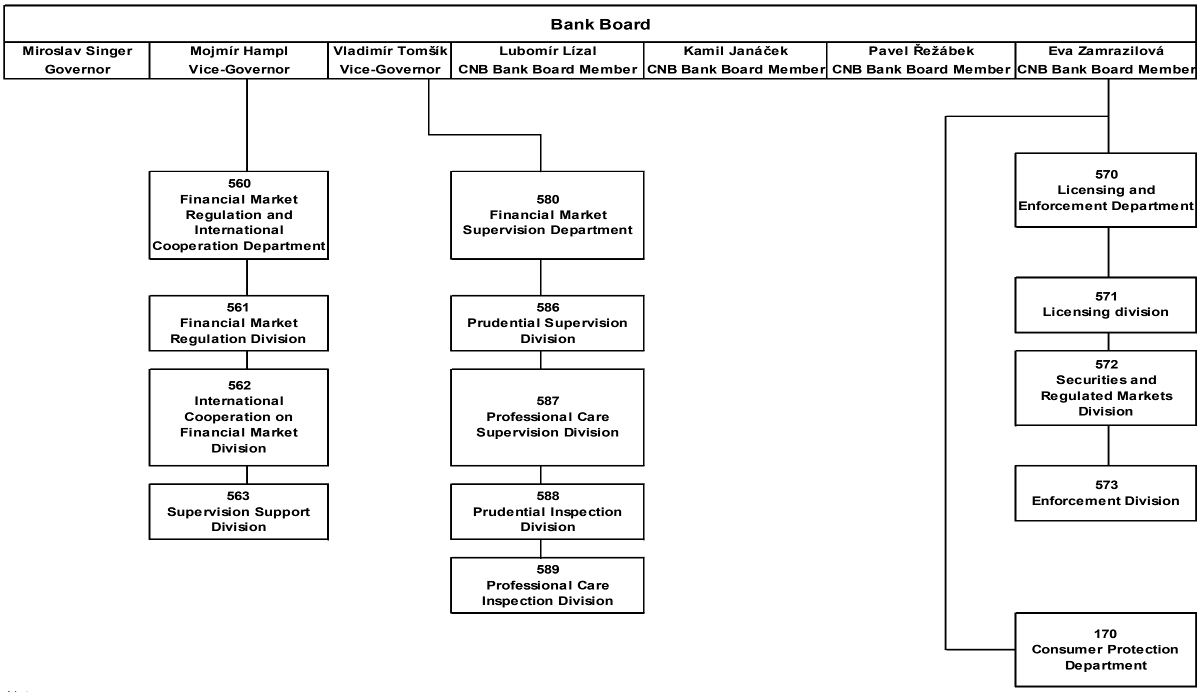
A total of 12 examinations were commenced or conducted in banks in 2013. Four of these were comprehensive and the remainder were partial.

Two partial examinations were conducted in credit unions in 2013.

ORGANIZATIONAL CHART OF BANKING AUTHORITY

Organisational structure of CNB financial market supervision

as of 31 December 2013



Note:
With effect from 1 March 2014, the President of the Czech Republic appointed Jiří Rusnok a member of the CNB Bank Board. Jiří Rusnok replaced Eva Zamrazilová, whose term of office expired.

INTERNATIONAL ACTIVITIES OF THE CZECH NATIONAL BANK

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 inspections organised by the home supervisor and allows the home supervisor to participate in inspections 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 CZECH REPUBLIC

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 IN THE COURSE OF LAST YEAR

In 2013, the CNB performed its regular half-yearly stress-testing of banks' loan portfolios. The two rounds of stress tests assessed banks' resilience to adverse economic developments using data as of 31 December 2012 and 30 June 2013. Nine selected banks which have received approval to use the special IRB approach for calculating the capital requirement for credit risk, or which are in the process of IRB pre-validation by the CNB, took part in the testing. The aggregated results of the two rounds of stress tests confirmed the good resilience of domestic banks. In addition to these bottom-up tests, the CNB conducts half-yearly stress tests of the entire banking sector (top-down tests). The results are regularly published on the CNB website.

In connection with the preparation of credit and payment institutions for the entry into force of the new Civil Code as of 1 January 2014, the CNB paid increased attention to the procedures applied by these institutions when changing contracts, especially contracts for payment services. In the performance of supervision of the credit and payment institutions sector, emphasis continued to be placed on the execution of clients' payment orders in accordance with the law. Last but not least, the CNB focused on the procedures applied by building societies when withdrawing from building savings contracts

STATISTICAL TABLES

Number of financial institutions
(at year-ends)

Type of financial institution	2011	2012	2013
Commercial banks	23	23	23
Branches of foreign credit institutions	21	20	21
Credit unions	14	13	12
Banking sector, total:	**58**	**56**	**56**

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

Type of bank	2011	2012	2013
Public sector ownership	3.0	4.2	3.8
Other domestic ownership	0.9	0.4	0.5
Domestic ownership total	3.9	4.6	4.3
Foreign ownership	96.1	95.4	95.7
Banking sector, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions
(2013 year-end)

Type of financial institution	3 largest (%)	5 largest (%)	HHI*
Commercial banks	54.7	69.2	0.120
Branches of foreign credit institutions	63.2	87.7	0.161
Credit unions	70.2	90.5	0.202
Banking sector, total:	49.3	62.5	0.099

Note: Banking sector including credit unions.

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

Type of financial institution	2011	2012	2013
Commercial banks	19.3	21.41	18.40
Branches of foreign credit institutions	n.a.	n.a.	n.a.
Credit unions	5.50	n.a. [i)]	n.a. [i)]
Banking sector, total:	18.8	n.a. [ii)]	n.a. [ii)]

[i)] The indicators do not have information content due to the different accounting periods in the credit union sub-sector.
[ii)] The CNB only has banking sector data due to the different accounting periods in the credit union sub-sector.

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	88.0	89.8	90.2
Branches of foreign credit institutions	11.4	9.3	9.2
Credit unions	0.6	0.9	0.6
Other	n.a.	n.a.	n.a.
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	2011	2012	2013
Financial sector	10.4	10.0	8.8
Nonfinancial sector	48.8	48.3	48.4
Government sector	1.7	1.7	1.6
Other	39.1	40.0	41.2
Liabilities	**2011**	**2012**	**2013**
Financial sector	11.2	8.9	11.3
Nonfinancial sector	58.9	60.0	58.8
Government sector	7.0	8.3	8.4
Capital	8.1	9.2	9.0
Other	14.8	13.6	12.4

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

Capital adequacy ratio of banks (%)

Type of financial institution	2011	2012	2013
Commercial banks**	15.27	16.42	17.08
Credit unions**	12.07	13.27	14.34
Banking sector, total:	n.a.	n.a.	n.a.

(* - for Basel I; ** - for Basel II)
Note: Commercial banks do not include foreign bank branches.

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

Asset classification	2011	2012	2013
Non financial sector	6.6	6.2	5.9
- households	5.0	5.2	5.0
- corporate	8.2	7.4	7.2

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 2013 (%)
(at year-end)

	Deposits	Loans
Households	59.5	56.0
Government sector	14.1	2.7
Corporate	25.5	41.2
Other (excluding banks)	0.9	0.1
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)
Income statement of the Czech banking sector
Absolute indicators
(data as of the given date; in CZK millions)

P&L account	31.12.2011	31.12.2012	31.12.2013
1. Financial & operating income and expenses	162 089	167 152	168 147
1.1 Interest income	172 328	170 378	154 897
1.2 Interest expenses	62 393	62 469	49 384
1.3 Dividend income	7 578	6 607	8 823
1.4 Fee and commission income	50 0002	49 151	49 845
1.5 Fee and commission expenses	10 944	11 876	12 810
1.6 Realised gains (losses) on financial assets and liabilities not measured at FV through profit or loss, net	-1 112	633	5 265
1.7 Gains (losses) on financial assets and liabilities held for trading, net	1 149	7 571	-6 106
1.8 Gains (losses) on financial assets and liabilities designated at fair value through profit or loss, net	- 1 868	888	-585
1.9 Gains (losses) from hedge accounting, net	51	-422	-1 096
1.10 Exchange differences, net	8 388	5 192	20 090
1.11 Gains (losses) on derecognition of assets other than held for sale, net	233	1 433	36
1.12 Other operating income	3 044	4 460	5 300
1.13 Other operating expenses	4 359	4 395	6 129
2. Administration costs	66 049	66 646	65 723
2.1 Staff expenses	33 774	34 437	34 292
2.2 General and administrative expenses	32 275	32 209	31 431
3. Depreciation	6 826	6 747	6 495
4. Provisions	707	721	1 593
5. Impairment	25 492	16 179	20 732
5.1 Impairment on financial assets not measured at fair value through profit or loss	25 235	14 386	18 586
5.2 Impairment on non-financial assets	257	1 793	2 146
6. Negative goodwill immediately recognised in profit or loss	0	0	0
7. Share of the profit or loss of associates and joint ventures	13	0	13
8. Profit or loss from noncurrent assets and disposal groups	405	-205	4
Total profit or loss before tax from continuing operations (1 - 8)	63 432	76 655	73 621
9. Tax expense	10 095	12 348	12 224
10. Profit (loss) after taxation, total	53 337	64 307	61 397
10.1 Profit (loss) from continuing operations after taxation	53 337	64 307	61 397
10.2 Profit (loss) from discontinued operations after taxation	0	0	0

Note: Commercial banks and foreign bank branches.

Total own funds in 2013 (in EUR mil.)

Type of financial institution	Total Regulatory Capital (for CAR)	Tier 1	Tier 2	Tier 3
Commercial banks	13,429	13,191	514	0
Credit unions	144	132	12	0
Banking sector, total:	13,573	13,323	526	0

Note: Banking sector = commercial banks + credit unions.
Note: EUR = 27.425 CZK as at 31 December 2013.

2013 DEVELOPMENTS IN THE ESTONIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The economic growth in Estonia slowed down in 2013. According to the data of Statistics Estonia, the gross domestic product (GDP) increased by 0.8% in comparison with the previous year, i.e. the growth in 2013 was the smallest in the last four years (+3.9% in 2012). The increase in GDP was primarily supported by trade, but also by processing industry and information and communication sector. The growth of processing industry was driven by increasing export, but also by increasing sale of processing industry products in domestic market. Weak external demand and lower construction volumes hindered the economic growth in Estonia.

Prospects of Estonian export partners remained virtually the same in 2013, despite the improvement of general confidence and economic activity in Europe. Unexpectedly sharp slowdown of real GDP growth in the second half of 2013 affects inevitably also future growth expectations.

Exports of goods and services increased by 1.8% compared to the previous year in spite of the decrease in the last two quarters of 2013. Modest growth was in line with developments in foreign markets, as the decline in import volumes of Finland and Sweden – main trading partners of Estonia – deepened. Imports of goods and services decreased in the last quarter compared to the previous year, but grew by 2.6% as a whole in 2013. The deficit of current account balance decreased from 1.8% in 2012 to about 1% of GDP, primarily due to the decline in revenue outflow.

In 2013, the consumer price index increased in comparison with the last year's average by 2.8% (3.9% in 2012), primarily driven by the increase in prices of electricity.

Although unemployment increased at the end of the year, the average unemployment rate of 2013 was still 1.4 percentage points lower than in 2012 – 8.6%. The number of unemployed persons was 59,000 at the end of 2013, i.e. 10,000 less than in 2012. However, the decline in unemployment has gradually slowed down since 2011. Modest economic activity driven by low demand hinders the decline in unemployment.

The average employment rate was 62.1% in 2013, exceeding the respective figure of 2012 by 1.3 percentage points. The average number of active persons increased by 6,000 in comparison with 2012. Employment increased the most in accommodation and catering industry, professional, scientific and technology sectors, and in trade and culture.

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

As at 31 December 2013, there were 8 locally authorised credit institutions and 7 branches of foreign credit institutions operating in Estonia. The ratio of banking sector's total assets to GDP was 107%.

Estonian banking market was still very concentrated in 2013. The aggregate market share of 4 major banks by loan volumes – Swedbank AS, AS SEB Pank, Nordea Bank Finland

Plc Estonian Branch and Danske Bank A/S Estonian Branch – totalled 89% (90% in 2012). Branches of foreign credit institutions have been more active in credit markets in recent years than local credit institution, but this trend changed in 2013. Market shares of two major branches of foreign credit institutions, Nordea Bank Finland Plc Estonian Branch and Danske Bank A/S Estonian Branch, decreased. Smaller banks, especially AS DNB Pank, AS LHV Pank and BIGBANK AS increased their market shares. Changes in the aggregate market share of five smaller foreign credit institutions were mostly driven by the exit of AS UniCredit Finance Estonian Branch from the Estonian banking market and the increased activity of Pohjola Bank plc Estonian Branch.

Total assets of banks increased by 2% in 2013 and totalled € 19.8 billion as at 31 December 2013. The growth in balance sheet volume was mostly driven by the increase in loan portfolio but also in securities portfolio of banks. The combined loan portfolio of banks amounted to € 14.4 billion at the end of 2013, accounting for 73% of total assets (73% also in 2012).

Annual increase in the loan portfolio accelerated in comparison with 2012 but the growth was still moderate. Annual increase in the aggregate loan portfolio of the banking sector reached to 2.5%. Lending activities of banks became more active, especially in the area of corporate loans. Still, banks were very prudent in their lending activities and granted finances only to clients whose risks were assessed to be low. The growth in deposits was significant also in 2013; total annual growth being 8%.

The total volume of overdue loans decreased in the end of 2013 both in absolute figures and as a share of the combined loan portfolio. The quality of loan portfolio improved primarily due to the decrease in the volume of long-term loans overdue. This decrease was the most prominent in case of loans overdue for more than 90 days – in total 35%. At the end of 2013, loans overdue for more than 90 days accounted for 2.0% of the combined loan portfolio (3.1% in 2012).

The volume of long-term loans overdue dropped due to write-offs in order to clean up loan portfolios and also due to the selection of better risk classes. Changes in the valuation reserves occurred generally in conformity with changes in quality parameters of loan portfolio. The drop in valuation reserves was mostly driven by the improved quality of loan portfolios due to better ratings and the value increase in collateral securities contributed to the drop in valuation reserves. The coverage with valuation reserves was still good: 82% of loans overdue for more than 90 days were covered by valuation reserves at the end of 2013 (81% in 2012).

At the end of 2013, the total volume of resources of credit institutions totalled € 17 billion, increasing by 2% in a year. Resources increased mostly due to the growth of client deposits. The volume of client deposits grew by 8% and the share of client deposits in total resources of banks reached to 81% by the end of 2013 (76% in 2012). Due to the significant increase in the volume of deposits, the ratio of loans to deposits continued to improve in 2013: from 113% at the end of 2012 to 107% at the end of 2013. The share of loans received from foreign credit institutions decreased in total resources, as the volume of client deposits increased significantly and loan demand stayed at a relatively moderate level. Consequently, the share of foreign borrowing decreased even further by the end of 2013: from 23% in 2012 to 19% at the end of December 2013.

Year 2013 was another profitable year for banks. Profits were earned on both solo and consolidated basis: on solo basis by 28% more and on consolidated basis by 2% less than in the previous year. Credit institutions earned the profit of € 445.5 million on solo basis and € 310.2 million on consolidated basis (€ 348.4 million and € 318.1 million respectively in 2012). Increased profits on solo basis were primarily driven by significantly higher dividend incomes compared to the previous year. As before, the Euribor remained on a low level in 2013, and thus also the average interest rate for loans and interest revenues of banks continued to decrease. Interest revenue of banks decreased by 3% in 2013 compared to the previous year. However, the drop in the net interest margin (NIM) stopped – this had a positive impact on the profit development of banks. In addition, profitability of banks was also supported by the average factor cost of banks that declined by 0.23 percentage points in 2013.

Capitalisation of the banking sector remained excellent on both solo and consolidated basis in 2013. As at 31 December 2013, the composite capital adequacy of credit institutions on solo basis was 19.97% (19.32% in 2012). Consolidated capital adequacy of banking groups was 24.42% at the end of 2013 (23.53% in 2012). 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 19.67% and on consolidated basis 24.20% at the end of 2013 (18.93% and 23.23% respectively at the end of 2012).

As before, the major risk in the banking sector was the credit risk: assets weighted with credit risk accounted for about 88% of all positions converted into risk-weighted assets at the end of 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

In 2013, legislation related to the financial sector was developed based on domestic needs and in line with amendments made in EU law. The FSA contributed to this legislative process within the scope of its powers, depending on the importance of the regulated area and its potential impacts on development and seamless functioning of the financial sector, and presented its opinions and approvals to working groups that developed draft legislative acts or ministries that were responsible for developing draft legislative acts.

In 2013, two important EU regulations were adopted that govern the reporting of credit institutions and investment firms – the new Capital Requirements Directive 2013/36/EU and the Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements (hereinafter: the Banking Regulation). Both regulations became effective on 1 January 2014. The Banking Regulation provides the establishment of common requirements on supervisory reports for all investment firms and credit institutions operating in the European Union. A directly applicable Regulation of the European Commission and of the Council is used for the establishment of common requirements. That means that all credit institutions and investment firms will submit uniform reports to national supervisory authorities. Financial supervisory authorities are entitled to adopt a technical form for such reporting. It was previously presumed that the European Commission standard for supervisory reporting enters into force simultaneously with the Capital Adequacy Directive and the Banking Regulation.

Entry into force of the new standard brings along significant changes in the reporting system of credit institutions and investment firms. Most of the current reports would be replaced by common pan-European reports. Content, form, reporting periods and submission deadlines of prudential norms and consolidated financial reports of credit institutions and investments firms would be harmonized. Entry into force of this standard implies that Estonian credit institutions and investment firms would have to submit a quarterly report to the FSA instead of current monthly prudential reports. Submission deadlines are extended from the present 10 business days to 30 business days, whereas the number of reports increases considerably. Further, entry into force of this standard brings along significant changes in the supervisory process as the supervision would be based on inter alia information obtained from reports. In addition, the FSA would be required to forward a certain part of received information to the European Banking Authority (EBA) and the single banking supervision of the euro area.

In relation to the delayed implementation of the risk-based capital adequacy framework Solvency II of life and non-life insurance, the European Insurance and Occupational Pensions Authority (EIOPA) adopted a document "Guidelines on Submission of Information to National Competent Authorities" in October 2013. These guidelines are addressed to national supervisory authorities and they provide instructions for the preparatory phase before the implementation of Solvency II requirements. Guidelines for the preparatory phase are implemented since 1 January 2014 and they are aimed at ensuring that insurance and reinsurance undertakings, consolidation groups and supervisory authorities are prepared for the implementation of Solvency II requirements since 1 January 2016. According to the guideline, insurance undertakings have to submit to supervisory authorities qualitative and quantitative annual reports for 2014 and quantitative quarterly reports for the third quarter of 2015.

Based on the FSA's strategic goals in decreasing the costs for the development and submission of supervisory reports, also payment institutions, management companies and branches of foreign insurance companies were granted the possibility to submit reports via the website of the FSA.

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. Besides explaining legislative provisions and guiding the supervised entities, the Advisory Guidelines assist in decreasing regulative competitive advantages and the legal risk of market participants in their business activities as well as promotes good practice in the financial sector.

Advisory Guidelines of the FSA "Requirements for presentation of information on insurance contract" entered into force on 1 August 2013. These Guidelines assembled all FSA existing instructions on the provision of insurance services and made certain substantive amendments to current guidelines. The aim was to bring the instructions into line with applicable legislation and practices, and to give instructions for the mitigation of risks that arise from potentially unclear or inadequate actions related to the presentation of contractual information.

Advisory Guidelines of the FSA "Anti-money laundering and terrorist financing measures in credit institutions and financial institutions" adopted in 2013 entered into force on 1 January 2014. These Guidelines were aimed at giving explanatory instructions to credit institutions and financial institutions, based on principles provided by the Money Laundering and Terrorist Financing Prevention Act and in the 2012 Recommendations of the Financial Action Task Force (FATF). These Guidelines focused primarily on the duty of obligated persons to apply a risk-based approach in the implementation of due diligence measures and in the performance of other statutory obligations. The Guidelines provide principles of and explanations on the risk-based implementation of due diligence measures, as well as give instructions for the determination of risk levels of clients or persons participating in transactions. Credit institutions and financial institutions can choose the extent of due diligence measures based on the risk level of clients or persons. Annex of these Guidelines include an indicative model for the determination of risk levels of clients or persons participating in transactions.

Advisory Guidelines of the FSA "Requirements for management of liquidity risk" entered into force on 1 January 2014, establishing the principles to be applied by credit institutions in the management of liquidity. These Guidelines were adopted in order to clarify the requirements provided by the Credit Institutions Act and they foresee inter alia the duties of the Supervisory Board and the Management Board of credit institutions in the management of liquidity risk. In addition, they deal with issues related to the centralized management of liquidity, stress testing of liquidity risk and contingency planning of liquidity.

The FSA Advisory Guidelines transposed and enacted also the following guidelines of the European Securities and Markets Authority (ESMA) in 2013:

- Guidelines on the model MoU concerning consultation, cooperation and the exchange of information related to the supervision of AIFMD entities;
- Guidelines on key concepts of the AIFMD;
- Guidelines on sound remuneration policies under the AIFMD;
- Guidelines on remuneration policies and practices (MiFID);
- Exemption for market making activities and primary market operations under Regulation (EU) 236/2012 of the European Parliament and the Council on short selling and certain aspects of Credit Default Swaps;
- Guidelines on ETFs and other UCITS issues;
- Guidelines on certain aspects of the MiFID compliance function requirements.

The FSA Advisory Guidelines transposed and enacted also the following guidelines of the European Insurance and Occupational Pensions Authority (EIOPA) in 2013:

- Guidelines on pre-application of internal models;
- Guidelines on forward looking assessment of own risks (based on the ORSA principles);
- Guidelines on system of governance;
- Additional explanations regarding the Guidelines on system of governance.
- In addition, the FSA Advisory Guidelines transposed and enacted the "Guidelines on the assessment of the suitability of members of the

management body and key function holders" of the European Banking Authority (EBA).

Finally, the FSA commenced with the renewal of its Advisory Guidelines "Responsible lending requirements" in 2013. These Guidelines clarify the requirements applied to credit institutions in granting loans, including in the assessment of borrower's solvency, as well as disclosure of relevant precontractual information and warnings.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2013

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;
- to increase the role of the FSA in providing advice and guidance to consumers of financial services.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY LAST YEAR

In 2013, the FSA issued licenses to three companies and two providers of financial services left the market.

One of the strategic goals of the FSA is the proactive risk analysis in order to implement primarily preventive measures. In 2013, the risk analysis of credit institutions performed by the FSA was based on traditional quarterly reports. Besides the analysis of developments in the economic environment and financial market as a whole, also major risk areas of credit institutions – credit risk, operational risk, liquidity risk, market risk, etc. – are evaluated during such an analysis. The analysis is based both on quantitative and qualitative information. Profitability and adherence to standards is also monitored. Results of this analysis provide an important input for planning supervisory activities and are regarded as a primary source of information for performing on-site inspections.

Considering current developments in the economic environment, the FSA continued to focus its attention in 2013 primarily on the area of liquidity risk and monitoring of the quality of loan portfolios of credit institutions.

Under the Internal Capital Adequacy Assessment Process of Pillar 2 – one of the components of Basel II capital adequacy framework – the FSA performed in 2013 the Supervisory Review Evaluation Process (SREP) in credit institutions. Pillar 2 consists of two complementary components: the Internal Capital Adequacy Assessment Process (ICAAP) that is implemented by credit institutions themselves and the Supervisory Review Evaluation Process (SREP) that is implemented by the supervisors. One of the main goals of SREP is to evaluate the reliability of credit institution's Internal Capital Adequacy Assessment Process and its capital need. As a result of SREP, the FSA can set an additional capital requirement above the minimum capital requirement or implement other supervisory measures.

The additional capital requirement of the banking sector under Pillar 2 amounted to € 159 million in comparison with Pillar 1, whereas the additional capital requirement amounted to € 132 million for major banks (i.e. 19.6% higher than under Pillar 1) and € 28 million for small banks (i.e. 40% higher than under Pillar 1). The FSA considers the capitalisation level of credit institutions that operate in Estonia to be strong and adequate for regulative requirements.

In 2013, both the FSA and credit institutions evaluated the adequacy of capital in case of various adverse scenarios. According to the Credit Institutions Act, all material risks of a credit institution must be at any moment adequately covered by own funds. As the prospective compliance with this requirement always includes a certain uncertainty, stress testing is one of the possibilities to assess the capital adequacy of credit institutions in case of various scenarios.

Stress tests performed by the FSA in 2013 showed that the major difference comparing to the previous economic crisis is that adverse effects are increasingly long-term and the crisis would hit the hardest the export sector and to a lower extent also the activities focused on domestic economy. In light of the economic environment and the internal capital plans of credit institutions, it is possible to state that the capital level of credit institutions is satisfactory in case of conservative stress scenarios and adequate in relation to regulative standards.

Similarly to previous years, the FSA performed the monitoring of liquidity risk in 2013, by mapping the status of authorised credit institutions in ensuring the liquidity and assessing the potential occurrence of liquidity risk in various credit institutions. The monitoring process of liquidity risk was mainly focused on preparations for the new capital requirement regulation. The new Capital Requirements Directive 2013/36/EU and the directly applicable Capital Requirements Regulation of the European Parliament and the Council (EU) No 575/2013 provide more strict quality requirements for the capital of credit institutions, set higher capital requirements and establish also new quantitative liquidity requirements. In 2013, the supervision of liquidity risk was important also at the level of parent bank groups where the FSA pursued close cross-border cooperation with home country supervisors of credit institutions. In addition, a testing period for new liquidity standards LCR and NSFR was established. Also, a daily reporting obligation was established in order to assess the liquidity risk of banks with elevated liquidity risk.

In 2013, the FSA continued to perform checks in the area of depositary services in order to assess the compliance with requirements while keeping the assets of investment funds and providing the administration service for funds.

During on-site inspections performed in credit institutions in 2013, the FSA also examined due diligence measures implemented in the area of preventing money laundering and terrorist financing for the identification of politically exposed persons. Also, the FSA assessed the activities of credit institutions in servicing non-resident clients as well as the application of due diligence measures in establishing business relationships.

Regular risk analyses based on quarterly data of 2013 covered all supervised entities. Also, the FSA analysed the capital adequacy of credit institutions under the SREP process, performed stress testing of credit risk and several targeted risk-based analyses as well as participated in the work of supervisory colleges for cross-border financial groups, including in joint risk evaluation activities.

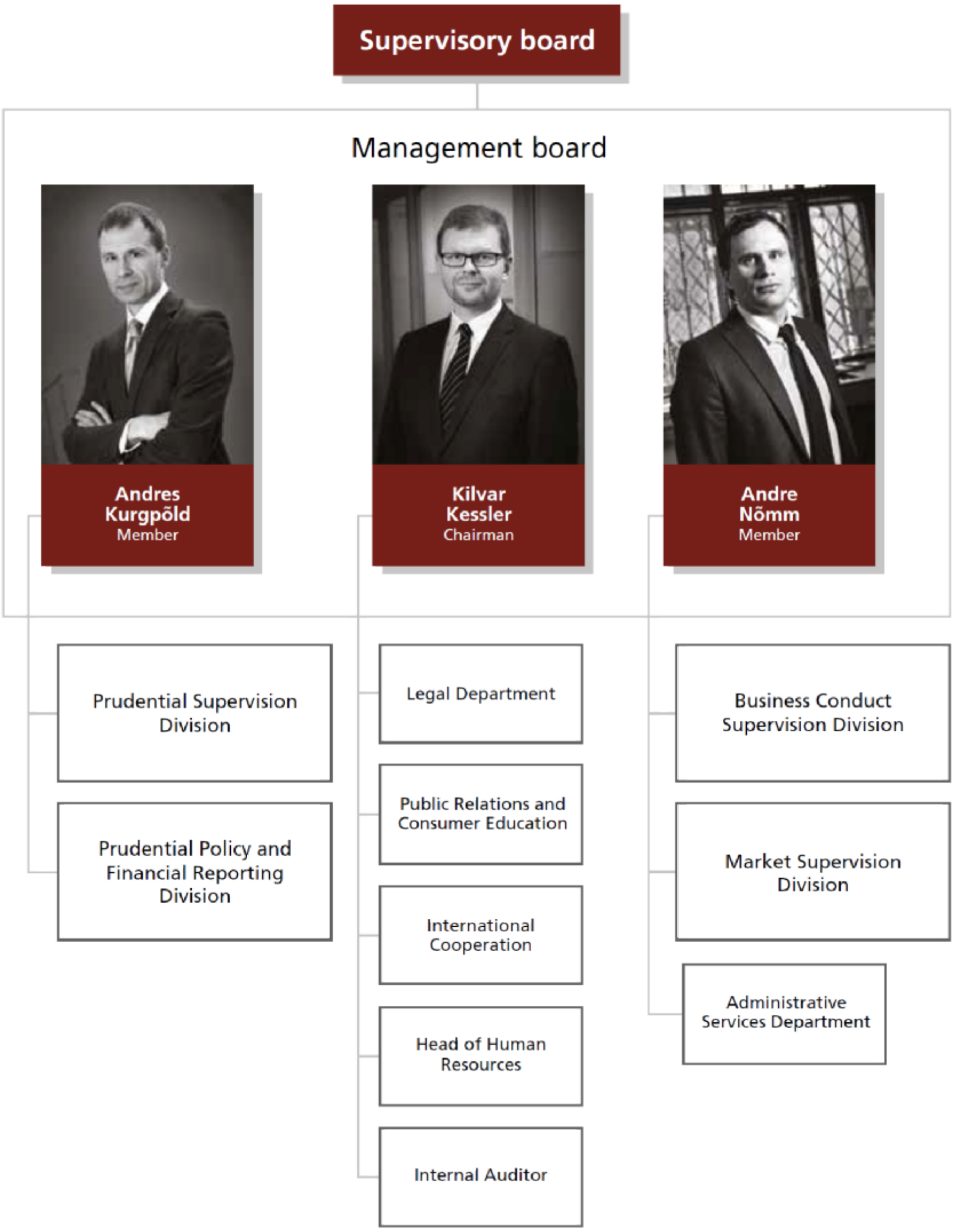
In 2013, the FSA conducted besides other supervisory activities also on-site inspections in three credit institutions and their branches.

These on-site inspections covered the following areas:

- Compliance with requirements in provision depositary services;
- Arrangement of the management and control of operational risk;
- General arrangement of business continuity process;
- Business continuity and recovery plans for essential business processes;
- Corporate governance;
- Functioning of internal audit;
- Credit activities and management of credit risk;
- Liquidity management.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

As at 31 December 2013, the Management Board of the Financial Supervision Authority included: Mr Raul Malmstein (Chairman), Mr Andres Kurgpõld, Mr Kilvar Kessler and Mr Kaido Tropp. The Supervisory Board approved the new composition of the Management Board of the Financial Supervisory Authority that took the office starting from January 2014. Mr Kilvar Kessler, Mr Andres Kurgpõld and Mr Andre Nõmm were appointed as members of the Management Board. Mr Kilvar Kessler was elected the Chairman of the Management Board.



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

Estonia as an EU Member State is a part of the common financial services market and its financial stability depends directly on its cooperation with other EU Member States, especially with Nordic countries. In addition to its participation in the establishment of the common Euro Area banking supervision under the European Central Bank, the FSA influenced the development of European supervisory practices and policy also through its participation in the work of European financial supervisory authorities in 2013.

In 2013, representatives of the FSA acted as members in 55 different committees or working groups and participated in 98 meetings of these committees or working groups. Participation of officials of the FSA in various working groups of EU supervisory authorities is based on the principle of feasibility, i.e. on the extent to which the working group is related to the Estonian market and on the importance of various issues in the context of the European Union.

The FSA has worked in active cooperation with the European Central Bank since 2012 in connection with launching the Single Supervisory Mechanism (SSM). Mr Raul Malmstein, Chairman of the FSA Management Board, participated in the top-level decision-makers group and Mr Kilvar Kessler, member of the FSA Management Board, participated in the Task Force for Supervision. Both groups were charged with the task to examine, analyse and design the architecture of the future SSM. In addition, the FSA participated actively in the task force that designed specific draft legislation for SSM. Since 2013, the FSA also participates in the SSM decision-making process through the ECB’s Governing Council.

The FSA continued its cooperation with supervisory authorities of EU Member States in 2013; such cooperation is imperative for understanding and evaluating the impact that the events in home countries of parents have on the entities supervised in Estonia. One of the goals of this cooperation’s is to inform home country supervisors of financial institutions that operate in Estonia of developments in Estonian financial sector and risks taken by supervised entities.

As before, regular meetings were organized between representatives of Estonian financial supervision and home country supervisors or financial institutions. Also, the FSA participated in multilateral risk meetings together with other supervisory authorities and representatives of parent companies of entities supervised in Estonia. In addition, it participated in the activities of supervisory colleges.

Intense exchange of information was continued in supervisory colleges and several meetings were organized between representatives of Scandinavian and Baltic financial supervisory authorities. One of the core tasks of these supervisory colleges is the development of Joint Risk Assessment Decisions (JRAD).

Under the framework of JRAD, the FSA together with other authorities supervising cross-border banking groups assessed the financial strength of banking groups and their subsidiary banks, functioning of internal control systems, major risks, and the adequacy of capital. Supervisory authorities focused besides these Joint Risk Assessment Decisions on the quality assessment of assets of pan-European credit institutions as well as on issues related to the launch of SSM and authorization procedures of several internal models. Estonia participated in 6 supervisory colleges of banking groups in 2013 – Swedbank, SEB, Danske, DnB, Nordea and Citadele.

Together with the Eesti Pank, the FSA participated in the work of the European Systemic Risk Board (ESRB) under the auspices of the European Central Bank. The FSA participates in meetings of the General Board of ESRB as a member without voting rights and in the work of the Advisory Technical Committee (ATC) as a full member. Participation in the process of analysing the EU financial stability and exchanging the information is important for the preparation of its own analyses by the FSA and for promoting cooperation with supervisory authorities and central banks in the area of crisis management.

In 2013, the FSA participated as a member in the work of following global organisations: International Association of Insurance Supervisors (IAIS), Bank of International Settlements (BIS), including the Group of Banking Supervisors from Central and Eastern Europe (BSCEE) and the International Organisation of Securities Commission (IOSCO), and the Organisation for Economic Cooperation and Development (OECD). Cooperation encompassed the provision of answers to questions and inquiries.

In addition, the FSA participated in the post-accession evaluation process of Estonia in 2013 and gave an overview to the OECD on the implementation of post-accession recommendations. OECD assessed the functioning and promotion of FSA's cross-border supervisory cooperation with foreign competent authorities and developments in following its Corporate Governance recommendations. The latter will be subject to additional presentation of Progress Report in 2015.

The FSA is also a member of the Central and Eastern European Forum of financial supervisory authorities (CEE Forum) that focuses primarily on legal and implementation issues related to the supervision of financial institutions in host country. Its members continued to exchange information in 2013 and develop common approaches in drafting pan-European regulations on supervisory activities.49

STATISTICAL TABLES

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

Type of financial institution	2011	2012	2013
Commercial banks	7	8	8
Branches of foreign credit institutions	10	8	7
Banking sector, total:	**17**	**16**	**15**

Ownership structure of banks on the basis of assets total

Type of financial institution	2011	2012	2013
Public sector ownership	0.0	0.0	0.0
Other domestic ownership	2.9	4.2	5.2
Domestic ownership total	2.9	4.2	5.2
Foreign ownership	97.1	95.8	94.8
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
Banks	76.3	89.2	2,456.0

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

Type of financial institution	2011	2012	2013
Banks	37.5	9.5	11.7

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	69.9	69.6	71.2
Branches of foreign credit institutions	30.1	30.4	28.8
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Commercial banks	18.6 **	19.3 **	20.0 **

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

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

Asset classification	2011	2012	2013
Non financial sector	4.6	3.1	2.0
- households	**4.3**	**3.2**	**2.6**
- corporate	**5.9**	**3.7**	**1.8**

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

	Deposits	Loans
Households	39.9	47.9
Government sector	8.2	3.6
Corporate	43.9	44.1
Other (excluding banks)	8.0	4.4
Total	**100.0**	**100.0**

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

P&L account	2011	2012	2013
Interest income	627	568	480
Interest expenses	232	175	101
Net interest income	395	393	379
Net fee and commission income	130	134	132
Other (not specified above) operating income (net)	407	81	247
Gross income	**1 213**	**831**	**920**
Administration costs	269	258	268
Depreciation	11	11	12
Provisions	4	5	9
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	10	41	23
Profit (loss) before tax	660	363	462
Net profit (loss)	**657**	**348**	**445**

Total own funds in 2013 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	1 848 629 497	1 820 953 057	27 676 441	0
Cooperative banks	1 848 629 497	1 820 953 057	27 676 441	0
Banking sector, total:	**1 848 629 497**	**1 820 953 057**	**27 676 441**	**0**

2013 DEVELOPMENTS IN THE HUNGARIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2013, gross domestic product increased by 1.1% while inflation was 1.7%. Meanwhile, the budget deficit remained well below 3 per cent, while the current account registered a significant surplus (above 6 per cent, including capital transfers).

Inflation continued to decelerate at the beginning of the year and it remained at a historical low far below the 3 per cent inflation target. Favorable cost developments, restrained demand, the gradual adjustment of expectations and cuts in regulated prices all contributed to the moderate inflation.

The real economy returned to growth in 2013, GDP increased in every quarter. Agriculture was the main driver thanks to a good harvest, but more and more sectors returned to growth throughout the year. On the demand side, the rise in exports and investment were the key factors behind the upturn. In a low inflation environment and with increasing real income, household consumption grew modestly, but consumption growth dynamics were restrained due to households' strong precautionary motives.

Economy-wide investments were primarily fuelled by government investments implemented with EU funding, while the Funding for Growth Scheme 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 need for balance sheet adjustment due to the deleveraging of accumulated debt and strict credit conditions continued to constrain household investments. In parallel with the central bank base rate cuts, interest rates continued on the downward trend seen in recent quarters. According to respondents to the Lending Survey, non-price conditions eased somewhat overall during the period under review, but the vast majority of banks maintained their tight credit standards. In the household segment, conditions for consumer credit continued to ease, while those of housing loans remained practically unchanged. As a result of falling inflation expectations, the 1-year real interest rate has increased since October 2013, but in comparison with previous experiences, it is still considered to be historically low.

Labour market developments continued to improve in 2013. Along with growth in the participation rate, employment rose, not just due to the expansion of public work programs, but also thanks to rising private sector employment. As a result, the unemployment rate fell below 9 percent by the end of the year. The labour market can still be considered slack, contributing to moderate wage dynamics.

The external financing capacity rose to above 6 per cent of GDP in 2013 Q3, thereby reaching yet another historical record. The significant external balance position reflected the unprecedented high level of foreign trade surplus and the relatively high transfer balance. Debt ratios continued to decline: external debt fell below 40 and 90 per cent of GDP in net and gross terms, respectively. Based on preliminary financial accounts data, the 2013 ESA deficit of the general government is estimated to amount to 2.5 per cent of GDP. The

European Commission terminated its Excessive Deficit Procedure in 2013, acknowledging the progress made in fiscal consolidation in recent years.

Economic growth is expected to keep improving over the forecast horizon; this was already reflected in the favorable Q1 GDP figure (3.5%). Overall, the structure economic growth is expected to become more balanced. Besides exports, domestic demand (especially fixed capital formation) is expected to boost growth. Inflation is expected to steadily rise towards the medium-term inflation target over our forecast horizon. The reductions in regulated prices carried out in several steps have decreased inflation considerably over the short run, and inflationary pressure from foreign trade partners might also remain subdued. Restrained wage dynamics and lower inflation expectations generally support the low inflation environment.

DEVELOPMENTS IN THE BANKING SYSTEM

The Hungarian banking sector's total assets as percentage of GDP decreased from 100.6 per cent at the end of 2012 to 95.4 per cent at the end of 2013. Net bank lending to the household sector remained negative during 2013. The rate of contraction of corporate loans declined significantly, while the contraction of loans to SMEs stopped due to the Funding for Growth Scheme of the Magyar Nemzeti Bank. As private sector faces balance-sheet adjustment, driven by the net savings accumulated in the private sector, Hungary may retain its external financing capacity in the coming years. Despite the increase in real wages, household consumption may only pick up gradually due to tight credit conditions, the reduction of debt accumulated prior to the crisis and the slow easing of precautionary considerations.

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. Corporate non-performing loan ratio reached 20 per cent by the end of June then it decreased to 18 per cent during H2. The improvement was primarily due to a one-off, historically high portfolio cleaning in Q4. In the household segment the NPL ratio (on a contractual basis[14]) increased from 16 per cent to 18.6 per cent during the last year. The utilization of exchange rate cap scheme did not change on the merits, while the FX-denominated mortgage portfolio continued to deteriorate. The cost of provisioning as a percentage of the loan portfolio increased from 2.3 to 2.8 per cent in the household segment and fell from 2.6 per cent to 2.1 per cent in the corporate segment.

There is a significant asymmetry within the banking sector. Overall, the banking sector's profitability remained weak in 2013 as well, which is mainly attributable to the risk costs and fiscal costs. Pre-tax profit amounted to HUF 114 billion and ROE accounted for 4.2 per cent. However it was attributable to one-off item i.e one bank's debt relief by its parent bank. Nevertheless it remains low in international comparison, deteriorating competitiveness for foreign capital and funds.

To offset losses, several foreign parent banks have raised capital in their subsidiaries. As a result, the banking sector's capital adequacy ratio (CAR)

[14] In the household segment we consider the NPL ratio on contractual basis, meaning that a household defaults only on the debt with more than 90 days arrears, not on all debts (no bankruptcy law for households). In the corporate segment we gauge NPL on customer basis, meaning that a default on a loan means default on all of the bank loans of the given corporation.

increased to 17.4 per cent, a relatively high level in international comparison. However, the CAR is also asymmetrical: at year-end, 60 per cent of the regulatory capital buffer was held by three banks, reflecting the vulnerability at individual level. In the baseline scenario, as a result of massive capital injections by parent banks in 2011–2013 and steady deleveraging, every bank can meet the regulatory minimum level of 8 per cent. In the event of a severe but plausible two-year shock, only HUF 18 billion capital injections would be required for the banking system as a whole to meet the 8 percent minimum capital requirement, which is considered to be low, thus manageable.

The banks are meeting the liquidity requirements imposed in January 2012. In the event of a low-probability, severely negative scenario involving the simultaneous occurrence of financial market turbulence, deposit withdrawals and an exchange rate shock, banks' liquidity reserves remain adequate. However, since liquidity reserves are mostly denominated in forints, in a protracted stress situation one fundamental condition for stable liquidity is the smooth functioning of the FX swap market.

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

On its session on 16 September 2013, the Parliament adopted the draft legislation on the Magyar Nemzeti Bank (MNB), which decided on the integration of the function of financial supervision into the central bank. The objective of the draft legislation was to ensure that, as in several other countries, central bank and supervisory activities are performed by a single organisation; i.e. the Hungarian financial sector is supervised by the harmonised application of interconnected micro- and macroprudential instruments. In line with the adopted legislation, the handover-acceptance procedure between the Hungarian Financial Supervisory Authority (HFSA) and the MNB took place on 1 October 2013. As of 1 October 2013, the former rights and obligations of the HFSA as defined in Article 176 of the MNB Act were conferred upon the MNB.

The handover-acceptance procedure was efficient and did not cause any disturbance in day-to-day work. As a result of the merger, the classical central bank mandate and functions were enhanced by the expanded dimensions of responsibility and instruments. The integrated MNB exercises macroprudential supervision, which is intended to ensure the stability of the entire financial system and a healthy contribution to economic growth; while on the other hand, exercises microprudential supervision over the institutions constituting the system, thereby facilitating the enforcement of comprehensive system objectives at the individual level. MNB also carries out market surveillance and financial consumer protection duties. These tasks are not independent of one another; they ensure the stability of the financial system and the efficient operation of the financial intermediary system together, in close interaction. In the new, integrated organisation the decision-making structure was transformed as well, and a Financial Stability Council was set up to discuss micro and macroprudential issues.

MAIN STRATEGIC OBJECTIVES OF THE HFSA IN 2013

Following the integration, there was a need for developing a strategy built on the new organisational framework and taking advantage of the MNB's expanded set of instruments. In developing the supervisory strategy for the period of 2014–2019, the starting point was the vision of an ideal, smoothly functioning financial sector and a strong supervisory authority acknowledged and recognised in the supervisory community of the European Union, capable of shaping the financial system consistently and efficiently. During this work, the mission of the supervisory area was defined. 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 leadership of the MNB designated confidence and stability as priority values for the supervisory area. The renewed strategy determines a number of clearly defined objectives for the next five years that the MNB wishes to achieve in the supervised markets and with respect of 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 ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY LAST YEAR

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. With the application of the framework renewed and determined by the methodology, the MNB has conducted all scheduled inspections. 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, in case of large banking groups, recovery plans were requested and examined. 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 supervisory work, preparations for these new regulations also played an important role.

The supervisory colleges of financial conglomerates operating in multiple countries are cooperation forums for national supervisory authorities, and constitute a part of the European supervisory structure. In Central and Eastern Europe only the MNB exercises leadership over a banking supervision college and it does so in relation to the OTP Group. The MNB participates in the rest of the EU supervisory colleges as a host authority supervising the subsidiary or the branch office. In recent periods, the international tasks related to the colleges and to the European Banking Authority have been completed as scheduled. On

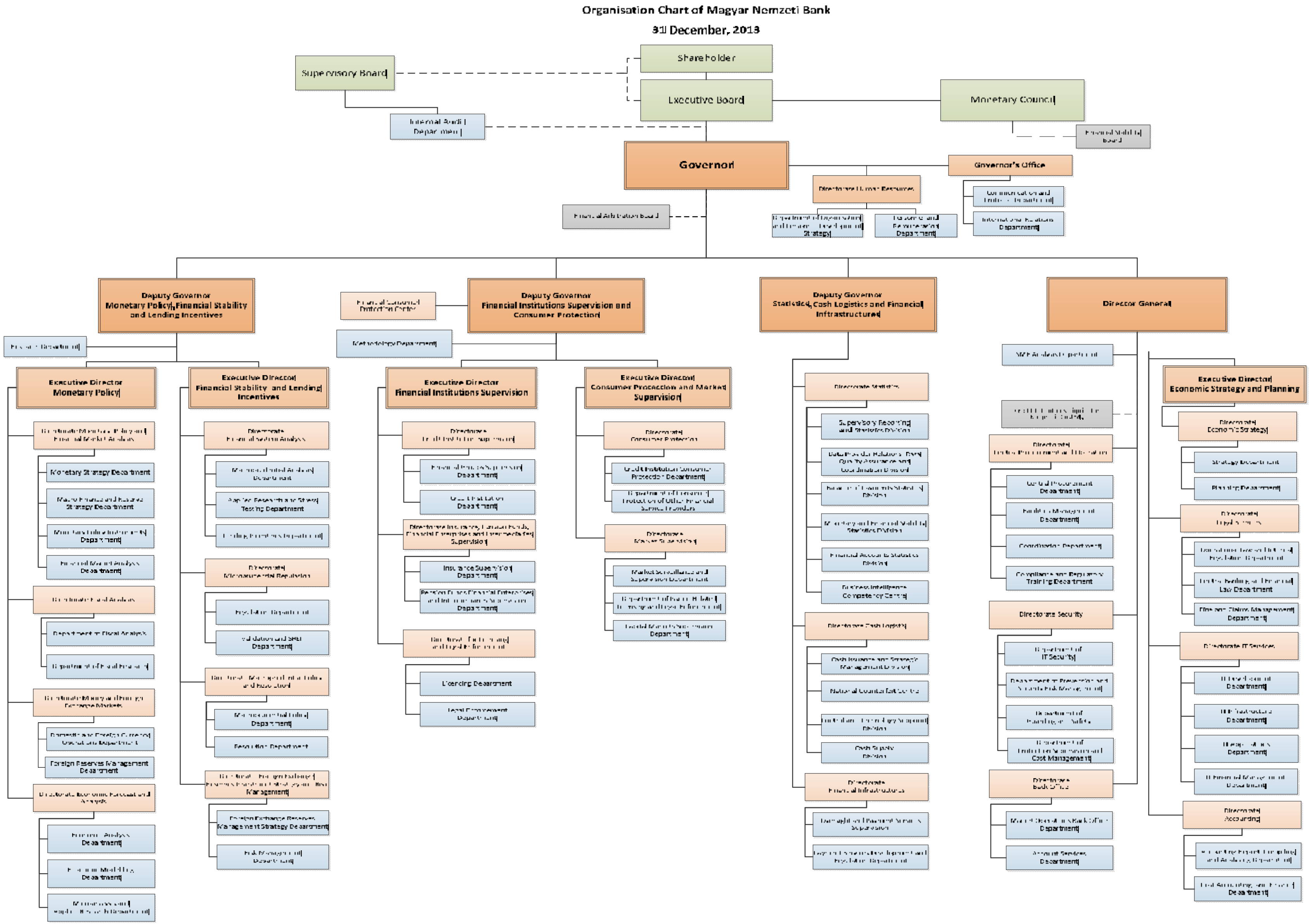
23 October 2013 the European Central Bank published a communication on a comprehensive asset quality review (AQR) to be conducted in 2014 for the 130 largest banks of the euro area. Preparations for an active participation in the international review commenced as early as 2013.

The phase scheduled for Q4 in the 2013 Inspection Plan has been completed; on 1 October 2013 a total of 32 inspections were in progress, of which 13 inspections were completed by 31 December 2013.

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

Type of institution	Type of inspection	In progress on 1 Oct 2013	Launched after 1 Oct 2013
Insurance companies	Comprehensive	7	7
Pension funds	Comprehensive	8	2
Health funds	Comprehensive	7	3
Mutual aid funds	Comprehensive	1	-
Intermediaries	Target	-	2
Credit institutions	Comprehensive	30	4
Credit institutions	Target	2	-

ORGANIZATIONAL CHART OF THE HFSA BANKING SUPERVISORY AUTHORITY



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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. Colleges are organised and led by the national supervisory authority supervising the parent institution of the financial group (consolidating or home supervisor). College members (home and host supervisors) regularly exchange supervisory information on the group concerned, assess risks and may request each other to carry out supervisory procedures.

In total, the MNB participates in 20 banking colleges. Colleges also play a significant role in representing the interests of host countries. The 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. In the case of other EU-based supervisory colleges, the MNB attends meetings in the capacity of host supervisory authority overseeing a subsidiary or significant branch. In addition, the MNB also works with the supervisory authorities of certain non-EUcountries in quasi-colleges.

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.

ESRB

The MNB actively participates in the ESRB’s work at managerial level and expert level. The leaders of national supervisory authorities and central banks meet four times per year in General Board sessions, while their vice presidents meet with the same frequency at Advisory Technical Committee (ATC) 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 the key issues of financial stability.

FSB Regional Consultative Group for Europe

The Ministry for National Economy and the MNB are all members of the FSB’s regional organization. The Hungarian authorities were represented at managerial level at the sessions attended both meetings of the FSB European Regional Consultative Group in 2013.

V6 Financial Stability Meeting

Under the arrangements of the V6, the region’s central bank governors and financial supervisory authorities of countries where this authority is not yet part of the central bank hold consultations once a year about current financial stability issues and cross-border cooperation options. This was the second time that Hungary’s central bank hosts the meeting.

Central bank governors and supervisory authorities of Austria, the Czech Republic, Hungary, Poland, Slovakia and Slovenia met in Budapest in September to discuss the region's challenges.

Their discussion covered the potential advantages and disadvantages of joining the banking union, the theoretical and practical challenges of macro-prudential policies and the results of the MNB's growth credit program.

The MNB participates in the activities of the AMLC CPMLFT, IOSCO and BSCEE.

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 Financial Stability Board functions as an important cornerstone of such cooperation. The Financial Stability Board is responsible for ensuring the stability of the financial intermediary system, the coordination of the efficient micro and macro level prudent supervision, monitoring and regulation of the sector.

The cooperation of the MNB with the Ministry for National Economy is closest in the area of legislation. The central bank plays an active role in working out the regulation policy concept of the financial intermediary system, the institutions and markets, analyses the impact of central bank measures and external regulatory changes on the activities of financial institutions.

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, and organisations operating the financial infrastructure.

The professional associations play an important role, such as the Hungarian Banking Association, the Hungarian Leasing Association, the National Federation of Savings Co-operatives.

MNB collaborate with other competent Hungarian authorities, 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	2011	2012	2013
Commercial banks	35	35	37
Branches of foreign credit institutions	10	9	9
Cooperative banks	132	128	122
Banking sector, total:	**177**	**172**	**168**

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

Type of financial institution	2011	2012	2013
Public sector ownership	-	-	-
Other domestic ownership	37,6%	39,6%	41,4%
Domestic ownership total	37,6%	39,6%	41,4%
Foreign ownership	62,4%	60,4%	58,6%
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	45,2%	60,3%	0,1196
Branches of foreign credit institutions	84,20%	95,05%	0,2765
Cooperative banks	12,07%	17,50%	0,0149
Banking sector, total:	**39,1%**	**52,1%**	**0,09875**

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

Type of financial institution	2011	2012	2013
Commercial banks	-9,4%	-6,8%	1,7%
Branches of foreign credit institutions	5,5%	7,4%	1,7%
Cooperative banks	7,2%	12,0%	7,5%
Banking sector, total:	**-8,0%**	**-5,1%**	**2,5%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	79,4%	79,8%	79,0%
Branches of foreign credit institutions	7,0%	6,4%	7,7%
Cooperative banks	5,2%	5,7%	5,8%
Other	8,5%	8,1%	7,5%
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2011	2012	2013
Financial sector	17,8%	16,0%	15,1%
Nonfinancial sector	42,5%	40,6%	38,7%
Government sector	28,6%	30,8%	34,6%
Other	11,1%	12,6%	11,6%
Liabilities	**2011**	**2012**	**2013**
Financial sector	32,9%	28,1%	27,3%
Nonfinancial sector	38,9%	42,9%	42,9%
Government sector	3,0%	3,4%	6,0%
Capital	7,7%	9,0%	10,1%
Other	17,8%	16,0%	15,1%

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Commercial banks	12,9%	15,8%	17,4%
Cooperative banks	15,9%	16,9%	18,1%
Banking sector, total:	**13,1%**	**15,9%**	**17,4%**

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

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

Asset classification	2011	2012	2013
Non financial sector	14,4%	16,6%	17,2%
- households	13,7%	16,1%	18,5%
- corporate	15,1%	17,1%	15,8%

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

	Deposits	Loans
Households	47,4%	42,5%
Government sector	4,1%	4,9%
Corporate	46,1%	49,8%
Other (excluding banks)	2,3%	2,7%
Total	**100.0**	**100.0**

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

P&L account	2011	2012	2013
Interest income	7 418,0	8 172,1	6 636,2
Interest expenses	4 192,2	4 991,0	3 539,4
Net interest income	3 225,8	3 181,1	3 096,7
Net fee and commission income	863,5	911,2	1 383,4
Other (not specified above) operating income (net)	50,5	-1 179,8	-1 044,8
Gross income	3 938,2	2 719,4	3 767,9
Administration costs	2 037,8	2 184,6	2 078,3
Depreciation	181,0	193,6	202,4
Provisions	-	-	-
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	2 384,3	610,5	992,2
Profit (loss) before tax	-665,0	-269,3	495,0
Net profit (loss)	-810,6	-547,5	-

Total own funds in 2013 (in million EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	8 091	7 212	879	-
Cooperative banks	448	400	48	-
Banking sector, total:	8 539	7 612	927	-

2013 DEVELOPMENTS IN THE GEORGIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2013 economic growth in Georgia reached 3.2%. Major contributors to the growth in 2013 were manufacturing industry (31%), agriculture (27%) and trade (22%). High growth rates were recorded in manufacturing industry, agriculture, financial, operation with real estate and hospitality sectors. After decline in 2012 output of agriculture has increased by 11.4%.

Under low growth rate of about 1% of private consumption, it accounted for less than 30% of nominal growth of GDP in 2013. Other source of growth, namely, export of goods and services, has increased by 20%. Tourism sector has also supported the growth of export revenues in 2013. Investments in fixed capital made up 22% of GDP, decreased from last year 25% level.

Savings rate has increased up to 20% of the national income from 18.3% in 2012. Unemployment rate remained high and was about the same as in the previous year (15%).

Inflation rate was negative for most Q1-Q3 period of 2013. But since October it became positive and reached 2.4% in December. As a response on deflation in Q1-Q3, NBG has reduced the policy rates from 4.75% to 3.75% by the end of 2013 and increased up to 4% in February 2014 to control the upward trend in inflation.

Fiscal consolidation continued in 2013. Consolidated budget deficit has declined to 2.6% of GDP compared with 2.8% in 2012 and 3.6% in 2011. Tax revenues of consolidated budget have decreased insignificantly by 0.2%, but budget expenditures declined even more by 2.7% in 2013. Tax burden made up 24.8% of GDP, which is 0.7 percentage points less than in 2012. Public debt to GDP remained on sustainable level and made up 36.8% in 2013, while in 2012 it was 37.8%.

After significant decreasing of current account deficit in Q1-Q3 that was related with declining, but still positive, economic growth rate, current account deficit has increased in Q4 2013 as economic growth has accelerated. In total, current account deficit reached 5.9% of GDP in 2013, which is significantly (5.8 percentage points) lower than in 2012. The growth of import was very insignificant 0.3%, but export growth made up to 21.2%, that is higher than its growth rate of 7.6% in 2012. Trade deficit has narrowed and made up 21.7% of GDP in 2013, when in 2012 it was 26.6%. 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 billion USD in 2013 that is by 11% more than in 2012. At the same time, there was no significant inflow of portfolio investments in 2013, unlike the previous ear, when it made up almost 900 million USD (mainly derived by long term Eurobond placements of one commercial bank and two large state-owned corporations). As the result, total external debt increased only by 140 million USD up to the 13.6 billion USD, which is 0.6 percentage points decline to 84.6% of GDP (mainly consisting of FDI-related debt through intra-company lending and/or long-term borrowing). In the same period, external public debt declined by 6.3% (mainly due to monetary authorities) and amounted to 28% of

GDP. Large portion of the state borrowing consisted of low interest bearing loans from donor organizations.

Lari exchange rate was mainly characterized by stability especially for Q1-Q3 2013. But in Q4 Lari has depreciated against US dollar by 3.1 %. NBG interventions on FX market were oriented on purchasing of foreign currency in Q1-Q3, but selling it in November-December. In general, NBG has bought 335 million USD more foreign currency than sold it in 2013 through currency auctions. Due to deflation in Q1-Q3 and depreciation in Q4, Georgian Lari's real effective exchange rate has declined by 1.5% in 2013.

DEVELOPMENTS IN THE BANKING SYSTEM

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 2013, with moderate rate (8%-14% range) during the Q1-Q3 year, but growth has accelerated in November-December, that was related with increased economic activities in Q4 and seasonal factors. Credit portfolio increased by 21% at the end of 2013, compared with 12.8% in 2012. In total, credit portfolio accounted for 38.2% of GDP,[15] which is 4.8% higher than in 2012. As for the total assets of banking sector, they accounted for 64.4% of GDP that is 9.5 percentage points higher than in 2012.

In 2013, the highest growth rate was recorded in retail lending (31% annual growth), followed by SMEs and corporate sectors. Banking sector loan portfolio break-down by products is the following: 38% accounts for corporate sector, 42% - retail sector, and 20% - SMEs.

Throughout the year, loan portfolio quality has moderately improved. NPL ratio has decreased by 1.8 percentage points and made up 7.5% of total portfolio (mainly caused by improved risk management, moderate increase of portfolio, lowering of interest rates on loans and economic growth). At the same time, NPL ratio calculated with widely accepted methodology - the loans with more than 90 days overdue to total portfolio had improved and made up 3.1% in 2013, compared with 3.7% in 2012.

In 2013, banking sector accumulated liquidity significantly above the prudential minimum. The share of liquid assets to total assets and non-bank deposits made up 24% and 43%, respectively. As a result, banks started lowering interest rates on liability side more aggressively.

Banking system still remains highly dollarized, contributing to currency induced credit risk. In 2013, the dollarization of loans decreased by 5.3 percentage points, down to 62.4%, and dollarization of deposits, decreased by 4.2 percentage points to 59.9%.

To mitigate this risk, NBG employs additional risk weights for foreign currency exposures.

Georgian banking system is well capitalized, mainly driven by aforementioned risk weighting. At the end of 2013, CAR for Tier I capital and regulatory capital were 13% and 17.2%, respectively, which are significantly higher than the required prudential minimum. The same indicators, calculated based on Basel I methodology, were 18.3% and 25.2%, respectively.

[15] Includes only non-bank loans.

Profitability of banks had increased in 2013. Financial profit of the system has jumped from 134 million GEL in 2012 to 389.1 million GEL in 2013. At the end of 2013 RoA made up 2.6% and RoE made up 14.6%. Moderate growth rate of credit portfolio, increased interest rate spread, decrease in net provisions (218 million GEL by the end 2013 versus 326 million GEL in 2012, including loans which were provisioned and written off) led to higher profitability in banking system. In addition, the efficiency of banking system continued to improve with the economies of scale. Cost to income ratio declined from 56.9 % in 2012 to 52.5% 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 HUNGARY

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). NBG is the central bank of Georgia and an independent public body. In 2013, 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.

The legal framework of the operation and supervision of financial institutions is primarily defined 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 2013, important legislative amendments have been introduced to the legislation. To illustrate, the grounds on which NBG can currently refuse to issue license for/to register any person/company as a financial sector representative, or allow any person/company acquire a significant share of an entity concerned expanded and currently includes the reasonable grounds for suspecting that the permission to register can endanger financial sector stability, or lead to the violation of the requirements established by the binding decisions or recommendations of international organizations, and more (Amendment N262 of 06.03.2013).

As for the amendments introduced to by-laws regulating NBG's supervisory practice - the new Decree of the Governor of the NBG on approving the Regulation on Capital Adequacy Requirements has been adopted on October 28, 2013 (N100/04), consistent with the Basel II/III standards on capital adequacy. Pillar I reporting entered into force from December 31, 2013. However, compliance with the new requirement will become mandatory since June 2014. In addition, NBG developed guidelines for Pillar II, which becomes Mandatory from September 2014.

Amendments have been introduced to the Regulation on Setting, Calculating and Maintaining Overall Open Foreign Exchange Position Limit of

Commercial Banks as well, requesting that banks comply with consolidated (balance sheet plus off-balance sheet) FX position limit (Decree 85/04 of 04.09.2013 of the Governor of NBG). The Regulation on the Supervision and Regulation of the Activities of Commercial Banks, approved under Decree №69/04 of June 28, 2013 of the Governor of NBG, has been amended too, which currently requires higher liquidity on non-resident deposits.

In 2013 NBG completed a project on implementing the use of electronic signatures by commercial banks; special regulations establishing procedures for coordinating safety policy for the use of electronic signatures with NBG, as well as methodological guidelines for implementing their use, were developed and instituted.

In 2013 NBG has also developed Draft Regulation on Liquidity Coverage Ratio Requirement for Commercial Banks. The draft regulation establishes, among others, minimum Liquidity Coverage Ratio standard and monitoring tools mandatory for all commercial banks and branches of foreign banks in Georgia. Where the regulation does not provide specific instructions, commercial banks, with the agreement from NBG, shall apply standards of the Basel Committee on Banking Supervision. Commercial banks shall maintain levels of liquidity buffers which are adequate to face any possible imbalance between liquidity inflows and outflows under gravely stressed conditions over a period of 30 days, and during times of stress, commercial banks may use their liquid assets to cover their net liquidity outflows.

Next, Decree on GRAPE (General risk assessment program) was enforced in 2014. GRAPE organizes the risk-based supervision process towards commercial banks and establishes main processes for the risk assessment of commercial banks, for implementing supervisory actions, for the quantitative assessment of risks and for setting the respective level of supervisory attention. Risk Assessment by NBG is based on international methodological guidelines and standards such as "Core Principles for Effective Banking Supervision," guidelines of leading supervisory agencies and "CAMEL" assessment framework.

MAIN STRATEGIC OBJECTIVES OF THE HFSA IN 2013

In 2013, main strategic objective of National Bank of Georgia was to promote successful implementation of Basel II/III framework, including preparation for pillar 2 processes. In that regards, new decree on supervisory processes was approved, regulation on capital adequacy and LCR was developed as well as guidelines on ICAAP. Intensive dialogue took place with boards and management of commercial banks to clearly communicate supervisory expectations on sound governance practices and pillar 2 processes. NBG has already established dialogue with banks that have moved forward in developing their pillar 2 internal models.

Further, one of the major strategies of NBG was to transition regulatory reporting towards IFRS. Existing regulatory accounting rules for commercial banks in Georgia are based on IFRS 1998 guidelines, which have not been significantly modified since their imposition. In line with this objective, NBG intensified its gap analysis process, which includes both quantitative and qualitative parts. Through the finalization of detailed analysis of IFRS based accounting figures and models, NBG will introduce IFRS based prudential reporting. NBG undertook intense dialogue with auditing firms as well in order to benefit from synergies of the tasks of the two parties. Such a process should facilitate well prepared transition to IFRS. IFRS transition process should as well be accompanied by a formalized consolidated supervision framework which is currently performed under the group structure risk assessment of commercial banks.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY LAST YEAR

During 2013, the National Bank of Georgia granted banking licenses to two commercial banks. Pasha Bank Georgia JSC obtained banking license in January of 2013, while Finca Bank Georgia JSC was licensed in August of 2013.

Throughout 2013, NBG also initiated a project for the introduction of electronic signatures in the banking system. A working group was formed whose task was to oversee the successful implementation of the project. Electronic signatures have already been introduced at one of the larger commercial banks. The new system is intended to increase the efficiency and security of some of the client-oriented banking operations that are/will be based on electronic signatures. It must be mentioned that the electronic signatures, as implemented by the Georgian banking system, can be considered as digital signatures since the system relies on the principles of cryptography for ensuring data integrity.

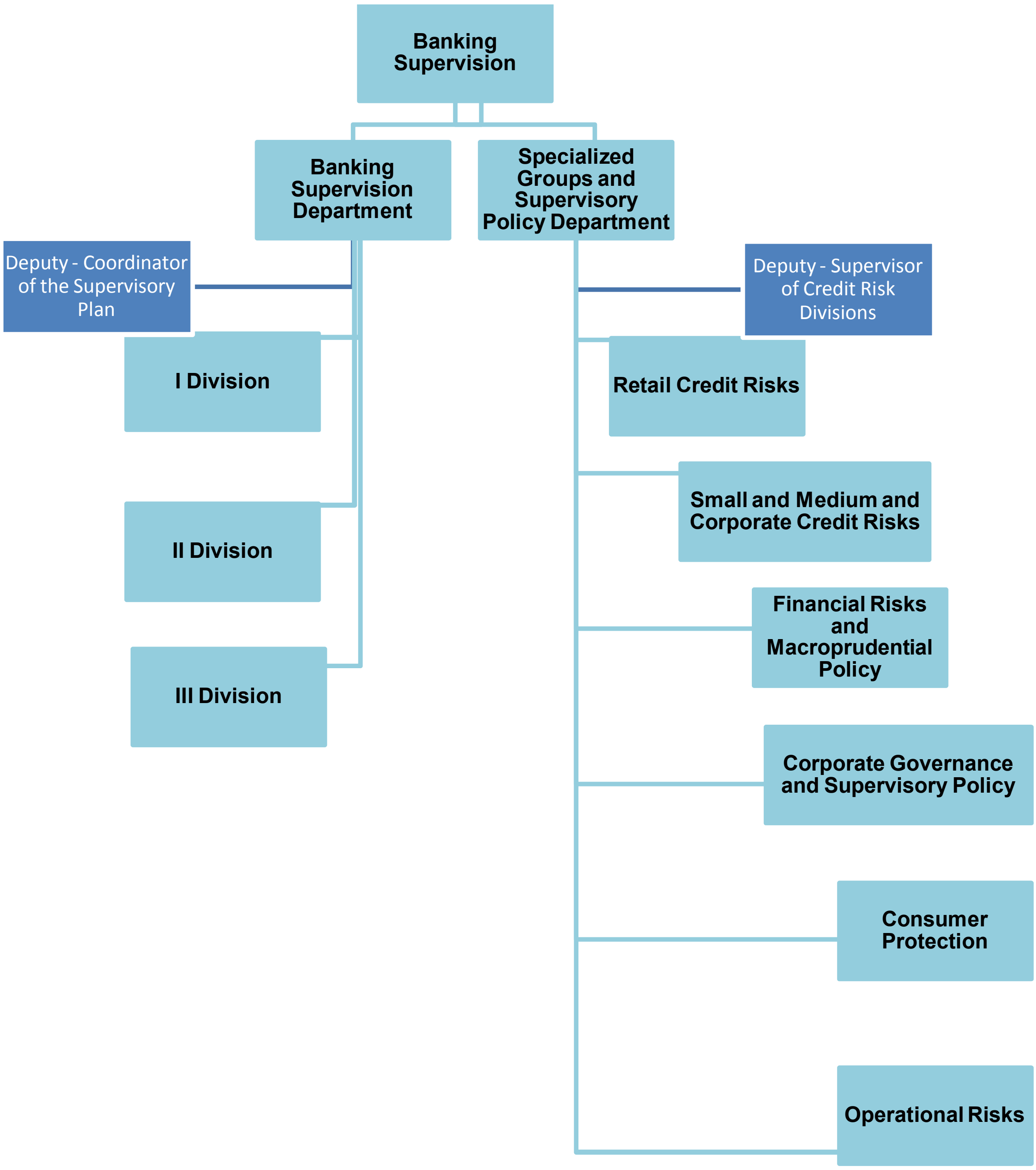
Further, in 2013, for the purpose of promoting better credit risk assessment and governance, NBG held conference on lending standards. During the conference, stakeholders shared their views view on significant aspects of lending standards and their influence on credit risk stance of the lender, and assessed current prevailing practice in this regard. NBG presented main trends in lending standards, basic borrower coefficients and wider macroeconomic indicators to open discussion and judge both current state of financial depth and client base indebtedness level locally. Different corporate and retail ratios, their historical and current levels and impact on credit quality are supposed were discussed. Discussions were facilitated around broad questions on what are sound lending standards for different types of borrowers, for instance whether foreign currency as well as lending at floating interest rates have material implications on credit standards and/or credit risk pricing etc. The conference proved fruitful platform for sharing views, and NBG arrived at final conclusions and possible further steps, including: All stakeholders agreed upon the importance of lending standards for defining the risk profile of credit institutions; Stakeholders agreed to discuss incorporation of lending standards more formally in asset classification/provisioning (although they are already incorporated in it in a less formal way) and/or in risk weighting under recently enforced Basel II/III capital adequacy framework; Stakeholders agreed to discuss possibility of additional public disclosures by bank on their lending standards in corporate, SME and retail exposures; Stakeholders agreed to actively develop additional disclosure content in their contracts with customers. Such disclosures would be incorporated in transparency decree of NBG.

In 2013 NBG initiated self-assessment against Basel core principles and in 2014 IMF and WB conducted joint Financial Sector Assessment Program (FSAP) in Georgia.

In 2013 NBG concentrated on transition of existing regulatory accounting rules to International Financial Reporting Standards (IFRS). In order to identify gaps between existing accounting rules and IFRS, activities performed by NBG included general analysis of financial information of commercial banks. The analysis implied comparison of IFRS financial statements of the commercial bank with financial information in accordance with existing accounting rules. Purpose of the analysis was to identify scope of the IFRS transition and extent of internal and external resources necessary for NBG during the transition process. In addition, NBG deepened communication with Big 4 audit firms to improve quality of reporting of commercial banks both according to existing accounting rules and IFRS. NBG planned pre-audit and post-audit meetings with the Big 4 audit firms.

NBG was also actively facilitating implementation of sound stress-testing framework in commercial banks that would form an essential part of pillar 2 processes. Enterprise-wide stress-testing framework requires from commercial banks to stress-test their loan portfolio based on parameters provided by NBG. Such stress-tests have so far been performed by large banks, but NBG would facilitate their implementation by all banks in future. As per ICAAP guidelines, beyond the internal stress-test models, bank would also be obliged conduct any stress and scenario tests that are required by the supervisor. NBG expects banks to put in place stress-testing frameworks by the end of 2014 as part of ICAAP. The first versions of ICAAP are to be submitted by September 30, 2014. The major challenge would be to ensure clarity regarding how the bank actually uses stress testing as part of its risk governance and decision-making, i.e. to highlight vulnerabilities and to enable the Supervisory Board to take its own view of whether it is comfortable with the extent to which the capital and other resources of the bank provide a defense against different levels of stress events.

ORGANIZATIONAL CHART OF THE HFSA 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 45, 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. Both groups have a Head of the department and a Deputy Head of the department. Deputy Head of specialized groups is concentrated on credit risk assessment and analysis, while Deputy Head of banking supervision department is a plan coordinator for banking supervision function.

Banking supervision department consists of three divisions. Banks to be supervised by each division were selected on the basis of their systemic importance and scale/size of activities. The first division of supervision covers only one largest systemic bank. Other systemic banks are supervised by the second division and the third division covers smaller banks in the Georgian banking sector. More supervisory attention is applied to banks with bigger systemic importance, and NBG is currently considering adding two more divisions to the banking supervision department. The specialized groups department incorporates six divisions and each is responsible for the supervision of particular risk category. The two departments exchange information daily and with joint efforts conduct continuous assessment of banks' risk profiles.

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 October of 2013, the National Bank of Georgia participated in the "Regional Workshop on the Implementation of Basel II / III," where NBG representatives shared their experience, providing a perspective from an emerging country outside the region that has been implementing the frameworks. The workshop was organized by IMF - East Africa Technical Assistance (East AFRITAC), and held in Kigali, Rwanda (November 18-22, 2013). The workshop aimed at discussing practical issues and challenges in the implementation process of the Basel II and III frameworks. 29 officials from central banks' supervisory and financial stability departments participated in the workshop.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

In 2009 NBG became the single regulator of the whole financial sector up until April 2013, when insurance supervision function was separated from NBG. Therefore, there is a need for signing a memorandum of understanding and establishing an effective collaboration framework in the near future.

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 THE COURSE OF LAST YEAR

Throughout 2013, Consumer Protection division at NBG has been monitoring provision of financial services to identify problems with financial product transparency and promote good practice. To that end, NBG adopted general principles to regulate advertising practice by commercial banks that would prevent from provision of misleading information to consumers. Further, 2% cap on fee for credit prepayment, enforced in 2011 for commercial banks, was also extended to MFIs in 2013. Lastly, through special regulatory framework, NBG was granted discretionary right to impose special requirements on legal entities, not registered by NBG, which attract funds from broader public. Currently, one legal entity is subject to this framework.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2011	2012	2013
Commercial banks	17	16	19
Branches of foreign credit institutions	2	3	2
Cooperative banks			
Banking sector, total:	**19**	**19**	**21**

Ownership structure of banks on the basis of assets total

Type of financial institution	2011	2012	2013
Public sector ownership			
Other domestic ownership			
Domestic ownership total	2.3%	3.6%	4.0%
Foreign ownership	97.7%	96.4%	96.0%
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%	19.02%
Branches of foreign credit institutions	0.43%	0.43%	0.001%
Cooperative banks			
Banking sector, total:	65.21%	77.33%	19.02%

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

Type of financial institution	2011	2012	2013
Commercial banks	17.26%	5.85%	14.62%
Cooperative banks			
Other			
Banking sector, total:	17.26%	5.85%	14.62%

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	99.68%	99.61%	99.57%
Branches of foreign credit institutions	0.32%	0.39%	0.43%
Cooperative banks			
Other			
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2011	2012	2013
Financial sector	0.17%	0.15%	0.5%
Nonfinancial sector	60.22%	60.23%	60.26%
Government sector	0.65%	0.46%	0.41%
Other	38.96%	39.16%	38.83%
Liabilities	**2011**	**2012**	**2013**
Financial sector	4.79%	3.74%	3.42%
Nonfinancial sector	50.57%	52.08%	54.55%
Government sector	2.63%	1.21%	1.50%
Capital	16.60%	16.65%	16.75%
Other	25.42%	26.32%	23.79%

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Commercial banks*	25.58%*	25.26%*	25.22%*
Cooperative banks			
Banking sector, total*:	25.58%*	25.26%*	25.22%*

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

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

Asset classification	2011	2012	2013
Non financial sector	4.82%	4.81%	4.35%
- households	4.22%	5.00%	3.44%
- corporate	5.13%	4.71%	4.89%

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

	Deposits	Loans
Households	49.8%	46.0%
Government sector	2.7%	0.7%
Corporate	47.5%	53.3%
Other (excluding banks)	**0.0%**	**0.0%**
Total	**100.0**	**100.0**

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

P&L account *(in EUR)*	2011	2012	2013
Interest income	1,342,822,351	1,549,935,178	1,714,135,144
Interest expenses	626,646,846	754,762,988	751,904,241
Net interest income	716,175,505	795,172,190	962,230,903
Net fee and commission income	176,676,806	182,407,071	205,045,098
Other (not specified above) operating income (net)	166,893,813	192,047,866	210,984,311
Gross income	1,686,392,969	1,924,390,115	2,130,164,552
Administration costs	322,005,494	351,129,316	396,187,437
Depreciation	81,000,723	80,265,139	80,384,355
Provisions			
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	78,447,937	326,063,358	218,239,688
Profit (loss) before tax	360,699,149	178,590,858	436,958,594
Net profit (loss)	323,037,282	134,230,695	389,131,586

Total own funds in 2013 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	1,233,117,851	937,264,294	295,853,557	
Cooperative banks				
Banking sector, total:	1,233,117,851	937,264,294	295,853,557	

2013 DEVELOPMENTS IN THE LATVIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2013, the GDP growth in Latvia, like in 2012, was the highest in the EU (4.1%). Contrary to 2012, when exports, investment and private consumption contributed equally to GDP growth, in 2013, the main driver of growth was private consumption. Inflation was uncharacteristically low (0% on average) given the recovery in the economic activity, and it were mostly external and supply-side factors that determined this development.

The increase in employment and the average wage led to a rise in disposable income, which was the key determinant of the private consumption growth. As opposed to the pre-crisis period, the rise in disposable income was based on increasing productivity and thus was sustainable.

The real exports of goods and services grew at a slower pace in 2013. Even though the competitiveness of Latvian exporters remained high, the weak foreign demand limited the export growth. Imports of goods and services decreased slightly due to the weaker investment dynamics. The closure of the large metallurgical company had a negative impact on the growth of both imports and exports. At the same time, many other export groups, including the largest product groups – wood and wood products, foodstuffs and mechanisms, demonstrated successful development in 2013.

External uncertainty, the completion of some major investment projects and the "wait-and-see" attitude towards the euro introduction took a toll on the investment growth in 2013. Recovery in investment activity can be reasonably expected in 2014 due to the start of the new round of EU financing, provided the tensions in Ukraine and Russia do not escalate and have a significant impact on business confidence.

The current account deficit in 2013 lowered to 0.8% of GDP, aided by the decreasing imports and the growing trade surplus of the services sector. The consolidated general government budget deficit also continued to shrink reaching 1.0% of the GDP.

Labor market developments in 2013 were highly positive. The unemployment rate has reached its long-term average, decreasing by almost a half compared to the peak in 2010, and dropping below the euro zone average. It was the private sector that determined the employment growth, confirming the fact that the increase is sustainable.

While the average monthly wages and salaries increased by 4.6%, the productivity gains were also notable. It points to a continued competitiveness of the Latvian economy and, ultimately, the sustainability of the ongoing recovery.

DEVELOPMENT IN BANKING SYSTEM

Year 2013 in the banking sector was a year of moderate development, with continuing improvements in the key performance ratios.

Banks dominate the financial sector in Latvia, accounting for about 90.2 % of its total assets. At the end-2013, 28 banks, including 9 branches of the EU banks, were operating in Latvia. Total banking assets to GDP ratio reached 125.2% at the end of 2013 (20 516 million lats (assets) / 16 386 million lats (GDP)). 73.2% of the Latvian banks' share capital was owned by foreign investors (one bank, "Unicredit", left the Baltic countries as from 01.01.2014). All other banks in Latvia are privately owned, except for 2 government-controlled banks, of which one, the state owned bank "Latvijas Hipotēku un zemes banka", on 01.01.2014 was transformed into the joint stock Latvian development financial institution "Altum".

All banks comply with the regulatory requirements. Still comparatively low lending activity determined the high level of the liquid assets and the liquidity ratio retained a high level – 64.4% at the end of 2013. The bank capitalization level improved, as a number of banks had made use of the possibility to strengthen capital base and by the end of 2013 the capital adequacy ratio was 18.9%, whereas the tier 1 ratio stood at 17.3%.

Latvia's joining the euro zone on 01.01.2014 has facilitated a steep growth in resident deposits (in the last quarter of 2013 just before the introduction of the euro there was an upsurge in both the household and corporate deposits) in 2013 by 848 million lats (1.2 billion euro) or 13.3%, whereas following an increase in non-resident deposits by 384 million lats (546 million euro) or by 6.3%, the amount of total deposits reached 13.7 billion lats (19.5 billion euro) by the end of 2013.

In 2013, the loan portfolio reduced by 6.5%. Except for the effect of loan write-offs, which was rather the final stage of putting the bank balance sheets of the years of crisis in order than the reflection of the current situation, the loan portfolio shrank by 3.1% (incl. resident non-financial undertakings – by 1.8% and resident households – by 4.5%).

New lending continued to resume gradually in line with a positive macroeconomic development. In 2013, banks granted new loans to resident non financial enterprises – 1.3 billion lats, resident households – 0.3 billion lats and 1 billion lats to non-residents.

The quality of loan portfolio improved slightly. The share of loans with more than 90 days overdue payments in the total loan portfolio continued shrinking and by the end-2013 was 8.3% (11.1% at end-2012). The total share of overdue loans in the banking sector loan portfolio reduced from 17.4% to 14.6% over the year. The balance of loan loss provisions made by the banks at the end-2013 shrank to 673.6 million lats or 6.1% of total banking loan portfolio (8.0% at end-2012).

In 2013, due to a loan portfolio contraction and increase in deposits the necessity for additional financing reduced and the funding raised by banks from MFI continued declining by 23.9% (993 million lats), mainly due to contraction in funding volumes from parent banks by 923 million lats.

After the three loss-making years, the year 2013 was the second in a row where the banking sector made profits amounting to 173.0 million lats (122.7 million lats in 2012). Banking profitability was positively affected by both the increase in the commission fee income and comparatively high interest rate spread on loans and deposits, and gradual improvement of loan portfolio quality (still the most significant banking sector expenditure item, i.e., net expenditures for loan loss provisions shrank by 10.9%).

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 nearly 13 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 the regulatory framework for and supervision of 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 competence of the FCMC is set forth in the Law on the Financial and Capital Market Commission and sectoral 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 set forth restrictions on the activities of banks, to examine compliance of the activities with the legislation, and regulations and directives of the FCMC, and to apply sanctions set forth by the regulatory requirement on banks and their officials in case any of regulatory requirements are violated.

In course of 2014 the preparations for single supervision mechanism will take place and as from November 2014 the FCMC will share banking supervision powers with the European Central Bank.

MAIN STRATEGIC OBJECTIVES OF FCMC IN 2013

According to the FCMC Strategic Priorities for 2012–2014, which were approved by the FCMC Board in 2012, there were three main FCMC's strategic objectives for 2013:

- 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

On 26 June 2013, the CRD IV Directive and CRR Regulation were approved, introducing Basel III requirements in the EU. In order to ensure harmonized application of the EU regulatory framework and promote uniformed developement of the financial market, most of the regulatory requirements are set in the CRR, which is directly applicable. In order to implement the provisions of the CRD IV into Latvian legislation the amendments to the Credit Institution Law and amendments to the Financial Instruments Market Law were developed. Drafting regulatory and implementing technical standards for introducing the CRR requirements was also continued, with the FCMC’s employees actively participating.

In 2013, based on the EBA "Guidelines on the assessment of the suitability of members of the management body and key function holders" the FCMC developed the "Recommendations for assessment of the suitability of board and council members, and a person who performs basic functions", setting criteria and processes that institutions are advised to follow in assessing elected (appointed) board and council members and persons who perform the basic functions in the credit institution.

In the reporting year amendments related to the adoption of the euro currency to a number of laws and the FCMC’s regulations were drafted.

Supervision

In 2013, the FCMC continued its work on improving the methods and tools used in bank examinations and off-site supervisions, by improving monitoring procedures of stress testing and updating the supervisor’s stress testing procedure, improving bank management evaluation criteria and reviewing operational risk assessment methodology, introducing an early warning indicator system to be used for monitoring purposes, which aims to provide a timely and transparent information to the supervisor on significant banking activities and risk indicators and trends, as well as improving the methods and tools to be used for the banking supervision in accordance with the methods set by the ECB single supervisory mechanism.

During the reporting year, priority tasks in supervising the banks in Latvia were to assess: the adequacy of the capital base; liquidity maintenance and management adequacy and quality, taking into account the bank's chosen business model; the activities of banks with problem loans and the recognition of loan impairment losses in bank statements; the potential impact of bank operating strategy on the structure and volume of risks; the bank's ability to ensure the successful introduction of the euro and monitor the process of currency changeover, as well as to initiate development of the bank recovery plans and evaluation of the plans.

In performing 25 on-site inspections and analyzing financial statements of banks the FCMC continued monitoring the measures taken by banks for ensuring efficient credit risk management in loan restructuring. Apart from individual bank on-site inspections, also horizontal reviews were carried out to assess the credit restructuring process and market risk management in these banks, as well as enforcement of policies under the FCMC regulations. Internal capital adequacy assessment processes in the banks were thoroughly evaluated to clarify whether minimum capital adequacy requirements were sufficient to cover credit risk, market risks and operational risk inherent in the bank activities and if there were no other material risks arising from the bank activities (for instance, concentration risk, interest rate shift risk in a banking book and other) where capital add-on would be required to cover risks.

The FCMC has entered into the cooperation and information exchange agreements with all foreign supervisory authorities regarding bank group supervision, if subsidiaries of their banks operate in Latvia or Latvian banks have subsidiaries in their countries. The FCMC representatives participated in the colleges of supervisors on a regular basis. The FCMC continued regular supervision of parent bank exposures in Latvia, which are registered in the EU Member States, to all type of debt instruments and capital, as well as net deposits granted to banks in Latvia.

Consumer education

In 2013, the FCMC ensured implementation of its strategic priorities for "improving the level of financial education and raising customer awareness" and continued its work with ongoing activities launched during the previous years, as well as launched a range of new financial literacy promotion projects.

In January 2013, the FCMC became a partner of the organization "Child and Youth Finance International" and national coordinator for further financial education activities in Latvia related to the annual international event "Global Money Week" (first financial education week in Latvia took place already in the spring of 2013), in March the FCMC opened its information booth in the Bank of Latvia Training Centre "Money World", at the end of April the FCMC became a full-fledged member of the OECD International Network on Financial Education (INFE).

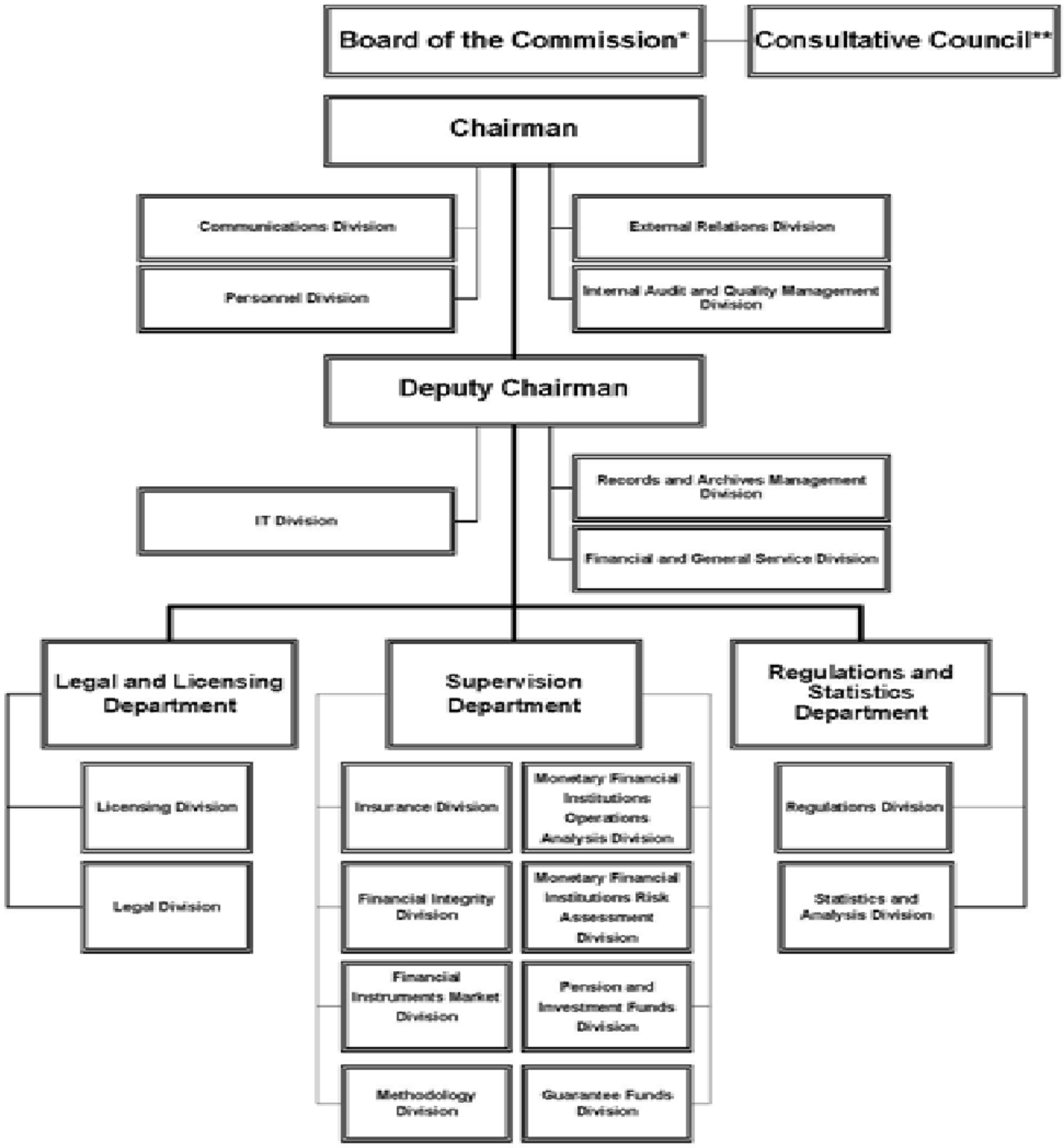
In 2013, a new concept design was developed for the FCMC's education site KLIENTU SKOLA (Customer School, available at www.klientuskola.lv) and a three-pronged structured content for the newly developed educational subsection CUSTOMER ABC was approved.

The FCMC in cooperation with its partners in the area of financial education developed the National Strategy for Financial Literacy in Latvia 2014-2020 aimed at promoting the public financial literacy.

During the reporting year, to estimate the financial literacy level of Latvian population, as well as accurately define the future activities in this area, the FCMC concluded regular public opinion surveys on the financial literacy topics.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

In 2013, there have been minor changes to the structure of the FCMC – to optimize the use of resources and management processes position of an Advisor of the Chairman was closed and two divisions performing support functions – Financial Division and General Services Division – were merged into the Financial and General Services Division subjected to the Deputy Chairman.



*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 2013, negotiations on the legislative proposals concerning the CRD IV/CRR, single banking supervision mechanism (SSM), bank recovery and resolution mechanism, including single resolution mechanism, payment accounts directive and proposals on anti money laundering were conducted at the level of the Council of the EU, where inter alia the negotiations on the CRD IV/CRR and SSM were concluded. 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.

As the national supervisory authority the FCMC regularly participated in the work of the EBA and the European Systemic Risk Board (ESRB), their committees and working groups and made its contribution to the documents elaborated and negotiated by the EBA and the ESRB. As of July 2013, the FCMC has been participating also in the committees and working groups of the ECB (SSM composition).

As regards cooperation with other supervisory authorities the FCMC gave priority to cooperation within the Nordic-Baltic region. 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, as well as an exchange of views took place in the Nordic Baltic Stability Group created under the cooperation agreement in the area of cross-border financial stability, crisis management and prevention. Also, cooperation with supervisory authorities of the Central and Eastern Countries continued in order to negotiate positions regarding EU legislative proposals with the aim to protect interests of host countries' supervisors during the negotiation in EU.

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	2011	2012	2013
Commercial banks	22	20	19
Branches of foreign credit institutions	8	9	9
Cooperative banks	0	0	0
Banking sector, total:	**30**	**29**	**28**

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

Type of financial institution	2011	2012	2013
Public sector ownership	14.7	9.0	8.9
Other domestic ownership	20.3	27.1	26.6
Domestic ownership total	35.0	36.1	35.6
Foreign ownership	65.0	63.9	64.5
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2012
(at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	49.9	71.5	0.121
Branches of foreign credit institutions	95.9	98.4	0.688
Cooperative banks	-	-	-
Banking sector, total:	**44.0**	**64.1**	**0.104**

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

Type of financial institution	2011	2012	2013
Commercial banks	-11.2	5.6	8.7
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**-11.2**	**5.6**	**8.7**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	87.7	86.6	88.2
Branches of foreign credit institutions	12.3	13.4	11.8
Cooperative banks	0	0	0
Other	0	0	0
Banking sector, total:	**100**	**100**	**100**

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

Assets	2011	2012	2013
Financial sector	25.0	28.7	33.1
Nonfinancial sector	64.6	60.2	56.1
Government sector	3.9	5.3	5.3
Other	6.5	5.8	5.5
Liabilities	**2011**	**2012**	**2013**
Financial sector	27.3	23.7	18.1
Nonfinancial sector	48.1	54.9	60.3
Government sector	2.1	3.6	3.9
Capital	7.5	9.4	9.9
Other	15.1	8.4	7.8

Capital adequacy ratio of banks

Type of financial institution	2011**	2012**	2013**
Commercial banks	17.40	17.61	18.94
Cooperative banks	-	-	-
Banking sector, total:	**17.40**	**17.61**	**18.94**

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

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

Asset classification	2011	2012	2013
Non financial sector	18.1	11.6	8.8
- households	19.6	15.1	11.9
- corporate	17.2	9.2	6.6

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

	Deposits	Loans
Households	32.4	39.8
Government sector	5.8	0.9
Corporate	57.4	54.2
Other (excluding banks)	4.4	5.1
Total	**100.0**	**100.0**

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

P&L account	2011	2012	2013
Interest income	910 850	764 763	674 877
Interest expenses	478 464	317 081	180 429
Net interest income	432 386	447 682	494 447
Net fee and commission income	235 252	269 768	306 425
Other (not specified above) operating income (net)	187 959	215 231	178 810
Gross income	855 598	932 681	979 683
Administration costs	480 851	457 874	476 147
Depreciation	36 442	28 532	28 973
Provisions	542 400	228 197	177 665
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	542 400	228 197	177 665
Profit (loss) before tax	-204 095	218 078	296 898
Net profit (loss)	-254 211	174 079	246 201

Total own funds in 2013 (in thousands of EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	2 769 186	2 531 963	237 223	0
Cooperative banks	-	-	-	-
Banking sector, total:	2 769 186	2 531 963	237 223	0

2013 DEVELOPMENTS IN THE LITHUANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2013, Lithuania's economy grew at one of the fastest rates in the EU. It was mainly driven by domestic demand supported by growth in both household consumption and domestic investment. Household consumption was mostly driven by growth in real disposable income, and domestic investment — by one-off factors and favourable economic climate. However, the growth of exports decelerated in 2013, mostly hampered by more subdued external demand and unfavourable developments in import prices of commodities and the global market for petroleum products.

With domestic demand taking over as the main economic growth driver, the growth of employment in inward-oriented activities picked up. The most noticeable boost to employment was provided by the recovery in the construction industry as well as the effects of the EU Council presidency.

In 2013, the average annual inflation rate was significantly lower than in the previous year and lower than the long-term average. The slowdown in inflation is attributed to the trends of administration, fuel and food prices, which are favourable for consumers. These tendencies are fuelled by external factors, i.e. the developments in energy and food commodity prices in global markets, in particular a fall in crude oil and food commodity prices in 2013. The growth in prices that are more sensitive to domestic factors decelerated only slightly in 2013 and did not contribute much to the decline in inflation.

DEVELOPMENT OF THE BANKING SYSTEM

At the end of 2013, the banking sector comprised of seven banks and eight foreign bank branches. As of 1 January 2014, the assets of the banking system stood at LTL 77.6 billion. As usual, loans account for the bulk of bank assets (for as much as 70% of bank assets, including financial leasing).

As of late 2013, the banks' portfolio of loans and leases amounted to LTL 54.5 billion. The volume of business loans, which account for the largest share of the total loan portfolio, contracted by LTL 775 million in the course of the year and stood at LTL 23.6 billion at the end of 2013. Quality indicators of the loan portfolio continued to improve in 2013.

Banks in Lithuania use two sources of funding — local loans and funding from parent banks. At the end of 2013 they had a total of LTL 47.6 billion in deposits and LTL 19.1 billion in loans received from parent banks. For several years now, the deposit portfolio in banks has shown a growth trend (the volumes of residential and private company deposits in banks have reached record highs) at a faster rate than the loan portfolio, which, naturally, prompted the banks to reduce liabilities to parent banks steadily.

In 2013, the banks and foreign bank branches operating in the country earned LTL 785.5 million profit — up by one-tenth from 2012. Last year, the activities of six banks and six branches of foreign banks were profitable, whereas one bank and two foreign bank branches operated at a loss.

As of 1 January 2014, all banks complied with all prudential requirements for banking activities. The bank capital adequacy ratio was 17.6 per cent (minimum requirement is 8%), and the liquidity ratio — 41.2 per cent (minimum requirement is 30%) and the total asset ratio to GDP stood at 64.9 per cent.

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

With continuing integration into the EU single market, in 2013, the Bank made arrangements for the implementation of fundamental EU legislation, including the Capital Requirement Directive (CRD IV), the Capital Requirement Regulation (CRR) and Technical Standards, and drafted amendments to legislation, such as the Law on the Bank of Lithuania, the Law on Banks, and the Law on the Central Credit Union. Given that the CRR and the technical standards shall be directly applicable, the resolutions of the Board of the Bank of Lithuania underwent a substantial revision, and the resolutions with provisions falling in the scope of the Regulation were repealed. As part of its new obligations to adopt decisions on the application of certain provisions of the Regulation, the Bank of Lithuania adopted a list of national exemptions. Much emphasis was put on communication with market participants in order to discuss the most relevant aspects of CRD IV and CRR implementation, and to adjust a new financial and supervisory reporting package.

The Bank of Lithuania adopted the requirements facilitating the assessment of the suitability of executives of the financial institutions supervised in order to ensure that the persons appointed to governing bodies in the organisations of financial market participants are duly qualified and experienced and to promote the autonomy and responsibility of market participants. Those provisions entered into force on 1 May 2014.

In 2013, the Bank of Lithuania drafted a number of laws governing the activities of credit unions (already endorsed by the Government of the Republic of Lithuania) as it sought to address urgent matters relating to increase of capital and to achieve a proper balance between the development of credit unions and their ability to absorb losses arising from risk exposures. It continued the review of legislation governing the activities of credit unions and tightened the requirements applied thereto. The Bank of Lithuania prepared and published a public discussion paper on a business model of credit unions in Lithuania. It outlines a number of options and approaches to the sector’s structural reform, which will allow strengthening credit unions and ensuring sustainable and long-term operations of the sector in future.

MAIN STRATEGIC OBJECTIVES OF THE BANKING SUPERVISORY AUTHORITY IN 2013

The licencing process was further improved 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 of good repute. The Bank of Lithuania refused to issue licences to those credit institutions, which, although intended to be established, were not ready to ensure adequate provision of financial services and were not able to carry out safe and sound operations.

Supervision of market participants is forward looking and focused on identification of problems and solutions at an early stage before the problems turn chronic. Systemically important and riskiest participants of each sector are subject to the closest supervision. In addition, the Bank is engaged in more intensive dialogue with market participants and foreign supervisory authorities and seeks to become a consultant for the entities being supervised while being a demanding supervisor. The development of a supervisory model and improvement of efficiency through the increased use of new IT solutions remain one of the top priorities.

The primary aim of the supervision of financial market participants was to ensure their ability to cover the losses incurred due to the last crisis and their resilience to new shocks. They were required to build additional capital and liquidity buffers and strengthen the management of the risks assumed and the governance of the entire financial institution. In addition, the banks had to develop individual recovery plans pursuant to new European requirements.

THE ACTIVITIES OF BANKING SUPERVISORY AUTHORITY LAST YEAR

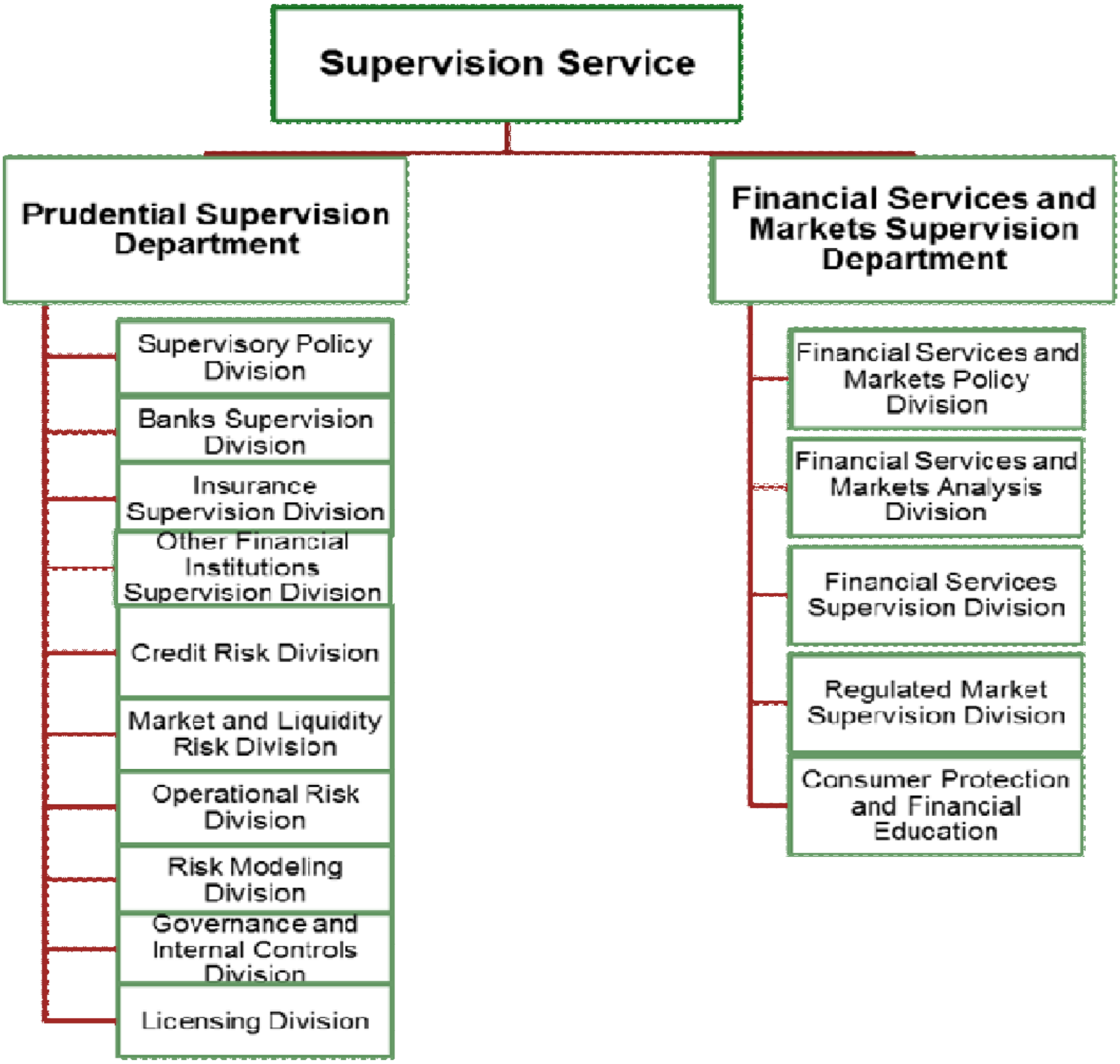
2013 was a year of changes in the number of market participants and the ensuing redistribution of the market. In the course of the year, the number of banking sector participants decreased due to the initiation of bankruptcy proceedings against AB Ūkio bankas and the discontinuation of operations of the Lithuanian branch of AS UniCredit Bank in Lithuania. At the same time, a new participant — a branch of Finland’s Pohjola Bank Plc, which has been actively operating in Lithuania — entered the market.

Discontinuation of operations of AB Ūkio bankas had the biggest impact on the banking sector and the redistribution of market shares, in particular on AB Šiaulių bankas, basically due to the transfer of a sizeable portion of AB Ūkio bankas’ assets and liabilities. The Bank of Lithuania made all efforts to resolve the problem of AB Ūkio bankas quickly and efficiently and maintain confidence in the national financial system. The approach chosen for the reorganisation of AB Ūkio bankas, i.e. to transfer a part of its business to an existing bank and to open bankruptcy proceedings against the remaining part, proved to be effective, as customer service was restored swiftly. Moreover, this option involved the smallest financial contribution from Deposit Insurance Fund. Improvements in the banking sector indicators demonstrate that the decision made was right and confidence in the country’s financial system was preserved. In 2013, the banking sector kept growing and generating profits amid improvements in the quality of banks' assets and growth of their liquid assets and capital buffers.

Certain organizational changes are also under way within the Nordea group, which operates in Lithuania through the Lithuanian branch of Nordea Bank Finland Plc. Last year, the group took decisions to centralise its business in Sweden and to transfer all branches, including the Lithuanian branch of Nordea Bank Finland Plc, to the Nordea bank established in Sweden.

In 2013, the Bank of Lithuania undertook supervisory review and evaluation processes in respect of all banks. They involved a comprehensive assessment of each bank, including the evaluation of business plans, financial status, sustainability of capital and resilience to adverse shocks, risk profile and risk management capacity as well as the capital set aside against particular risks. This was followed by notification of banks of the deficiencies that should be eliminated. In the absence of other effective measures, the Bank of Lithuania may introduce individual prudential requirements or take enforcement measures against a bank. Pursuant to the European Union's legislation, supervisory review and evaluation process of the banks that are part of cross-border banking groups with subsidiaries in other countries shall be undertaken in cooperation with financial supervisory authorities of those other countries and decisions on supervisory measures that should be applied to the group or its individual subsidiaries shall be taken jointly. Last year, the Bank of Lithuania took such decisions in respect of SEB, *Swedbank*, DNB and *Citadele* groups.

THE ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

During the Lithuanian Presidency of the EU Council in the second quarter of 2013, the cooperation of the Bank of Lithuania with EU institutions became very intense. Regarding the aims of the Presidency of the EU Council, the Bank of Lithuania contributed significantly to the implementation of Lithuania's goals in the area of services, set for the six-month period of its EU Presidency focusing particularly on the progress in such areas as creation of the banking union, supervision of financial markets and improvement of payment infrastructure, regulation of insurance mediation, and adequate representation of the EU in international fora.

By ensuring the supervision of the financial market, the Bank of Lithuania actively participates in the work of European institutions responsible for macro-prudential oversight such as the European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA), and European Securities and Market Authority (ESMA) 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, to supervise them within these groups, the Bank of Lithuania regularly cooperates with the financial supervisory authorities of other countries. A particularly intensive cooperation is with representatives of the supervisory authorities of the financial sectors in Sweden and the Baltic States through the supervisory colleges.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

Bankruptcies of several financial market participants emphasized the importance of reliability and responsibility of property valuers and external auditors. 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 IN THE COURSE OF LAST YEAR

Important changes in the supervision of credit unions were implemented. In particular, the Bank of Lithuania initiated amendments to the Law on Credit Unions. For this purpose, it took an active part in the activities of a working group established by the Minister of Finance for the improvement of legislation governing the activities of credit unions. The task force produced a set of harmonised proposals (amendments to the Law on Credit Unions) on measures to be taken to improve the safety and reliability of this sector's operations. Identification of a supervision credit union operation and supervision model, which would best fit Lithuania's national situation and would mitigate the threat posed by this sector to the interest of the society, remained a priority. The Bank of Lithuania prepared and published a public discussion paper on the credit union operation model in Lithuania. It outlines a number of options and approaches to the sector's structural reform, which will allow strengthening of credit unions and ensuring sustainable and long-term operations of the sector in future. The IMF provided technical assistance in this field in November 2013.

STATISTICAL TABLES

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

Type of financial institution	2011	2012	2013
Commercial banks	8	8	7
Branches of foreign credit institutions	12	8	8
Cooperative banks*	75	78	77
Banking sector, total:	**95**	**94**	**91**

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

Type of financial institution	2011	2012	2013
Public sector ownership	-	-	-
Other domestic ownership	-	-	-
Domestic ownership total	12.3	12.7	10.9
Foreign ownership	87.7	87.3	89.1
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	88.0	97.9	1850
Branches of foreign credit institutions	97.3	99.1	184
Cooperative banks	22.2	30.6	-
Banking sector, total:	**69.2**	**87.5**	**2034**

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

Type of financial institution	2011	2012	2013
Commercial banks	15.23	6.57	11.67
Branches of foreign credit institutions	-9.30	-30.80	-19.70
Cooperative banks*	-	-	-
Banking sector, total:	-	-	-

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	78.8	77.5	78.7
Branches of foreign credit institutions	19.1	19.9	18.6
Cooperative banks	2.1	2.6	2.7
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2011**	2012**	2013**
Commercial banks	13.92	14.17	15.41
Cooperative banks	19.76	16.53	18.44
Banking sector, total:	14.04	14.23	15.51

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

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

Asset classification	2011	2012	2013
Non-financial sector	16.27	13.87	10.70
- households	**x**	**x**	**x**
- corporate*	**x**	**x**	**x**

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

	Deposits	Loans
Households	58.87	43.49
Government sector	5.67	7.93
Corporate	33.72	44.38
Other (excluding banks)	1.73	4.20
Total	**100.0**	**100.0**

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

P&L account	2011	2012	2013
Interest income	593.1	664.4	568.8
Interest expenses	283.0	334.8	234.0
Net interest income	310.1	329.6	334.8
Net fee and commission income	151.0	176.0	186.0
Other (not specified above) operating income (net)	-	-21.7	-14.9
Gross income	470,7	527.3	568.3
Administration costs	252	130.8	145.9
Depreciation	21.4	18.7	15.0
Provisions	-4.5	2.4	-1.2
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-51.9	-16	-0.9
Profit (loss) before tax	322.2	236.6	307.1
Net profit (loss)	288.3	209.0	277.4

Total own funds in 2013 (in mln EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	1931.3	1881.6	49.6	-
Cooperative banks	52.7	44.7	8.0	-
Banking sector, total:	**1984.0**	**1926.3**	**57.6**	**-**

2013 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF MACEDONIA

MACROECONOMIC ENVIRONMENT

Macedonian economy in 2013 recorded a significant recovery, with real GDP growth of 3.1%, versus the small decline in the previous year. The growth was mainly driven by net exports and personal consumption, followed by further gradual reduction of unemployment in the economy. In this context, it is important to emphasize the added value of the new production facilities that had a significant contribution to the export side, providing greater export diversification and flexibility. Improved trade balance allowed for further narrowing of the current account deficit, which was reduced to 1.9 % of GDP, in circumstances where private transfers are normalized after extremely high level in the previous year. Moreover, the economic recovery was supported by the fiscal stimulus aimed at infrastructure projects, as well as adaptive monetary policy.

The average annual inflation in 2013 was reduced to 2.8, with a declining trend, starting from the second half of the year, mainly due to energy prices. Foreign exchange reserves remained adequate during the whole year, contributing to stable exchange rate expectations. In these circumstances, NBRM eased the key interest rate and undertook non-standard measures, with the basic challenge of stimulating the banks' credit growth.

The developments in the external sector during 2013 were significantly influenced by the still weak conditions in the Euro area and unfavorable changes in prices on the world markets of key export products. On the other hand, structural changes in the domestic economy had a positive impact on the external position and they increased the resistance of exports, amid the still unfavorable external environment. The current account deficit decreased annually by 1.1 pp of GDP, which in 2013 was reduced to 1.9% of GDP. The narrowing of the deficit was caused by the smaller negative gap in the exchange of goods and services.

In 2013 the central government debt was increased by 8.4%, and it reached 2.757 million Euros, which led to an increase of the share of the central government debt to GDP ratio by 1.7 percentage points, reaching 35.8%, versus 34.1% in 2012. This annual growth was entirely due to the increase of the domestic borrowing (25%), while external debt was decreased (1.3%). The larger growth of the domestic debt was a result of the more intense issuance of government securities on the domestic financial market. It is important to point out the gradual extension of the maturity of the existing portfolio of government securities, which reduces the need for more frequent refinancing and reduces the liquidity risk.

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

The registered recovery of the domestic economic in 2013 had a corresponding impact on the growth of banking system activities, and especially on lending dynamics. Thus, after a period of relatively limited lending activity to corporate sector, it accelerated in 2013, particularly evident in the last quarter of the year. Nonetheless, banks are still rather cautious when lending to corporate sector entities, partially a result of the conservative strategies applied by some major banking groups present in the country. The revival of the domestic credit market was further encouraged by the monetary measures undertaken by the National Bank, which provided additional liquidity in the banking sector, coupled with some macro-prudential measures in the same direction. Improved expectations on domestic economy growth and the further stabilization of the international environment in 2014 are expected to have a positive impact on the banks activities in the coming period. Major challenges remain in terms of effective revival of banks credit activity, amid still fragile non-financial legal entities, while maintaining satisfactory level of profitability, liquidity and capital position.

As of December 31, 2013, the total assets of the banking system equaled Denar 369,505 million, which meant an annual growth rate of 4.7%, being the lowest in the last twelve years. The asset structure underwent certain changes, with a slowdown of the credit growth, increase of the liquid securities investments and rise in placements with banks. Regarding the degree of financial intermediation of the banking system, at the end of 2013 there was an increase of all indicators. The assets-to-GDP ratio equaled 77.9%, which is an increase of 1 percentage point relative to 2012. The gross credits and the deposits reached 48.5%, i.e. 54.7% of the gross domestic product, respectively (growth of 1.4 percentage points, i.e. 1.2 percentage points, respectively, compared to 2012)[16].

At the end of 2013, total loans to non-financial entities increased by Denar 13,907 million, while the annual growth rate slowed by 0.4 percentage points and accounted for 6.4%.

The annual growth rate of the deposits in 2013, as the main driver of the assets movements, equaled 5.7%. The long term household deposits in Denars are the main generator of the banks' deposit base. After the annual decrease of total enterprise deposits in 2012, they registered a certain growth in 2013 (3.2%).

The quality of the banks' loan portfolio registered various movements during the year, corresponding to the changes in domestic economy conditions. In July 2013, the overall NPL ratio reached its highest level of 12.4%, caused by the high growth of non-performing loans to corporate sector. During the second half of the year, banks made efforts to restructure a certain portion of loans to clients, mainly encouraged by the signs of reviving of the domestic economy and in the same time the enhanced collection of non-performing claims. These activities are also supported with the new regulations on credit risk management, which encourages banks to perform timely restructuring of claims, some time before they obtain a non-performing status. Thus, at the end of 2013, the NPL

[16] Financial intermediation indicators are calculated according to the last available data on GDP. Data on GDP were last revised as on 14.03.2014.

ratio was reduced at the level of 11.5%, which is partially a result of the accelerated credit activity to corporate sector in the last quarter of 2013.

The liquidity of the banking sector is stable and high. In 2013 banks liquid assets register some weaker growth, compared to the previous year but nonetheless, they remain to comprise one third of the total assets of the banking sector, covering almost 60% of the total household deposits.

Parallel to the stable liquidity, the high solvency is the second pillar of the banking system stability and its resilience to shocks. As of December 31, 2013, the capital adequacy ratio equaled 16.8% being twice higher than the regulatory minimum of 8%. The profitability of the banking system improved, due to the increase of the net interest income, and the simultaneous drop in net-impairment of financial assets. The ROA and ROE increased substantially, and on December 12, 2013 they equaled 0.6% and 5.7%, respectively. Operational efficiency of the banks improved.

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 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 Capital Requirements Directive, as well as the principles and standards developed by the Basel Committee on Banking Supervision and the European Banking Authority.

In order to achieve further enhancement of the banking regulatory framework, in 2013 the following acts were prepared and adopted:

- New Decision on credit risk management, which has enhanced the existing regulation by introducing the following main amendments: (1) monthly classification of credit exposures, (2) possibility for using materiality threshold for determining non-performing claims which are more than 90 days pass-due, as well as new conditions for exclusion of claims from the category of nonperforming loans, (3) enhancement of the manner for classification and calculation of impairment and special reserve on a group basis, (4) more detailed definition of the type, conditions and the manner for determining the value of the collateral that could be taken into account when determining the impairment of exposures classified in highest risk categories ("D" and "E"), and (5) new thresholds for determining the impairment/special reserve for each risk category. According to the new Decision, the portion of the profit registered at the end of 2013 as a result of the provisions of the new

Decision, could only be used by the banks for covering losses from previous years or for enhancing the their core capital.

- New Decision on accounting and regulatory treatment of foreclosed assets which prescribes in more details the treatment of foreclosed assets and their effects on the bank's profit and loss account. The new Decision requires the bank to recognize an impairment of at least 20% of the initial accounting value of the foreclosed assets in the balance sheet on the date of foreclosure. If the bank fails to sell the foreclosed asset at the end of the fifth year, its accounting value should be reduced to zero. In addition, the New Decision determines that if the amount of derecognized impairment/special reserve related to the uncollected claim is greater than the impairment of at least 20% on the date of the foreclosure, the bank should recognize this difference as a revaluation reserve which should be part of the bank's supplementary capital. Revaluation reserve may be excluded from the amount of supplementary capital only if the foreclosed asset is sold or if the bank allocates adequate funds with higher capital quality.
- New Decision on issuing licenses developed as a result of the amendments to the Banking Law adopted in February 2013. Inter alia, the new Decision specifies the criteria that need to be meet by shareholders and persons with special rights and responsibilities and the documentation and the procedure for issuing license for status change and/or transformation of the savings house into a bank.
- New Decision on issuing approvals developed as a result of the amendments to the Banking Law adopted in February 2013, as well as a result of some practical problems that have appeared during the implementation of the previous Decision, concerning the issuance of prior approval for commencement of certain activities, as well as documents, data and information for issuance of the approval for the appointment of a member of the Supervisory and Management Board of a bank.
- New Decision on the contents and the manner of functioning of the Credit Registry, which improves and expands the existing content of the Credit Registry with some new data and information mainly related with the changes introduced with the new Decision on credit risk management and also overcomes some practical problems that have appeared during the implementation of the previous Decision issued in 2011.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2013

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 development of the model for prediction 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 LAST YEAR

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 2013 the National Bank has performed the following activities:

- 8 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 shareholder with qualified holdings in the bank. In 2013 a prior consent for termination of the operation of three savings houses were issued, in the course of their transformation into financial companies.
- 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 LAST YEAR

During 2013, the regular activities of the Department were performed according to the annual plans approved by the Governor. Therefore, in this period all of the planned on-site examinations were performed, in addition one extraordinary on site supervision of a saving house was conducted, as well as supervisions of the compliance with the regulatory terms for opening 21 new foreign currency exchange offices. In accordance with the plans, 13 on-site risk based supervisions of banks were performed, as for the control of the compliance with the laws and regulations supervision of 14 banks, 4 saving houses, 2 providers of fast money transfer services, 10 subagents and 126 authorized foreign exchange offices were conducted in this period.

The accomplishment of the program duty, regulating the technical standards and criteria obligatory for the intermediary in micropayments was conducted by adopting the Decision on issuing a micropayment license and Decision on micropayment technical standards. The first decision determines the documentation, data and information needed for confirming the fulfillment of the terms for providing the service on micropayment. The second decision determines the technical standards obligatory for the persons that intend to be intermediary in micropayments in accordance of providing secure information system for micropayments, its operational availability, as well as efficient transfer of assets between the intermediary in micropayments and the participants in the system of micropayment.

Creating a data base for the aggregate level of credit risk as well as the determined amount of impairment for each bank that has been subject of supervision. To this effect in collaboration with the IT Department an application - RTK was created and started functioning from 20.3.2013 consisting of data from the last two controls concerning the determined amount of impairment for each bank.

In 2013 the process of revising and advancing of the The Decision on the banks information system security was initiated with the tendency of strengthening the standards for the systemically important banks regarding the aspects of business continuity, corporate governance as well as the standards for development and upgrade of the information system.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

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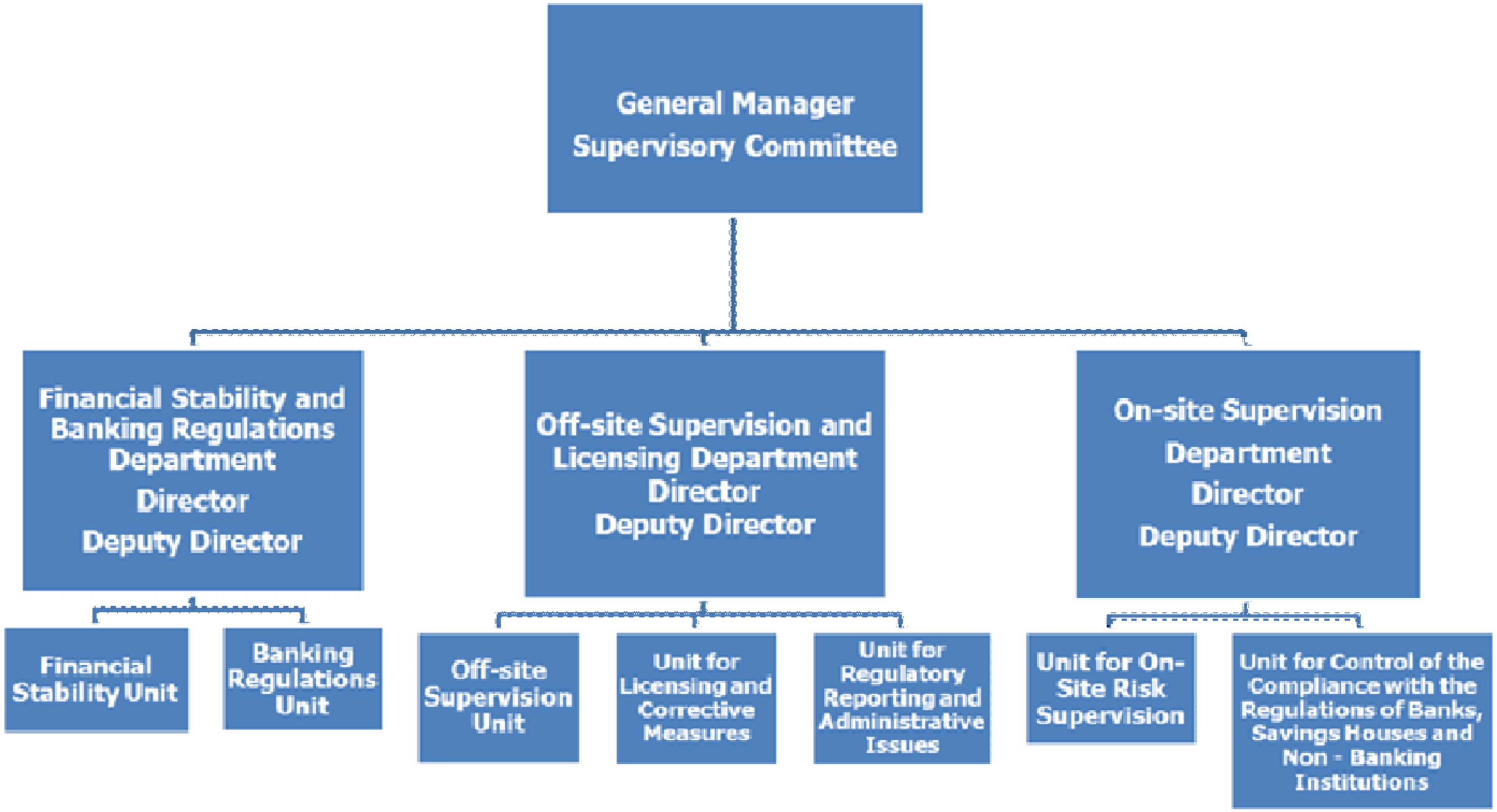


INTERNATIONAL ACTIVITIES OF THE AUTHORITY

The cooperation with foreign supervisory bodies continued in 2013 under the signed MoUs. Among other activities, within this cooperation NBRM supervisory staff attended supervisory colleges in one country (Greece).

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The cooperation with other domestic supervisory authorities continued on a regular basis in 2013. Previously signed bilateral Memorandum of Understanding with the Central Securities Depositary was updated with new obligations for both parties and the Memorandum of Understanding with the Central Registry of the Republic of Macedonia was re-signed.

In 2013 the National Bank of the Republic of Macedonia made a further step in realizing its commitment to raise the level of financial literacy of the population of the Republic of Macedonia. This mission project was discussed with all financial regulatory authorities in the country, such as the Ministry of Finance, the Securities and Exchange Commission, Insurance Supervision Agency and the Agency for Supervision of Fully Funded Pension Insurance, as a result of which a Memorandum of Understanding was signed. The goal of this Memorandum is to unite the authorities in promoting common projects and activities. Under the provisions of the Memorandum, a joint body named Coordinative body of the regulatory authorities of the Republic of Macedonia was established. The body will have regular meetings and will work, among other activities, on preparation of a national strategy for financial literacy.

As of the end of 2013 the National Bank of the Republic of Macedonia started the process of concluding a Memorandum of Understanding with the Council for Promotion and Supervision of the Audit. This Memorandum will strengthen the collaboration between contracting parties regarding the External Audit in the supervised institutions and is intended to be signed during the first half of 2014.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN THE COURSE OF LAST YEAR

In 2013 some initial steps were made towards more detailed analysis of Macedonian bank's efficiency in terms of defining the so called efficiency frontier of Macedonian banking system, determining the deviation of each bank from this defined efficiency frontier and also the factors that stand behind the individual banks' inefficiency. For the purposes of this analysis, an expert assistance was provided by the Central Bank of Finland under the Technical Assistance Information Exchange Instrument (managed by the European Commission).

STATISTICAL TABLES

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

Type of financial institution	2011	2012	2013
Commercial banks	17	16	16
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**17**	**16**	**16**

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

Type of financial institution	2011	2012	2013
Public sector ownership	3.1%	3.5%	3.8%
Other domestic ownership	4.5%	4.4%	27.9%
Domestic ownership total	7.6%	7.9%	31.7%
Foreign ownership	92.4%	92.1%	68.3%
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	61.1	74.1	1.439
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	**61.1**	**74.1**	**1.439**

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

Type of financial institution	2011	2012	2013
Commercial banks	3.4%	3.8%	5.7%
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	**3.4%**	**3.8%**	**5.7%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
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 system (%)
(at year-end)

Assets	2011	2012	2013
Cash, balances and deposits with central bank (NBRM)	11.5	11.7	10.5
Placements in securities	14.9	16.1	17.1
- issued by domestic government sector	5.0	8.5	10.0
- issued by central bank (NBRM)	9.7	7.4	6.9
- other (including non residents)	0.2	0.2	0.2
Loans, deposits and accounts with financial institutions (excluding central bank, including non residents)	13.1	12.2	12.0
Loans with non-financial sector (including non residents)	54.8	54.0	54.7
- loans with domestic government sector	0.1	0.5	0.6
Other assets	5.7	6.0	5.7
Total	**100.0**	**100.0**	**100.0**
Liabilities	**2011**	**2012**	**2013**
Deposits of financial institutions (including non residents)	4.2	4.9	4.6
Deposits of non financial sector (including non residents)	70.5	69.5	70.1
- deposits of domestic government sector	0.4	0.3	0.2
Borrowings, issued securities and liabilities on the basis of subordinated and hybrid instuments (including non residents)	11.6	12.0	11.6
- domestic financial sector	3.4	4.4	4.0
- domestic government sector	0.4	0.4	0.3
- other	7.8	7.2	7.3
Other liabilities	1.9	1.7	1.7
Equity and reserves (including loss in current year)	11.0	11.2	11.3
Profit after tax in current year	0.8	0.7	0.7
Profit after tax in current year	0.8	0.7	0.7
Total liabilities	100.0	100.0	100.0

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Commercial banks*	16.14%*	17.12%**	16.85%**
Cooperative banks	/	/	/
Banking sector, total:	16.14%*	17.12%**	16.85%**

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

Asset portfolio quality of the banking sector

Asset classification	2011	2012	2013
Non financial sector	9.9%	10.5%	11.5%
- households	**7.5%**	**7.1%**	**6.4%**
- corporate	**11.4%**	**12.9%**	**15.2%**

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

	Deposits	Loans
Households	73.2	40.0
Government sector	0.2	0.9
Corporate	23.4	58.7
Other (excluding banks)*	3.2	0.4
Total	**100.0**	**100.0**

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

Type of financial institution	2011	2012*****	2013
Interest income	19,522	20,104	20,100
Interest expenses	-9,120	-8,734	-7,942
Net interest income	10,401	11,370	12,158
Net fee and commission income	3,482	3,790	3,918
Other (not specified above) operating income (net)	2,356	2,092	1,767
Gross income	16,240	17,252	17,843
Administration costs**	-9,318	-9,556	-9,645
Depreciation	-1,145	-1,084	-1,013
Provisions***	-676	-567	-1,007
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)****	-3,883	-4,540	-3,828
Profit (loss) before tax	1,218	1,504	2,350
Net profit (loss)	1,183	1,461	2,311

* 1 EUR = 61.5113 MKD, as of 31.12.2013
** 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.
***** Some figures have been revised since the last reporting year (2012)

Total own funds in 2013 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	740,354,384	634,756,041	105,598,343	/
Cooperative banks	/	/	/	/
Banking sector, total:	740,354,384	634,756,041	105,598,343	/

2013 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF MOLDOVA

MACROECONOMIC ENVIRONMENT

Moldova's economy rebounded strongly in 2013 after the decline in 2012 due to drought. In 2013, GDP grew by 8.9 percent compared with 2012.

Economic growth was more pronounced in the second half of the year. In the third and fourth quarters were recorded rates of 12.9 and, respectively, 11.2 percent, a development determined mostly by the imposing contribution from the agricultural sector. At the same time, the GDP growth was supported by the national currency's depreciation during 2013 against the currencies of major trading partners through the exports and domestic consumption channels. The increase in disposable income and the development in agriculture led to a 6.5 percent growth of household consumption in 2013. Government consumption contracted by 0.8 percent compared with 2012, but this component's contribution to the GDP was insignificant. Gross value added (GVA) in industry grew by 7.4 percent, contributing to the GDP growth by 1.0 percentage points. The GVA growth in industry was driven mainly by the increase in manufacturing and extractive industry by 8.8 and 24.3 percent, respectively. Meanwhile, the energy sector decreased by 3.0 percent. The pronounced dynamics of agriculture had also a considerable impact on net exports, the exports growth (11.0 percent) significantly outpacing the imports growth (5.4 percent).

The economically active population increased, while unemployment recorded a reduction. As a result, the unemployment rate was 5.1 percent, by 0.5 percentage points lower than in 2012. During 2013, the economically active population grew on average by 1.8 percent (in annual terms).

The National Bank of Moldova has created the appropriate conditions to keep the inflation rate within the range of 5.0 percent ± 1.5 percentage points, a goal set according to the National Bank's medium term monetary policy strategy. In the first four months of 2013, due to disinflationary pressures from the aggregate demand, the annual rate of inflation was in the lower band of the variation range, registering an average value of 4.4 percent. In May and June 2013, the annual inflation rate came in the upper band of the range, registering values of 5.7 and 5.5 percent respectively, due to the intensification of inflationary pressures caused by food prices against a backdrop of poor harvest in 2012 and due to changes in the tracking process of strongly seasonal products made by the NBS. In the summer months, due to a good harvest of fruits and vegetables, the annual inflation came in the lower band of the range of ± 1.5 percentage points from the target of 5.0 percent, down in July to a low of 3.7 percent. Subsequently, in the second half of the year, the annual inflation rate has outlined an upward trajectory, returning close to the inflation target and stood at 5.2 percent by the end of 2013, amid the national currency depreciation against the currencies of major trading partners.

During 2013 the nominal official exchange rate of the national currency against the U.S. dollar weakened by 8.2 percent and against the EUR – by 12.3 percent as compared to the end of 2012.

Meanwhile, in 2013 the real effective exchange rate of the national currency[17] depreciated by 3.9 percent as compared to December 2012. The main contributor to this development was Romania (with 1.51 percentage points), due to an appreciation of its currency against the Moldovan Leu and the US dollar.

The dynamics of the exchange rate of the Moldovan Leu in 2013 was mainly determined by NBM's FX interventions aimed to reduce the disinflationary pressures and build up reserves, as well as by the dynamics of the main foreign currencies on the international markets. Given the excess liquidity on the domestic FX market generated by a higher net FX supply from individuals (around 2.9 bn. USD) compared to the net FX demand of economic agents (around 2.7 bln. USD) the NBM intervened by purchasing 304.6 mln. USD.

DEVELOPMENT IN THE BANKING SYSTEM

At the end of 2013, Tier I capital amounted to 440.7 million EUR. It increased during 2013 by 8.6 million EUR (2.0 percent). As of 31.12.2013 all banks met the NBM requirements for Tier I capital (minimum required capital - 11.1 million EUR), with the exception of one bank, which Tier I capital constituted 9.7 million EUR.

Tier I capital increase was due to obtaining income during 2013 in the amount of 56.8 million EUR and the issuance of shares by four banks, in the amount of 31.7 million EUR due to additional money contributions made by the shareholders.

Concomitant, the calculated but unformed yet amount of allowances for impairment losses on asset and conditional commitments increased with 4.7 million EUR or 3.1 percent, which are deducted from the calculation of Tier I capital.

System average risk-weighted capital adequacy still remains at a high level of 23.4 percent, well above the 16% prudential level, indicating a high degree of safety of banks, determined by the existence of potential for conducting operation without affecting the capital. Compared with 2012, this indicator has decreased by 0.9 percentage points, due to increase of investments. This indicator is met by all banks.

Assets under IFRS amounted to 4239.6 million EUR, increasing by 603.3 million EUR (16.6 percent), compared to the previous year. The asset growth was determined by the increase in liabilities with 593.1 million EUR (19.7 percent) and the capital increase of 10.2 million EUR (1.6 percent). Also the share of assets in GDP increased from 66.0 percent to 76.3 percent.

Gross loan portfolio increased during 2013 by 160.3 million EUR (7.3 percent) and constituted 2347.1 million EUR at 31.12.2013. The share of non-performing loans (substandard, doubtful, losses) in the total amount of loans decreased by 2.9 percentage points from the beginning of the year, and constituted 11.6 percent. The share of net non-performing loans in regulatory capital decreased by 9.3 percentage points, amounting to 16.6 percent at 31.12.2013.

The largest share of the total loan portfolio was held by loans to trade – 40.0 percent, followed by loans to food industry – 9.6 percent, other granted loans - 9.4 percent, loans to productive industry - 7.3 percent, consumer loans

[17] Dec. 2000=100

– 6.2 percent, loans to agriculture – 5.3 percent, loans for transport, telecommunications, and network development – 5.0 percent, loans for purchasing/building real estate – 4.3 percent, loans to individual practicing activity – 3.6 percent, loans to constructions – 3.6 percent, loans to nonbanking financial sector – 2.6 percent, loans to energy industry – 2.4 percent. The share of the other branches are insignificant.

The net profit for the banking sector amounted to 56.7 million EUR. Compared with 2012, the profit has increased by 29.6 million EUR (109.0 percent). This situation was determined by decrease of non-interest expenses by 54.2 million EUR (25.2 percent).

Return on assets and return on equity of licensed banks have equaled 1.6 percent and 9.4 percent respectively, increasing by 0.8 percentage points and 5.1 percentage points respectively, compared to previous year.

Long-term liquidity in the banking sector amounted to 0.7 (maximum is 1.0) by December 31, 2013. Current liquidity in the banking sector was 33.8 percent (minimum requirement is 20.0 percent) at the end of 2013. Both indicators are met by all banks.

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 the National Bank of Moldova and 14 licensed banks. The National Bank of Moldova is performing the regulation and supervision of 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 this 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 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, conducting of banking operations, banking reporting, violations, remedial measures and sanctions, withdrawal of license.

At the same time, through a number of requirements stipulated in its regulations, the National Bank maintains the mechanism of banking activity supervision and regulation in the Republic of Moldova.

During 2013, the Law on financial institutions has been amended. The respective amendments provide the exact criteria of evaluation of the banking shareholdings and a specific provision regarding some sanctioning measures. Additionally, taking into account the important role of the banking shareholders in determining the directions of banking activity, the amendments empower the National Bank to assess the quality of potential acquirer of shares.

Therefore, the regulations of the National Bank of Moldova comply with the principles of European Union legislation and transpose in general the norms and the best practices of the European countries.

MAIN STRATEGIC OBJECTIVES OF THE BANKING AUTHORITY IN 2013

In order to ensure the stability and consolidation of the banking system, during 2013, the National Bank of Moldova has supported a policy of prudential evolution stimulation of the banking system through a continuous development of the prudential regulations and the banking supervision methods taking into account the generally accepted standards.

Simultaneously, the National Bank of Moldova has continued to encourage the information disclosure regarding the activity of the banking sector in compliance with the international financial reporting standards. A special attention was paid to the regulation and supervision of the shareholders and banking exposures, including their transparency.

In 2013, the legal and normative framework in the context of banking shareholding has been improved, which has as final aim, stability maintenance, well-functioning and viability of the banking system in the Republic of Moldova by creation of shareholding that offer a certain assurance of a prudent and strong management within each bank and following the shareholders' conduct through overall banking existence.

At the same time, according to the Strategic Plan of the National Bank of Moldova for years 2013 – 2017, in order to achieve the strategic objective related to the development of banking supervision function is to identify the optimum ways for Basel II / Basel III Framework implementation that will lead to the amendment of the existent legal framework and preparation of new legal norms regarding capital adequacy that will be aligned to the EU requirements. In this context, the National Bank of Moldova has prepared the Fiche of Twinning project for "Strengthening the NBM's capacity in the field of banking regulation and supervision in the context of Basel III requirements" that has been sent to the European Commission for approval and, further, will pass to the next stages of the respective project.

ACTIVITY OF THE BANKING SUPERVISORY AUTHORITY LAST YEAR

During 2013, the National Bank 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 National Bank has reviewed some of prudential regulations.

Thus, in order to improve the banking supervision methods, **Instruction on procedure for preparing and submission by banks of reports for prudential purposes** was completed with a set of reports that present the list of bank's affiliated persons, information on portfolio of letter of credits and issued guarantees, property, plant and equipment transmitted in exchange for loans and debts repayment, "large" deposits. At the same time, the respective amendments have as purpose the gathering of detailed information on the bank's shareholders registered in the Register securities holders of the bank as of the reporting date, as well as information on the indirect holders, including beneficial owners of qualifying holding in the share capital of the bank, fully disposed of shares by the shareholder of the bank, and improvement of the layout and the information gathering from some reports.

Additionally, **the Regulation on licensing of banks** was improved through setting the requirements related to the fact that banks may perform activities or services, to the extent that these are within the financial field and for which the permission of the National Bank has been obtained.

At the same time, **Regulation on holding equity interest in the capital of banks** was prepared that detailed the legal framework through setting a set of requirements meant to ensure the stability and viability of the banking system. The regulation defines the key-notions, such as "dominant influence over the person", "close links", "persons acting in concert", determines the exigencies and limits for obtaining a significant interest, as well as regulates the conditions regarding the NBM's preliminary approval obtaining for reach or increase of the significant interest in the capital of a bank. Simultaneously, taking into account the important role of the banking shareholders and their influence on formulation of strategic directions of banking activity, the regulation describes the assessment criteria of the potential acquirer by setting also the instruments available for the assessment process of the shareholders.

Also, there was prepared and approved the **Regulation on the calculation of voting rights and registration of the transfer of ownership of bank shares**. The goal of the respective regulation is to establish the legal framework for calculation of the voting rights, as well as the procedure of registration of the transfer of ownership of bank shares.

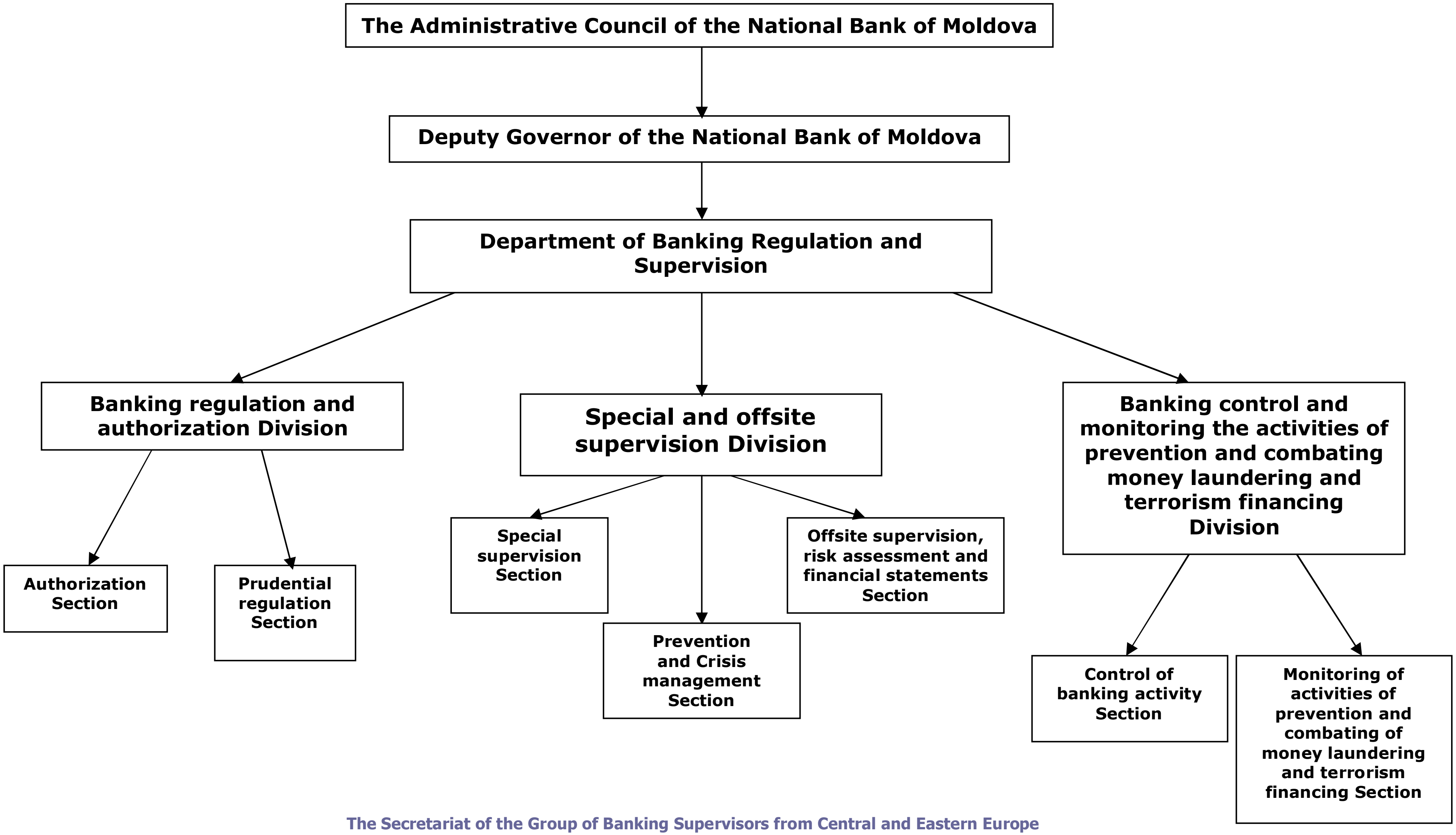
In order to ensure a single reporting framework on consolidated financial statements in accordance with the provisions of IFRS, the **Instruction on FINREP financial statements at consolidated level, applicable to banks has been prepared**. The mentioned instruction provides the compulsory reporting of the consolidated financial statements FINREP by the banks that control an entity, or holds investment in associated entities or are part of joint arrangements as they are defined by the International Financial Reporting Standards.

Regulation on "large" exposures and **Regulation on bank's transaction with its affiliated persons** have been approved, that have the aim of diversification and minimization of the risks assumed by the bank when exposed to correspondent banks, as well as develop some limiting measures for banking risks caused by different types of credit risk concentration.

In order to improve the system of continuous encouragement of the bank's staff that corresponds to "fit & proper" principles, the **Regulation on requirements to bank administrators** was modified and complemented. Thus, the requirements related to theoretical experience of the candidates to member of the Board of the bank, Chairperson, Deputy Chairperson, members of the executive body and the manager of bank's branch were supplemented by additional requirements regarding university degree in law, including in economy or finance obtained at the international organizations, multilateral development banks or international financial and banking groups, as well as those related to adequate practical experience within a banking supervision authority.

The updated regulations of the National Bank of Moldova related to banking regulation and supervision are available online both in Romanian and English on the official web page – www.bnm.md

ORGANIZATIONAL STRUCTURE OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In order to further develop the domestic banking system, which also implies the improvement of the prudential regulations and of the banking supervision mechanism, in 2013 the National Bank of Moldova collaborated with a number of international organizations, such as: World Bank, European Commission, 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' authorizing, in 2013 the National Bank of Moldova cooperated with other central banks, and namely: the National Bank of Romania, the National Bank of Bulgaria, the National Bank of Ukraine, the Central Bank of Russian Federation, the Bank of Albania.

The National Bank of Moldova has concluded cooperation agreements with banking authorities from other countries, such as: Romania, Russia, Kazakhstan, and Belarus. Currently, other cooperation agreements are negotiated with supervision authorities from Germany, Italy, France and Austria.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

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 IN THE COURSE OF LAST YEAR

Republic of Moldova continues to register progresses in its commitment to implement all necessary measures in order to further strengthen the process of European integration, which, during last years, became the main priority of the internal and external policy. A new milestone in this process represents the initialing of the Association Agreement between the Republic of Moldova and the European Union at the Summit of the Eastern Partnership in Vilnius (November 29, 2013), which includes provisions regarding the establishment of a Deep and Comprehensive Free Trade Area, therefore, contributing to the economy development of the Republic of Moldova.

At the same time, at the turn of 2013, in order to organize and efficiently to carry out the FSAP assessment mission of the International Monetary Fund and the World Bank, the National Bank of Moldova has prepared a self-assessment review of its activities, functions, legal framework in force, banking regulations, including system infrastructure to determine the compliance level with Core principles for effective banking supervision, issued by Basel Committee.

STATISTICAL TABLES

Number of financial institutions
(at year-ends)

Type of financial institution	2011	2012	2013
Commercial banks	12	10	10
Branches of foreign credit institutions	3*	4	4
Cooperative banks	-	-	-
Banking sector, total:	**15**	**14**	**14**

* Only branches of foreign banks.

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

Type of financial institution	2011	2012	2013
Public sector ownership	7.1	6.52	3.82
Other domestic ownership	42.7	43.42	48.97
Domestic ownership total	49.8	49.94	52.79
Foreign ownership	50.2	50.06	47.21
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	49.72	70.43	0.109
Branches of foreign credit institutions	15.72	17.01	0.009
Cooperative banks	-	-	-
Banking sector, total:	**49.72**	**70.43**	**0.118**

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

Type of financial institution	2011	2012	2013
Commercial banks	10.55	4.26	9.39
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**10.55**	**4.26**	**9.39**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	83.65	80.22	82.99
Branches of foreign credit institutions	16.35*	19.78	17.01
Cooperative banks	-	-	-
Other	-	-	-
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	2011	2012	2013
Cash	4.18	4.20	3.69
Due from banks and NBM, net	16.47	16.03	21.43
Net loans and financial leasing	58.21	56.93*	53.86*
Total securities, net	13.47	7.27**	5.36**
Other, net	7.67	15.57	15.66
Total assets	**100.00**	**100.00**	**100.00**
Liabilities	**2011**	**2012**	**2013**
Deposits by natural persons	43.39	43.81	41.15
Deposits by legal persons	22.06	17.99	18.37
Others	17.72	20.99	25.48
Shareholder capital	16.83	17.21	15.00
Total liabilities and shareholder capital	**100.00**	**100.00**	**100.00**

* Calculated according to IFRS.
** Includes only government securities. Data for total securities is no longer available.

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Commercial banks	30.11*	24.38*	23.38*
Cooperative banks	-	-	-
Banking sector, total:**	**30.11***	**24.38***	**23.38***

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

Asset portfolio quality of the banking system (%)

Loan classification	2011	2012	2013
Standard	49.78	48.32	47.22
Supervised	39.49	37.18	41.20
Substandard	7.97	4.97	3.70
Doubtful	2.29	6.36	2.96
Bad	0.46	3.17	4.92
Classified total	**100**	**100**	**100**
Specific Reserves/Total Loans	6.96	10.65	9.68

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

	Deposits	Loans
Households	60.41	14.05
Government sector	2.05	0.26
Corporate*	35.11	76.02
Other (excluding banks)	2.43	9.67
Total	**100.0**	**100.0**

* Including bank deposits and loans

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

P&L account	2011	2012**	2013
Interest income	-	276.16	265.24
Interest expenses	-	138.56	149.35
Net interest income	-	137.60	115.89
Net fee and commission income	-	50.51	47.53
Other (not specified above) operating income (net)	-	-59.93	-11.63
Gross income	-	381.25	367.38
Administration costs	-	93.49	87.07
Depreciation	-	14.19	12.29
Provisions	-	128.67	133.17
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets, (%)	-	35.81%	13.14%
Profit (loss) before tax	-	37.89	64.04
Net profit (loss)	-	27.17	56.73

* As of December 31, 2013, 1 EUR=17.9697 MDL.
** As of Januay 1, 2012, the banks moved to International Financial Reporting Standards (IFRS).

Total own funds in 2013 (in mln. EUR*)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	454.08	440.65	18.84	-
Cooperative banks	-	-	-	-
Banking sector, total:	454.08	440.65	18.84	-

*As of December 31, 2013, 1 EUR=17.9697 MDL.

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2013 DEVELOPMENTS IN THE MONTENEGRIN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

According to available indicators, economic situation in Montenegro in 2013 improved in relation to the previous year. Key 2013 indicators point to positive trends in most of sectors. According to preliminary Monstat data on quarterly GDP, positive rates were recorded in all quarters, while data on GDP movement for 2013 show real growth of 3.5%. Assessment of forecasting institutions on Montenegrin GDP growth for 2013 are also stable, with somewhat more optimistic GDP forecast for 2014.

Inflation declined in 2013, thus, the annual inflation rate in December 2013 amounted to 0.3%. Substantially lower inflation in relation to the previous years resulted from high base (price level) from the previous year, as well as prices decline, especially in the categories food and non-alcoholic beverages and transport.

Growth of the average number of employees of 3% in relation to the average number of employees in 2012 represents a positive trend, while according to the Employment Agency of Montenegro data, unemployment rate in December amounted to 14.88% which in relation to the previous year represents a growth of 1.45 percentage points.

Monstat data show that an average salary in Montenegro in 2013 amounted to EUR 726, being 0.1% lower than in the previous year. An average salary without taxes and contributions totaled EUR 479, also showing the year-on-year decrease of 1.6%.

Total Budget expenditures amounted to EUR 1,605.2 million or 48.1% of the estimated GDP. Consolidated budget expenditure amounted to EUR 1,363.5 million or 40.9% of GDP.

Fiscal deficit was lower in relation to the previous year amounting to 3.8% of GDP. Deficit decline from 6.8% of GDP at end-2012 represents success, due to the fact that 2013 recorded high level of extraordinary revenues. At end-2013, the public debt of Montenegro amounted to EUR 1,933.7 million or 58% of the estimated GDP for 2013. In relation to end-2012, state debt increased by 13.8%.

In 2013, according to preliminary data, current account deficit recorded decline of 17.1% compared to the previous year. Current account deficit amounted to EUR 486.9 million, or 14.6% of GDP, and it has been under the deficit level recorded in the last seven years (since 2006). Improvement of the current account balance was mostly due to the decrease of the external trade deficit, as well as recorded surplus at the other current account’s sub-accounts.

In 2013, FDI declined. Preliminary data show that net FDI inflow amounted to EUR 323.9 million or 9.7% of GDP, which is 29.8% less than in the previous year. Of total FDI inflow, the share of equity investments was 58.1%, while the share of debt investments amounted to 39.4%.

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

In 2013, banking system was stable. Restrictive lending policy continued to be implemented, as well as the sale of transfer of a part of the loan portfolio to the factoring companies.

There were changes in the structure of individual banks' share. At end-2013, aggregate capital adequacy ratio amounted to 14.44% or 0.27 percentage points less in relation to end-2012, when it amounted to 14.71%. Total own funds of banks amounted to EUR 270.2 million, while total risk weighted assets and off-balance assets amounted to EUR 1,554.9 million.

Banks' total capital amounted to EUR 397.8 million at end-2013, but it increased by EUR 109.1 million or 37.80% in relation to 2012. Financial result was positive amounting to EUR 2 million, whereby two banks operated with loss.

Liquidity of the banking sector was satisfactory in the reporting year. Due to banks' liquid assets growth, key liquidity indicators recorded substantial annual growth. Daily and ten-day liquidity indicators of banks were above the prescribed minimum.

Total loans and receivables of banks and clients, less value adjustments (net loans and receivables), amounted to EUR 2,241.3 million at end-2013. In the maturity structure of total net loans and receivables, long-term loans' share was 68.26% while short-term loans accounted for 31.74%.

Total deposits of banks and clients (increased by funds at escrow accounts and prepayments and accruals) amounted to EUR 2,118.2 million or 6.94% more in relation to the previous year. The most important banks' depositors were natural persons (58.42%) and private companies (19.75%). Demand deposits amounted to 41.60%, time deposits 57.35%, while deposits at escrow accounts and prepayment and accruals accounted for 1.05% of total deposits.

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

In 2013, regulatory activities referring to the banking sector mainly focused on further harmonization of secondary legislation with relevant EU directives. In Q1 2013, the Decision Amending the Decision on the Content, Deadlines and Manner of Compiling and Submitting Bank's Financial Statements (OGM 18/13) was passed.

Pursuant to the Law on Consumer Loans, the Central Bank passed the following set of regulations for implementation of the Law in October 2013:

- Decision on the Uniform Manner of Calculation and Reporting of Effective Interest Rate on Loans and Deposits (OGM 51/13);
- Decision on registration of credit intermediaries with the Central Bank of Montenegro (OGM 51/13);
- Decision on the content of the form for informing consumers on consumer loans (OGM 51/13).

Moreover, the following two decisions were passed aimed at improving resolution from the existing Central Bank's secondary legislation were passed in October 2013:

- Decision Amending the Decision on Minimum Standards for Bank Investment in Immovable Properties and Fixed Assets (OGM 51/13);
- Decision Amending the Decision on Minimum Standards for Country Risk Management (OGM 51/13), which harmonized the Decision with the system of calculating required capital of banks, determined by the relevant EU directives.

Primary and secondary legislation in the area of banking was subject to the European Commission's assessment within the screening for Chapter 9 – Financial Services. The EC Screening Report for Chapter 9 – Financial Services concludes that Montenegro can be considered to be sufficiently prepared at this stage for the opening of accession negotiations on this chapter. Therefore, the Commission recommended the opening of accession negotiations with Montenegro on this chapter without additional chapters.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2013

Changes in the regulatory framework, affected by the implementation of the IAS and simultaneous prudential rules, relating to minimum standards for credit risk management in banks, affected changes in the chart of accounts for banks and reporting system of the Central Bank by commercial banks, applicable as of 01 January 2013. Starting as of January 2013, these changes have affected that data at the banking system level are not fully comparable with data from the previous period, thus it is not possible to make comparisons of certain indicators with their values in the previous year, as it was the case so far. Therefore, it is very important to take into account the changes in the regulation while interpreting the data.

In accordance with the new regulations, banks are required to implement internal methodologies for measuring impairment of financial assets according to the IAS. Although banks can use methodologies of parent banks as a starting point, it is necessary to take into account the business environment at the local market.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY LAST YEAR

In 2013, during the implementation of the supervision function of the banking sector, the Central Bank has issued three orders approving the request for acquisition of qualified participation in banks, and two orders which denied the request. In addition:

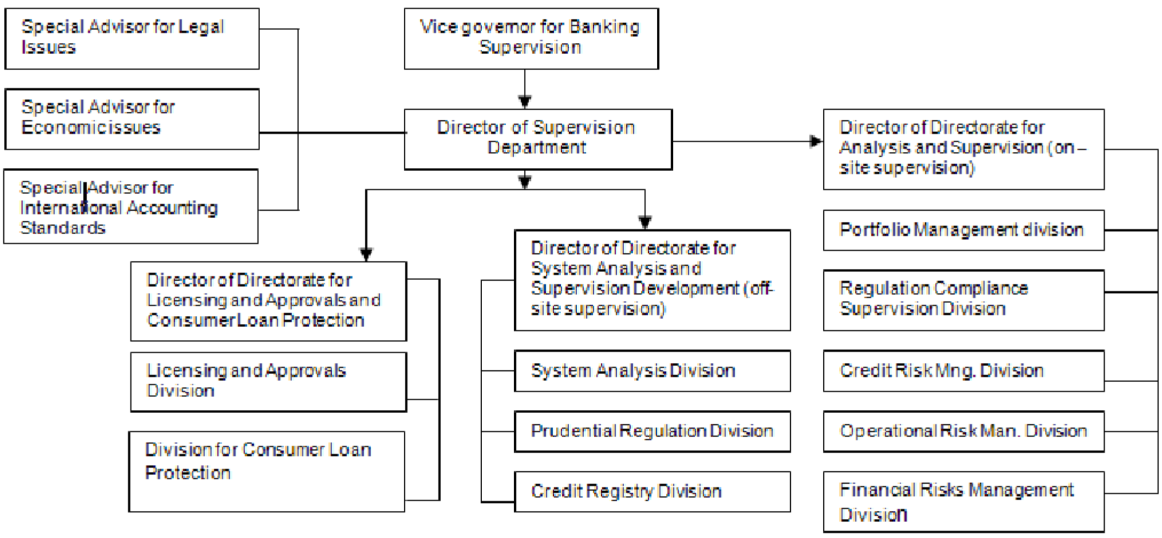
- Upon the request for the establishment of related legal entities and parts of banks abroad, that is, branches, one order were issued (one approval);
- Upon the request for issuing the approval for the election of members of the board of directors in banks, eight orders were issued (six approvals,

and two requests for the election of two members of the board of directors were rejected);

- Upon the request for issuing the approval for the election of executive directors in banks, eight orders were issued (eight approvals);
- Upon the request for issuing the approval for the selection of a company for audit in banks, ten orders were issued (10 approvals);
- Upon the request for issuing the approval to carry out internal audit in banks, two orders were issued (two approvals);
- Upon the request for issuing the approval to conduct activities that are not determined by the order on the issuance of work permit, two orders were issued (two approvals);
- Upon the request for issuing the approval to obtain consent for the inclusion of profit into the bank's core capital, one order was issued (one approval);
- Upon the request for issuing the approval to obtain consent for the payment of outstanding debt to the creditor on the basis of subordinated debt, one order was issued (one approval);
- Upon the request for issuing the approval to obtain consent for the payment of dividends, one order was issued (one approval);
- Upon the request for issuing the approval to obtain consent for the sale of receivables which the bank has in one business organization, one order was issued (one approval).

In 2013, in accordance with the supervision plan, 12 targeted, regular and on-site inspections were conducted, covering 10 banks in the system, as well as two extraordinary, target, on-site inspections, covering two banks in the system. During 2013, the focus was on the credit risk and operational risk supervision and information systems, liquidity risk, prevention of money laundering and terrorist financing and capital adequacy.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

During 2013, the CBCG continued to actively participate in the process of accession of Montenegro to the European Union. As members of working groups for preparation of negotiations for chapters under the competence of the CBCG, the representatives of the CBCG participated in explanatory and bilateral meetings and continued with preparation of reports, documents and materials necessary for efficient membership negotiations.

During 2013, the CBCG intensified cooperation with the representatives of the EU institutions, strengthening in particular the cooperation with the European Central Bank (ECB). ECB initiated the implantation of the technical cooperation programme to be financed from IPA funds. The project aims to provide a comprehensive analysis of the level of compliance of CBCG's standards with the ESCB's standards during the preparation for Montenegro's accession to EU.

Successful cooperation with the IMF resulted in activities related to organization of the first banking forum in Montenegro (Cross-Border Banking Forum), which will be organized by the CBCG and the IMF. The Forum will gather representatives of the largest banks operating in Montenegro, their parent banks and regulators, representatives of competent financial institutions in the country as well as international financial institutions.

The focus of cooperation with the World Bank were intensive activities regarding the continuation of the technical assistance in preparation and implementation of specific strategy for reducing non-performing loans in the financial system of Montenegro, the so-called "Podgorica Approach".

COOPERATION WITH OTHER SUPERVISORY BODIES IN MONTENEGRO

Within the project of resolving non-performing loans (NPLs), implemented in cooperation with the World Bank and the Ministry of Finance, the draft Law on Voluntary Financial Restructuring Resolution was prepared in November 2013, and it was submitted to the relevant ministry for further procedure.

Pursuant to Decision Amending the Decision on Minimum Standards for Credit Risk Management in Banks (OGM 57/13), passed in November 2013, banks have to apply a special treatment of NPLs, which includes developing a comprehensive NPL resolution strategy, determining annual operating objectives for implementing the strategy, and quarterly reporting to the Central Bank on the implementation of these objectives.

STATISTICAL TABLES

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

Type of financial institution	2011	2012	2013
Commercial banks	11	11	11
Branches of foreign credit institutions			
Cooperative banks			
Financial institutions, total	**11**	**11**	**11**

Ownership structure of banks on the basis of assets total

Type of financial institution	2011	2012	2013
Public sector ownership	-	-	-
Other domestic ownership	10	10	10
Domestic ownership total	10	10	10
Foreign ownership	90	90	90
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	50.10	70.00	1,273
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total	**50.10**	**70.00**	**1,273**

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

Type of financial institution	2011	2012	2013
Commercial banks	-1.08	-18.32	0.49
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	-1.08	-18.32	0.49

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	98.45	98.71	98.84
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Other*	1.55	1.29	1.16
Banking sector, total	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Banks	16.51	14.71	14.44
Cooperative banks	-	-	-
Banking sector, total	**16.51**	**14.71**	**14.44**

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

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

Asset classification	2011	2012	2013
Non financial sector*		97.32	98.42
- households		19.40	23.26
- corporate**		73.78	74.35

*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 2013 (%) (at year-end)

	Deposits	Loans
Households	58.42	36.88
Government sector	4.78	6.70
Corporate	27.98	37.74
Other (excluding banks)	8.82	18.68
Total	**100.0**	**100.0**

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

P&L account	2011	2012	2013
Interest income	195960	189451	179149
Interest expenses	-89797	-83472	-74895
Net interest income	106169	105979	104253
Net fee and commission income	30384	25660	33863
Other (not specified above) operating income (net)	84402	46026	17652
Gross income			
Administration costs	-106447	-112756	-96091
Depreciation			
Provisions	-116300	-120510	-44036
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	-1792	-55599	3555
Net profit (loss)	**-3219**	**-56527**	**2049**

Total own funds in 2013 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	270,2	243,6	38,1	-
Cooperative banks	-	-	-	-
Banking sector, total:	**270,2**	**243,6**	**38,1**	**-**

2013 DEVELOPMENTS IN THE POLISH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2013 GDP in Poland increased by 1.6%, compared to 2.0% in 2012 and 4.5% in 2011. It is net exports that had the highest contribution to the economic growth. 2013 was a stagnant year in the labor market with only a slight improvement in terms of employment level and the average wage. Moreover, the average unemployment rate (labour force statistics) in 2013 totalled 10.3%, which is a bit more than the year before (10.1%). 2013 was a year of very low CPI levels, caused mainly by lower energy sources' costs for both household and transport purposes. In 2013 CPI reached 0.9% - the lowest value since 2003.

During 2013 the Polish Zloty appreciated against the US Dollar reaching a 3-year record exchange rate of 3.04 at the end of the year. The relation to the Swiss Franc and the Euro remained stagnant - fluctuating around 3.4 and 4.2, respectively.

The National Bank of Poland originated the easing cycle in November 2012. Since 4th July 2013 the reference rate has stayed at 2.5%, which represents a historical low. The Monetary Policy Council maintains the view that interest rates should be raised no sooner than in Q4 2014. Last-year cuts in interest rates in Poland made interbank rates (WIBOR) decline visibly. However, they are still much above the rates in core economies.

What still poses non-negligible problems to the Polish economy is the situation of public finance. In 2013 the government deficit (to GDP) rose to 4.3% from 3.9% in 2012 and public debt (to GDP) rose to 57.0% from 55.6% in 2012. In 2013 the government performed a major transformation of the pensions funds which effected in one-time budget transfer equal to 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 2013 the situation of the banking sector remained stable.

The situation with respect to the capital base remained strong and at the end of 2013 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 2 small banks (out of 640) did not fulfill one or more liquidity measures. The level of non-performing loans decreased slightly but still poses risks to the banking sector.

After the slowdown in the Polish economy, observed in the second half of year 2012 and at the beginning of year 2013, Polish economy switched to recovery in the second quarter of year 2013, which ensured favorable environment for further development of the Polish banking sector. However, low central bank and interbank interest rates and still existing uncertainty on the international financial markets makes it hard to increase banks' profits.

One of the issues that raise concerns about Polish banking sector is quite high share of FX loans in banks' portfolios. Although according to PFSA recommendations there are no new FX loans granted by banks to clients (except for FX earners), loans already granted in previous years still constitute a significant part of portfolios. Fortunately, almost all of loans were (and are) granted by Polish banks at flexible interest rate and any depreciation of PLN is traded off by change in currency parity so that the instalments of such loans remain moderate.

Another point of concern is long term liquidity gap in banks' balance sheets. PFSA encourages market participants to issue more long-term instruments. Together with other public bodies and market participants PFSA has elaborated a set of proposals to change law – some obstacles to develop long-term instruments market should be removed.

The importance of banking sector in Polish economy remains at the level comparable to that in year 2012 – in year 2013 relation of banking sector assets to GDP amounted to 86% compared with 84.8% in 2012, 84.7% in 2011.

Credit Unions (SKOKs)

In the end of 2013 there were 55 credit unions operating in Poland with the number of members equal to 2.65 mn (increase of 2.6% yoy). With total assets at the level of 19.1 bn PLN (4.6 bn EUR, 13.8% yoy), the credit unions' sector is still 5 times smaller than the sector of co-operative banks. Throughout last year SKOKs were characterized by high both interest rate margin (8%) and ROA (1.31%, although in Q1-Q3 it was negative), as well as poor cost effectiveness (C/I equal to 77.8%). Moreover, as a majority of credit unions faces capital problems, recovery plans were implemented in 83% of them (in terms of deposits). The average capital adequacy ratio totalled 0.85% in the end of 2013, but after inspections it declined significantly to -2.87%.

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 Polish Financial Supervision Authority (the KNF) acts pursuant to the Act on Financial Market Supervision of 21 July 2006. The KNF supervises the banking sector, the capital market, the insurance industry, credit unions and pension funds. The KNF lays down rules safeguarding the stability of the entire financial sector. It systematically regulates, supervises and, where appropriate, issues penalties for non-compliance with these rules.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2013 AND THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY LAST YEAR

In 2013, the Polish Financial Supervision Authority adopted the amended Recommendation T concerning good practices with regard to the management of detail credit exposures. The first Recommendation T was issued in February 2010. Amended Recommendation T was issued in February 2013 and PFSA require banks to implement its recommendations till July 31, 2014. The amended Recommendation T has simplified rules for evaluating client's creditworthiness and the value of the DTI ratio should be determined by every bank on its own (fixed 50%/60% limits depending on one's earning no longer apply).

The Management Board of a bank determines the levels of the DtI ratio relating to the maximum level of expenditure related to credit liabilities servicing and other non-credit financial liabilities (of which a retail customer cannot resign, i.e. including those under the law or those of permanent and irrevocable nature) to retail customer's income. The DtI level should be determined in bank's risk management strategy approved by the Supervisory Board.

In the event that a retail customer has credit exposures in currency other than the currency in which he/she receives salary/income or applies for a retail credit exposure which is offered in currency other than the currency in which he/she receives salary/income, the maximum limit relating to the relation of debt servicing burden to retail customer's income should be determined with an adequate additional buffer, specified while taking into account exchange rates fluctuation. The buffer should be applied by assuming that repayment burden will be at least 20% higher.

In 2013, the Polish Financial Supervision Authority adopted also the amended Recommendation S concerning good practices with regard to the management of credit exposures secured by mortgage. The Recommendation entered into force in 2006 and was amended several times. The current version of Recommendation S was issued in 2013 and has been binding since 1 January 2014 (with some exceptions for which the implementation date was set for 1 July 2014).

As stated above, Recommendation S concerns exposures secured by a mortgage, so in consequence the Recommendation covers only those of FX loans which are secured by a mortgage. Recommendation S issued in 2013 states the procedure for determining DtI level, and there is no specified regulatory limit of DtI. The maximum levels of the DtI ratios should be specified in the bank's strategy and approved by the Supervisory Board. In the case of cooperative banks, the Management Board approves the maximum levels of the DtI ratio and informs the Supervisory Board and affiliating bank of the adopted parameters. Special attention in the process of assessing customers' creditworthiness should be paid in case of:

- customers with DtI ratio exceeding 40% and incomes below the average in their region and
- customers with DtI ratio exceeding 50%.

In Recommendation S 2013, certain LtV ratio limits for home loans are introduced:

- 80% or
- 90% if the part between 80% and 90% is adequately insured or borrower gives additional collateral (strictly limited scope to frozen funds in a bank account or a pledge on the debt securities of the State Treasury or the National Bank of Poland denominated in PLN).

KNF also adopted amended Recommendation M concerning operational risk management at banks. The amended recommendation aims at improving operational risk management in banks and facilitating implementation of best practices tied to operational risks in all banks, regardless of their scale or type of activity. The recommendation concerns risk oversight, procedures, documentation and terminology related to risk management. It entered into force in June 2013.

Amended Recommendation D concerning management of IT areas and IT environment safety at banks was also adopted. Changes included rules regarding quality of data management, cooperation rules between business and technical areas, Cloud Computing.

In 2013, works on the new version of the "BION Methodology" ("BION" stands for "Supervisory Review And Assessment") were still in progress. BION process rules were reviewed and the new version was adopted on 30th December. The aim of the review was to develop draft with amendments allowing to consider banks' risk profile more completely, integrate arrangements arising from analysis and inspection procedures with the use of the proportionality rule to the extent greater than to date. As a result of performed works, the BION Methodology was amended through elimination or adjustment of certain criteria, grade scale modification as well as change to the rules on weight determination for individual risk types.

In 2013, in total 706 BION analyses were carried out, including 704 in co-operative banks (330 as part of the BION process for 2012 and 376 for 2013) and 2 in associating banks. As a result of the analytical works, 28 supervisory warnings were issued as part of analytical activities taken in co-operative banks.

In 2013 the KNF carried out 9 complex inspections and 45 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.

One of the important activities of the KNF in 2013 was banking sector stress-testing, based on bottom-up approach. The KNF Office performed stress-tests of the banking sector aimed at determining the potential impact of the volatile macroeconomic environment on the financial standing and capital position of the Polish banking sector institutions as well as resilience of the Polish banking sector to potential adverse macroeconomic scenarios. All commercial banks covering 90% of banking sector's assets were included. As in previous years, the KNF also took part in EBA stress-test exercise.

INTERNATIONAL ACTIVITIES OF THE AUTHORITY

The most important forum of KNF's international activity in the area of banking supervision is EBA. The Polish supervisor wants to be active in shaping EBA's regulatory polices to make sure they serve the sole purpose of safeguarding financial stability in Europe, and in host states in particular. KNF is represented in all the major committees and in the several important working groups. In September 2013 its representative was elected to the EBA Management Board. The authority also co-hosted with EBA a training seminar on the new XBRL standard in October 2013.

Throughout 2013, two international issues were attracting KNF's highest attention: the delegated acts to the CRD IV package and the emerging banking union. While work on the former was concentrated in the EBA, the latter issue required continuous contact with the Polish government, European Commission and the European Central Bank. While not entering the banking union any time soon, Poland took efforts to ensure that the positions of member states outside it would not be hurt.

One of KNF's priorities is cementing relations and cooperation with supervisors from other host countries within the EU, mostly from Central and Eastern Europe. Besides BSCEE, the CEE Forum is instrumental to this end.

As an integrated supervisor, KNF is also a member of ESMA, EIOPA, IOSCO and IAIS.

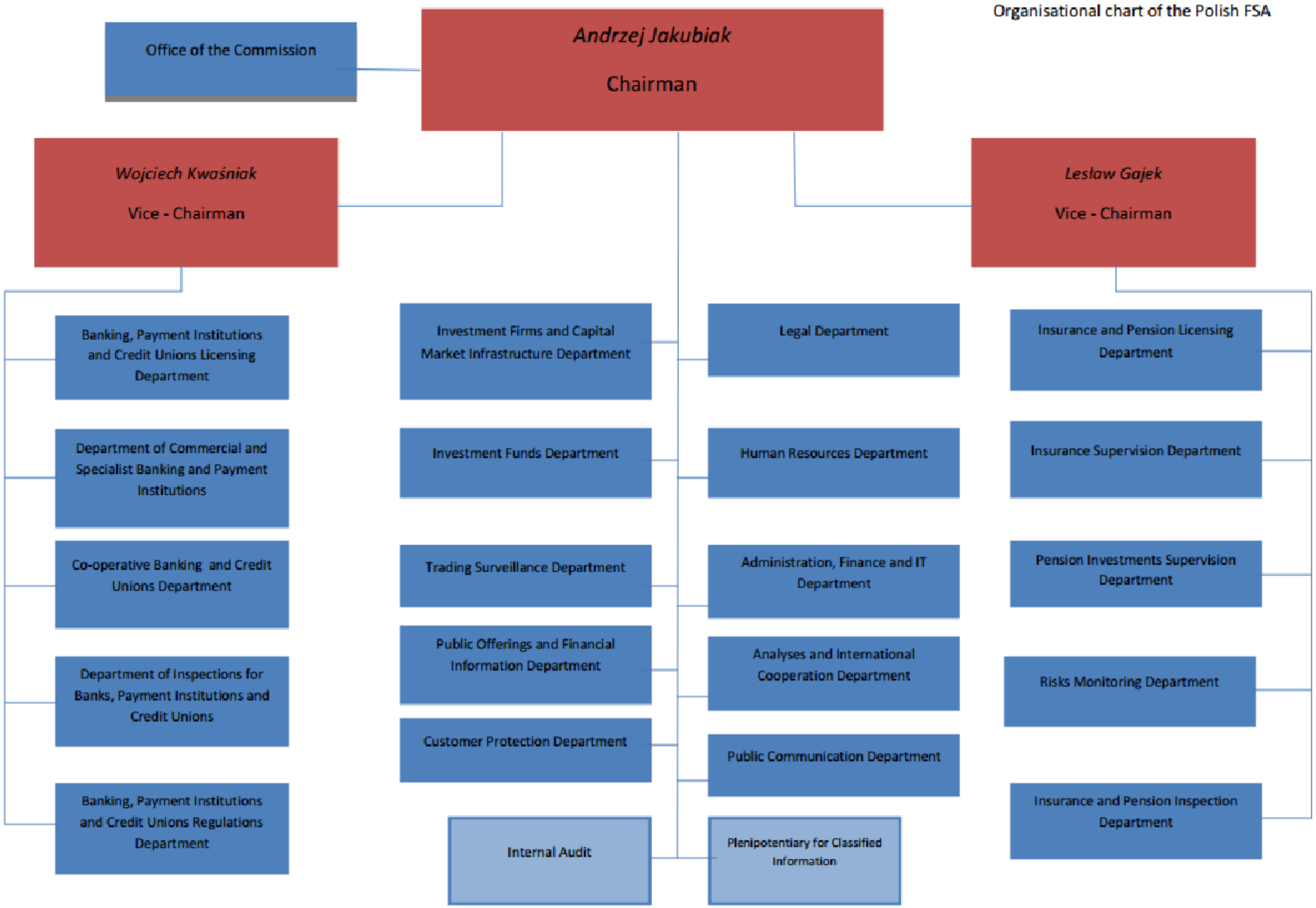
In 2013 the Polish supervisor participated in 13 supervisory colleges for international banking groups and 20 colleges for insurance groups.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The KNF is the only authority in Poland responsible for supervising the financial sectors. Besides credit institutions (commercial banks, cooperative banks, credit and savings unions), we supervise insurance and reinsurance undertakings, publicly-mandated pension funds, the Warsaw Stock Exchange, the clearing house, investment firms, investment funds, payment institutions and some other types of entities. Division of tasks within the KNF is mostly sector-wise, with common support functions.

The KNF maintains close relations with other institutions responsible for financial stability, that it the Ministry of Finance (regulations), National Bank of Poland (macroeconomic analyses) and the Bank Guarantee Fund (fortunately, not activated for many years). To deal with emergency situations, Financial Stability Committee has been created - it encompasses the KNF, the MoF, the NBP and the BGF and meets at least twice a year.

ORGANIZATIONAL CHART OF THE SUPERVISORY AUTHORITY



STATISTICAL TABLES

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

Type of financial institution	2011	2012	2013
Commercial banks	47	45	41
Branches of foreign credit institutions	21	25	28
Cooperative banks	574	572	571
Banking sector, total:	**642**	**642**	**640**

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

Type of financial institution	2011	2012	2013
Public sector ownership	22.2	22.9	22.3
Other domestic ownership	12.8	13.5	14.4
Domestic ownership total	35.0	36.4	36.8
Foreign ownership	65.0	63.6	63.2
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	32.5	46.0	724
Branches of foreign credit institutions	1.4	1.7	1610
Cooperative banks	0.6	0.8	55
Banking sector, total:	**32.5**	**46.0**	**598**

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

Type of financial institution	2011	2012	2013
Commercial banks	12.43	11.16	10.22
Cooperative banks	11.59	11.13	7.87
Other	-	-	-
Banking sector, total:	**12.38**	**11.16**	**10.07**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	91.7	91.6	90.9
Branches of foreign credit institutions	2.2	2.1	2.3
Cooperative banks	6.1	6.3	6.9
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2011	2012	2013
Financial sector	7.5	7.9	8.4
Nonfinancial sector	61.9	60.0	59.6
Government sector	6.6	6.8	6.6
Other	24.1	25.3	25.4
Liabilities	**2011**	**2012**	**2013**
Financial sector	26.3	25.1	24.7
Nonfinancial sector	54.0	53.6	55.1
Government sector	3.8	4.4	3.9
Capital	10.0	10.9	10.9
Other	6.0	6.0	5.3

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Commercial banks	13.1	14.8	14.2
Cooperative banks	13.4	13.8	13.4
Banking sector, total:	13.1	14.7	14.1

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

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

Asset classification	2011	2012	2013
Non financial sector	8.2	8.9	8.5
- households	7.2	7.4	7.0
- corporate	10.4	11.8	11.5

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

	Deposits	Loans
Households	61.6	57.1
Government sector	6.2	9.5
Corporate	23.6	28.6
Other (excluding banks)	8.7	4.8
Total	**100.0**	**100.0**

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

P&L account	2011	2012	2013
Interest income	64 773	71 269	61 688
Interest expenses	29 793	35 785	27 185
Net interest income	34 979	35 484	34 503
Net fee and commission income	14 283	14 337	13 676
Other (not specified above) operating income (net)	6 984	8 030	6 588
Gross income	57 305	58 773	55 526
Administration costs	26 684	27 785	27 557
Depreciation	2 576	2 590	2 652
Provisions	670	1 151	415
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	7 609	8 243	7 801
Profit (loss) before tax	19 594	19 200	18 662
Net profit (loss)	15 539	15 467	15 313

Total own funds in 2013 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	31 149	27 988	3 094	67
Cooperative banks	2 348	2 195	153	0
Banking sector, total:	**33 497**	**30 184**	**3 247**	**67**

2013 DEVELOPMENTS IN THE ROMANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The year 2013 marks a turnaround in Romania's economic performance due to a combination of structural and one-off factors: rapid economic growth (judged by the contemporaneous EU standards), sizeable adjustment in the current account deficit, record low inflation, while keeping the fiscal deficit below 3%. After peaking at 9% of GDP in 2009, the public deficit was successfully brought down to just below 3% as of end-2012 and to 2.3% of GDP in 2013. After re-entering positive territory in 2011, the economy grew by 3.5% in 2013. However, the cumulative 6.5% growth through 2013 has not yet offset the decline in output that took place during the adjustment phase (2009-2010). The recovery was accompanied by a shift in the composition of growth, from domestic absorption to net exports. CPI inflation followed an uneven downward path, falling from a peak of around 8% in 2010, associated with the 5 percentage point increase in the VAT rate and a severe drought, to 1.6% in December 2013, within the variation band of the 2.5% ±1 percentage point target. After hovering around 4% of GDP in the next three years, the current account balance has further improved to 1.1% 2013, largely as a result of the trade deficit narrowing by 53.6% in annual terms and the significantly larger surplus of services balance (amounting to EUR 2.6 bn) prompted particularly by receipts from transport services (in correlation with higher exports of goods).

DEVELOPMENT IN THE BANKING SYSTEM

The number of credit institutions was 40 at end-2013, the Romanian banking system comprising 31 banks, Romanian legal entities (including the credit cooperative organization) and 9 branches of foreign banks. Among them, two banks merged through absorption, a branch of a foreign bank ceased its activity, and another bank entered the Romanian market by opening a local branch. Also, from the significant changes experienced in 2013, it is to underline that there was a spin-off process of a Romanian bank by transferring the majority of its assets and liabilities to another Romanian bank while the remaining part (over 90 percent of the capital) was acquired by a domestic investor.

The NBR closely monitors domestic and international developments, while also adequately managing and maintaining system-wide liquidity and pursuing comfortable levels of provisioning and solvency ratios. To date, the Romanian Government has not used public funds to support the stability of the financial system. The recapitalization of the banking sector was entirely supported by bank shareholders. Despite of the deleveraging trend, the Romanian banking sector remained sound and stable in 2013, with adequate capital buffers, comfortable liquidity and reassuring loan-loss provisions. The solvency indicator of 15.5 percent at end-2013, almost entirely composed of Tier 1 capital (Tier 1 ratio stood at 14.1 percent). The high level of reported capital ratios creates the conditions for the smooth implementation of the additional capital requirements imposed by Basel III regulations, which are to be introduced in the national legislation via the CRD IV/CRR package applicable starting with 2014 (the package will be gradually implemented until the end of 2018). Shift of banks from foreign to domestic funding sources, the important growth of local deposits (7.6 percent at end-2013, real terms) has enabled banks to cover the reduced roll-over of funding provided by foreign parent banks and contributed to the alleviation of the currency mismatch between loans and deposits. The loan-to-deposit ratio improved gradually, reaching the lowest level since the financial crisis onset (104.6% in December 2013 versus 117.4% in December 2012).

Non-performing loans ratio (NPLs) continued to rise in 2013 (up to 21.9 percent at the end of 2013), reflecting reduced lending activity. However, the risks posed by the NPLs are balanced by the comfortable levels of provisioning and capital buffers. The coverage ratio of non-performing loans with IFRS provisions and prudential filters (positive difference between the total prudential provisions and those determined according to IFRS) increased to 89.8 percent in December 2013 (67.6 percent without prudential filters) compared to 86.3 percent in December 2012 (61.0 percent without prudential filters). In line with EU regulatory requirements, the prudential filter will be gradually phased-out between January 2014 and January 2018. This measure will have a positive impact on the capital ratios, due to the gradual decrease of the amount of prudential filters previously used as deductions from own funds.

The profitability of the banking sector reverted to positive territory in 2013 (following three consecutive years of aggregate losses), under the favorable impact of reduced new loans loss provisions and improvement of the operating profit following a decline in financing costs. Consequently, ROA and ROE turned positive (0.1 percent and 1.3 percent respectively).

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

Credit institutions are currently principally regulated by Government Emergency Ordinance No. 99/2006 on credit institutions and capital adequacy (the "Banking Law") and, among others, by Government Ordinance No. 10/2004 regarding the procedure of judicial reorganisation and bankruptcy of credit institutions. One of the key objectives of the regulations is to continue the harmonization process of national regulations with the guidelines and standards issued by CEBS/EBA. As regards the implementation of Basel III and CRD IV Directive (Capital Requirements Directive IV), Romania will follow the implementation timetable at EU level.

Prudential regulation has witnessed significant progress in 2013 by adopting new regulations with the following objectives: i) modification of the regulatory framework by harmonizing with legislative package CRD IV / CRR by issuing NBR Regulation no. 5/2013 on prudential requirements for credit institutions. The said Regulation transposes the technical provisions of Directive

2013/36/UE and specifies the way of implementation in the national framework of the discretion included in the pakage CRD IV/CRR. However, the regulation takes, amend and/or supplement the relevant provisions of the previous regulatory framework, harmonized with guidelines CEBS/EBA in areas such as: corporate governance (including responsibilities of the governing body of the credit institutions, risks management, internal control, policies and practices on remuneration, outsourcing conditions of credit institution' activities), the internal assessment of capital adequacy, stress testing, internal rating models for credit risk, specific operational risk approaches, internal models used in determining the capital requirements for market risk; ii) transposition of the provisions on capital buffers from Directive 2013/36/UE on access to credit institutions and the prudential supervision of credit institutions and investment firms. iii) reviewing, improving and completing the regulatory framework for the classification of loans and investments, and prudential adjustments in the context of application of the CRD IV/CRR package in terms of implementation of new provisions and making changes to adjust the national regulatory framework to new European requirements.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2013

The main objective of NBR was linked with 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. NBR acted to limit the impact of the international crisis on the local banking market. At that time the most likely way to affect domestic credit institutions condition appeared to be the liquidity channel. As a result, NBR has taken a number of important measures to manage developments in this field. Also, measures to strengthen banks capital positions and to maintain access to external finance have had a high priority.

The main challenges lying ahead are: (i) managing the risk that could occur in the event of adverse developments in international markets (ii) improving bank asset quality; (iii) achieving a more balanced currency breakdown of flows of new loans; and (iv) enhancing the early intervention tools and stabilisation measures for distressed credit institutions. These challenges call for further efforts to maintain adequate solvency, provisions and liquidity, as well as for additional prudential measures.

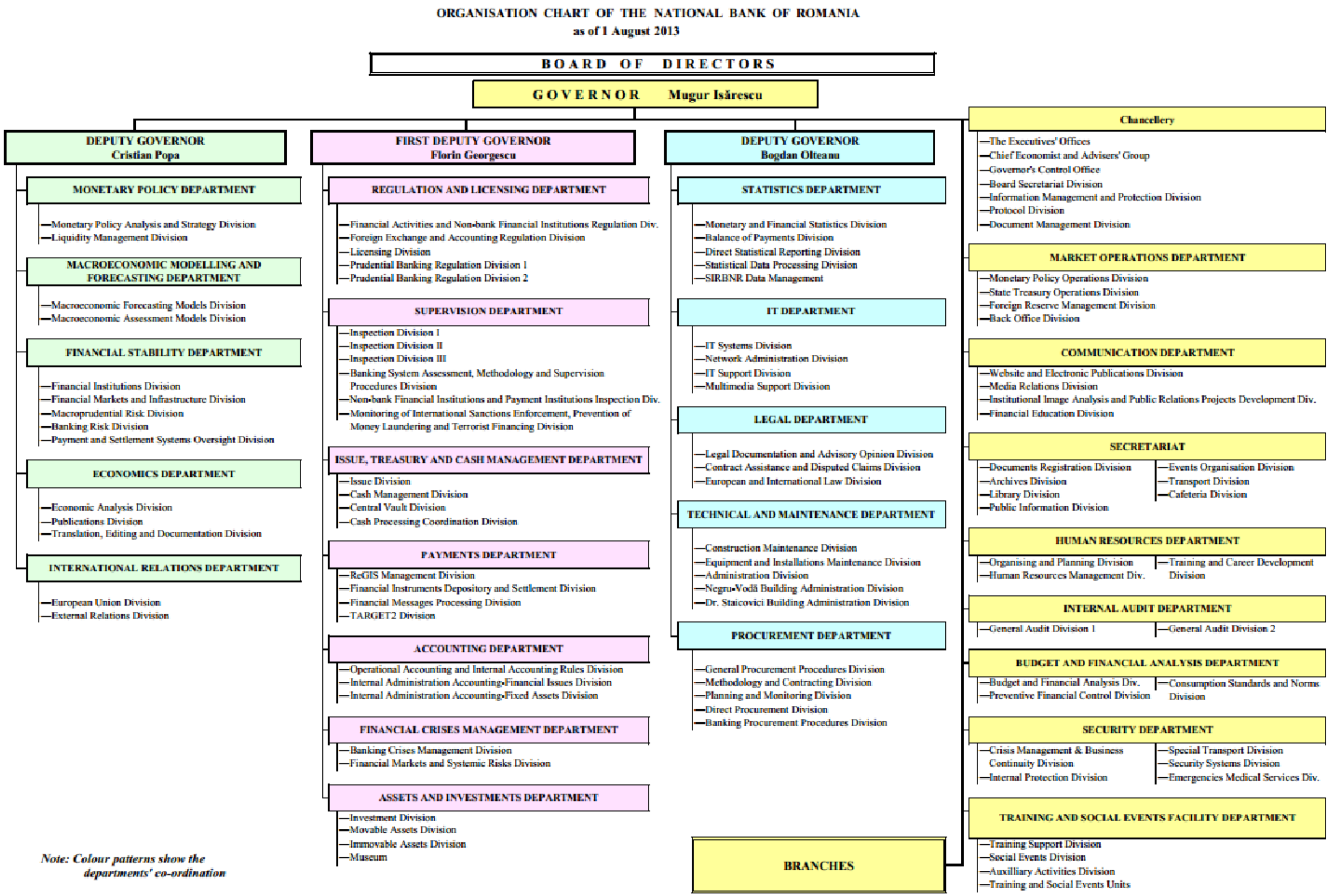
THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2013

In order to prevent the worsening of capital adequacy ratio, as a result of larger losses due to non-performing loans, the supervisory authority stepped in to preserve a comfortable solvency level, by requesting that the structure and the level of capital are adequate to the risk profile specific to each credit institution, as well as to the context of the crisis. In this regard, a number of credit institutions supplemented own funds by raising share capital in cash, retaining the prior year's profit or by resorting to subordinate loans.

In the supervisory process, within the 2013 evaluation program approved by the NBR board, were carried out 39 inspection actions to Romanian credit institutions, out of which 32 being both on and off-site inspections, and to 7 branches of foreign banks. The inspections paid a special attention on the assessment of the banks' risk profile, financial condition, business strategy, internal audit function, significant risk assessment, ICAAP oversight.

Additionally, there were performed 49 actions on specific topic, such as minimum capital requirements, own funds at individual and consolidate level, lending activity, large exposure, trend of placements, organizational structure, oversight of ICAAP, FINREP reporting at individual and consolidate level, evolution of the prudential indicators.

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.

In 2013, the NBR was actively involved in the finalization of legislation process at European level, in the areas under the jurisdiction of the central bank, the most important being:

- participation in the revision of the Directive on the Deposit Guarantee Schemes - the project was approved by the European Parliament on December 17, 2013 and includes most of the NBR's proposals. Under the new regulatory framework at European level, the protection of depositors will be improved, either by providing uninterrupted access to their deposits either by paying compensation in a short time. To increase confidence in the banking system, derived from robust mechanisms for the protection of depositors, were introduced provisions on mandatory ex ante funding of deposit guarantee schemes on a model very close to the existing legislative framework in Romania;
- participation in the revision of the Directive in the area of real estate loans - project approved by the European Parliament on December 10, 2013 - governing, in addition to aspects similar with those existing in the acquis communautaire on consumer lending (market conduct of creditors and credit intermediaries, pre contractual practices, uniform European way of determining the loan annual rate that is charged for borrowing, information and contractual rights, etc.), and some specific aspect for real estate loan: (i) introducing a mechanism to record and supervise credit intermediaries; (ii) the obligation of Member States to regulate and supervise non-bank lenders; (iii) establishment of the requirements for professional competence and experience for staff of creditors/credit intermediaries directly involved in consumer lending; (iv) imposing the obligation of creditors to establish remuneration policies for staff and credit intermediaries so as not to prejudice the interests of consumers; (v) the obligation of creditors to lend only to borrowers with proven credit worthiness; (vi) establishing creditor's obligation to provide conversion of foreign currency loans in local currency, with previous notification of the consumers about the conditions of the conversion;
- participation in the revision of the Directive on preventing and combating money laundering and terrorist financing – in conformity with the central bank powers in this area, were formulated proposals which were supported in the negotiation process at European level.

After Romania accession and central bank integration into the European System of Central Banks, NBR joined to the European Central Bank and the other central banks efforts, in the framework of technical cooperation programs, with a view to assist the partner institutions from the candidate states to comply with the acquis communautaire requirements.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

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.

In 2013, the NCFS members signed the Addendum no. 4 to the Co-operation Agreement in the field of financial stability and financial crisis management, according to which, during the transitional period, until the inter-institutional structure for coordination in the field of macro-prudential supervision of the national financial system becomes operational, the NCFS is entitled to issue recommendations and advisory opinions on this field. During the ordinary meeting of the NCFS that took place on December 23rd, 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.

For this purpose, the NCFS members adopted the NCFS Recommendation No. 1/2013 whereby the National Bank of Romania and the Financial Supervisory Authority are recommended not to impose the accelerated implementation of the capital preservation buffer and anti-cyclic capital buffer, starting with January 1st, 2014, on the credit institutions, respectively on the financial investment services providers. Also, the NCFS members recommended to the National Bank of Romania, as well as to the Financial Supervisory Authority, to impose a 0 (zero) level of systemic risk buffer for the credit institutions as well as for the financial investment services providers, starting with January 1st, 2014.

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	2011	2012	2013
Commercial banks	32	31	30
Branches of foreign credit institutions	8	8	9
Cooperative banks	1	1	1
Banking sector, total:	**41**	**40**	**40**

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

Type of financial institution	2011	2012	2013
Public sector ownership	8.2	8.4	8.5
Other domestic ownership	8.8	1.8	1.5
Domestic ownership total	17.0	10.2	10.0
Foreign ownership	83.0	89.8	90.0
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	43.6	60.2	969
Branches of foreign credit institutions	86.0	96.5	3451
Cooperative banks	-	-	-
Banking sector, total:	**39.4**	**54.4**	**821**

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

Type of financial institution	2011	2012	2013
Commercial banks	-3.79	-6.85	-0.66
Branches of foreign credit institutions	24.84	16.99	17.22
Cooperative banks	3.33	1.97	1.33
Banking sector, total:	**-2.56**	**-5.92**	**0.13**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	91.8	91.1	90.4
Branches of foreign credit institutions	8.0	8.7	9.4
Cooperative banks	0.2	0.2	0.2
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2011	2012	2013
Financial sector	20.6	18.1	20.5
Nonfinancial sector	56.7	58.8	55.9
Government sector	19.0	-	-
Other	3.7	23.1	23.6
Liabilities	**2011**	**2012**	**2013**
Financial sector	29.0	29.0	23.3
Nonfinancial sector	56.8	57.3	63.2
Government sector	-	-	-
Capital	5.5	10.4	10.4
Other	8.7	3.3	3.1

Capital adequacy ratio of banks

Type of financial institution	2011**	2012**	2013**
Commercial banks	14.8	14.9	15.4
Cooperative banks	32.8	32.4	31.7
Banking sector, total:	**14.9**	**14.9**	15.5

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

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

Asset classification	2011	2012	2013
Non financial sector	14.3	18.2	21.9
- households	11.3	12.3	13.5
- corporate	16.9	23.6	29.2

The structure of deposits and loans of the banking sector in 2012 (%) (at year-end)

	Deposits	Loans
Households	51.4	33.5
Government sector	14.5	26.0
Corporate	28.1	36.4
Other (excluding banks)	6.0	4.1
Total	**100.0**	**100.0**

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

P&L account	2011	2012	2013
Interest income	26,142.1	23,389.0	20,193.7
Interest expenses	11,869.8	11,467.0	8,854.0
Net interest income	14,272.3	11,922.0	11,339.7
Net fee and commission income	4,117.3	3,833.5	3,957.6
Other (not specified above) operating income (net)	4,634.2	3,373.8	3,976.8
Gross income	**23,023.8**	**19,129.3**	**19,274.1**
Administration costs	14,491.7	10,227.1	9,943.6
Depreciation	1,114.2	1,005.1	955.0
Provisions	7,827.5	780.4	688.8
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	na	9,866.6	8,174.0
Profit (loss) before tax	**-409.6**	**-2,749.9**	**-489.2**
Net profit (loss)	**-777.3**	**-2,341.9**	**48.6**

Total own funds in 2013 (in million EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	6,217.6	5,670.8	546.8	-
Cooperative banks	53.3	43.9	9.4	-
Banking sector, total:	6,270.9	5,714.7	556.2	-

2013 DEVELOPMENTS IN THE RUSSIAN BANKING SYSTEM

MACROECONOMIC SITUATION IN RUSSIA

Development of the Russian economy was restrained by external factors. Nevertheless negative influence of net exports on the GDP growth was lower in 2013 compared to 2012 due to the increase in physical volumes of exports and the slowdown of imports growth on the back of contraction of investment demand and depreciation of the rouble.

Current account surplus decreased more than twice from $ 71.3 billion to $ 32.8 billion. Trade surplus fell by 5.9%. The average annual price of Urals crude on global markets decreased by 2.2% year on year to $108.3 per barrel. Net outflow of private capital remained significant in 2013 and grew by 10.7% to $ 59.7 billion.

Russia's international reserves shrank by $28 billion to $509.6 billion as of January 1, 2014. The international reserve level necessary to comply with internationally recognized criteria of minimum adequacy was exceeded many times. The volume of reserves could support the import of goods and services for 12.9 months (as compared with 14.5 months in the previous year). Russia's foreign debt rose by 14.2% in 2013 and was estimated as $727.1 billion at the beginning of 2014.

Russia`s real GDP growth slowed down from 3.4 percent of 2012 to 1.3 percent in 2013. Unemployment rate was low in 2013 and in the second half of a year stabilized at 5.5%. Consumer prices rose by 6.5% (December 2013 to December 2012).

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

In 2013, the Russian banking sector grew rapidly, significantly outpacing the growth of the overall economy, that resulted in the growth of macroeconomic indicators of the banking sector. Thus, in 2013 the ratio of assets to GDP reached 86.0%; credit to the economy – 48.6%, capital of the banking sector – 10.6% (in 2012 – 79.6, 44.5 and 9.8%, respectively). Key indicators of the banking sector are approaching targets, defined by the Strategy of the Banking Sector of the Russian Federation for the Period up to 2015: assets to GDP no less than 90%; loans to non-financial organizations and individuals to GDP – 55-60%; capital to GDP – 14-15%.

LEGISLATIVE AND INSTITUTIONAL FRAMEWORKS FOR THE ACTIVITY OF CREDIT INSTITUTIONS AND BANKING SUPERVISION, MAIN CHANGES. SUPERVISORY AUTHORITY'S LEGAL COMPETENCE

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 body of banking regulation and banking supervision. The principal objectives of banking regulation and banking supervision are to maintain the stability of the Russian banking system and protect the interests of depositors and creditors. The Bank of Russia exercises supervision over credit institutions' and banking groups' in compliance with Russian legislation, Bank of Russia's regulations and required ratios.

The Bank of Russia sets rules obligatory for credit institutions, banking groups and banking holding companies for compiling and presenting accounting (financial), statistical and other reports required for assessing risks and conducting supervision of credit institutions on a consolidated basis.

To fulfill its functions the Bank of Russia has the right to request information on activities of credit institutions, banking groups and banking holding companies, including data on the members of banking groups and banking 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 issue directions on how to eliminate the breach violations.

The Bank of Russia is entitled to set qualification requirements and requirements for the business reputation of chief accountants (and their deputies), heads of branches, members of a board of directors (supervisory board), large shareholders (members) of credit institutions, and also 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 has the right to demand the replacement of persons holding the specified positions in the event of their failure to comply with the qualification requirements and the requirements for business reputation.

The Bank of Russia establishes the methodology for calculating capital and required ratios of a credit institution (banking group), taking into account international standards. The Bank of Russia is empowered 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), issues binding orders for the elimination of violations that have been discovered in their operations, and applies the 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 being part of banking groups and banking holding companies and located abroad. 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, if the credit institutions being members of banking groups have given a written consent. The supervisors shall inform the Bank of Russia about the results of such off-site and on-site reviews.

In cases of a credit institution's violation of federal laws or the Bank of Russia's regulations and orders, failure to provide information, or provision of incomplete or inaccurate information, the Bank of Russia has the power to demand that the credit institution should eliminate the identified violations, to impose a fine of up to 0.1% of minimum charter capital, or restrict the credit institution from engaging in certain operations for a period of up to six months, including operations with the parent credit institution of the banking group, the parent organisation of the banking holding company, participants of the banking group, participants of the banking holding company or persons related to the credit institution.

The Bank of Russia has the power to revoke a credit institution's banking license on grounds stipulated in the Federal Law on Banks and Banking Activities. The procedures for banking license revocations are established in Bank of Russia regulations.

Within the framework of risk-focused supervision of the systemically important credit institutions the Bank of Russia appoints its authorised representatives to the credit institutions which have obtained state supports, and also to the credit institutions which assets total 50 and more billion roubles and (or) the funds of private individuals under bank deposit and bank account contracts 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 has become an authority of regulation, control and supervision 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-credit financial institutions, their associations and unions and self-regulatory organisations, 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.

Russian Federation banking legislation (including the Bank of Russia's regulations) in the area of banking supervision is being changed in order to maintain it's effectiveness in light of the development of the national banking system and regulatory practices, taking into account the international banking supervision experience.

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 January 1, 2014 (in line with the initial date of the introduction of these requirements by EU and 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 requirements (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 January 1, 2014, 6% – since January 1, 2015).

A draft regulation on the leverage ratio was published in July 2013 with a parallel run period having started in the 3rd quarter of 2013.

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 start calculating the LCR for monitoring purposes. According to the internationally agreed timeline for Basel III implementation, the LCR is expected to come into force in Russia as a prudential requirement starting from January 1, 2015.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2013

In 2013, the main efforts of the banking supervision were still focused on the development of risk-based approaches to assess the stability of credit institutions and oversight mechanisms to protect the interests of depositors and creditors and maintain the stability of the banking sector. The key task of supervision was the early detection of adverse trends in banking operations. Important regulatory objectives were increasing the transparency of credit institutions and adequate reflection of risk exposures in the financial statements.

The Bank of Russia has paid close attention to the largest banks on the federal and regional level, as well as the banks with financial difficulties and the banks involved in fictitious transactions on a large scale.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY DURING THE LAST YEAR

In 2013 the Bank of Russia in order to improve banking regulation and supervision adopted regulatory acts, including the state registration of credit institutions, licensing of banking activities, off-site supervision, on-site inspections, the financial rehabilitation and liquidation of credit institutions, anti-money laundering and counter-terrorist financing.

In 2013 the banking supervision was focused on the credit institutions' aggressive policy in the area of borrowing and placing funds, non-transparency of business and high risk concentration.

To reveal the situations threatening the interests of creditors and depositors of the banks, the Bank of Russia develops the supervisory response to the changes in credit institutions, due to abrupt assets (liabilities) fluctuations or in relations with third parties which substantially affect the activities of credit institutions. To take effective preventive measures, the daily mode of bank reporting was established where appropriate. Given the legal grounds, the Bank of Russia applies restrictions (bans) on certain banking transactions; for unviable banks the procedure of going out of business (a revocation of banking licenses) was used.

In the center of supervisory attention there were questions of adequate assessments of the value of particular assets: securities, including closed-end investment funds shares and real estate.

In 2013 the Bank of Russia paid considerable attention to the banks taking household deposits and extending unsecured consumer lending. The supervisor regularly monitored the level of interest rates on household deposits and retail lending.

Close attention was paid to the real concentration of bank owners' business risks monitoring.

In the supervision process, the Bank of Russia watched over bank operations with non-resident companies and banks, including those registered in offshore zones: the extension of loans to private non-resident companies, securities transactions registered in non-resident depositories, requirements for non-residents concerning asset trust management and etc.

The additional supervisory attention was paid to financial analysis on consolidated basis. Operations with credit institutions which are members of banking groups, as well as operations with non-resident credit institutions were examined.

ORGANIZATIONAL STRUCTURE OF BANKING REGULATION AND SUPERVISION IN RUSSIA

The Supervisory Authority of the Bank of Russia's head office includes the Banking Supervision Department, the Banking Regulation Department, the Credit Institution Licensing and Financial Rehabilitation Department, the Systemically Important Banks Supervision Department, the Financial Monitoring and Foreign Exchange Control Department and the Bank of Russia Chief Inspection. The major tasks of these divisions are to provide methodological and organizational support of statutory functions of banking supervision within the framework of the entire supervisory cycle.

The supervisory divisions are managed by the Bank of Russia Banking Supervision Committee, which is headed by the Bank of Russia First Deputy Governor 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 regions of the Russian Federation.

As of 01.01.2014 the Bank of Russia supervisory divisions employed 4473 executives and specialists, of whom 41.5% work at the head office, and 58.5% are engaged in the regional branches. The vast majority of specialists have worked in the banking system for more than three years (82.5%).

INTERNATIONAL ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2013, 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.

In 2013, 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.

The Bank of Russia also took part in the mutual assessment of BCBS documents' implementation by countries participating in BCBS.

Within the framework of its cooperation with the G20, the Bank of Russia contributed to quarterly reports on the implementation of Russia's commitments under the Framework for Strong, Sustainable and Balanced Growth and the Seoul Plan of Action, including information on building additional capacity and enhancing transparency of the financial market; improving legal regulation of the financial market; the creation of an international financial centre in Russia.

In the framework of its cooperation with the International Monetary Fund (IMF), the Bank of Russia met with IMF experts for Article IV consultations. Moreover, a long-term IMF resident advisor provided technical assistance to the Bank of Russia in the field of banking supervision on a permanent basis.

Efforts were continued to update information on banking laws and regulations for the IMF electronic database on a regular basis, which is published quarterly on the Bank of Russia website.

As it cooperated with the Organization for Economic Cooperation and Development (OECD), the Bank of Russia provided comments and proposals on draft surveys on the Russian Federation made by the OECD Financial Market and the Investment Committees, as well as analytic material concerning access of non-residents to Russian market of banking services.

The Bank of Russia attaches great importance to cooperating and exchanging information with the banking supervisory authorities of foreign countries. It has signed 37 cooperation agreements (memorandums of understanding) with foreign bank supervisors. Cooperation agreements (memorandums of understanding) were drafted with the banking supervisory authorities of several foreign countries.

In this regard aiming at enhancing cross-border cooperation the Bank of Russia informed 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.

These changes to the Russian legislation were introduced by the Federal Law No. 146-FZ "On Amendments to the Certain Legislative Acts of the Russian Federation", in particular to the Federal Law of 02.12.1990 No. 395-1 "On Banks and Banking" and the Federal Law of 10.07.2002 No. 86-FZ"On the Central Bank of the Russian Federation (Bank of Russia)».

In 2013, the Bank of Russia met to review key topics related to banking supervision and regulation with the supervisory authorities of Austria, China and Netherlands.

To coordinate the activities of authorities supervising banking groups' cross-border establishments, the Bank of Russia has been cooperating with foreign supervisors in multilateral colleges. In particular, the Bank of Russia representatives participated in supervisory colleges held by supervisory authorities of Austria, China, Hungary, Italy, the Netherlands.

COOPERATION WITH OTHER SUPERVISORY BODIES

The Bank of Russia has developed cooperation with agencies, regulators and supervisors of financial markets within the framework of inter-agency agreements and arrangements with the Ministry of Finance, the Federal Anti-Monopoly Service, the Federal Tax Service, the Federal Customs Service, Federal Treasury, Pension Fund of Russia and other federal agencies.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN THE COURSE OF LAST YEAR

Assets of the banking sector increased by 16.0% to 57.4 trillion rubles in 2013. Own funds (capital) of the banking sector increased by 15.6% to 7.1 trillion rubles. Total number of operating credit institutions dropped from 956 to 923.

Last year, the resource base of credit institutions expanded mainly due to customer accounts – which increased by 16.0% to 34.9 trillion rubles. The total amount of funds raised from organizations (other than banks) increased by 13.7% and reached 17.8 trillion rubles. Amount of individual deposits (including savings certificates) increased by 19.0% to 17.0 trillion rubles.

In 2013 the resources expanded significantly due to the funds offered by the Bank of Russia: their volume increased 1.7 times to 4.4 trillion rubles.

During 2013 the volume of loans and other funds provided by banks to non-financial institutions increased by 12.7%. The value of the loan portfolio reached 22.5 trillion rubles. Lending was mainly determined by the economy condition and companies' demand for loans.

Over 2013 a high growth rate of consumer loans was observed and their stock increased by 28.7% to 10 trillion rubles. The implementation of additional regulatory requirements for consumer lending, especially for unsecured lending, by the Bank of Russia has slowed-down the lending to households.

As of the beginning of 2013 the Russian banking sector was a net borrower from non-resident banks with the net debt amounting to 23 billion rubles. Since February 2013, the banking sector became a net creditor of non-resident banks, and the amount of net claims on non-residents at the interbank market was 792 billion rubles as of the beginning of 2014.

Financial result of the credit institutions in 2013 amounted to 994 billion rubles, which is 1.8% lower than in 2012. Mainly due to more conservative assessment of the banks risks and the creation of additional loan losses provisions net provisions in 2013 amounted to 315 billion rubles against 99 billion rubles in 2012.

Due to the steady growth of the banking sector assets and negative dynamics of profit, the return on assets decreased from 2.3% in 2012 to 1.9% in 2013. Return on equity amounted to 15.2% as of January 1, 2014 (18.2% – in 2012).

In 2013 the capital adequacy ratio of the banking sector, taking into account the dynamics of risk weighted assets, has stabilized, reaching 13.5% as of January 1, 2014. At the same time the ratio of Tier 1 capital to risk weighted assets increased from 8.5 to 9.1%.

STATISTICAL TABLES

Number of financial institutions
(at year-ends)

Type of financial institution	2011	2012	2013
Banks	922	897	859
Non-bank credit institutions	56	59	64
Banking sector total	**978**	**956**	**923**

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

Type of financial institution	2011	2012	2013
State-controlled banks	50,4	50,6	51,5
Other banks controlled by residents	32,6	31,5	33,2
Banks controlled by residents, total	83,0	82,1	84,7
Foreign-controlled banks (banks with non-resident interest in excess of 50%)	17,0	17,9	15,3
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	45,6	52,8	0,108
Non-bank credit institutions	80,0	87,3	0,347
Banking sector, total	**45,5**	**52,7**	**0,107**

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

Type of financial institution	2011	2012	2013
Banks	17,6	18,1	15,1
Non-bank credit institutions	48,7	58,2	48,1
Banking sector total	**17,6**	**18,2**	**15,2**

* 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	2011	2012	2013
Banks	99,6	99,7	99,7
Non-bank credit institutions	0,4	0,3	0,3
Banking sector total	**100,0**	**100,0**	**100,0**

* Share in aggregate banking sector assets

Structure of Credit Institutions' Assets
(at year-ends, %)

Assets	2011	2012	2013
Financial sector	16,1	16,5	15,7
Nonfinancial sector	42,6	40,3	56,5
Government sector (including the Bank of Russia)	9,2	7,5	7,0
Other	32,1	35,6	20,7
Liabilities	**2011**	**2012**	**2013**
Financial sector (including credit institutions)	14,5	13,5	12,6
Nonfinancial sector	51,4	49,2	49,6
Government sector (including the Bank of Russia)	5,2	7,1	8,6
Capital (profits, funds)	11,9	11,9	11,5
Other	17,0	18,3	17,7

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Banks	14,6	13,7	13,4
Non-bank credit institutions	38,2	36,9	34,8
Banking sector, total	**14,7**	**13,7**	**13,5**

Asset portfolio quality of the banking sector (share of non-performing loans, %)

Asset classification	2011	2012	2013
Non financial sector	7,7	6,9	6,8
households	7,9	6,5	7,5
corporate (including individual entrepreneurs)	7,6	7,0	6,5

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

	Deposits and other funds raised by credit institutions	Loans, deposits and other funds provided by credit institutions
Households	61,0	28,2
Government financial authorities and off-budget funds *	1,6	2,3
Non financial and financial institutions *	37,3	67,1
Other *	0,02	2,4
Banking sector, total *	100,0	100,0

* Excluding credit institutions and the Bank of Russia

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

P&L account	2011	2012	2013
Interest income	66 767 871	89 018 905	98 091 365
Interest expenses	30 555 209	43 512 634	48 595 053
Net interest income	36 212 662	45 506 272	49 496 312
Net commission income	11 963 258	14 052 923	14 546 949
Other (not specified above) income (net)	4 577 883	7 537 236	9 475 488
Gross income	52 753 803	67 096 431	73 518 749
Administration costs	29 752 830	36 814 528	37 779 667
Depreciation	n/a	n/a	n/a
Loan loss provisions	2 645 635	5 102 870	13 635 682
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	20 355 338	25 179 033	22 103 401
Profit (loss) after tax	16 625 730	20 101 727	17 906 761

Total Own Funds in 2013 (in EUR)

Type of financial institution	Total own funds (capital)	Core capital	Additional capital
Banks	156 693 743	105 632 333	52 844 580
Non-bank credit institutions	396 871	268 465	128 409
Banking sector, total	**157 090 614**	**105 900 798**	**52 972 989**

2013 DEVELOPMENTS IN THE SERBIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Macroeconomic developments in 2013 were more favorable compared to the year before – the economic growth of 2.5% was one of the highest in the region, inflation was on a constant decline and measured 2.2% at year-end and some positive tendencies emerged in the labor market as well. Significant progress was also achieved in reducing external imbalance due to significantly faster growth in exports and fiscal consolidation measures. The euro area economy did contract by 0.4% in 2013 relative to 2012, but managed to climb out of recession in Q2. The recovery took hold in H2, spilling over its positive effects to the domestic market. As a result, a sounder footing has been created for the sustainability of the country's external position and stability of the exchange rate of the dinar.

In 2013, the economy grew 2.5%, led by the recovery of agricultural and industrial production which contributed to GDP growth +1.4pp and +1.0pp, respectively. Industrial rebound in 2013 was largely led by the automobile and oil industry, which, according to NBS estimate, contributed to GDP growth with +1.2pp and +0.8pp, respectively. Positive trends were also observed in several other industrial branches such as energy, chemical, pharmaceutical and electronic industry. The construction sector, on the other hand, had a negative impact and dragged economic activity down by -1.1pp.

From the expenditure side point of view, GDP growth in 2013 was driven entirely by net exports (+5.1pp), primarily due to the activation of earlier investments in the automobile and oil industries. On the other hand, domestic demand recorded a fall (-2.6pp). All components of domestic demand were on the decline, the decline being the steepest in government investment due to fiscal consolidation.

After a significant price increase in 2012, caused by bad agricultural season and weakening of the dinar amid excessive government spending in H1, y-o-y inflation recorded a significant decline in 2013 – from 12.8% in January to 2.2% in December. In addition to monetary policy measures, low inflationary pressures in 2013 reflected a good agricultural season, weak aggregate demand, relative stability of the dinar and falling inflation expectations, which retreated within the target tolerance band in Q4.

As inflationary pressures eased, the NBS lowered the key policy rate by 225bp from May until the end of the year – from 11.75% to 9.5%. Though inflationary pressures were on the downside, the NBS remained cautious in monetary easing, mindful of the pace of fiscal consolidation and risks stemming from international financial markets, notably the Fed's decision to wind down its monetary stimulus and its potential negative effects on Serbia.

Fiscal movements for the whole 2013 were in line with the supplementary budget adopted in July which primarily targeted government expenditures. Consolidated fiscal deficit at the end of the year came out lower than projected[18] (5.0% of GDP) and public debt reached 63.7% of GDP, up by 3.6pp compared to

[18] Government initially projected the consolidated fiscal deficit of 5.6% of GDP

previous year. In October, the government adopted a new package of mid-term fiscal consolidation measures aimed at public finance stabilisation and economic recovery.

Significant progress in 2013 was made in reducing external imbalances. The current account deficit was more than halved relative to 2012 and brought down to 5% of GDP. Greatest contribution to CAD reduction came from the narrowing down of the trade deficit thanks to export growth. This created a sounder footing for a sustainable external position and more stable exchange rate of the dinar. Unlike 2012, net capital inflow exceeded the current account deficit financing needs and fed through into higher NBS foreign exchange reserves. The net FDI inflow began to recover in 2013 and came at EUR 769 mln, but it is still below the level ensuring sustainable economic growth over a longer time horizon. What is deemed positive is that around 24% of FDIs were channelled to manufacturing, which should contribute to further growth in exports in the coming period.

In late 2013, FX reserves totalled EUR 11.2 bln, covering more than seven months of imports.

Key macroeconomic indicators

	2005	2006	2007	2008	2009	2010	2011	2012	2013	Q1 2014
Real GDP growth (in %)[1]	5.4	3.6	5.4	3.8	-3.5	1.0	1.6	-1.5	2.5	0.4
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	2.3
NBS foreign exchange reserves (in EUR million)	4,921	9,020	9,634	8,162	10,602	10,002	12,058	10,914	11,189	10,428
Exports (in EUR million)[3)8]	5,329	6,948	8,687	10,157	8,478	10,070	11,472	11,829	14,378	3.416[9]
- growth rate in % compared to a year earlier	19.1	30.4	25.0	16.9	-16.5	18.8	13.9	3.1	21.5	16,5[9]
Imports (in EUR million)[3)8]	-9,612	-11,970	-16,016	-18,843	-13,404	-14,643	-16,627	-17,153	-18,023	-4.131[9]
- growth rate in % compared to a year earlier	0.7	24.5	33.8	17.6	-28.9	9.2	13.6	3.2	5.1	2,0[9]
Current account balance[4)8]										
(in EUR million)	-1,778	-2,356	-5,053	-7,054	-1,910	-1,887	-2,870	-3,176	-1,585	-314[9]
as % of GDP	-8.8	-10.1	-17.7	-21.6	-6.6	-6.7	-9.1	-10.7	-5.0	-4,3[9]
Unemployment according to the Survey (in %)[5]	20.8	20.9	18.1	13.6	16.1	19.2	23.0	23.9	22.1	20.8
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	361.4
RS budget deficit/surplus (in % of GDP)[6]	0.7	-1.7	-1.1	-1.9	-3.3	-3.5	-4.1	-5.7	-4.8	-8.6
Consolidated fiscal result (in % of GDP)	1.1	-1.5	-1.9	-2.6	-4.5	-4.8	-5.0	-6.6	-5.0	-7.7
RS public debt, (external + internal, in % of GDP)[6)7]	52.2	37.7	31.5	29.2	34.7	44.5	48.2	60.0	63.7	65.1
RSD/USD exchange rate (average, in the period)	66.87	67.03	58.39	55.76	67.47	77.91	73.34	88.12	85.17	84.47
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	83.89
RSD/EUR exchange rate (average, in the period)	82.99	84.11	79.96	81.44	93.95	103.04	101.95	113.13	113.14	115.75
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	115.38
MEMORANDUM:										
GDP (in EUR million)	20,306	23,305	28,468	32,668	28,952	27,968	31,472	29,601	31,994	7.251[9]

1) At constant prices of previous year.

2) Retail prices until 2006.

3) Trade with Montenegro is registered within relevant transactions as of 2003.

4) In accordance with BPM 5, a portion of estimated remittances was transferred from the financial account to the current account.

5) Source: Labour Force Survey, Statistical Office.

6) Source: MoF for public debt and NBS for estimated GDP.

7) Government securities at nominal value.

8) As of 1 January 2010, the Statistical Office, according to UN recommendations, applies the general trade system which is a broader concept and includes all goods entering/exiting the country's economic territory, apart from goods in transit. The Statistical Office published comparable data for 2007, 2008 and 2009. Previous years are disseminated under a special trade system.

9) NBS estimate.

Notes:

1. Data are subject to corrections in line with the official data sources.

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

The banking sector, as the largest portion of the financial system of Serbia (more than 92.4%), 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 2013, there were **30 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, 3 banks were in majority ownership of domestic natural persons and legal entities, while 6 banks are 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 (23.9% and 15.1%, respectively), followed by banks from Greece (14.4%), France (10.5%) and other countries (10.6% 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 79% at the end of December 2013.

Total balance sheet assets of the banking sector in Serbia reached 24.8 bln EUR at the end of 2013 which is a decrease of 2% since the end of 2012.

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 51.6% for assets, 53.2% for lending and 50.4% for deposits.

At the end of December 2013 total net value of loan portfolio was at the level of EUR 14.7 billion with a decrease of 4.5% in 2013. Loans to corporate sector (both private and public sector companies) make around 50% of total loans with EUR 7.4 billion, at the end of 2013. During 2013 loans to corporate sector have decreased by 12.2%. The growth rate of total household loans was 2.2% during 2013 and at the end of December 2013 they amounted to EUR 4.8 billion and made 32.5 % out of total loans.

At the end of December 2013, the share of **NPL**'s in total loans granted was 21.37% gross (11,91% net), while in absolute terms, their level reached 3.4 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 (55.8% of NPL's was provisioned) and local asset classification rules (113.8%).

Total banking sector deposits at the end of December 2013 stood at the level of EUR 15.1 billion with an increase of 0.9% in 2013. Household deposits made 59.2% of total deposits with increase of 4.6% in 2013. Savings deposits are most prominent in both household and total deposits with EUR 8.4 billion at the end of December 2013. Approximately, one fifth of all deposits are related to corporate sector with a EUR 3.1 billion at the end of 2013 and a decrease of 5.3% during the same year.

The growth rate of own funding sources was sufficient to maintain the proportion of own funds to total liabilities of 20.9% as of 31 December 2013. The **capital adequacy ratio** was 20.94%, at the end of December 2013, significantly above the regulatory minimum of 12%.

The average regulatory **liquidity ratio** for the Serbian banking sector as at 31 December 2013 was 2.41, indicating that liquid assets (core and receivables maturing in the next 30 days) are twice as large as liabilities without maturity and liability maturity within 30 days. Liquid assets comprised 38.50% of total assets and amounted to 62.21% 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 perform 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.

Implementation of Basel II standards was a strategically important activity for Bank Supervision Department and the whole NBS in 2010 and 2011. This process was successfully completed – regulation in accordance to Basel II standards was published and is effective from 31st December 2011.

During 2013, the National Bank of Serbia continued to develop its regulatory framework in line with international standards of supervision, while taking into account macroeconomic developments and characteristics of the local banking sector.

Amendments to the Decision on Risk Management by Banks were adopted in May and October 2013 in order to permit banks to assign due and not yet due receivables from legal entities and entrepreneurs to other banks, in order to allow the transfer of a bank's credit portfolio, in part or in whole, to another bank. Also, an obligation for banks to notify the NBS of the planned receivable assignment at least 30 days prior to the conclusion of the assignment contract was introduced. Additionally, this amendment obliges banks to assess the effects of the planned assignment on risk weighted assets, reserve for estimated losses, capital adequacy, total amount of NPLs in the bank's portfolio, as well the bank's risk profile.

Amendments from May also prescribe in more detail the requirements relating to introduction of new products and outsourcing of bank's activities and set out the documents that must be submitted to the National Bank of Serbia along with the prior notification on introducing new products/outsourcing.

The Decision on Implementing the Provisions of the Law on Banks Relating to Granting of a Preliminary Bank Founding Permit, Bank Operating Licence and Consents by the National Bank of Serbia, as well as the Provisions Relating to the Establishment of Criteria for Defining a First-Class Bank was amended in May 2013 in order to simplify the National Bank of Serbia's procedures of processing applications for bank founding permits and acquisition of ownership. Criteria for the assessment of solvency of a potential founder/acquirer of ownership which is a legal entity with an investment grade credit rating will be the same as for banks, and if the potential founder/acquirer is a special purpose vehicle (SPV), the assessment of solvency will be made for the persons financing the SPV's investment in the bank's capital rather than for the SPV itself.

In December 2013, the amendments and supplements to the Decision on the Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items were adopted in order to improve the regulatory framework for resolving high NPLs and preventing their further build-up. The main reason for amending the Decision was to change the rules on the classification of assets acquired through collection of receivables, receivables from assignees, and the calculation of days past due as of the subsequently agreed maturity date.

Amendments extend the period of exemption from classification requirements for assets acquired through collection of receivables in respect of real estate (to three years), with the period no longer running from the date of their acquisition, but from the maturity date of the relevant receivable. In cases where debtors are having difficulties in repaying their debt, the mentioned measure should motivate banks to start the process of collection of receivables earlier, and thus prevent further build-up of NPLs in their portfolios.

With a view to diversifying the pool of persons to which banks may assign receivables and thus clean their portfolios, amendments change the rules of classification of receivables from assignees. Instead of being classified automatically in category E, these receivables will be assessed and classified in the relevant category based on the applicable classification criteria (timeliness, financial position, collateral) and subject to meeting additional requirements relating to the timeliness in the settlement of liabilities and financial position. Amendments to the rules on the calculation of past due days as of the subsequently agreed maturity date provide for greater flexibility in negotiating repayment terms in cases where the change of repayment terms is not caused by the delay in the settlement of liabilities or by deterioration in the debtor's financial position.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2013

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 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 Basel III implementation; and
- a legislation drafting phase, i.e. drafting of regulations implementing Basel 2.5 and Basel III standards.

It should be noted that certain elements of Basel III have already been introduced to the Serbian regulatory framework: (i) exclusion of Tier 3 capital from the total regulatory capital, (ii) introduction of capital conservation buffer which effectively disallows banks with CAR of below 14.5% (or banks that would fall below CAR of 14.5% if dividends were to be paid) to payout dividends.

On the other hand, during 2012 as preparation for the SREP processes, the NBS developed the new Methodology for assessment of risk profile of the banks. Therefore, in the following period the NBS will devote a lot of its effort in organizing and conducting supervisory dialog with banks, based on principle of proportionality.

Last but not the least, the NBS has envisaged to strengthen its supervisory function. In order to implement SREP successfully, intensify on-site examinations, and prepare for Basel III implementation, the process of recruitment of additional 20 employees in BSD begun in the late 2012. This process was successfully completed at the beginning of 2013.

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 and their

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY LAST YEAR

A new risk assessment methodology was applied for the first time, entirely replacing the previous, CAMELS-based, methodology for bank evaluation and serving as the implementation platform for SREP. The methodology is applied to all the banks, and, as under the previous approach, reports are produced quarterly. In the new methodology, the scope of the reports is wider, list of risk indicators longer and more standardized and the elaboration of qualitative aspects of risk management more detailed.

The pace of on-site examinations was increased, and certain follow-up duties were transferred to the Off-site Division, with the aim of freeing up the resources of the On-site Division for the core activities. In addition, visits to meetings of bank supervisory boards were made more frequent.

In order to help enhance the effectiveness of external audits of bank financial statements, the NBS decided to improve dialog with external auditors. In parallel, a need for closer cooperation and its mutual benefits were communicated to the auditors.The improvements in the supervisory process were made possible by a significant increase in the number of staff.

13 on-site supervisions were conducted in 2013: 4 supervisions of safety and soundness and legality of bank's operations from the aspect of risk management, 3 target control (credit risk, concentration risk, investment risks and capital adequacy ratio) and 6 follow-up on-site supervisions of bank's operations, 3 related to AML/CTF issues and supervision of payment transactions, 8 follow up on-site supervisions of implementation of measures imposed to banks in relation to AML/CTF supervision and supervision of payment transactions, 1 related to supervision provisions of Financial Services Consumer Protection Law and 2 follow up on-site supervisions of implementation of measures imposed to banks in relation to supervision provisions of Financial Services Consumer Protection Law.

AML

National bank of Serbia, as supervisory body in the field of Prevention of Money Laundering and Financing of Terrorism continued participation in Project against Money Laundering and Terrorist Financing in Serbia (MOLI-Serbia), the most important and the most valuable project to date in Serbia intended against money laundering and terrorist financing. This project is worth 2,365,000 Euros and is mostly funded by the EU through its IPA funds (EUR 2 million), with the Council of Europe participation (EUR 200.000) and a contribution from Serbian Budget. The aim of the project is to improve Serbia's AML/CFT capacities in terms of legislative provisions, professional training and supervisory and operative capacities.

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.

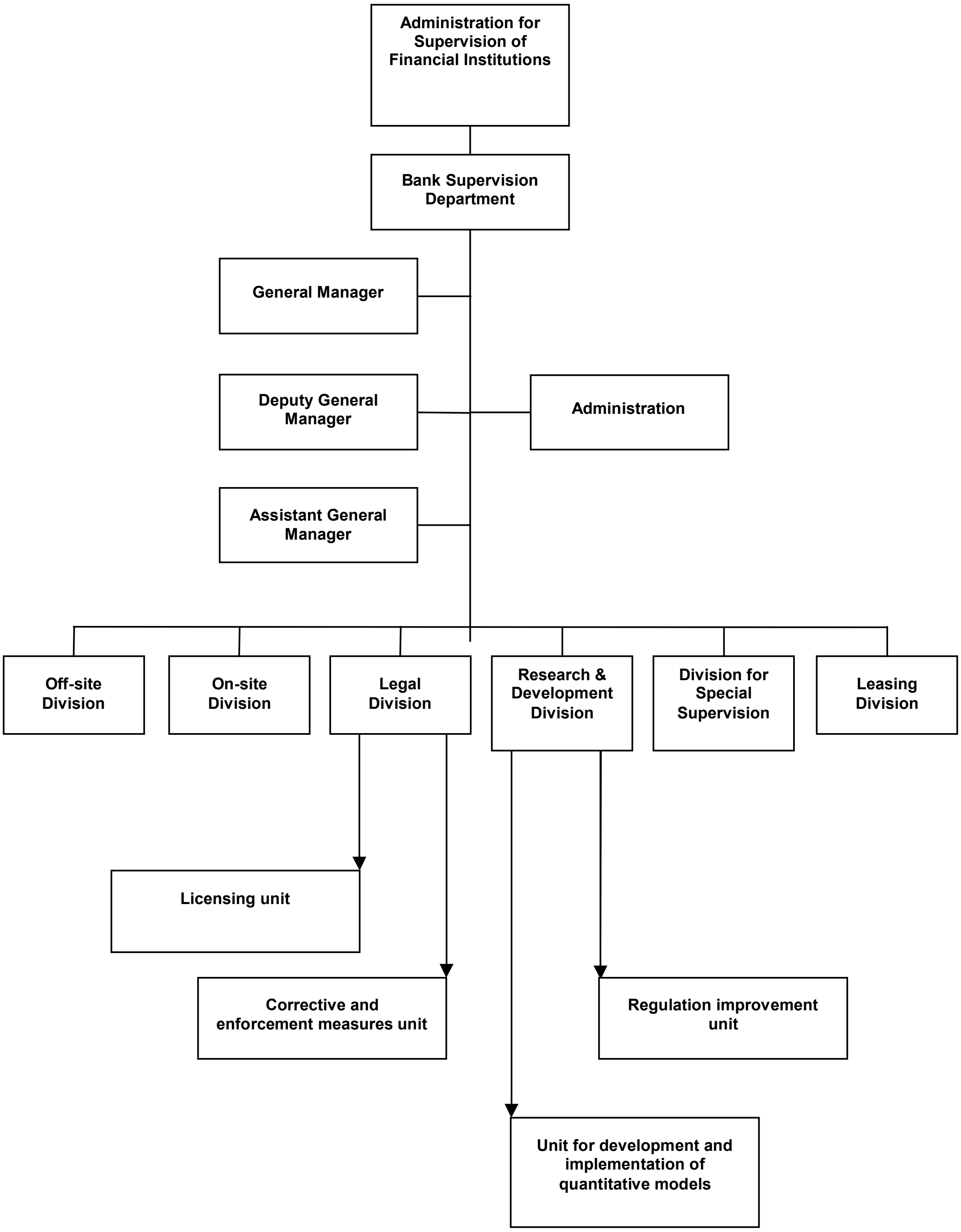
Measures Against Banks

During 2013, National Bank of Serbia – Banking Supervision Department (NBS – BSD) took following measures against banks: 8 letters of warning, 1 ordering letter, 2 resolutions with orders for banks to undertake certain measures, 2 resolutions on temporary measures and 2 resolutions on revoking banks' operating licenses. The NBS – BSD also rendered 6 resolutions on imposing fines to banks and/or a member (members) of the banks' managing and/or executive board and terminated 17 procedures of examination of particular banks and submitted 7 reports against banks and responsible persons for commercial offences and 6 requests for initiation of the proceedings for commercial misdemeanors against banks and responsible persons.

Licensing and Approvals Regarding Banks

In 2013, NBS - BSD approved 14 requests for amendments of banks' founding acts and their articles of association (1 procedure was terminated because the request was withdrawn) and 65 requests regarding appointment of managing and executive board members (2 request were denied and 3 procedures were terminated because requests were withdrawn); approved 6 times acquisiton of an ownership in banks in Serbia and 1 time denied such approval; 1 bank was permitted to acquire a subsidiary; 1 bank was permitted not to include a subsidiary in consolidated financial statements; 1 bank reqested an approval to include proft of tis subsidiary into its capital, but later withdrawn such request; 3 bank were permitted to distribute their profits, 1 was not and 1 withdrawn its reques. The NBS – BSD also processed 60 notifications from banks regarding externalization of their business activities and processed 4 notifications from three banks about their intent to include subordinated obligations into the supplementary capital.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In the field of banking supervision, in 2013 the NBS has signed 1 bilateral Memorandum of Understanding (with Autorite de Controle Prudentiel, France) and 2 Multilateral Agreements on Cooperation and Coordination regarding the consolidated supervision of a specific banking group - establishing College of supervisors for that banking group (1 with Austrian Financial Market Authority and 1 with Autorite de Controle Prudentiel). With that in mind, the NBS has signed Memoranda of Understanding with supervisory authorities from 12 countries and Multilateral Agreements on Cooperation and Coordination with authorities from 8 countries for 15 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 organized by competent authorities in Italy, Austria, Hungary, Greece, France and Belgium. Although more often as host supervisor, the National bank of Serbia was active as home supervisor, as well: a relevant supervisory college meeting was organized in Belgrade.

The NBS also welcomed a delegation of supervisors from the Central Bank of Russia for a study tour on the banking supervision process.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY.

Cooperation with other supervisory bodies in the country was already established. The NBS has signed in previous period Memorandums of Understanding with following domestic bodies and institutions:

- Association of Serbian Banks
- Deposit Insurance Agency
- Tax Administration of the Republic of Serbia
- Securities Commission
- Belgrade Stock Exchange
- Commission for Protection of Competition
- Administration for the Prevention of Money Laundering

The NBS successfully cooperates with all before mentioned supervisory authorities whenever there is a need for sharing information in accordance with MoUs signed.

In 2013, cooperation between the NBS and 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 (July 2013) with following annexes.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

In Serbia, as well as in other countries in the CEE region, there is relatively high level of non-performing loans. In addition to introducing regulatory measures aimed at resolving the problem of high NPLs in Serbia, the National bank of Serbia has analyzed various topics related to the monitoring of NPLs and loan loss provisioning.

STATISTICAL TABLES

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

Type of financial institution	2011	2012	2013
Commercial banks	33	32	30
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**33**	**32**	**30**

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

Type of financial institution	2011	2012	2013
Public sector ownership	17.9	18.1	18.7
Other domestic ownership	8.0	6.8	6.9
Domestic ownership total	25.9	24.9	25.6
Foreign ownership	74.1	75.1	74.4
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	36.6	51.6	741
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**36.6**	**51.6**	**741**

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

Type of financial institution	2011	2012	2013
Commercial banks	6.0*	4.7**	-0,4
Cooperative banks			
Other			
Banking sector, total:	**6.0***	**4.7****	**-0,4**

* Data without Agrobanka (licence revoked in May 2011)
** Data without Razvojna banka Vojvodine (licence revoked in April 2013)

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
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 system (%) (at year-end)

Assets	2011	2012	2013
Financial sector	9.6	7.1	10.0
Nonfinancial sector	52.5	53.0	50.2
Government sector	12.1	14.8	16.4
Other	25.8	25.1	23.4
Liabilities	**2011**	**2012**	**2013**
Financial sector	13.6	12.3	10.4
Nonfinancial sector	47.1	48.5	50.4
Government sector	3.3	3.5	4.1
Capital	20.6	20.5	20.9
Other	15.5	15.2	14.2

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Commercial banks	19.1	19.9	20.9
Cooperative banks			
Banking sector, total:	**19.1**	**19.9**	**20.9**

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

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

Type of financial institution	2011	2012	2013
Non financial sector			
- households	7.93	8.49	9.43
- corporate	24.62	21.19	27.10

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

	Deposits	Loans
Households	61.9	36.5
Government sector	4.4	8.2
Corporate	21.2	45.3
Other (excluding banks)	12.5	10.0
Total	**100.0**	**100.0**

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

P&L account	2011	2012	2013
Interest income	201,234	200,683	195,940
Interest expenses	82,558	83,611	77,029
Net interest income	118,676	117,072	118,911
Net fee and commission income	35,335	35,543	34,797
Other (not specified above) operating income (net)	10,818	16,528	9,982
Gross income	164,829	169,143	163,690
Administration costs	93,535	103,375	98,776
Depreciation	8,353	8,462	8,099
Provisions	0	0	0
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	61,689	45,652	58,931
Profit (loss) before tax	1,252	11,654	-2,118
Net profit (loss)	-1,877	8,446	-3,493

Total own funds in 2013 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	3,027,412	2,787,197	240,215	
Cooperative banks				
Banking sector, total:	**3,027,412**	**2,787,197**	**240,215**	

2013 DEVELOPMENTS IN THE SLOVAKIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Slovak economy grew by 0.9 % in the year 2013 which was the lowest annual growth rate since 2009. However, taking into an account quarter-on-quarter dynamics, a pattern of modest recovery can be observed in Slovakia during the course of 2013, against the background of stabilizing macroeconomic and financial conditions in the Eurozone.

As in the previous years, export was the main driver of GDP growth. Positive signal was the revival of investment activity towards the end of 2013. On the other hand, household consumption remained feeble as real disposable income of households increased only marginally. On the supply side, industrial production, focused mainly on automotive segment, represented the most dynamic part of the economy. Both, consumer and business sentiment were gradually improving during the year.

Average unemployment rate above 14 % in 2013 was still high, but its trend was slightly decreasing. Particularly, fourth quarter of the 2013 saw a positive development on the labour market, when number of employed persons began to rise.

In line with the rest of the Eurozone there was significant deceleration of consumer inflation rate in Slovakia. Annual rate of change of consumer prices decreased from around 3 % at the beginning of 2013 to 0.5 % in December.

DEVELOPMENT IN THE BANKING SECTOR

The most important trend in the Slovak banking sector in 2013 was growing volume of loans to households. Total stock of household’s loans grew by 10 % year-on-year which was one of the highest dynamics among EU countries. Both, housing loans and consumer loans were increasing. Demand for loans was primarily stimulated by low interest rates and related high proportion of housing loans suitable for cheaper refinancing.

Situation in lending to enterprises was significantly different. Stock of non-financial firms’ loans kept on decreasing on a year-on-year basis. There was moderate improvement in the flow of loans in the second half of 2013, however it was concentrated in large state-owned corporates to a large extent.

Credit quality of loans did not change significantly in 2013.

Banks operating in Slovakia decreased volume of domestic government bonds in 2013. Nevertheless, share of these bonds as a percentage of total assets of the banking sector remained one of the highest in EU.

All in all, combination of aforementioned trends in the balance sheet of domestic banking sector and evolution of nominal GDP means that total assets to GDP ratio slightly increased from 85.8 % at the end of 2012 to 86.5 % as at 31.12.2013.

Profitability of Slovak banks rose by 12 % in 2013. This was stemming mainly from growing interest income related to household loans. Decrease of costs of credit risk contributed positively too.

Capital adequacy ratio increased from 15.7 % to 17.2 % which was the highest level since 2005. It implies that Slovak banking sector has had high degree of resistance to potential negative development.

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

The National Bank of Slovakia performs supervision of the financial market.

As part of its supervision of the financial market, the National Bank of Slovakia 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.

No major changes in the area of legal competence of the National Bank of Slovakia were applied during the year 2013.

MAIN STRATEGIC OBJECTIVES IN 2013

The main strategic objectives of the banking supervision could be summarized in the following points:

- Credit Risk
- Liquidity Risk
- Market Risk
- Capital Adequacy Assessment
- IRB model validations
- Comprehensive Anti-Many Laundering Assessment focused on branch offices of foreign banks

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY LAST YEAR

on-site

10 on-site examinations started in 2013 (9 in banks and 1 in branch of foreign bank). Seven examinations were formally completed in 2013, while other was formally completed in the first quarter of the year 2014.

The main topics of on-site supervision of banks were checking the quality of the risk management system focused mainly on credit risk, liquidity risk, market and operational risks. In addition the investment services, payment services, internal governance and the prevention of money laundering were examined.

off-site

Off-site supervision of banks and branches of foreign banks includes regular analyzing of reports, monitoring of prudential indicators, analytical work, and communication with the supervised entities and with HOME supervisory authorities.

In the 2013 Department of the banking and payment services supervision prepared monthly assessment of banks and branches of foreign banks, quarterly analysis of individual banks and annual reports of each bank containing a detailed assessment of each bank, including an assessment of capital adequacy under Pillar II. Detailed reports were provided for HOME supervisors for the Join Risk Assessment purposes.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

- Executive Director of the Financial Market Supervision Unit
  - BANKING AND PAYMENT SERVICES SUPERVISION DEPARTMENT
    - First Instance Proceedings Section
    - Section for Supervision of Banks with Advanced Risk Management Approach
    - Section for Supervision of Banks with Standardized Risk Management Approach
    - Supervision of Payment Services and Foreign Exchange Supervision Section
  - SECURITIES MARKET, INSURANCE AND PENSION SAVINGS SUPERVISION DEPARTMENT
    - First Instance Proceedings Section
    - Securities Market and Pension Savings Supervision Section
    - Insurance Supervision Section
    - Financial Mediation and Financial Advisory Supervision Section
  - REGULATION DEPARTMENT
    - Banking and Payment Services Regulation Section
    - Securities Market and Pension Savings Regulation Section
    - Insurance Regulation Section
    - Financial Models and Information Support Section
  - MACROPRUDENTIAL POLICY DEPARTMENT
  - Financial Clients Protection Section

INTERNATIONAL ACTIVITIES

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.

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 IN THE COURSE OF LAST YEAR

In the course of 2013 the preparatory work for SSM implementation within NBS became even more intensive. Large number of supervisory staff was engaged into cooperation with ECB.

STATISTICAL TABLES

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

Type of financial institution	2011	2012	2013
Commercial banks	14	14	13
Branches of foreign credit institutions	17	14	15
Cooperative banks	-	-	-
Banking sector, total:	**31**	**28**	**28**

Ownership structure of banks on the basis of assets total (%)

Type of financial institution	2011	2012	2013
Public sector ownership	0.9	0.8	0.8
Other domestic ownership	0.3	0.4	0.4
Domestic ownership total	1.2	1.2	1.2
Foreign ownership	98.8	98.8	98.8
Financial Institutions, 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	63.1	81.4	1575
Branches of foreign credit institutions	71.1	85.6	2716
Cooperative banks	-	-	-
Banking sector, total:	**54.3**	**70.4**	**1217**

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

Type of financial institution	2011	2012	2013
Commercial banks	14.19	9.65	11.69
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**14.19**	**9.65**	**11.69**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	92.8	92.1	85.9
Branches of foreign credit institutions	7.2	7.9	14.1
Cooperative banks	-	-	-
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2011	2012	2013
Financial sector	10.1	11.0	11.4
Nonfinancial sector	60.2	60.0	62.2
Government sector	23.3	22.8	20.9
Other	6.4	6.1	5.5
Liabilities	**2011**	**2012**	**2013**
Financial sector	13.0	12.1	10.4
Nonfinancial sector	62.5	63.5	64.8
Government sector	1.5	1.5	1.7
Capital	13.6	14.2	14.6
Other	9.3	8.7	8.5

Capital adequacy ratio of banks (%)

Type of financial institution	2011	2012	2013
Commercial banks	13.41**	15.67**	17.23**
Cooperative banks	-	-	-
Banking sector, total:	**13.41****	**15.67****	**17.23****

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

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

Asset Classification	2011	2012	2013
Non financial sector	5.75	5.36	5.28
- households	**4.85**	**4.33**	**4.16**
- corporate	**7.97**	**7.63**	**8.13**

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

	Deposits	Loans
Household	61.2	52.0
Government sector	2.2	2.4
Corporate	35.9	45.1
Other (excluding banks)	0.6	0.5
Total	**100.0**	**100.0**

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

P&L account	2011	2012	2013
Interest income	2 522 076	2 486 004	2 399 937
Interest expenses	714 796	722 993	586 234
Net interest income	1 807 280	1 763 011	1 813 703
Net fee and commission income	444 026	426 328	439 043
Other (not specified above) operating income (net)	33 564	-281 368	-136 697
Gross income	2 302 153	1 943 058	2 156 786
Administration costs	990 124	1 005 767	1 027 764
Depreciation	133 577	144 012	138 722
Provisions	336 358	170 025	219 041
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	1 987 592	1 528 511	1 593 930
Profit (loss) before tax	824 811	588 167	730 522
Net profit (loss)	674 245	491 366	549 369

Total own funds in 2013 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	4 846 405 944	4 502 877 693	343 528 251	-
Cooperative banks	-	-	-	-
Banking sector, total:	**4 846 405 944**	**4 502 877 693**	**343 528 251**	**-**

2013 DEVELOPMENTS IN THE SLOVENIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

According to the revised SORS figures, there was a significant reversal in economic activity in Slovenia in 2013. Quarterly GDP growth increased to stand at 1.2% at the end of the year. The decline in economic activity of just over 1% over the year was solely the result of the low level of activity at the end of 2012. On the output side there was a significant increase in activity in industry in the second half of the year, which was seen in the vast majority of segments. Value-added also began to increase in private sector services after the first half of the year, which given the decline in exports of services could only be the result of the stabilisation of private consumption and the statistical effect of measures to curb the grey economy, which resulted in less concealment of activity. Further evidence of the reversal in domestic demand in the second half of last year came from the increase in imports, as a result of which the contribution made to GDP growth by net trade declined significantly last year.

The fall in employment had slowed sharply by the end of 2013. The year-on-year fall stood at 1.5% at the end of the year, compared with more than 3% in the early part of the year. Despite the increased stability on the labour market, there are no signs that demand for labour will increase sharply in the future. The trend of rising unemployment ended in 2013. The registered unemployment rate at the end of the year was slightly lower than at the beginning of the year at 13.5%, while the number of unemployed was slightly more than 124,000. The surveyed unemployment rate had also fallen by the end of the year, to 9.6%, less than the euro area average. Wage developments were in line with economic activity, as wages fell in the first half of the year but began to rise moderately in the second half of the year.

Average inflation in Slovenia as measured by the harmonised index of consumer prices stood at 1.9% in 2013, down 0.9 percentage points on 2012. Average annual inflation in Slovenia was slightly above the euro area average of 1.4%.

The current account surplus widened further in 2013. It amounted to EUR 2.2 billion, or 6.3% of GDP. The increase relative to 2012, when it amounted to 3.3% of GDP, was primarily the result of changes in the merchandise trade position. The merchandise trade deficit of 0.3% of GDP in 2012 became a surplus of EUR 630 million or 1.8% of GDP in 2013. With the gradual recovery in foreign demand, nominal growth in merchandise exports exceeded 2%. At the same time the decline in merchandise imports slowed to 1.2% overall. This was the result of growth in imports at the end of the year as a result of a reversal in domestic consumption and growth in industrial production.

The private sector increased its investments in the rest of the world by EUR 2.4 billion, EUR 1.6 billion more than in 2012. There was an increase in investments in all financial instruments other than loans. As in 2012, the largest increases were recorded by claims from currency and deposits and capital transfers. The private sector’s liabilities to the rest of the world declined by EUR 1.5 billion last year, primarily as a result of the continuing decline in the banking system’s debt to the rest of the world and a decline in FDI.

The net external debt amounted to EUR 12.5 billion at the end of the year, down EUR 1.8 billion on the end of 2012. Net debt repayments were recorded by all sectors other than the government, which last year increased its net external debt by EUR 4 billion. The largest contributions to the decline in the net debt to the rest of the world came from the Bank of Slovenia and the banking sector. They again made debt repayments in the rest of the world, in the amount of more than EUR 2.5 billion.

The general government deficit in 2013 was significantly wider than in the previous year, primarily as a result of the measures to stabilise the banking system and certain other one-off factors. The general government deficit stood at 14.7% of GDP, 10.7 percentage points more than in 2012. The measures to stabilise the banking system accounted for 10.3 percentage points of the deficit, compared with 0.2 percentage points in 2012. Other one-off factors include the compensation paid to people deleted from the register of permanent residents in the amount of 0.4% of GDP, and the net effect of the Supreme Court judgement in relation to funding for eliminating wage disparities in the amount of 0.3% of GDP. General government revenues increased by just 0.6% in the context of adverse developments in the tax base, particularly the tax base related to the situation on the labour market, and despite measures to raise revenues. The main measures on the revenue side were a rise in VAT, a higher tax burden on energy products and the introduction of a tax on financial transactions. The overall effect of all the revenue-side measures is estimated at around 1% of GDP. Indirect taxes thus increased by 4.8% in 2013, while personal income tax was down 7.7% and social security contributions were down 1.9%. General government expenditure was up 22.6%, and was concentrated in the item of capital transfers on account of the bank recapitalisations. Excluding the bank recapitalisations and the two aforementioned one-off factors, other expenditure increased by 0.3%. Expenditure on interest increased by just over a fifth to 2.6% of GDP. Wage agreements meant that employee compensation declined by 3.7%, while intermediate consumption also declined. After several years of decline, government investment increased by almost 13%. The general government deficit in 2013 was significantly wider than forecast in the Stability Programme update of May 2013 (7.9% of GDP), primarily as a result of larger bank recapitalisations. The structural deficit in 2013 stood at 2.2% of GDP according to the European Commission's estimates of February 2014, 0.4 percentage points less than in the previous year.

The general government debt amounted to EUR 25,307 million or 71.7% of GDP at the end of 2013, up EUR 6,103 million on a year earlier. The main factor in the increase in debt was the measures to stabilise the banking system. These had an impact via bank recapitalisations, which widened the deficit by EUR 3.6 billion, and via the issue of Bank Asset Management Company (BAMC) bonds in the amount of EUR 1 billion. The major borrowing was undertaken in April, May, November and December. An 18-month treasury bill with a nominal value of EUR 1.1 billion was issued April, which mostly replaced the maturing 18-month treasury bill issued in 2011. Two bonds were issued in May on the markets in the US and the UK. November's borrowing amounted to EUR 1.5 billion, the bond maturing in three years. In December certain existing bond issues were expanded by around EUR 0.9 billion, which was the government's non-cash contribution to the recapitalisation of the banks and the recapitalisation of the BAMC. In addition, non-performing claims were transferred to the BAMC in December by means of the issue of 2- and 3-year BAMC bonds with a total nominal value of EUR 1 billion.

Government sureties and guarantees increased by EUR 1.8 billion in 2013 to reach EUR 8.3 billion or 23.4% of GDP at the end of the year. Of the aforementioned amount, EUR 2.8 billion relates to guarantees issued to DARS d.d. The stock of Slovenian government guarantees tied to assistance to euro area countries in financial distress via the EFSF amounted to EUR 1.5 billion at the end of the year, guarantees having been given to Greece, Ireland and Portugal. The increase in the stock of government guarantees was primarily the result of the issue of BAMC bonds with a government guarantee as part of the bank resolution measures (EUR 1 billion) and the guarantee for the loan for the TEŠ6 project (EUR 0.4 billion). Guarantees constitute contingent liabilities for the government, which it must meet if the guarantee is called. A total of EUR 59 million of guarantees were called in 2013, more than in previous years.

The required yield on long-term Slovenian government bonds and the premium on long-term Slovenian government bonds over the benchmark German bonds remained relatively high last year. The required yield and the premium were relatively stable in the early part of the year, before temporarily rising sharply in March as a result of the uncertainty surrounding the Cypriot debt crisis. May’s amendments to the constitution in connection with the insertion of the fiscal golden rule and the tightening of referendum legislation did not have an impact on the required yield or the premium. The required yield and the premium rose slightly in June after figures showing the continuing contraction in economic activity in Slovenia were released, and then remained relatively stable until the end of the autumn, albeit at a higher level than in the early part of the year. The reason was the uncertainty on the financial markets before the release of the results of the stress tests and asset quality review of Slovenian banks. The required yield and the premium had begun to decline by the final quarter, partly as a result of the easing tension on the financial markets following the release of the stress tests results and after the first measures to stabilise the Slovenian banking system were taken. At the end of the year the required yield was slightly less than 5%, while the premium over the benchmark long-term German government bond was nearly 300 basis points.

In June 2013 the European Council extended Slovenia’s deadline for reducing the general government deficit to below 3% of GDP to 2015. The extension was approved on the basis of the finding that Slovenia took effective action to reduce the deficit in line with European Council recommendations, but there were unexpected economic developments with major adverse fiscal consequences. The structural position is forecast to be balanced by 2017 according to the plans in the Stability Programme. Further fiscal consolidation and structural reforms remain a commitment for Slovenia in the future, partly in light of the size of the government debt and the forecast high costs in connection with the ageing of the population. Measures for the recovery of the banking system will continue to have an impact on fiscal developments in 2014. In May 2013 the National Assembly amended Article 148 of the Constitution of the Republic of Slovenia to insert a fiscal golden rule, which stipulates that general government revenues and expenditure must be balanced or in surplus over the medium term. Details of the implementation of the fiscal golden rule will be set out in a special law, which the National Assembly will have to pass with a two-thirds majority.

DEVELOPMENTS IN THE BANKING SYSTEM

As at 31 December 2013 there were 17 banks operating in Slovenia (seven of which were direct subsidiaries of Eurosystem banks), three savings banks, and three branches of foreign (Eurosystem) banks. The banks dominate the banking sector, with a market share of 96.0% in terms of total assets. The total number of credit institutions was unchanged from the previous year, although a decision to carry out an orderly wind-down at two smaller banks was taken in early September 2013.

There was 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. In addition to the seven subsidiary banks and three branches that were under full foreign ownership as at 31 December 2013, there were seven banks under full domestic ownership, and three banks under majority domestic ownership, only one of which had more than 10% foreign equity. The proportion of capital held by non-residents as measured by equity stood at 31.3%, while the proportion under direct government ownership was 58.7%, and the proportion held by other domestic owners was 10.0%. There was 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 to cover losses by means of the interests of existing owners, thereby becoming the sole owner. As a result, the proportion of equity in the banking system held by the government increased by 35.9 percentage points, while the proportion held by non-residents declined by 10.7 percentage points and the proportion held by other domestic owners declined by 25.3 percentage points.

After the comprehensive review of the banking system the banks created additional impairments and provisions, and transferred certain claims to the Bank Asset Management Company (BAMC), as a result of which the banking system's total assets declined by EUR 5.7 billion to EUR 40.4 billion. The banking system's total assets at the end of the year stood at EUR 40.4 billion, down 12.3% on the end of the previous year. The banking system's total assets declined for the fourth consecutive year (since the end of 2009), taking the cumulative decline to EUR 11.6 billion, the largest decline of EUR 5.7 billion coming last year. The contraction in total assets meant that the ratio of the total assets of banks and savings banks to GDP declined by 10.6 percentage points last year to end the year at 126.6%.

The measures taken by the Slovenian government and the Bank of Slovenia to stabilise the banking system in December 2013 had a relatively strong impact on the major balance sheet categories. The following measures were taken: a) the recapitalisation of NLB d.d., NKBM d.d., Abanka Vipa d.d. and two smaller banks, Factor banka d.d. and Probanka d.d., which have been undergoing an orderly wind-down process since September; b) recapitalisation via government securities obtained by the aforementioned banks in their portfolios, with the exception of Abanka; c) the write-down of subordinated instruments (bail-in); and d) the transfer of certain non-performing claims at NLB d.d. and NKBM d.d. to the Bank Asset Management Company (BAMC). This resulted in an increase in equity on the liability side, and a decline in government deposits and subordinated debt. On the asset side, there was an increase in investments in securities as a result of the bonds and treasury bills received in the banks' portfolios. At the same time on the asset side the stock of loans was reduced by those transferred to the BAMC, while securities increased as the two largest banks received BAMC securities in their portfolios.

The sustained financial crisis was again reflected last year in a relatively sharp adjustment in funding structure, and consequently in an increase in interest rate risk. Deposits by the non-banking sector are the main source of funding, accounting for 55.8% of the total. The banks continued to reduce their dependence on wholesale funding in 2013: it accounted for 17.3% of total funding at the end of the year, down a half on the outbreak of the crisis. Deposits by the non-banking sector remain the most important source of funding, despite declining in 2013. Last year's decline in household deposits, which continue to account for the largest proportion of funding at 35.5%, was partly the result of developments in Cyprus and the lack of confidence in the stability of the domestic banking system, particularly large government-owned banks. Household deposits declined by 3.1% in 2013. The contraction in bank loans and deposits was partly compensated for by borrowing within the Eurosystem, which has remained stable at around 9% of funding over the last two years.

The liquidity of the Slovenian banking system remained at a relatively stable level in 2013, and had even improved by the end of the year after the recapitalisation and the transfer of non-performing claims to the BAMC. The issue of treasury bills and three government bonds brought an improvement in liquidity during the year. The positive impact of these measures was also reflected in an increase in secondary liquidity, a reduction in net debt to the Eurosystem, and an increase in the pool of eligible collateral at the Eurosystem and thus in the proportion of the pool that is free, which was up 10 percentage points overall to stand at 44% at the end of the year. However, in the second half of the year certain small banks had liquidity difficulties owing to an unstable funding structure and inadequate business models in crisis conditions.

Year-on-year growth in loans to the non-banking sector declined in 2013 at the domestic banks and the banks under majority foreign ownership. The banking system's loans to the non-banking sector declined by 21% over the year, 6 percentage points of which was the result of the transfer of non-performing claims to the BAMC. Last year's contraction in loans was largest at the large domestic banks.

The contraction in loans was the result of supply and demand factors. In 2013 the banks faced limited access to wholesale funding and constraints on capital, which restricted the money available for financing the Slovenian economy. By contrast, loans to corporates and households also declined as a result of weak demand. Last year there was a decline in demand for loans owing to low investment in gross fixed capital formation by Slovenian corporates and the high indebtedness of the corporate sector. The main factors in the decline in demand for household loans were the decline in household disposable income and the decline in final consumption.

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

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.

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.

Changes to secondary legislation in the area of banking supervision

Current developments in the banking system and the findings and experience that supervisors obtained in banking supervision were the main reasons for certain changes to Bank of Slovenia secondary legislation in 2013 and early 2014. In addition to these changes, within the framework of its legal powers the Bank of Slovenia drew up secondary legislation transposing European directives in relation to banks and the guidelines of the European Banking Authority (EBA) aimed at achieving a convergence of European banking and supervisory practices.

Changes to secondary legislation in response to identified risks and to practical experience and findings from supervision

Some of the changes to secondary legislation were adopted as a result of the findings from supervision of credit risk management at the banks. The aforementioned changes bring an upgrade to the methodology of the credit risk assessment, but also contribute to the qualitative aspects of credit risk management.

A more precise definition has also been established of when a debtor is in default. The definition of default that the banks use for classifying claims in categories A to E has now been brought into line with the definition of default as set out in EU banking legislation. The same definition is used in the rules of the

Eurosystem's prudential framework intended for assessing the eligibility of financial assets as collateral for Eurosystem credit operations (the new Regulation on the assessment of credit risk losses of banks and savings banks, February 2013).

Via changes to implementing regulations the Bank of Slovenia is also attempting to encourage banks to take a more active role in corporate restructuring and to reduce non-performing loans on bank balance sheets. The banks are required to strengthen their monitoring of forborne exposures, particularly to corporates for whom the successful forbearance of the banks' exposures requires comprehensive operational, ownership and financial restructuring. The banks are accordingly required to draw up corporate exposure forbearance plans, and to report to the Bank of Slovenia in connection with the corporate restructuring agreements that they reach (the new Regulation on risk management and implementation of the internal capital adequacy assessment process for banks and savings banks; the new Regulation on the reporting of individual facts and circumstances of banks and savings banks, May 2013). In addition, as part of the activities to encourage the banks to take a more active approach to the forbearance of non-performing investments, the definition of forborne financial assets was updated to accord with the technical standards for supervisory reporting to the EBA and the ECB. The types of forbearance that can be carried out by banks were defined, and requirements were prescribed for the classification of forborne financial assets into rating categories and in terms of their documentation or recording in books of account. As an incentive to faster write-offs of non-performing financial assets and redemption of collateral, a framework was put in place for the faster derecognition of non-performing financial assets from the statement of financial position when a bank judges that a financial asset will no longer be repaid or the conditions for derecognition under the IFRS have been met. A bank can make an assessment of the write-off of financial assets from a loan agreement or an exercised contingency when the following conditions have been met:

- for an unsecured financial asset, if the debtor is more than one year in arrears with repayment;
- for a financial asset secured by real estate collateral, if the debtor is more than four years in arrears with repayment;
- for an unsecured financial asset, if the debtor is undergoing bankruptcy proceedings.

The requirements for reporting the classification of financial assets were also updated. It involves the reporting of individual transactions or counterparties to financial assets (the code for the counterparty and the number of days in arrears at the level of the individual transaction) and the reporting of forborne financial assets (type of forbearance, date of initial forbearance, date of last forbearance) (the new Regulation on the assessment of credit risk losses of banks and savings banks; the Guidelines for the implementation of the regulation, March 2014).

The new secondary legislation also addresses liquidity management at banks, and the banks' policy of expanding into other parts of the financial sector. A requirement was introduced for banks to monitor and report on their liquidity flows, which should make a positive contribution to the quality of liquidity management at banks. The monitoring and reporting of liquidity inflows and outflows and of liquid assets is expected to give a better insight into a bank's future liquidity situation, an early warning of potentially problematic areas and the timely preparation of measures to prevent or bridge liquidity deficits (the new Regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks; the Guidelines for the implementation of the regulation, November/December 2013).

The other changes to secondary legislation were a response to practical findings in supervision. The questionnaire used in the assessment of the reputation and experience of a candidate for the position of member of the management board of a bank or savings bank was updated. The updated questionnaire sets out detailed questions for the efficient assessment of the reputation and experience of candidates for the position of member of the management board by the Bank of Slovenia (the new Regulation on the documentation for demonstrating fulfilment of the conditions for performing the function of a member of the management board of a bank or savings bank, January 2014). The levels of the individual fees and the ratios between the individual fees that banks pay for the issue of various authorisations have been changed.

Changes to secondary legislation as a result of the transposition of EU directives and EBA guidelines

Within the framework of its legal powers the Bank of Slovenia also passed several items of secondary legislation related to the implementation of EU banking legislation and EBA guidelines. A package of regulations was issued in connection with the transposition of the new financial conglomerates directive, which expanded supervision on a consolidated basis to groups headed by mixed financial holding companies (July 2013). There are no such groups for the moment in the Slovenian financial system. The EBA guidelines on the assessment of the suitability of members of the management or supervisory bodies and key function holders were transposed into Slovenian law by changes to Bank of Slovenia regulations (September 2013). On the basis of the changes banks will now have to adopt and implement policies setting out the criteria of reputation, experience and governance to be met by candidates for positions on management boards and supervisory boards. These criteria are also substantive guidelines for all entities participating in the proposal, selection or appointment of candidates for the aforementioned positions, including the owners of banks and savings banks. This should contribute to strengthening corporate governance at banks and savings banks. An amendment to the Regulation on the books of account and annual reports of banks and savings banks made minor changes to the structure of the statement of cash flows, and the structure of the statement of comprehensive income and the consolidated statement of comprehensive income, as a result of the amendments to IAS 1 and in consideration of the FINREP 3 form from the draft implementing technical standard on supervisory reporting. The Guidelines for compiling the statement of financial position, the income statement and the statement of comprehensive income, and for calculating performance indicators of banks and savings banks were also amended as a result (December 2013). For the implementation of new banking legislation, namely 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, which is applied directly in Member States, a regulation was issued to set out the manner and scope of the implementation of options and discretions and of other tasks that the aforementioned EU regulation assigns to the competent supervisory authority. These are primarily discretions that set out the way in which capital is calculated for banks during the transition period to full enforcement of the new rules and capital requirements for various types of risk and the treatment of certain other prudential requirements from the EU regulation (Regulation on the implementation of the EU regulation on prudential requirements for credit institutions and investment firms with regard to the implementation of options and discretions and of other tasks of the competent authority for credit institutions, January 2014).

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2013

The main strategic orientation of banking supervision is to design and introduce conditions for a stable and efficient banking system and for the security of deposits at banks and savings banks.

In the frame of this strategic objective and considering the current situation of the macroeconomic environment the main focus of banking supervision in 2013 were:

- evaluation of increasing credit risk in banks as a consequence of economic and financial crisis,
- carefully monitoring of overall liquidity in the banking system as well as the position of individual banks,
- emphasizing the attention to the capital position of banks and required increase of Tier I capital with the goal to increase robustness of banks,
- adoption of the national legislation according to the latest changes of EU legislation,
- further intensifying of cross-boarder cooperation with foreign supervisory authorities at IRB and AMA approval processes and supervisory colleges.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

The Bank of Slovenia has a mandate to conduct banking supervision. The principles of constant supervision and proportionality should in particular be applied in banking supervision, which means that supervision is conducted constantly and at all banks. Proportionality is applied by allocating the capacity available for supervision across the banks in relation to the estimated level of risk at each bank and the bank's importance to the stability of the entire banking system. The objective of supervision is that a comprehensive supervisory review is conducted every three years at each bank under the Bank of Slovenia's jurisdiction, and at least one examination is conducted at each bank every year.

An annual plan of bank reviews and examinations in a particular year is drawn up on the basis of the results and conclusions of the annual risk assessment in the banking system and at individual banks. Proceeding from the risk assessment and the requirements for constant and proportionate supervision, and with regard to the available capacity, ten prudential examinations at banks and banking groups were planned in 2013. In accordance with the level of credit risk, which is by far the largest risk at the banks operating in Slovenia, the plan envisaged an examination of credit risk at eight banks. The plan also included examinations of other areas of risk.

The planned thematic examinations focused on the following areas:

- in connection with the guarantee scheme, examinations of readiness for the implementation of the guarantee scheme at receiver banks and readiness for the timely and accurate submission of data to the supervisor and receiver banks were planned at five banks;
- examinations of the adequacy of the system and rules put in place for the prevention of money laundering and terrorist financing were planned at two banks;
- an asset quality review of eligible collateral for liquidity loans at the central bank was planned at three banks;
- a review of the fulfilment of the conditions for the use of an internal risk assessment model was planned at one bank.

Several extraordinary tasks were included in the plan. This was necessary because of an assessment of very large risks at certain banks where special measures have already been ordered, and delays in implementing these measures. These tasks comprised:

- permanent intensive monitoring of liquidity at three banks by order of the Crisis Management Group;
- a review of asset valuations during transfer to the Bank Asset Management Company;
- participation in activities to provide legal and other frameworks for the effective restructuring of the corporate sector, which were carried out at the initiative of the Bank of Slovenia.

The implementation of tasks in connection with bank recovery had a major impact on the implementation of the planned supervisory tasks in 2013. For this reason it was necessary to conduct a comprehensive asset quality review, and to assess the need for additional capital on the basis of stress tests. The new priority tasks required a larger HR component in supervision. Given the change in priority tasks and other capacities, in contrast to the plan there were just two regular prudential examinations conducted at two banks, while the numbers of follow-up examinations (22 examinations at 14 banks) and thematic examinations (20) were higher than planned. In addition to the areas previously planned, there was also an examination of the organisation of mortgage banking during the issue of a licence to a bank to provide mortgage banking services. Examinations of asset valuation and stress tests for the assessment of the need for additional capital were conducted at two banks. In conjunction with the Payment and Settlement Systems Department, three examinations were conducted at two firms that hold an authorisation to provide individual functions of payment transactions and to operate a payment system. In conjunction with the Securities Market Agency, a joint examination of the provision of custodian services and fund management was conducted at one bank.

The purpose of supervisory measures is to eliminate violations and deficiencies. Based on the findings of examinations and reviews, the Bank of Slovenia may issue banks with recommendations, admonishments or orders, or another measure in accordance with the Banking Act. There were 87 open (unresolved) measures in the process of implementation at the end of 2013, comprising 31 orders for the elimination of violations, nine admonishments, one recommendation to improve operations, and 46 additional requirements primarily relating to the need to meet capital requirements as assessed in the SREP, and to additional reporting for current monitoring of the implementation of measures and/or the monitoring of risks.

In the last two years there has been a notable trend of stricter supervisory measures being imposed. This was related to the adverse economic situation and the resulting difficulties in the performance of the banks and the corporate sector. Supervision is also identifying more serious or significant violations of regulations, such as significant shortfalls in the creation of impairments, difficulties in permanently meeting ever-increasing capital requirements as a result of increased risks, and persistent difficulties in meeting liquidity requirements, for which reason supervisors are imposing increasingly strict measures in the form of orders or even orders with additional measures. The number of measures issued is closely related to the materiality of the individual risk. A cross-section at the end of 2013 reveals that the largest number of open measures were in the area of credit risk, as it is the most significant risk at Slovenian banks, and the largest number of examinations are therefore conducted in this area.

In five cases banks were ordered to embark on procedures to investigate criminal liability and liability for damages on the part of the bank's responsible officers. This was necessary owing to the major violations identified in credit approval and credit risk management, and the resulting heavy losses and large capital deficit.

The failure to meet liquidity and capital requirements brought the most demanding action from supervisors. In September the contingency measure of an orderly wind-down was imposed on two banks that had failed to meet the required capital adequacy ratios as determined in the SREP and were no longer meeting liquidity requirements. A special administration was appointed, and the government recapitalised the banks and became their owner. The two banks had previously been the focus of intensive supervisory activity, particularly in the areas of analysis of the sustainability of the business model, liquidity, credit risk, and asset and collateral assessment. With the appointment of the special administration, the Bank of Slovenia assumed the role of the supervisory board and general meeting.

LICENSING

The Bank of Slovenia issued 16 authorisations in 2013, mostly authorisations to provide financial services and to hold office as a member of the management board of a bank. In four cases the procedure to issue the authorisation was suspended. The Bank of Slovenia issued five measures against members of the management board of a bank or savings bank during the reporting period.

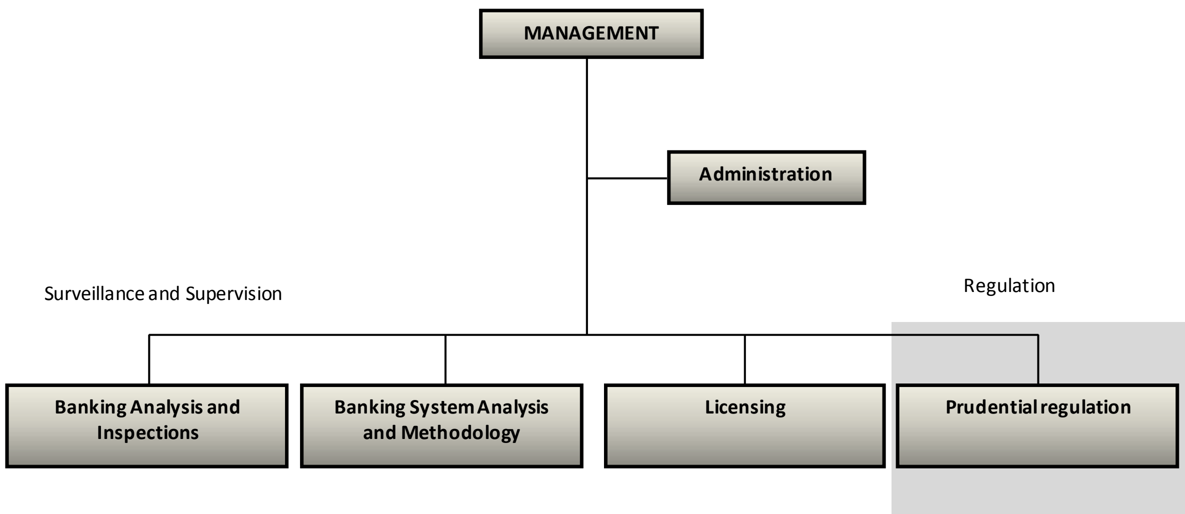
Two supervisory board members were dismissed at two banks in 2013 on the basis of Bank of Slovenia action. One resigned, while the other was issued with a ruling on disqualification from holding office as a member of the supervisory board of a bank. Five members of the supervisory board of banks and savings banks resigned from their positions in 2012 having been called to do so.

In 2013 the Bank of Slovenia received 16 notifications of the direct provision of services by banks of Member States in Slovenia, and one notification of the provision of services via a branch. A list of banks of EU Member States that may pursue their business activities in Slovenia is published on the Bank of Slovenia website.

A bank of a Member State that is entitled to provide banking services and other (mutually recognised) financial services in the bank's country of establishment may also provide these services in Slovenia. The Bank of Slovenia received 16 notifications of the direct provision of banking and other mutually recognised financial services in 2013 (the same as in the previous year), and one notification of the provision of mutually recognised financial services via a branch. Different arrangements apply to banks of third countries. Banks from third countries may only provide banking and other (mutually recognised) financial services via a branch, where the authorisation of the Bank of Slovenia is required for the establishment of a branch in Slovenia. There are no branches of a bank of a third country established in Slovenia at present.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

Organizational chart of Banking Supervision Department of Bank of Slovenia:



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

For the banks under majority foreign ownership, cooperation with foreign supervisors is firmly established within supervisory colleges, which in accordance with the provisions of the European capital directive have recently assumed an increasingly important role in the exchange of information of relevance to supervisors of an individual banking group, in the coordination of supervisory activities, in the formulation of a joint risk assessment of a banking group, its requisite capital and the allocation of capital within the group, in decisions on whether the conditions for using advanced models in risk assessment have been met, in the preparation of business plans for contingencies, and in relation to other matters of significance to the functioning of the entire group. Managing supervisors and examiners responsible for individual banks regularly participate in supervisory colleges for individual international banking groups. The Bank of Slovenia participates in seven supervisory colleges for the following banking groups: the Austrian banks Erste, Raiffeisen, Hypo Alpe Adria and Sberbank, the Italian banks UniCredit and Intesa SanPaolo, and the French bank Societe Generale. For the operational functioning of these supervisory colleges the Bank of Slovenia has signed the relevant multilateral agreements with all other supervisors involved in supervision of the particular group. Within the framework of the supervisory colleges for all seven foreign banking groups, which are headed by the supervisors of the banking group's parent bank, and where the Bank of Slovenia participates as host supervisor responsible for the subsidiary bank in Slovenia, nine joint meetings of colleges were organised in 2013, at which a joint decision on the capital adequacy of the banking group and of individual banks within the group was reached by all competent supervisors for five banking groups. In addition to regular meetings, an increasingly intensive exchange of information on various matters of significance to the entire group in question is developing under the aegis of the supervisory colleges: the majority of the supervisory colleges have regular briefings, usually on a quarterly basis, about the operations of the group in the form of supervisory notices, and, where necessary, briefings on significant events that have an impact on the operations of the entire group. There was a focus on the following themes in 2013: i) the preparation of an individual banking group for a comprehensive assessment of operations as part of the preparations for the introduction of the Single Supervisory Mechanism under the aegis of the ECB; ii) greater emphasis on information about the liquidity position of the group; iii) planned recapitalisations or restructuring; and iv) the new European regulations requiring groups to draw up contingency plans to be discussed within the framework of supervisory colleges. In addition to the regular supervisory information about the operations of banks in Slovenia from banking groups of Member States, the Bank of Slovenia also briefed consolidated supervisors on the results of the asset quality review and stress tests. In accordance with agreements in the supervisory colleges on the joint planning of the supervision of banking groups, Bank of Slovenia examiners worked with colleagues from the Austrian and Italian central banks on joint examinations of two subsidiary banks in Slovenia in 2013.

The Bank of Slovenia is responsible for organising and heading the supervisory colleges for the Slovenian banking groups of Nova Ljubljanska banka and Nova Kreditna banka Maribor. An extraordinary asset quality review and stress tests were conducted at the two banking groups in the second half of the year at the request of the European Commission to determine the actual need for capital, and recovery plans were drawn up for the two banks. With regard to the material significance of the results of the aforementioned activities, the two supervisory colleges, whose objective was primarily to determine a joint risk assessment and profile for the entire group on the basis of the risk assessment of all the participating supervisors, were postponed to the beginning of 2014, when the results of stress tests were known and the two parent banks had already been recapitalised.

Cooperation with supervisors of third countries and cooperation with supervisors of Member States on bilateral matters that are of significance solely to the signatories of the MoU and not to all the supervisors in the college are undertaken on the basis of bilateral memorandums of understanding. The Bank of Slovenia has MoUs with the foreign supervisory institutions from the following 13 countries: Austria, Belgium, Bulgaria, Bosnia and Herzegovina, France, Germany, Italy, Macedonia, Montenegro, the Netherlands, Republika Srpska, Serbia and the US. Their purpose is directly exchanging information on individual subsidiaries, and conducting joint examinations at banks. In accordance with an MoU, as the consolidated supervisor of the banking group the Bank of Slovenia participated in the completion of an examination at a subsidiary bank under the direct control of the supervisory authority from Bosnia and Herzegovina.

COOPERATION WITH OTHER DOMESTIC SUPERVISORY AUTHORITIES

On the basis of the rules on mutual cooperation between supervisory institutions, the Bank of Slovenia again worked constructively in 2013 with the other two supervisory authorities of the financial system, the Securities Market Agency and the Insurance Supervision Agency. This cooperation proceeded under the coordination of the Ministry of Finance, the body responsible for coordinating the joint work of the aforementioned supervisory authorities, the strategic development of the supervision of the entire financial system, and the active prevention and effective management of crisis situations in the financial system.

In accordance with the rules, the supervisory authorities are even more actively involved in the Commission for Mutual Cooperation. The commission in particular monitors the implementation of the strategic and annual policies put in place during coordination, and the supervisory authorities' MoUs and regulations on cooperation, and plans and coordinates the joint supervisory examinations. At joint meetings the commission consults on other matters relating to more effective supervision of individual financial sectors, banking, insurance and investment groups, and financial conglomerates.

The Bank of Slovenia assesses the mutual cooperation between the supervisory authorities in 2013 as positive. In 2013 the commission regularly discussed supervisory activities in the area of financial conglomerates and information on joint supervisory examinations conducted, and at the same time was briefed on activities in connection with the changes in the European legislation in the area of the financial system, including the introduction of the Single Supervisory Mechanism and the banking union, changes to the European directive on deposit guarantee schemes, the entry into force of the EMIR, the drafting of a new CRR and the CRD IV, activities in connection with the Solvency II directive and the other changes in the area of supervision of the insurance sector. At the meetings members of the commission also briefed one another on changes to Slovenian legislation in the area of the financial system and other systemically important and current issues in the financial sector, and on the work of the boards of supervisors of the EBA, the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).

In addition to the regular exchange of information and cooperation within the framework of the Commission for Mutual Cooperation, certain other joint activities were pursued in 2013. The following joint activities were carried out:

- the SMA and the Bank of Slovenia conducted the aforementioned joint examination at one bank;
- at the invitation of the ISA, the Bank of Slovenia participated for the first time in a supervisory college for an insurer that holds a significant qualifying holding in a bank.

The Bank of Slovenia cooperates with other competent authorities in Slovenia when irregularities and violations that exceed the jurisdiction of banking supervision alone are identified. This cooperation has strengthened in recent years, particularly in the area of criminal complaints. At the invitation or request of other authorities, the Bank of Slovenia contributed available data and information relating to banking supervision.

STATISTICAL TABLES

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

Type of financial institution	2011	2012	2013
Commercial banks[1]	22	20	20
Branches of foreign credit institutions	3	3	3
Cooperative banks	0	0	0
Banking sector, total	**25**	**23**	**23**

[1] including 3 savings banks

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

Type of financial institution	2011	2012	2013
Public sector ownership	24.2	22.9	54.9
Other domestic ownership	37.7	38.3	12.6
Domestic ownership total	61.9	61.2	67.5
Foreign ownership	38.1	38.8	32.5
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	43.5	57.5	0.0768
Branches of foreign credit institutions	100	/	0.7160
Cooperative banks	/	/	/
Banking sector, total	**42.6**	**56.2**	**0,0994**

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

Type of financial institution	2011	2012	2013
Commercial banks	-12.7	-19.2	-97.4
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total	**-12.5**	**-19.0**	**-97.3**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	98.7	98.3	97.8
Branches of foreign credit institutions	1.3	1.7	2.2
Cooperative banks	/	/	/
Other	/	/	/
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2011	2012	2013
Financial sector[1]	13.8	12.8	12.9
Nonfinancial sector[2]	64.8	63.3	56.3
Government sector[3]	12.8	14.8	20.7
Other	8.6	9.1	10.0
Liabilities	**2011**	**2012**	**2013**
Financial sector[1]	26.2	23.2	19.1
Nonfinancial sector[2]	42.9	45.2	51.7
Government sector	7.0	6.6	4.1
Capital	8.0	8.1	9.3
Other[4]	15.8	17.0	15.8

[1] banking sector
[2] non-banking sector
[3] included government debt securities
[4] included funding from ECB

Capital adequacy ratio of banks

Type of financial institution	2011	2012	2013
Commercial banks**	11.6	11.9	14.3
Cooperative banks	/	/	/
Banking sector, total**	**11.6**	**11.9**	**14.3**

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

Asset portfolio quality of the banking sector[1]
(share of impaired receivables / share of non-preforming loans[1])

Type of financial institution	2011	2012	2013
Non financial sector	11.1	14.4	13.3
- households[2]	4.5	4.9	4.1
- corporate	18.5	24.0	20.4

[1] Table includes only share of non-performing loans. Non-performing loans include all classified claims (financial assets at amortized cost and some risky-bearing off-balance sheet items) more than 90 days in arrears.
[2] Just citizens without small entrepreneurs

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

	Deposits	Loans
Households	63.70	34.67
Government sector	7.35	6.80
Corporate	18.61	47.42
Other (excluding banks)	10.35	11.11
Total	**100,0**	**100,0**

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

P&L account	2011	2012	2013
Interest income	2.207.430	1.944.092	1.504.051
Interest expenses	1.189.886	1.057.784	792.983
Net interest income	1.017.540	886.310	711.070
Net fee and commission income	346.460	339.436	339.486
Other (not specified above) operating income (net)	82.842	302.558	39.494
Gross income	1.446.842	1.565.693	1.090.051
Administration costs	687.096	658.268	640.262
Depreciation	89.502	84.411	79.644
Provisions	62.227	-30.100	123.057
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	1.144.536	1.629.502	3.600.558
Profit (loss) before tax	-536.521	-776.375	-3.353.475
Net profit (loss)	-441.998	-754.031	-3.490.414

Total own funds in 2013 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	3.754.219.146	3.554.445.754	199.773.393	/
Cooperative banks	/	/	/	/
Banking sector, total	**3.754.219.146**	**3.554.445.754**	**199.773.393**	**/**

* There is no Tier 3 capital applied in our banking system.

2013 DEVELOPMENTS IN THE TURKISH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT IN THE COUNTRY

GDP increased by 4.3% at constant prices in the first quarter of 2014 in line with the growth expectations determined by Medium Term Programme, prepared by the Ministry of Development. According to Programme, GDP growth rate is estimated to be 4% in 2014 and it is targeted to be 5% for both 2015 and 2016.

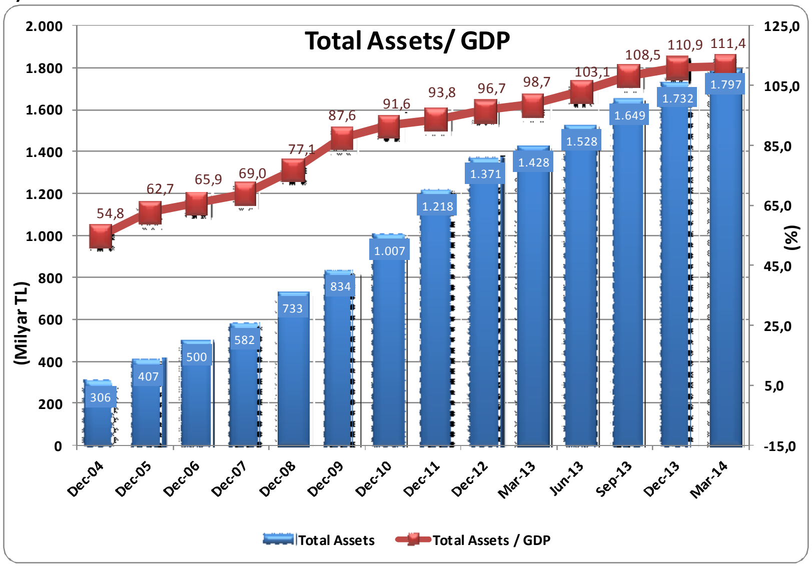
The current account deficit, which is considered as the main macroeconomic issue, was $64.3 billion (-8% of GDP) by January 2014 and decreased to $56.8 billion (-7.05% of GDP) by April 2014. Main reasons for this progress are higher amount of export, lower trade balance and macro prudential measures which decrease demand on imported goods by putting pressure on domestic demand. Thanks to macro-prudential measures taken by the Central Bank of the Republic of Turkey (CBRT) and Banking Regulation and Supervision Agency (BRSA), it converges to the target as $ 55.5 billion (-6.4 % of GDP) for the end of 2014.

The unemployment rate, which is estimated to be 9.4% at the end of 2014, realized as 9.7% as of March 2014. In the same period, employment rate realized as 45.1% while the target is 46.5% for the end of the year. As compared with the corresponding month of the previous year, Consumer Price Index increased by 9.66% in May 2014 while inflation target for the end of the year is 5.3%. General government nominal debt stock to GDP ratio (EU definition) realized as 36.3% in 2013. The targets determined in the Programme are 33%, 31% and 30% for the years 2014, 2015 and 2016 respectively. Also, IMF's estimation for 2014 is similar to target as 35.9%.

Turkey's economical outlook improves basicly with lower current account deficit and better than expected growth performance for the first quarter of 2014. There is no any important deviation from the Programme targets for the indicators mentioned above apart from inflation.

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

As of April 2014, there are 49 banks operating in Turkish banking sector (TBS). The total asset size of TBS is nearly 1.8 trillion TL which overpassed GDP. The total asset/GDP ratio is 111.4%.



The main investment item in assets is loan portfolio which has a 60.6% share in total assets. As of April 2014, the loan portfolio has reached to 1.1 trillion TL. The real annual increase in loan portfolio is 17.4%. The share of FX loans in loan portfolio is around 27.5% and the share of FX indexed loans is approximately 5%. In terms of segmentation, credit portfolio of the sector is granular. The share of corporate loans, retail loans and SME loans are 43%, 30.5% and 26.5% respectively. Also, in terms of sub-sectors, there is no substantial domination. NPL ratio is at 2.8% which is comparatively low when compared to other emerging markets.

Securities are the other important investment item. Total share of securities in the balance sheet is 16.5% and the amount of securities is nearly 295 billion TL. 69.7% of securities are classified in available for sale portfolio.

The main funding source is deposit (53.9% of total liabilities). As of April 2014, total deposit in TBS has reached to 967 billion TL. FX deposit constitutes 39.3% of total deposits. As of April 2014, funds from abroad item is around 138 billion USD and forms nearly 16% of total liabilities. Foreign borrowing includes repos, deposit, loans and syndication and securitization loans.

TBS's capital base is strong. CAR is 16.1% which is quite higher than 12% target CAR. Tier I CAR is nearly 14%. TBS has high and sustained profitability ratios. As of April 2014, annualized NIM is 3.2%, ROA is 1.3% and ROE is 12.1%. As of April 2014, the profit of banking sector decreased is 16%. During high interest rate environment, maturity mismatch of TBS (repricing deposit frequently than loan portfolio) effected profitability in a negative way. However, recently montly profits have started to increase.

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 positions.

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

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. And 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. And 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 will perform the independent audit, valuation, rating and outsourcing activities for banks. The number of institutions that are under the supervision of the BRSA are provided below.

Institutions Subject to Supervision

Types of Institutions	2009	2010	2011	2012	2013
Banks	**49**	**49**	**48**	**49**	**49**
Deposit Banks	32	32	31	32	32
Participation Banks	4	4	4	4	4
Development and Investment Banks	13	13	13	13	13
Non-Bank Financial Institutions	**135**	**122**	**118**	**122**	**122**
Financial Leasing Companies	47	35	31	31	33
Factoring Companies	78	76	75	78	76
Financing Companies	10	11	12	13	13
Other Institutions	**101**	**110**	**161**	**194**	**222**
Asset Management Companies	6	6	8	8	11
Institutions Authorized to Perform Independent Audits in Banks(*)	39	40	42	42	42
Rating Institutions	3	3	3	3	1
Valuation Institutions	4	14	56	91	114
Foreign Bank Representative's Offices in Turkey	42	40	45	43	47
Financial Holding Companies	3	3	3	3	3
Credit reference Institution	1	1	1	1	1
Card System Institutions	3	3	3	3	3
Total	**285**	**281**	**327**	**365**	**393**

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 incoporated into the scope of authority

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.

The Agency consists of the Banking Regulation and Supervision Board (Board) and the Presidency Organization. The Board is the decision-making body of the Agency and consists of seven members including the Chairman and Vice Chairman of the Board. Chairman is at the same time the President of the Agency. Presidency Organization consists of President, Vice Presidents and service units. Service units of the Agency consist of main service, advisory and auxiliary service units organized as departments. As of end-2013, there are sixteen departments within the Agency with board and decision affairs, human resources, training and communication, as well as administrative and financial affairs under the Department of Support Services.

The organizational structure is revised with a dynamic perspective to respond to evolving conditions, and necessary modifications are introduced to increase its efficiency. Recently, Department of Economic Assessments is established to closely and regularly follow up and evaluate national and international financial and economic developments and report them to the Agency’s senior management.

Another department that is established in 2013 is the Department of Financial Consumer Relations, the aim of which is to increase efficiency in financial consumer protection and introduce long lasting solutions for the problems of financial consumers. Furthermore, through amendment of Banking Law by Law No. 6693 dated 20 June 2013, the number of Vice Presidents has been increased to five from three, and the maximum number of the department increased to 20.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2013

"Strategic Plan 2013-2015" adopted in 2013 includes four main strategic objectives: (1) improving institutional capacity; (2) strengthening the regulation, supervision and enforcement framework; (3) boosting confidence, stability and competitiveness in financial markets; and (4) raising awareness among financial consumers and protecting them at the maximum level.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY LAST YEAR

In 2013, 1 new law, 4 laws amending the Banking Law, 5 new regulations and 2 new communiqués were published; 14 regulations and 3 communiqués were amended and 1 circular was issued. The new regulation regarding financial leasing, factoring and financing companies aimed at establishing an efficient oversight and supervision system for these companies; ensuring that these companies take an active role in the financial system and have a strong financial structure.

Throughout the audit activities, a total of 500 reports were prepared. In oversight function, a total of 2,424 bank-level reports were prepared, including 224 monthly and 2,200 weekly reports. Furthermore, through a change in organizational structure, oversight activities carried out by various units and audit groups have been combined under a single structure.

In 2013, 7 establishment permits of which 2 are for banks, and 8 operation permits of which 1 is for a bank were issued; and 24 companies were authorized for valuation and 2 for independent audit.

Macro-prudential policy instruments for consumer loans and credit cards were implemented within the framework of the requirements of financial conjuncture. These measures which are particulary related to credit card limits, minimum payment rates, installment limitations, risk weights, general provisioning rates and loan-to-value ratios were intended to raise domestic savings and contain the growth in consumer loans, in order to ensure a high and stable growth dynamic.

A draft strategy and action plan for financial consumers was prepared by the BRSA, with the cooperation of the related authorities. The strategy and action plan includes five basic objectives: Reinforcement of regulation and supervision framework, enhancement of institutional capacity of responsible authorities, ensuring the financial institutions to act responsibly, improvement of policies and practices regarding safety of consumer information, ensuring financial consumers to behave in informed and conscious manner, increasing efficiency in conflict resolution mechanisms. Accordingly, three public service spots aiming to strengthen financial literacy were prepared with the contributions of the related institutions and associations.

Basel III rules started to be implemented to further strengthen the own funds structure of banking sector. In this context, regulations and amendments regarding own funds, capital buffers and measurement and evaluation of capital adequacy and leverage ratios of banks were published.

"Participation Banking and Interest-Free Finance Workshop" was organized through the cooperation of BRSA and Participation Banks Association of Turkey in December 2013 with the participation of all related parties. Main purposes of the workshop were to identify the basic dynamics for development of interest-free financial markets in a sound a sustainable manner in Turkey, and lay down concrete suggestions to contribute to the strategies and action plans for establishing the necessary infrastructure.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

As of December 31, 2013

PRESIDENT

- Department of Legal Affairs

VICE PRESIDENT

- Department of Enforcement I
- Department of Enforcement II
- Department of Enforcement III
- 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 Strategy Development
- Department of Information Management
- Department of Foreign Relations

VICE PRESIDENT

- Department of Regulation
- Department of Access to Information

VICE PRESIDENT

- Department of Audit IV
- Department of Economic Assessments

VICE PRESIDENT

- Department of Audit I
- Department of Audit II
- Department of Audit III
- Department of Risk Management

Beginning from March 16, 2014

PRESIDENT

- **Department of Legal Affairs**

VICE PRESIDENT

- **Department of Enforcement I**
- **Department of Enforcement II**
- **Department of Enforcement III**
- **Department of Support Services**

* Board Affairs and Decisions Directorate
* Human Resources Directorate
* Training Directorate
* Administrative Affairs Directorate
* Financial Affairs Directorate

VICE PRESIDENT

- **Department of Strategy Development**
- **Department of Audit IV**
- **Department of Economic Assessments**

VICE PRESIDENT

- **Department of Regulation**
- **Department of Financial Consumer Relations**

VICE PRESIDENT

- **Department of Information Systems Compliance**
- **Department of Data and System Management**
- **Department of Institutional Communication and Foreign Relations**

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 internationalcorporation. 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) which conducts studies to enhance effective risk management practices and market discipline in banks and to improve efficiency of capital adequacy measurement techniques. BRSA also became a member of Islamic Financial Services Board (IFSB) which conducts studies on ensuring standardization in Islamic financial services on December 2010. 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.

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 2013. The meetings focused particulary on evaluations regarding the developments in the financial sector, Istanbul Financial Center Project and measures for boosting domestic savings.

The Coordination Committee 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 the meetings held in 2013, 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.

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 two meetings in 2013.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN THE COURSE OF LAST YEAR

Law No. 6493 on Payment and Securities Settlement Systems, Payment Services and Electronic Money Institutions, which was prepared to ensure alignment with the EU acquis and sound development of payment services, define the main concepts involved and establish the rights, obligations and sanctions, was published in June 2013. Law No. 6493 provides that payment system and security settlement system operators shall be regulated by the CBRT, and the authorization and supervision of payment institutions and electronic money institutions be undertaken by the BRSA.

Efforts for creating a regional financial center in the short term and an international financial center in the long term continued with Istanbul Financial Center Project. Through this project, which would further strengthen the integrated structure of the sector with international financial system, financial product diversity and financial deepening are expected to increase. Istanbul Financial Center Project is expected to play a key role in directing international interest in the field of participation banking towards Turkey in the near future.

STATISTICAL TABLES

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

Type of financial institution	2011	2012	2013
Commercial banks	29	30	31
Branches of foreign credit institutions	5	5	5
Cooperative banks	N/A	N/A	N/A
Banking sector, total:	**48**	**49**	**50**

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

Type of financial institution	2011	2012	2013
Public sector ownership	30,1	29,7	30,4
Other domestic ownership	54,9	54,8	52,9
Domestic ownership total	85	84,5	83,2
Foreign ownership	15,1	15,5	16,7
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	35,5	54,2	788,9
Branches of foreign credit institutions	0,23	(There are only 5 branches already) (0,26)	0,03
Cooperative banks	N/A	N/A	N/A
Banking sector, total:	35,5	39,1	792,5

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

Type of financial institution	2011	2012	2013
Commercial banks	%16,67	%16,71	%15,04
Cooperative banks	N/A	N/A	N/A
Other	%6,03	%6,83	%6,57
Banking sector, total:	%15,48	%15,68	%14,19

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
Commercial banks	95,7	95,6	95,7
Branches of foreign credit institutions	0,3	0,3	0,3
Cooperative banks	N/A	N/A	N/A
Other	4	4	4
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2011 *	2012**	2013**
Commercial banks	13.1	14.8	14.2
Cooperative banks	13.4	13.8	13.4
Banking sector, total:	13.1	14.7	14.1

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

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

Asset classification	2011	2012	2013
Non financial sector	%2,7	%2,9	%2,8
- households	%2,9	%2,9	%2,9
- corporate	%2,3	%2,6	%2,4
-Sme*	%3,1	%3,2	%3,1

*Current data classification of loans excludes Sme loans from corporate loans

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

	Deposits	Loans
Households	58,4	27,6
Government sector	5,5	0,7
Corporate*	36,2	71,7
Other (excluding banks)*	**N/A**	**N/A**
Total	**100.0**	**100.0**

* Corporate loans include Sme and corporate loans

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

P&L account	2011	2012	2013
Interest income	88.158.917	109.895.967	110.631.034
Interest expenses	48.829.258	57.642.130	53.287.299
Net interest income	39.329.659	52.253.837	57.343.735
Net fee and commission income	14.468.405	15.921.202	18.825.106
Other (not specified above) operating income (net)	-8.175.291	-13.947.153	-17.866.680
Gross income	114.423.020	138.462.643	144.947.656
Administration costs	24.323.904	25.578.178	32.783.347
Depreciation	1.700.902	1.870.877	2.131.277
Provisions	3.909.184	4.494.060	4.961.354
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	1.769.971	3.519.809	3.364.517
Profit (loss) before tax	25.242.478	30.107.356	31.144.967
Net profit (loss)	19.844.485	23.522.525	24.664.343

*Net Operating Income mainly consists of net interest income after provisions+net fee and commission income-administration costs-depreciation-provisions+net capital market transactions profits+net foreign currency gains. Therefore, other net operation income without these items consists of only net capital market transactions profits and net foreign currency gains.
**Provisions consist of special provisions for non-performing loans, provisions for general loan losses, termination indemnities, securities impairment, affiliates, subsidiaries and joint ventures impairment.
***Other provisions.

Total own funds in 2013 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	69.508.386	58.181.558	11.667.669	N/A
Cooperative banks	N/A	N/A	N/A	N/A
Banking sector, total:	76.087.799	64.620.217	11.815.232	N/A

Notes:

- With respect to questions regarding ***Number of financial institutions***, **other** implies Investment and Development Banks.
- With respect to your question regarding ***ownership of banks***, a bank is considered foreign owned only when the majority of shares are controlled by foreigners.
- There are no cooperative banks in Turkish Banking Sector, that's why questions regarding cooperative banks are filled N/A.
- With respect to your question regarding ***the structure of assets and liabilities,*** the table is left blank, since there is no applicable data classification.
- With respect to the question regarding ***asset portfolio quality of the banking sector,*** the calculation is based on NPL/(NPL+Loan) ratio.

2013 DEVELOPMENTS IN THE UKRAINIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2013 economic development of Ukraine was defined by unstable political situation, trade barriers introduced by the Russian Federation, slow dynamics of global commodities markets and low propensity of economic agents to invest. This had a respective impact on Ukraine's economic indicators.

Thus, in 2013, real GDP demonstrated zero growth compared to 0.2% in 2012. Nominal GDP equalled to UAH 1 455 trillion. Industrial output declined by 4.7% in 2013, while real effective household income rose by 5%.

Headline inflation made 100.5%. The producer price index was 95.3%.

The core inflation rate for 2013 made up 0.1%.

In 2013, net foreign direct investment inflow was USD 2.860 billion (the real economy sector received 31% of the investment).

DEVELOPMENT IN THE BANKING SYSTEM

As of January 1, 2014, 180 banks had the National Bank of Ukraine license to engage in banking activities.[19]

49 banks with foreign capital were operating in Ukraine, of which 19 banks were banks with 100% foreign capital. The percentage of foreign capital in the registered authorized capital of Ukrainian banks decreased from 42% to 39.5% in a year.

Foreign capital in Ukraine is represented by 26 countries. The highest shares within the total amount of foreign capital belong to Cyprus - 32%, the Russian Federation - 31% and Austria - 12%.

The banking system of Ukraine has completed the year 2013 with the following positive trends secured:

- In a year, total assets were up by 11%, to UAH 1 409 billion (EUR 128 billion);
- Lending to economic entities increased by almost 15%, to UAH 700 billion (EUR 63 billion);
- Bank's liabilities grew by 13%, to UAH 1 085 billion (EUR 98 billion);
- Household funds rose by 19%, to UAH 434 billion (EUR 39 billion);
- Legal entities' funds were up by about 16%, to UAH 235 billion (EUR 21 billion);
- Banks' regulatory capital increased by almost 15%, to about UAH 205 billion (almost EUR 19 billion). Banks' authorized capital increased by almost 6%, to UAH 185 billion (EUR 17 billion).
- The banking system made a profit of about UAH 1.5 billion (EUR 136 million) in 2013.

[19] Of which one bank was licensed to act as a remedial bank.

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 2013

In 2013, the National Bank of Ukraine took steps to maintain stability of the banking system of Ukraine, raise lending to the real economy sector, improve the loan portfolio quality, reduce the share of nonperforming loans and ensure appropriate supervision over banking activity.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2013

In 2013, 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:

- Regulation *On the Procedure for Banks Registration and Licensing*, *opening of separate subdivisions* and Regulation *On the Procedure for Submitting Data on the Ownership Structure.* The amendments provided for special aspects of document submittal by the owners of qualifying holding in a bank and by international financial institutions, as well as for the format of publishing the information on owners of qualifying holding in a bank on the NBU web-site;
- Instruction *On the Order of Regulation of Bank Activities in Ukraine* with regard to:
  - improvement of procedure for including mortgage bonds and mortgage loans granted by banks and used to back these bonds, as well as government-guaranteed loans on investment activities in calculation of capital adequacy ratio;
  - improvement of approaches to accounting in bank’s capital for funds raised as subordinated loan, as well as procedure for calculation of credit risk ratios.

- Regulation *On Procedure for Establishment and Use by Ukrainian Banks of the Provisions against Losses under Asset-Side Banking Transactions* with regard to broadening the list of collateral eligible for provisions calculation.
- Regulation *On Procedure for Submittal of Banks' Annual Audit Reports to the National Bank of Ukraine* was amended to reflect changes in the submittal deadline for auditor's reports and financial statements of banks, and to include requirements on submittal by auditors of information on assessment of provisions and capital adequacy in line with the NBU regulatory documents, as well as explanations and working papers on bank's audit (also on electronic media);

Also, *the Procedure for Calculation of Economic Ratios of Banks' Activities* in Ukraine was amended to introduce changes in the economic ratio calculation algorithm, in particular in regards of accounts for contributions to non-registered authorized capital, results of financial instruments' value adjustments at initial recognition, provisions against debt securities interest arrears, other financial investments, loans in investment activity.

ORGANIZATIONAL STRUCTURE OF THE BANKING SUPERVISORY AUTHORITY

In 2013, the following structural subdivisions within the National Bank of Ukraine were responsible for banking supervision:

- General Department of Banking Supervision;
- Department for Legal and Methodological Support of Banking Regulation and Supervision;
- Department for Registration, Licensing and Reorganization of Banks;
- Financial Monitoring Service.

General management of the said subdivisions was effected by the NBU Deputy Governor in charge of banking supervision.

INTERNATIONAL ACTIVITIES OF THE BANKING SUPERVISION SERVICE

During 2013, the National Bank of Ukraine continued to cooperate with the international financial institutions in the area of banking supervision and to maintain contacts with foreign supervisory authorities.

The National Bank of Ukraine cooperated with the IMF under the Stand-by Arrangement and with the World Bank on preparation of the First Programmatic Financial Sector Development Policy Loan and receipt of consultations and expert assistance on some issues of banking regulation and supervision.

Overall, the National Bank of Ukraine had entered into bilateral Memoranda on cooperation with supervisory authorities of 14 countries, namely: Greece, Cyprus, Latvia, Kyrgyz Republic, Republic of Armenia, Lithuania, People's Republic of China, Republic of Poland, Republic of Belarus, Russian Federation, Luxemburg, Hungary, Turkey and Sweden.

The National Bank of Ukraine has also signed two Multilateral agreements on cooperation and coordination of supervision over OTP Group and Cyprus

Popular Bank. The National Bank of Ukraine experts took part in supervisory college meetings concerning these banking groups.

COOPERATION WITH OTHER SUPERVISORY AUTHORITIES

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	2011	2012	2013
Commercial banks	176	176	180
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**176**	**176**	**180**

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

Type of financial institution	2011	2012	2013
Public sector ownership	14.1	15.4	15.5
Other domestic ownership	47.9	46.1	51.7
Domestic ownership total	62.0	61.5	67.2
Foreign ownership	38.0	38.5	32.8
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	32.3	40.0	0.0517
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	-	-	-

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

Type of financial institution	2011	2012	2013
Commercial banks	-5.27	3.03	0.81
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**-5.27**	**3.03**	**0.81**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2011	2012	2013
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	2011	2012	2013
Commercial banks	18.90*	18.06*	18.26*
Cooperative banks	-	-	-
Banking sector, total:	18.90*	18.06*	18.26*

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

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

Asset classification	2011	2012	2013
Non financial sector	13.8	16.5*	12.9*
- households	**4.3**	**6.2**	**4.6**
- corporate	**9.5**	**10.3**	**8.3**

(*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 2013 (%)
(at year-end)

	Deposits	Loans
Households	62.1	18.1
Government sector	0.4	0.7
Corporate	33.7	75.6
Other (excluding banks)	3.8	5.6
Total	**100.0**	**100.0**

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

P&L account	2011	2012	2013
Interest income	11.007	11.156	11.767
Interest expenses	5.778	6.451	7.325
Net interest income	5.229	4.705	4.442
Net fee and commission income	1.496	1.710	1.901
Other (not specified above) operating income (net)	-984	-700	-653
Gross income	13.865	14.229	15.295
Administration costs	3.333	3.524	3.683
Depreciation	343	366	370
Provisions	3.545	2.215	2.533
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-	-	-
Profit (loss) before tax	-631	499	278
Net profit (loss)	-749	463	130

Total own funds in 2013 (in EUR)

Type of financial institution	Total own funds (for CAR)	Tier 1	Tier 2	Tier 3
Commercial banks	19.00	14.12	4.89	-
Cooperative banks	-	-	-	-
Banking sector, total:	19.00	14.12	4.89	-

MAIN GROUP EVENTS OF THE YEAR 2013

26th Annual BSCEE Members' Conference

Sarajevo, Bosnia and Herzegovina, June 12 – 14, 2013

The Chairmanship of the BSCEE Group in 2013 was held by the Banking Agency of the Federation of Bosnia and Herzegovina and Mr. Zlatko Barš, Director of the Banking Agency of the BiH, was entrusted the position of the Chairman. Therefore, the 26th Annual BSCEE Members' Conference was hosted by the FBA of Bosnia and Herzegovina on April 12 - 14, 2013 in Sarajevo.

The two day conference was dedicated to the themes of *Modalities of the NPL resolving* and *BSCEE vs. Basel III: Capital Requirements*. It was attended by around forty representatives of the central banks and supervisory institutions from twenty four countries from Central and Eastern Europe, and other institutions for banking supervision. The conference, with words of welcome, was opened by the Director of the Banking Agency of the F BiH and the Chairman of the BSCEE, Mr. Zlatko Barš, the Director of the Banking Agency of RS, Ms. Slavica Injac, and the Governor of CBBH, Mr. Kemal Kozarić. International experiences, among others, were presented by the representative of the Bank for International settlements (BIS) from Basel and the Advisor to the Executive Board of the European Central Bank.

The meeting was held with a goal to, through exchange of opinion and coordination, strengthen the regulatory functions which are of key importance for the promotion of stability of the banking system and its integration. Furthermore, in the work of this year's conference special attention was devoted to the consideration of the future improvements in the cooperation in the area of bank supervision in the central and Eastern Europe, protection of the financial stability in the region and the role of the bank supervision in that regard. In addition, exchanged were the notions and insights in regard to the application of the provisions of the so called Basel III in the banking supervision, as well as ways to reduce the non performing loans which weigh down the banks' operations.

The Central Bank of the Republic of Armenia volunteered to hold the 2014 BSCEE Chairmanship as well as host the 27th Annual Conference and the Member countries accepted this candidature by acclamation.

FSI – BSCEE Regional Seminar

Yerevan, Armenia, May 14 – 16, 2013

The Central Bank of Armenia in cooperation with the Financial Stability Institute and the BSCEE Secretariat organized a regional seminar for BSCEE member countries on *Revised Core Principles* and *Basel III.* The emphasis of the seminar was on discussing practical issues with supervisory and industry experts. The programme for the seminar covered the topics of:

- The 2012 revision to The Core Principles
- Supervisory approach, techniques and tools
- Basel III: Micro-prudential elements
- Capital Buffers as a Macro-prudential tool
- Core Principles Self-Assessment
- Case Study on Basel III capital buffers and on Core Principles

BSCEE High-Level Meeting in Basel, Switzerland, March 12, 2013

The third High-Level Meeting was jointly organized by the Basel Committee on Banking Supervision (BCBS), the Financial Stability Institute (FSI) and the Group of Banking Supervisors from Central and Eastern Europe (BSCEE), on *Strengthening Financial Sector Supervision and Current Regulatory Priorities*.
The meeting was organized as a joint forum for heads of supervisory authorities from Central and Eastern Europe. The objective was to discuss the latest developments in banking and banking supervision, and promote an active and productive dialogue on the challenges the banking supervisors face.

The specific topics that were discussed during the meeting included:

- Aspects of the "Basel III Health Plan"
- Mission Possible: Implementation of Basel III
- Current Work on Recovery and Resolution
- On-going Focus: Systemically Important Banks
- Supervision of Liquidity Risk
- International Regulation and its Challenges – a Regional Perspective
- Latest Developments in Accounting and Current Issues for Supervisors
- Operationalising the Selection and Application of Macroprudential Instruments
- The Swiss Policy Framework for Systemically Important Banks
- Eastern European Banking Sector – Insights from the Private Sector
- Cross Border Issues in the Eastern European Financial Sector

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