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Group of Banking Supervisors from Central and Eastern Europe

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INTRODUCTION

The Group of Banking Supervisors from Central and Eastern Europe (the BSCEE Group) was established in 1990. The BSCEE Group has started its traditional activity since the Stockholm International Conference of Banking Supervisors (ICBS). The BSCEE Group is operating according to its Agreement that determines its organizational structure and the rules governing its operations. It was originally signed by seventeen member countries: Albania, Republic of Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Poland, Romania, Russia, Slovakia, Slovenia and Ukraine. The Chairmanship of the BSCEE Group rotates on annual basis: In 1999, the Deputy Governor of the Bank of Slovenia, in 2000 the Chief Executive Director at the Czech National Bank fulfilled the position. In 2001 the Director of the Credit Institution Supervision Department at the Bank of Lithuania chairs the Group. The BSCEE Group has expanded its' membership to the Federation of Bosnia and Herzegovina.

The function of the Secretariat of the BSCEE Group also rotated on an annual basis until 1996. In 1996 the BSCEE Group entered into an agreement setting out a framework for cooperation and coordination in organizing common events. The primary role of the Secretariat is to provide technical assistance in organizing conferences, leaders' meetings, workshops, and training seminars. The Secretariat also facilitates cooperation among the member countries as well as provides documents for their work. The permanent Secretariat of the Group is located in Budapest, at the Hungarian Financial Supervisory Authority (HFSA).

According to the previous years tradition the Annual Report of the BSCEE Group summarizes the developments of the member countries in 2000. This publication gives an overview of the macroeconomic circumstances in the 18 member states, and it describes the banking sector as well as the supervisory activities.

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

I hope that you will consider this publication informative and useful. I am sure that this will help you to 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 Basle Committee.

Deák Andrea

Andrea Deák
Senior Coordinator
of the Secretariat

CONTENTS

2000 DEVELOPMENTS IN THE BANKING SYSTEM OF THE MEMBER COUNTRIES

2000 DEVELOPMENTS IN THE ALBANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The Albanian economy was characterised by stability and the achievement of macroeconomic targets in the year 2000. GDP increased by 7.8%, the inflation rate was 4.2%. Consequently, an upward trend in foreign direct investments was noticed; in 2000 FDI amounted to 143 million USD, the highest amount recorded.

Based on this stable macroeconomic situation, BoA abandoned the application of direct instruments of monetary policy, and during the second half of 2000 started to use exclusively indirect instruments, which showed positive effects in decreasing interest rates in economy.

The year 2000 showed a boost in supplying credits for the economy. The banking system granted 24 billion leks in loans, which was three times as high as in the previous year. That reflected the close relationship between the banking system and the Albanian economy, as well as the support that banking system is giving to the economy for its further development.

The stable economic situation created an environment for a relatively safe and sound banking system. What is more, the banking system's performance affected the economic development of the country. Banks and other financial institutions play an important role in the financial system and economy of a country. Therefore, the public follows their activities attentively and with great interest.

DEVELOPMENT IN THE BANKING SYSTEM

During 2000, especially non-bank entities and foreign exchange bureaus noticed an increasing interest of various entities for activities licensed by BoA.

The number of banks and branches of foreign banks in Albania continued to be 13 during 2000. There were no new banks opened; however, existing banks increased their number of branches, expanding their branch network all over the country.

Number of banks that compose the banking system

Group of banks according to ownership	1998	1999	2000
G1 (state-owned banks)	2	2	1
G2 (joint-venture banks)	2	2	2
G3 (private banks)	6	9	10
Total banks	**10**	**13**	**13**

Characteristics of the development of banking system for 2000 were the following:

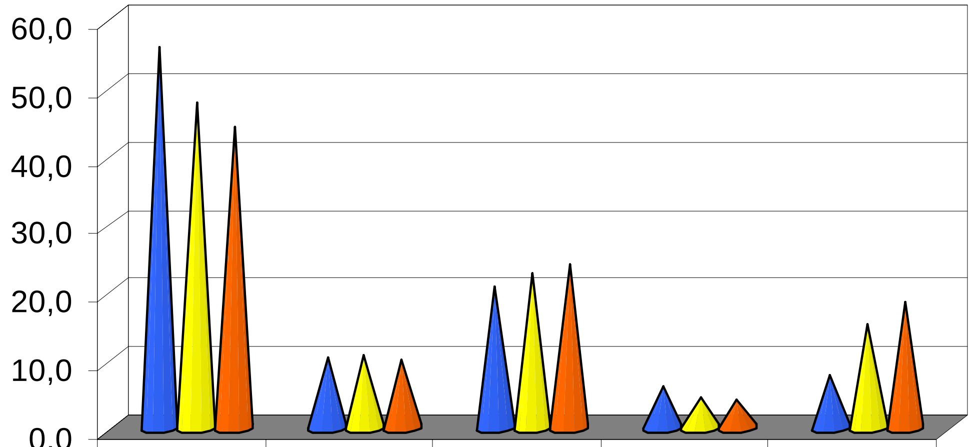
- Expansion of the banking system via branch network, bank offices and agencies, associated with an increasing number of bank employees, improvement and extension of bank service technology (i.e., SWIFT, at least one ATM was installed, or new products were introduced, such as consumer loans).
- Acceleration of privatisation process for state-owned banks. The privatisation process for National Commercial Bank (the second largest state-owned bank) was completed, and the privatisation of the Savings Bank – the largest bank that has a dominant position in the banking market for saving accounts and t-bills - is underway.
- Banking activities continued to be offered only by universal banks; there has been no attempt to open any specialised or cooperative bank;
- Expansion of activities by non-banks; the first non-bank institution licensed by BoA was *Unioni Financiar* in 1999, which further expanded its activity during 2000. This institution had 77 offices in all districts at year-end 2000, from 22 at year-end 1999.
- Competition in the banking system increased and was an incentive, on one hand, to expand bank's activities, provide a wider range of products and improve their quality, and on the other hand, to find potential ways to reduce costs;
- Increase of the percentage of foreign capital in banking system from 59.8% as of year-end 1999 to 84% of the capital of banking system as of year-end 2000, causing the decrease of percentage of the capital of state-owned banks in the banking system;
- Banking system ended the year with a profit;
- Increase of lending activity and improvement of loan portfolio quality for all banking system.

The Albanian banking system's activity in 2000 increased by 31.5% and 8.6% compared with 1998 and 1999, respectively. Banks of G2 and G3 had the greatest impact on this increase.

The expansion of activities for G2 and G3 banks has slightly reduced the dominance of banking system by state-owned banks, although the market share of this group of banks continues to be high. The privatisation of the Savings Bank will further change the market shares in favour of G3 banks, which it is expected to represent the largest group in banking system, considering both the number of banks and balance sheet; however, the dominance issue will not be solved immediately.

The phenomenon of concentration in one activity or a few activities continued during year 2000. The banking system invested mainly in: treasury bills, which represented 55.5% of total assets; accounts with banks (mainly non-resident banks) for 20.6% of total assets; loans for 6.1% of total assets; and securities 2.9% of total assets. Banks continued to invest in risk-free or low risk investments, while loans represented minimal figures. Hence, banks have chosen easy ways to make profits, while minimizing risk.

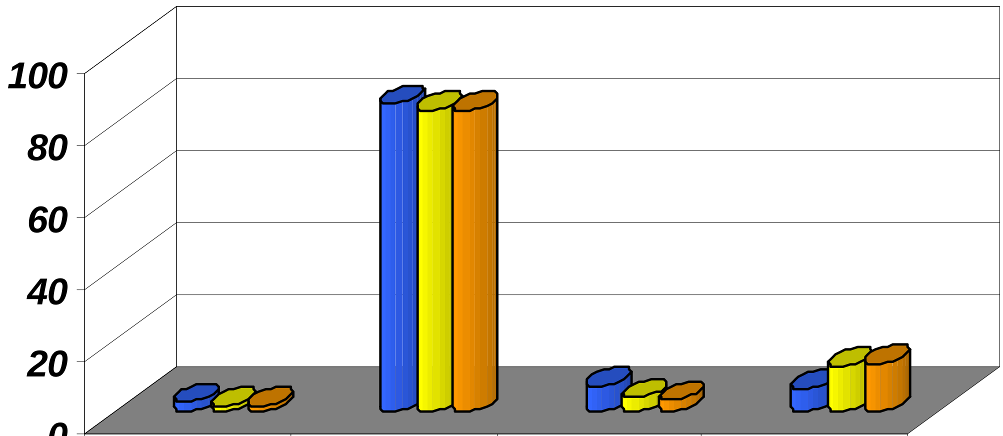
Asset structure for banking system



	T-bills	Acc. with central	Accounts with other	Net loan	Other
2000	55,5	10,3	20,6	6,1	7,5
1999	47,4	10,6	22,5	4,3	15,2
1998	43,9	10,0	23,7	4,2	18,2

Deposits were the main source for funding banking activities (84.8% of total assets of banking system), while shareholders' equity represented 6.7% of total assets. Indicators showed an upward trend during 2000 compared with the previous year. This revealed the fact that with the increasing of public confidence in banks, banks more efficiently exercise their role as financial intermediaries by increasing the utilization of third parties funds. Meanwhile, accounts between banks remained in very low levels, which reflects frozen relationships in inter-bank market and completion of most of transactions via Bank of Albania.

Liabilities and shareholders' equity structure of banking system



	Interbank operations	*Accounts & deposits*	*Shareholders' equity*	*Other*
2000	*2,3*	*84,8*	*6,7*	*6,2*
1999	*1,3*	*82,9*	*3,6*	*12,2*
1998	*1,4*	*83,0*	*2,8*	*12,8*

Deposits of the banking system at year-end 2000 increased by 9.7% compared with year-end 1999.

Nevertheless, deficiencies in legal framework, country risk, lack of knowledge of economic environment by banks, as well as lack of the public's culture to work with banks efficiently, resulted in banks being a little passive in engaging themselves into risky activities (more profitable) and offering a wider range of banking products.

The general condition of the banking system during 2000 was estimated as relatively sound. In general, indicators for the banking system showed improvements at year-end 2000; earnings for 2000 amounted to 5.3 billion leks up from 1.2 billion for 1999. The banking system made a profit for the second consecutive year, after a period of four-year generating losses.

Net interest income had the most significant impact on earnings for 2000. Net interest income as of 31.12.00 reached 7.7 billion leks (up from 5.1 billion as of 31.12.99 or 39.3 million loss as of 31.12.98). The increase of net interest income was affected, among other factors, also by the following:

- decrease of interest rates, which had stronger effect in decrease of interest rates on liabilities than on decrease of interest rates on assets;
- Albanian banking system faced relatively weak competition, which enables the keeping of high interest margins.

Interest income was the main source of income generated by the banking system during 2000, representing 75.5% of total banking system income. Interest income consisted of the following:

- income from investment in t-bills;
- income from deposits and current account with foreign banks; and
- income from loans.

On the other hand, interest expenses were the main expenses for banks. About 51% of total income for 2000 was spent for interest expenses, mainly for customers' deposits.

In general, the net interest margin for the banking system increased, affecting the increase of net interest income.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS

Banking supervision functions are exercised according to law no. 8269, dated 23.12.1997 "On the Bank of Albania" and law no. 8365, dated 02.07.1998 "On Banks in the Republic of Albania". This legal framework and the Basle Committee recommendations for effective banking supervision have fostered the development of the banking supervision regulatory framework. In the development of the banking industry and expansion of foreign investment in the Albanian banking industry, the activities of banking supervision and regulations have been flexible to reflect and adapt to banking system development. Banking supervision has made efforts to implement recommendations of the Basle Committee for effective banking supervision by adopting the best practices.

The co-operation between the supervisory authorities of different countries, especially between those of Central Eastern European countries, has been an important factor for the development of banking supervision in designing the supervisory regulations and manuals according to international standards. Banking supervision has played a crucial role in identifying problems in current financial conditions of particular banks and improving their financial condition.

Law no. 8537, dated 18.10.1999 "On secured transactions" became effective in January 2000. The purpose of drafting this law was the establishment of securing rights, that according to this law are called "charges (or liens)" and ensuring the creditor that the debtor is going to meet its obligations, a very important moment for banks regarding their lending activities. Based on this law, according to "Charge (lien) agreement", a commercial entity ("charge" or "lien holder") grants loans, and in exchange gains the right on a movable property or on real estate property (collateral) of the borrower-debtor.

This law applies to transactions between various customers (e.g., operations that aim at giving loans). The benefit of securing finance is in transactions between commercial entities and lending institutions (banks).

The law "On securing charges" considers the charge agreement as "an executive title". This instrument for execution of an unsecured monetary obligation is considered very efficient, especially considering the Albanian lending history. Implementation of this law will be a guarantee for banks in case of defaults of loan payment.

A considerable achievement was the implementation of quantitative assessments of bank financial conditions based on CAMELS rating and banks' classification matrices. In addition, this was associated with the development of on-site and off-site manuals.

Assessment of bank financial conditions according to CAMELS rating, includes the following components:, C - capital and capital adequacy; A - asset quality; M - management E – earnings, L – liquidity, S - sensibility to market risk

This system is used to assess the performance of financial institutions on an equal basis and identify institutions that need special supervision. The assessment is made using numbers from 1 to 5. Rating "1" shows a generally very successful condition of the bank and minimum supervision by supervisory authorities, while rating "5" demonstrates unsafe conditions and poor practices, critical situation for the bank, therefore, the highest concerns for supervisory authorities. The assessment shows the general condition of the bank, its compliance with legal and regulatory framework, and management abilities of banks' administrators.

By using CAMELS rating, on-site supervision has increased significantly the scope of recognising the financial condition of banks and identifying in time the risks that banks face, hence, strengthening the overall performance of banking system.

Moreover, by using the same rating, off-site supervision has unified bank assessment and is helping in the early warning of negative performance that individual banks or banking system may face.

Changes in the organization of the Bank Supervision Department during the fourth quarter of 2000 aimed at increasing the role of the department in decision-taking and preparing BoA's policies. This was accomplished by naming the First Deputy Governor of BoA as Director. The First Deputy Governor of BoA is also a member of senior management of the BoA and its Supervisory Council.

On the other hand, the union of on-site and off-site units in a single one was decided in order to create a more harmonious connection between early warning and analysis functions with on-site inspection.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

Banking supervision has made continued efforts to improve its work. With regard to its licensing function, banking supervision was focused more on development of licensing methodology for non-bank institution.

Considering licensing process, it was decided that some entities that carry out lending activities would not be subject to the requirement to be licensed by Bank of Albania. This exclusion from banking law requirements regarding lending activities was determined because the origin of funds used for lending was from international organizations or governments of foreign countries, which provided aid for development of small and medium businesses in the Republic of Albania.

According to law, the BoA as the regulatory agency of the banking system, has the right to use a series of instruments such as rules, procedures and guidelines, to establish requirements and impose sanctions on banks, in order to accomplish its duties for supervising banking activities and to ensure the stability of the banking system.

For the regulatory agency it is important not only to choose instruments that will apply to improve banking system, but also to combine these instruments and use them effectively to achieve the goal.

BoA, in its roles as the banking system's regulatory agency, determines requirements and conditions for licensing the performance of various financial operations. With regards to this, the main purpose is not to give a license to those entities that do not meet the minimum standards established by Law "On Banks in the Republic of Albania" and relevant regulations.

Setting minimal standards for applicants intends to restrain the entities that have suspicious activities, do not pay debts correctly, do not have a good reputation, do not have the necessary professional experience and do not have a regular, registered and controlled organization entering into the banking market. All requirements aim to protect the bank's potential clients and depositors as well as to have a safe and sound banking system.

The established standardised rules have their positive and negative effects; however, the purpose of establishing them is subject to the final goal, to protect depositors and have a safe and sound banking system.

However, establishing these minimal requirements has not restrained the presentation of applications, whose completion and review sometimes takes time due to various administrative and bureaucratic reasons.

During 2000, the process of completion of documentation and reviewing the request of the Al Karafi Group, a commercial bank of Kuwait to open a bank, continued.

Diners Club Albania Association received a license as a non-bank institution to intermediate in monetary transactions (including foreign currencies).

During this period, some banks had the idea to open branches or subsidiaries in Kosovo; however regulations "On the granting of the license to conduct banking business in the Republic of Albania"," did not provide for the permission of BoA to grant banks the approval to open branches or subsidiaries abroad. Therefore, this gap in the regulation was filled with the decision of the Supervisory Board of the Bank of Albania, which set out the criteria for the BoA to grant approval to open a branch or subsidiary outside the territory of the Republic of Albania.

In addition, the request of Rural Financing Fund to get a license as a non-bank entity was reviewed. According to decision no. 26 of Supervisory Council, dated 29.03.2000 "On exemption of some subjects from the requirement of the provisions of the Banking Law", it was decided that RFF is excluded from licensing, because of the fund's origin and nature, and it has only to report activity information to the Bank of Albania.

During 2000, 10 foreign exchange bureaus were licensed, pursuant to guideline "On licensing of foreign exchange bureau".

In addition to giving licenses for carrying out financial activities, banking supervision also gave authorisations for the following:

- opening new bank branches (Durres Branch of the American Bank of Albania, and an agency within the territory of the USA; Durres and Elbasan Branches of Alpha Bank, Gjirokaster Branch of Tirana Bank, Elbasan Branch of Fefad Bank);
- approving the reduction of shareholders' equity for the Arab Albanian Islamic Bank and National Commercial Bank;
- various approvals related to the privatisation of NCB and SB;
- giving authorisations for cash transfers abroad, opening bank accounts abroad; and
- prior approval for the new administrators of banks and branches of foreign banks, since there have been numerous changes, recently.

Bank regulations

The main purpose of banking supervision at the Bank of Albania is to establish a regulatory system according to international standards, so that it can apply the Basle Committee recommendations for effective supervision.

The banking supervision activity related to regulatory issues was concentrated mainly in the improvement of regulations and adopting the Basle Committee recommendations.

During 2000, an important development was the increase of paid-in capital for all banks to a minimal of 700 million leks[1] .

In early 2000, the regulation "On bank's liquidity" was rewritten. The purpose was not to establish limits for the liquidity levels for banks, but to establish principles and methodologies for liquidity management. This regulation requires that banks have information systems that enable the qualitative assessments of funds incoming to and outgoing from the bank, based on maturity of assets and liabilities, methodologies for funding bank's activities.

The regulation "On market risks" is another regulation that deals with risks that banks face during their operations. However, market risk is only partially regulated. The level of implementation of this regulation is insufficient, because the level of products exposed to market risks is still low.

An amendment to the regulation "On the requirements to be met by administrators of banks and branches of foreign banks" was made, regarding the prior approval for foreign administrators. The amendment deals with the required procedures to get the employment and stay permissions in the Republic of Albania.

The Banking Law, in addition to giving rules for the creating and functioning of universal banks, provides for co-operative banks. Based on this law, a related regulation "On co-operative banks" was approved. This regulation provides rules for

[1] The banks licensed earlier started their activities with a minimal paid-in capital amounting to 100 million leks. Between 1992 and 1998, the requirement for the paid-in capital rose several times from 100 million to 700 million leks.

creation, functioning and supervision of these banking institutions. However, to date no request for a license has been presented.

The design and approval of guidelines "On management of interest rate risk" aimed at giving recommendations regarding the management of risks deriving from a bank's positions in securities, trading portfolios and movements of interest rates, as well as the bank's assessment of adequacy and effectiveness of interest rate risk management. This guideline makes regulation "On market risks" more complete.

By making non-bank institutions that carry our financial activities as provided in Article 26 of Law "On banks in the Republic of Albania, subject to this Law, the Bank of Albania undertook the responsibility of supervising them. Consequently, the regulation "On supervisory norms for non-bank financial institutions" was approved.

On-site inspections and corrective actions

On-site inspection is a very important part of banking supervision because it assesses areas that cannot be assessed by way of off-site analysis. More precisely, it assesses banking management, banking procedures to identify, monitor and manage risks, and internal control systems. Additionally, on-site inspections play an important role to insure accuracy and improve the quality of data reported to Bank of Albania.

On site inspectors base their work on contacts with banks they inspect, which is very important for a positive solution of all problems found during examinations.

On-site inspections in banks are made according to a working program approved in the beginning of the year, aiming at having a full scope exam for each bank annually. This program also includes partial exams for specific issues emerging during the year.

During 2000, 11 full-scope examinations and 5 partial inspections were carried out.

The main examination objectives during 2000 were the following:

- banking engagement in safe and sound activities;
- identification of specific banks or banking activities that require the attention of supervisory authority;
- completion, approval and supervision of bank's policies, procedures, and other bank's internal regulations by banks' board of directors.

Findings during inspections:

- Some banks continued not to have lending policies in place and sufficient provisions set aside. Occasionally, violations of supervisory norms on lending to a single borrower or group of related borrowers were found.
- In almost all banks, violations of BoA regulation "On the requirements to be met by administrators of banks and branches of foreign banks" were found when banks' administrators started their employment without the prior approval of BoA.
- In a few banks, the ALCO committee did not function, and there were no written policies on foreign exchange operations.

- Deviations from the bank's business plans and lack of strategic plans for bank's development (fast asset growth, new branches) were found.
- Occasionally, violations of regulations of BoA and laws were found, and in such cases, actions for immediate correction were taken.

Recommendations given during inspections:

- Loan reclassification and recalculation of provisions;
- Suspending administrators who do not have prior approval of BoA;
- Completion of the bank's organization staffing with personnel to meet bank's activities, especially in lending;
- Board of directors should review periodic management and audit committee reports;
- Approval of certified public accountants (independent external auditors);
- Compliance with bank accounting manual;
- Strict compliance with laws and BoA's regulations;
- Senior management should become familiar with rating system used by supervision to assess the general financial condition of financial institutions (CAMELS rating).

The BoA is entitled to take corrective measures and actions against irregularities identified in banks during inspections. "Irregularities" shall mean those conditions, actions or lack of actions that may threaten the safety and soundness of a bank, or all banking system.

Banking supervision, depending on extension and type of irregularities or problems found in the bank, as well as the bank's willingness to correct irregularities, determines corrective measures, based on provisions of law no. 8365, dated 02.07.1998 "On banks in the Republic of Albania" and BoA regulations.

The more used corrective measures are the following:

- Recommendations or suggestions during on-site inspections to correct minor irregularities.
- Requirement that the bank has to present a program to BoA with actions to improve the banks condition, and in case of many irregularities, action plan must have specified deadlines.
- Punishment for bank's management in case of serious and reoccurring irregularities, or irregularities that have caused losses to the bank.

The banks paid attention to the completion of their internal regulations for all banking activities especially for lending, management of assets and liabilities, risk management, based on requirements and recommendations presented in the reports of examination. They are becoming aware of the necessity of compliance with the laws, regulations and recommendation of the Bank of Albania. That creates possibilities for developing correct relations with banks.

One of the conclusions that can be drawn is that banks are making efforts to complete their organizational structure with qualified staff and evaluate more the role of an internal auditor.

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY

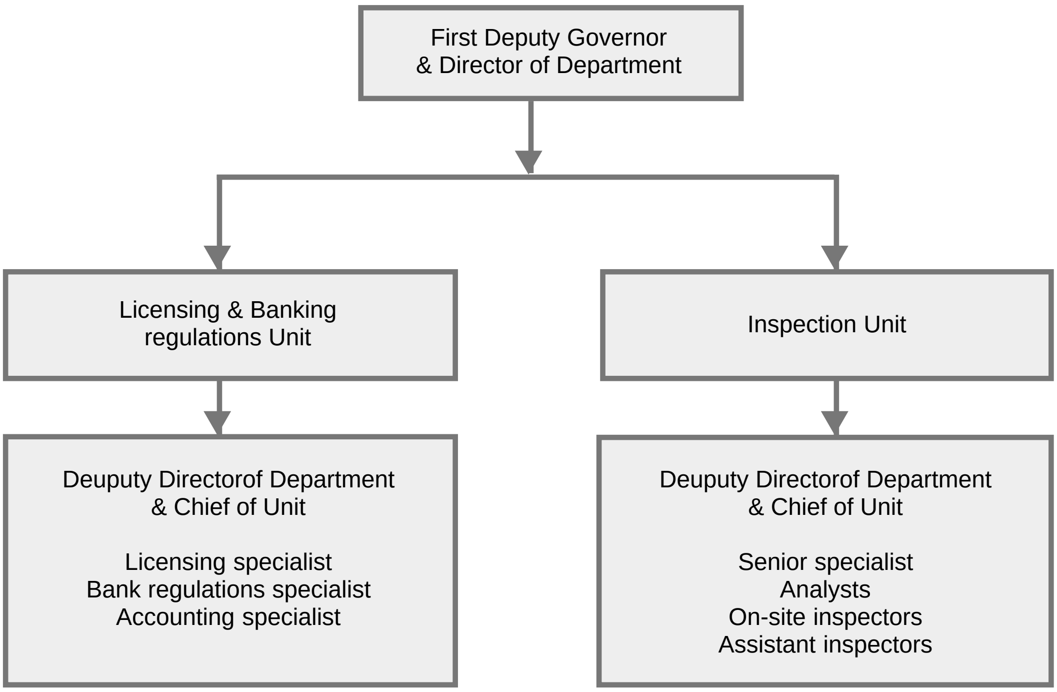
The legal competence of the banking Supervisory Authority in our country (BOA) based on law no. 8269, dated 23.12.1997: "On the Bank of Albania" and law no. 8365, dated 02.07.1998: "On banks in Republic of Albania". The main legal competences are:

- According to Article 7, the Bank of Albania shall have sole responsibility for the issuance of licenses to banks for conducting banking business in the Republic of Albania.
- By Article 11 a license shall be granted for an indefinite period of time and shall not be transferable. Without the prior written consent of the Bank of Albania, the bank shall not change its name, terminate the twining agreement for administration and management of the bank, engage in financial activities other than those prescribed in the licence, increase the capital with non-liquid resources, repurchase its shares or other related persons to the bank, decrease the capital.
- Article 13 may revoke the license of a bank only by a decision of the Bank of Albania.
- By Article 22 the merger, amalgamation allocation or sale of all the assets of a bank shall have legal effect only after the approval of the Bank of Albania.
- By Article 30 banks shall maintain a regulatory capital as prescribed by the Bank of Albania. They shall observe the following limits when prescribed by regulation of the bank of Albania:
  - The maximum ratios and exposures to be maintained by a bank concerning its assets, risk-weighted assets, and off-balance sheet items and various categories of regulatory capital;
  - The maximum aggregate amount of credit, expressed as a percentage of its regulatory capital that a bank shall be permitted to have committed or outstanding to or for the benefit of any single person or group of affiliated persons;
  - The maximum aggregate amount of all its credit, that a bank shall be permitted to have committed or outstanding to or for the benefit of the ten persons (including group of persons), with respect to whom the Bank's exposure on account of credit affiliated transactions, is the greatest.
- By Article 44 the remedial measures and penalties provided for infractions shall be determined by the Bank of Albania.
- By Article 48 upon the determination by the Bank of Albania that a bank's ratio of its regulatory capital to its risk-weighted assets is less than 50 percent of the required minimum regulatory capital prescribed by the Bank of Albania, Bank of Albania shall require shareholders to remedy the situation within a period not exceeding six months. If, after the expiration of that period, this ratio is less than 50 percent, the Bank of Albania shall appoint a conservator to take possession and control of the bank for a period not exceeding twelve months.
- By Article 51 the Bank of Albania shall appoint a receiver to take possession and control of a bank, and revoke the bank's license, whenever the Bank of Albania determines that one or more of the following circumstances exist:

- There is a violation or violations of laws or regulations that are likely to cause insolvency or substantial dissipation of assets or earnings, or is likely to otherwise seriously prejudice the interests of depositors.
- The Bank of Albania acquires objective evidence that bank administrators are involved in illegal operations, have committed serious fraud acts, or have personally benefited and caused serious damage to the bank or third parties.
- The Bank of Albania shall appoint a receiver to take possession and control of a bank whenever person to whom a bank has liabilities certifies to the Bank of Albania that 10 percent of such liabilities, as determined by the most recently issued balance sheet of the bank, were not paid by the bank, as they fell due.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

Currently, the organizational chart of Bank Supervision Department of the Bank of Albania is as follows:



COOPERATION WITH OTHER SUPERVISORY BODIES

Bank of Albania have the agreement with the Bank of Greece, concerning their co-operation in the field of banking supervision. The co-operation of the parties under this agreement shall have the accomplished in accordance with the principle of reciprocity. The main subjects of this agreement are as following:

- Responsibility of the authorities,
- Professional secrecy,
- Exchange of information,
- Co-operation in special fields of supervision (market risks, liquidity),
- Customer complaints,
- Crisis situations, breaches of host-country legislation.

Co-operation in the field of on site-examinations is the important part of this agreement, also co-operation as regards subsidiaries, owner control, and so on.
The Bank of Albania is still working for the agreement with the Bulgarian National Bank and banking Regulation and Supervision Agency.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY

The primary objective of banking supervision is to maintain the stability of banking system. However, the existence of a banking supervision system does not mean a full guarantee and a safe and sound banking system. Nevertheless, having effective banking supervision that aims to detect problems and assist banks to prevent or address problems with the least consequences, will minimise the risk taken by banks, therefore, protect the banking system in general, and depositors, in particular.

STATISTICAL TABLES

Number of Banks
(at year-ends)

Type of Banks*	1998	1999	2000
State-owned banks (100%) (G1)	2	2	1
Joint-ventures (G2)	2	2	2
Banks with foreign capital (G3)	6	9	10
Banks, total	**10**	**13**	**13**

**G1= State owned banks (100%); G2- Joint-venture banks; G3= banks with foreign capital hereinafter in all tables*

Distribution of market shares in balance sheet total (%)

Type of banks	1998	1999	2000
G1	85.1	81.4	64.8
G2	5.8	5.8	6.2
G3	9.1	12.8	29.0
Banks, total	100.0	100.0	100.0

**based on assets*

Ownership structure of banks in 2000 on the basis of registered capital (%) (at year-ends)

Item	Type of banks			Total 2000
	G1	G2	G3	
State ownership	100.0	40.0	0.0	13.4
Other domestic ownership				
Domestic ownership total	100.0	40.0	0.0	13.4
Foreign ownership (private banks)	0.0		100.0	71.7
Other foreign ownership (joint-venture)		60.0		14.9
Foreign ownership total	0.0	60.0	100.0	86.6
Banks, total	**100.0**	**100.0**	**100.0**	**100.0**

Item	1998	1999	2000
State ownership	53.6	37.0	13.4
Other domestic ownership			
Domestic ownership total	53.6	37.0	13.4
Foreign ownership	20.3	44.0	71.7
Other foreign ownership (in j-v)	26.1	19.0	14.9
Foreign ownership total	46.4	63.0	86.6
Banks, total	**100.0**	**100.0**	**100.0**

The Structure of Assets and Liabilities of the Banking System (%) (at year-ends)

Assets	1998	1999	2000
Treasury operations and interbank	79.0	81.2	88.4
Operations with customers (net)	11.6	10.7	6.1
Securities transactions (net)	3.5	0.8	2.9
Other assets	2.7	4.3	0.6
Fixed assets	3.1	3.0	1.9
Total accrued interest	0.1	0.1	0.1
Liabilities and shareholders' equity	**1998**	**1999**	**2000**
Treasury operations and interbank transactions	1.4	1.3	2.3
Operations with customers	83.0	82.9	84.8
Securities transactions	0.0	0.0	0.0
Other liabilities	6.3	8.9	4.6
Permanent resources	5.7	4.8	7.1
Total accrued interest	**3.5**	**2.0**	**1.2**

Solvency Ratio of Banks

Type of Banks	1998	1999	2000
G1	-57.7	-11.0	44.5
G2	76.8	44.8	39.4
G3	43.6	43.5	41.8
Banks, average	**-8.9**	**8.2**	**42.0**

Asset Portfolio Quality of the Banking System (%)

Asset Classification	1998	1999	2000
Standard	40.9	48.0	59.1
Special mentioned	2.4	2.9	7.4
Substandard	7.4	6.6	3.3
Doubtful	6.2	2.4	4.1
Loss	40.5	36.6	26.0
Overdue loans/Total of loans	41.0	32.7	42.8
Classified Total	**97.4**	**96.5**	**100.0**
Provisions	**46.9**	**44.0**	**30.1**

The Structure of Deposits and Loans at year-end in 2000 (%)

	Deposits	Loans
Households	83.8	33.8
Public Sector	7.6	9.5
Private Sector	8.6	56.7
Total	**100.0**	**100.0**

The Structure of Deposits and Loans (%)
(at year-end)

Maturity of Deposits		Loans	
At sight	38.9	Short-term loans	39.0
Within one year	60.5	Medium-term loans	28.0
Over one year	0.6	Long-term loans	14.7
		Real estate loans	12.0
		Other loans	6.3
Total	**100.0**	**Total**	**100.0**

Proportion of Foreign Exchange Assets and Liabilities
(at year ends)

Type of banks	FOREX Assets /Total Assets			FOREX Liabilities/Total liab & Equity Capital		
	1998	**1999**	**2000**	**1998**	**1999**	**2000**
G1	21.6	21.9	15.5	23.7	18.1	15.2
G2	97.3	93.3	92.1	98.1	91.6	88.2
G3	81.5	81.7	62.9	91.8	81.2	41.3
Banks, average	**29.7**	**21.9**	**34.0**	**27.9**	**30.5**	**27.3**

Structure of Incomes and Expenses for Banks

Incomes	1998	1999	2000
GI	93.3	88.8	73.3
G2	2.1	2.8	5.1
G3	4.5	8.4	21.6
Banks, total	**100.0**	**100.0**	**100.0**
Expenses			
G1	93.9	89.2	70.2
G2	1.6	2.3	5.7
G3	4.5	8.5	24.1
Banks, total	**100.0**	**100.0**	**100.0**

Incomes and Expenses
(as % of total income, total expenses)

Incomes	1998	1999	2000
Interest income	67.8	66.0	74.0
Income from operations with securities & other fin.operations	0.3	0.1	1.6
Banking services commissions	3.7	4.1	5.4
Income from leasing operations	0.0	0.0	0.1
Other banking operations income	0.0	0.2	0.5
Profit on FX operations	25.5	25.5	5.6
Reversals of provisions for depreciation of fixed assets	0.0	0.0	0.0
Reversals of provisions for depreciation of receivables	2.1	3.0	12.5
Extraordinary income	0.6	1.0	0.3
Banks, total	**100.0**	**100.0**	**100.0**
Expenses	1998	1999	2000
Interest expenses	62.3	54.6	55.5
Expenses and losses on securities transactions & other fin.operations	0.0	2.4	5.7
Commissions	0.2	0.4	0.6
Expenses for leasing operations	0.0	0.0	0.0
Other banking operating expenses	0.5	1.8	1.2
Losses on FX operations	22.1	23.2	3.7
Operating expenses	5.2	6.9	12.1
Amortization and provisions for depreciation of fixed assets	1.0	1.3	3.3
Losses on unrecoverable receivables and charges for provisions	8.3	7.2	8.8
Extraordinary expenses	0.2	0.6	0.3
Taxes other than income taxes	0.2	1.1	0.2
Income tax	0.0	0.4	8.6
Banks, total	**100.0**	**100.0**	**100.0**
Net profit after tax (in billion of Lek)	**-3.2**	**1.3**	**5.3**

Profitability of Banks

Type of Banks	1998		1999		2000	
	ROA	ROE	ROA	ROE	ROA	ROE
G1	-1.9		0.5		2.9	
G2	1.2	2.9	1.6	6.1	0.6	2.8
G3	-0.9	-4.4	0.3	2.0	0.7	3.0
Banks, average	**-1.7**		**0.6**		**2.1**	

Structure of Registered Capital and Own Funds of Banks

in mil. of USD

Type of Banks	Registered Capital	/Total Assets	Own Funds	/Total Liabilities
	USD	%	USD	%
G1	3.0	0.2	35.1	2.9
G2	22.0	18.7	25.2	21.4
G3	63.3	11.5	67.7	12.3
Banks, average	**88.3**	**4.6**	**128.0**	**6.7**

Note: Rate of exchange USD/Lek =142.64

2000 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF BELARUS

MACROECONOMIC ENVIRONMENT IN THE COUNTRY

Belarus is one of the most advanced republics of the former Soviet Union (FSU), which gained independence in 1991. After 1991, a deep recession began to show in virtually all the socio-economic indicators. During 1992-1995, real GDP dropped by more than a third; industrial output more than 40%; with average monthly inflation rate amounting to 15-20%, whereas households' real incomes declined by 38% on the whole.

Implementation of the Socio-economic Development Guidelines for 1996-2000 ensured a reversal of economic trends. Beginning in 1996, promising economic growth rates were observed. Over a five-year period, real GDP grew by almost 36%; industrial output by 65%; real household incomes by 71%.

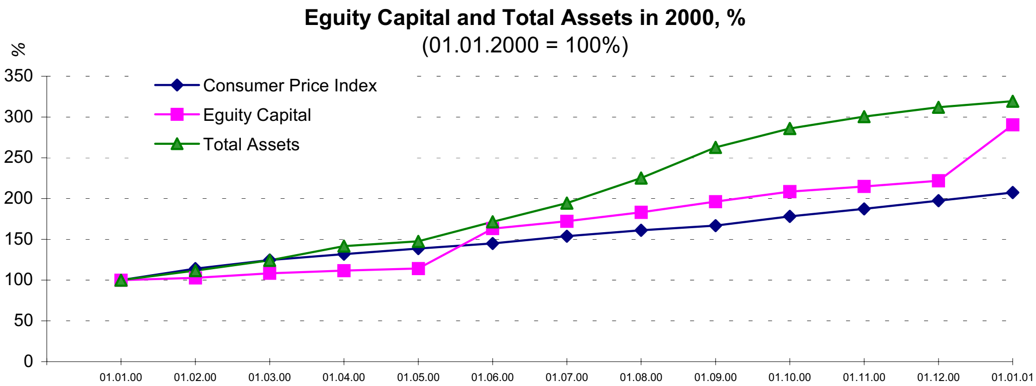
Monetary policy was instrumental in implementing the Guidelines. On the whole, it was being progressively tightened: where in 1992-1995 the rouble money supply increased almost 2150 times, or by 17.3% per month on average, in 1996-2000 the nominal rouble money supply increased 53.6 times, or by 6.9% per month on average, i.e. 2.5 times less. The pace of average monthly devaluation of the Belarusian rouble official exchange rate decreased 3.2 times (from 25.6 to 8% per month on average). As a result, a decline in production was being overcome against the background of declining inflation rates. During 1996-2000, the average annual value of the GDP deflator reduced 5.4 times compared with 1992-1995. In 1996-1999 both the relative size of credit issue by the National Bank and its orientation underwent changes. Credits were issued with a view to financing priority industries (particularly housing and agro-industrial complex). In 2000, the National Bank virtually ceased directed lending, and credits to the national economy were granted on a non-issue basis.

On September 14, a unified exchange rate was introduced which is one of the most important achievements of monetary policy in 2000. Elimination of multiple exchange rates and expanding scope of Belarusian rouble utilization in foreign trade significantly improved conditions for Belarusian enterprises involved in foreign economic activity. Exporters' situation also improved due to the abolishment of a "tax" imposed on them, whereby exporters were required to surrender part of their foreign exchange proceeds at an undervalued exchange rate. In addition, transition to the unified exchange rate, on the one hand, ensured elimination of economic prerequisites for the development of "shadow relations" in the field of foreign exchange and, on the other, created conditions necessary for the achievement of high transparency and controllability of the foreign exchange market.

DEVELOPMENT OF THE BANKING SYSTEM

As of January 1, 2001, the banking system of the Republic of Belarus included 28 functioning banks, of which 17 were joint banks with participation of foreign capital (their share in the assets of the banking system being 20.9 %) and 2 banks (branches of the Russian banks) with a 100% share of foreign capital in the authorised funds (whose assets account for 0.5 % in the total amount of assets of banks in the Republic of Belarus). 3 banks are in the process of liquidation and self-liquidation. The network of bank branches totals 529 branches.

The financial potential of the banking system increased substantially. The total own capital of commercial banks grew in real terms by 40%, almost all of them increased their authorized funds to a level which is not lower than the prescribed one (EUR2 million for all commercial banks and EUR5 million for joint and foreign banks).



There was a significant increase in the amount of resources attracted by banks from the public. Citizens' rouble deposits in real terms grew nearly 1.9 times, amounting to BYB112.8 billion; foreign currency deposits grew by 26.7% (up to USD252.4 million). Funds attracted from enterprises and organizations almost tripled during the year and remain the major source of attracted funds.

As before, credits remained the primary area of banks' investment: the share of credits in the total assets of the banking system virtually did not change, accounting for 63.5% at the start of 2001. Given this, the National Bank was paying particular attention to the state of credit portfolios of commercial banks.

Today, a core of some major structure-forming banks is available in the republic. They are the so-called "Big Seven", containing *Belpromstroibank, Belvnesheconombank, Belagroprombank, Belarusbank, Priorbank, Belorusskiy Bank Razvitiya* and *Belbiznesbank.* Those banks have a substantial financial potential, a dense network of correspondent relations and are active in mastering advanced techniques of banking operations and technologies.

Said banks have created provisions for doubtful debts, set up internal audit services, their annual balance sheets and profit and loss statements are verified by an external audit organization and are published in the press.

Since 2000, prudential norms have been calculated (in accordance with international standards) on the basis of determining "two-tier bank capital". On the whole, the system of safe functioning norms meets the Basle Committee recommendations.

LEGAL AND ECONOMIC FRAMEWORK OF OPERATION OF FINANCIAL INSTITUTIONS AND SUPERVISION THEREOF; NEW DEVELOPMENTS

In the year 2000 banking legislation of the Republic of Belarus was subject to drastic changes. Taking into account global experience of legislative regulation of relations in the banking industry, the Banking Code of the Republic of Belarus was completed. The Code came into effect on January 1, 2001. In particular, it details the list of banking operations; gives their description and characteristic; specifies, to a marked degree, procedures for the establishment, licensing, reorganization and liquidation of banks; expands the rights of National Bank in the field of banking regulation and supervision; introduces, at a statutory level, the definition of non-bank credit and financial institutions; determines the manner in which they must established and conditions of their activity.

With active participation of the National Bank, the Law of the Republic of Belarus "On Economic Insolvency (Bankruptcy) " was finalized and adopted. The Law regulates procedures for banks' bankruptcy and implementation of measures designed to avoid bankruptcy, including measures by banks intended to improve their financial standing and appointment by the National Bank of a temporary administration. Nowadays, in developing said Law, the National Bank is devising documents regulating the above procedures in more detail.

The National Bank takes a favourable attitude towards the increase of foreign capital in the banking system of the country. In this context, preferential conditions were introduced in 2000 for the establishment and regulation of activity of joint and foreign banks in free economic zones (there are five such zones in the republic and the establishment of the sixth one, in the Moguilev Oblast, is under consideration). They provide for a simplified procedure for registration and reporting as well as exemption from certain norms and restrictions mandatory for other banks operating in the rest of the country.

ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

According to Article 34 of the Banking Code of the Republic of Belarus, the National Bank inspects banking activity, coordinating its work with that of the bodies of state control and management.

During 2000, 14 comprehensive bank inspections, as well as a number of inspections concerning particular subjects, basically dealing with supervising elimination of the infringements revealed during the course of previous inspections and compliance with rules and registrations pertaining to banks' foreign exchange transactions and securities transactions took place. Inspection results suggest that a trend towards better quality of banking operations has emerged. At the same time, in some instances current legislation is still being breached and, as a consequence, various sanctions were applied to banks and their officials.

In 2000, the National Bank put into effect the following new documents:

- Rules for establishing and regulating activity of banks in free economic zones of the Republic of Belarus;
- Rules for ensuring compliance with commitments regarding the return of foreign exchange placed in accounts and deposited with the authorized banks of the Republic of Belarus to natural persons; and

- Rules for making public information on banks and non-bank financial institutions that provide for a mandatory volume of information subject to disclosure by banks.

On the whole, organization of supervision and economic standards of safe bank functioning correspond to the recommendations of the Basel Committee on Banking Supervision. To maintain stability and steadiness of the banking system of the Republic of Belarus, the National Bank shall establish the following economic standards for banks:

- minimum size of the authorized fund for a newly established (reorganized) bank;
- minimum size of ownership capital (equity) for a functioning bank;
- limit for non-monetary portion of the authorized fund;
- liquidity standards;
- capital adequacy standards;
- maximum risk per client (a group of interrelated clients);
- maximum risk per insider and persons associated therewith;
- maximum size of major risks;
- standard for bank participation in investment activities;
- foreign exchange risk standard (open currency position);
- maximum risk per creditor/depositor;
- maximum size of a bank's liabilities on bills of exchange; and
- maximum size of funds deposited by natural persons.

In 2000, the National Bank was constantly monitoring banks' compliance with the requirements for maintaining the required minimum amount of the authorized funds by making nearly 30 state registrations of increases in the banks' authorised funds. On the whole, the authorised funds in the banking system as at 01.01.2001 amounted to EUR254 million.

During 2000, 24 banks brought their constituent documents in conformity with current legislation.

Six banks were liquidated and removed from the Registration Book.

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY

In the Republic of Belarus the function of supervision is assigned to the central bank of the country – the National Bank, which incorporates a division specializing in said issues, i.e. the Banking Supervision Directorate.

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

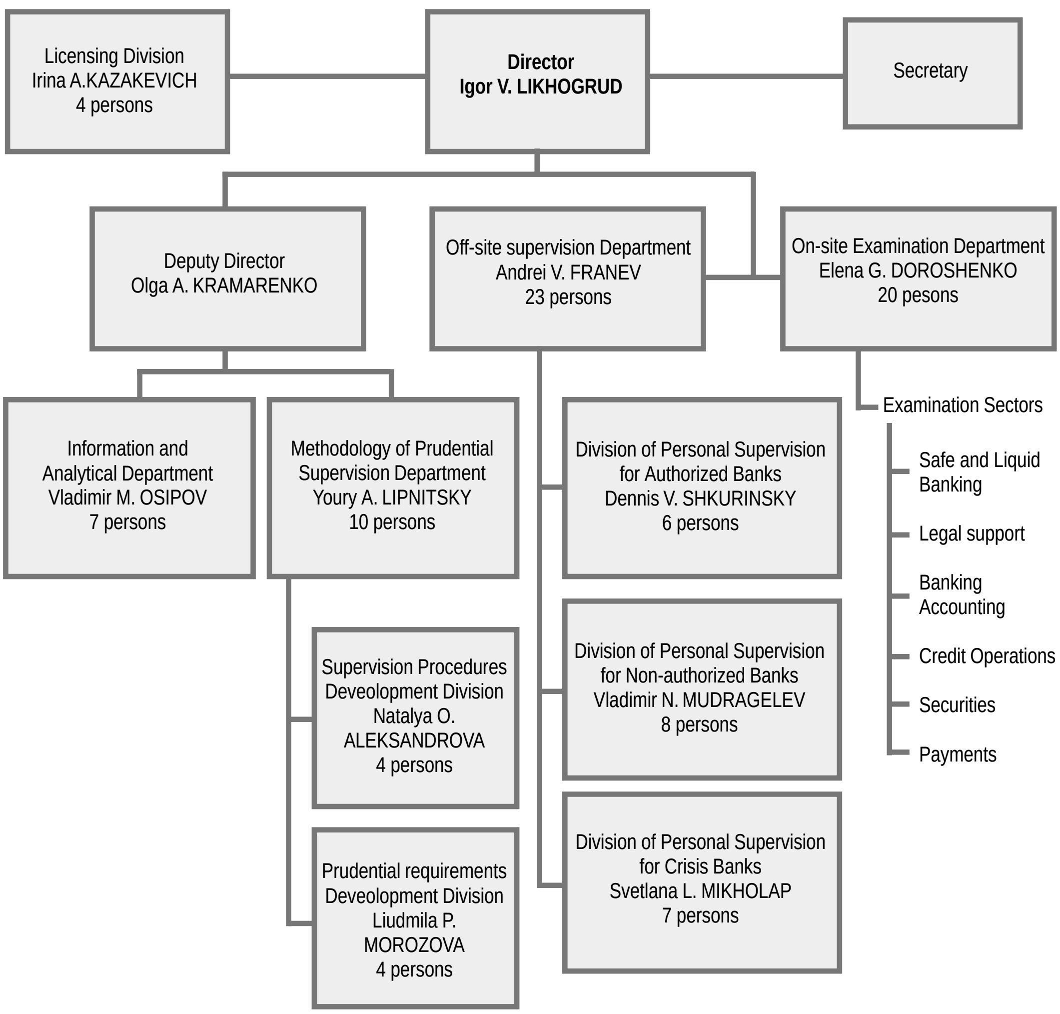
- State registration of banks, licensing of banking activity,
- Development of prescribed economic standards for maintaining stability and soundness of the banking system,
- Development of rules and procedures for banking operations,

- Identification of infringements of banking legislation and application of sanctions thereof,
- Currency control regulation,
- Determination of publication rules and contents of information being published used for assessing the degree of reliability of banks and non-bank financial institutions,
- Review of bank reports,
- Regulation of foreign capital admission to the banking system of the country,
- Regulation of banks' reorganization and liquidation, and
- Involvement in ensuring the return of funds attracted by banks to natural persons.

The majority of the above functions is carried out by the Banking Supervision Directorate, whose new structure was approved in April 2001.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISION DIRECTORATE

Banking Supervision Directorate
67 persons



INTERNATIONAL COOPERATION OF THE SUPERVISORY AUTHORITY

International contacts (such as exchange of written information, consultations by phone) with the Basel Committee on Banking Supervision (Basel) and the Secretariat of Group of Banking Supervisors from Central and Eastern Europe (Budapest) are maintained. Information on the banking system of the Republic of Belarus requested by the IMF and EBRD was given to their representatives.

During 2000, the National Bank of the Republic of Belarus, in concert with the Central Bank of Russia, was focusing its efforts on the unification of principles and mechanisms of monetary policy of Belarus and Russia. Four meetings of the Interbank Currency Council were held, each of them resulting in crucial decisions in that area.

Over the course of the past two years trans-boundary supervision contracts with the supervisory bodies of Russia, Ukraine, Armenia, and Cyprus were made. On 09.03.2001 the Memorandum of Mutual Understanding in the field of bank supervision with the Bank of Latvia was signed.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

In carrying out its functions of banking supervision, the National Bank cooperates on a regular basis with the Ministry of Internal Affairs, the Office of Public Prosecutor, the Committee of State Control, financial investigation bodies, and tax authorities.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY

It is stipulated that in 2001 banks will be developing with a view to securing their financial soundness, stable and safe functioning and achieving international standards of banking supervision. A very particular dimension will be added to measures securing sustained enhancement of reliability of the national banking system in general and of each individual bank in particular. This will be achieved through timely determination and adoption by the National Bank of supervisory measures in relation to problem banks, as well as restructuring of problem banks. It is envisaged that regulation of banking activity and supervision of banks by the National Bank will be improved by using modern methods and instruments, such as means of early warning of problematic situations in banks, increasing the level of transparency of banks and non-bank credit and financial institutions, development of cross-border supervision, consistent application of banking supervision standards to all banks without exception, etc.

In 2001, banks will continue to build up their equity and to expand their resource base by attracting funds from legal entities and the general public. Improvement of banks' financial standing should be based on the enlargement of banks' active operations in the real sector of the economy and on an increase of the share of credit and investment operations. Structural reorganization of banks will be realized by speeding up withdrawal of problem banks from the banking system and transfer of the National Bank's share in the banks' authorized funds to the Government of the Republic of Belarus.

Implementation of measures with a view to strengthening the banking system that are scheduled for 2001 should enhance attractiveness of Belarusian banks for foreign and domestic investors and strengthen households' interest in keeping their savings with Belarusian banks.

STATISTICAL TABLES

Number of Financial Institutions (at year-ends)

Type of financial institution	1998	1999	2000
Commercial banks	37	36	31

The Structure of Assets and Liabilities of the Banking System (%) (at year-ends)

	1998	1999	2000
Assets			
Credit to national economy	45.7	47.1	50.4
Credit to individuals	6.7	8.9	5.2
Credit to General Government, Local Government	7.0	7.7	8.0
Securities issued by legal entities (excluding banks)	0.2	0.7	0.9
Own debt securities	0.0	0.0	0.1
Required reserves	5.0	6.0	4.6
Cash assets, gold, precious metals	1.7	1.6	1.9
Assets in other banks	18.0	11.3	13.0
Participations	0.1	0.1	0.4
Permanent assets and intangibles	2.8	3.6	4.9
Correspondent accounts in other banks	8.4	7.9	6.5
Other assets	4.6	5.1	4.2
Total	**100.0**	**100.0**	100.0
Liabilities			
Funds and undistributed profits	6.9	16.5	14.8
incl. statutory fund	1.4	12.2	8.0
Budget accounts	1.5	1.3	1.4
Accounts of individuals	13.3	11.3	15.8
Accounts of enterprises	36.4	37.4	35.2
Non budgetary resources and funds and			
resources of fiscal organisations	4.1	5.3	4.1
Debt securities	0.6	1.1	1.0
Correspondent accounts of other banks	3.4	2.0	1.4
Deposits of other banks	20.1	11.7	12.1
Credit from General Government	1.7	1.0	3.0
Other liabilities	12.1	12.4	11.1
Total	**100.0**	**100.0**	**100.0**

Development of Off-balance Sheet Activities (%) (Off balance Sheet Liabilities / Balance Sheet Total)

Type of financial institution	1998	1999	2000
Commercial banks	143.80	157.16	131.63

Solvency Ratio of Financial Institutions

Type of financial institution	1998	1999	2000
Commercial banks	11.30	31.48	24.43

Asset Portfolio Quality of the Banking System

mln.roubles

Asset classification	1998	1999	2000
Loans, total	241,607.5	524,344.4	1,701,805.3
Extended loans	12,396.3	19,285.7	72,207.0
Past due loans	3,455.3	6,304.9	36,037.7
Doubtful loans	24,108.3	43,132.6	150,129.1
Past due interest			
up to 30 days	1,951.2	3,756.1	13,415.9
more than 30 days	9,945.0	17,554.3	75,936.3
Special reserves	**12,106.2**	**30,617.5**	**122,294.3**

The Structure of Deposits and Loans (%)
(at year-end)

	Deposits	Loans
Non financial state institutions	47.30	45.13
Private sector	17.55	45.22
Households	30.08	9.56
Nonbank financial institutions	2.46	0.09
Local Government	2.61	-
Total	**100.0**	**100.0**

Time Structure of Deposits and Loans (%)
(at year-end)

Types of Deposits		Types of Loans	
Demand deposits	60.38	Long-term lending	43.10
Time deposits	39.62	Short-term lending	56.90
Total	**100.00**	**Total**	**100.00**

Proportion of Foreign Exchange Assets and Liabilities (%)
(at year-ends)

Type of financial institutions	FOREX Assets/ Total Assets			Forex Liabilities /Total Liabilities		
	1998	**1999**	**2000**	**1998**	**1999**	**2000**
Commercial banks	52.36	40.28	55.75	50.21	38.80	54.16

Distribution of Market Shares in Balance Sheet Total (%) *

Type of financial institution	Quantity of banks	market share	Quantity of banks	market share	Quantity of banks	market share
	1998		1999		2000	
Bank's equity capital	**26**	**100.00%**	**27**	**100.00%**	**28**	**100.00%**
incl.						
negativ equity capital	2	13.51%	1	0.79%	2	1.82%
to 1 bln. roubles	16	8.47%	10	3.85%	1	0.06%
from 1 to 10 bln. roubles	8	78.02%	14	41.25%	18	10.70%
from 10 to 40 bln. roubles	0	0.00%	0	0.00%	5	33.24%
more than 40 bln. roubles	0	0.00%	2	54.11%	2	54.18%

**: groupage of acting banks according to equity*

Structure of Registered Capital and Own Funds of Financial Institutes

Type of the financial institutions	Registered capital /Total assets		Own Funds / Total liab.	
	USD	%	USD	%
Commercial banks	178.2 mln.	4.85	328.5 mln.	8.94

Structure of Revenues and Expenditures of Financial Institutes (at year-end)

bln.roubles

	1998	1999	2000
Revenues			
Interest revenues	29.9	165.9	551.1
Commission	5.9	25.3	65.5
Other revenues	12.6	41.5	96.3
Other operational revenues	1.0	2.1	3.2
Reserve settlement	0.7	2.1	6.2
Unanticipated revenues	0.0	0.0	0.2
Total revenues	**50.1**	**236.9**	**722.5**
Expenses			
Interest expenses	19.6	103.0	387.1
Commission	1.0	3.4	6.4
Other expenses	8.0	31.1	54.6
Other operational expenses	15.0	74.0	215.5
Allocation to reserve	4.4	16.1	40.4
Unanticipated expenses	0.0	0.0	0.0
Total expenses	**48.0**	**227.6**	**704.0**
Economic revenue	**2.1**	**9.3**	**18.5**

Excluding banks under liquidation

2000 DEVELOPMENTS IN THE BANKING SYSTEM OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

INTRODUCTION

Although the previous four years of bank reconstruction has shown significant progress, the system as a whole and the banks as its components still have numerous problems. First, delayed privatization in banks in which the state is majority owner delayed final resolution of its status and resolving problems inherited from earlier times. What is more, certain banks, in which private-sector owners are in majority, suffered from lack of capital, poor assets, especially in the loan portfolio, operation with related entities, lack of adequate programs, procedures and policies necessary to adequately manage risks, deficiency of expert staff and underdeveloped systems of internal controls.

Significant progress was noted in foreign investments. Thanks to a safer environment owing to improvement in the legal framework and the intensified work of the Banking Agency F BiH, foreign investments in total share capital in banking industry in the Federation BiH comprises 25%. Foreign capital was used to found new banks or purchase shares in domestic banks. Up to now it has mostly been purchase of common shares, and in the future we can expect additional investments in capital.

Since preparations for internal payment system were completed successfully in 2000, internal payment transactions have been transferred from ZPP to commercial banks in the beginning of 2001. Thanks to that measure, there is now possibility to employ new assets in the banking industry, but that also generates new risks. What is more, that will result in additional incomes and improvement in the banks' profitability.

Inception of Deposit Insurance Agency in the Federation of BiH, which already commissioned four certificates on deposit insurance up to 5,OOOKM, is especially important agent for the process of returning confidence in the banking system and increase of savings, which have risen by almost 20%.

Enforcement of Law on Changes and Annexations to the Banking Law and its implementation (March 8, 2001) will accelerate the reconstruction of banking industry. Higher standards related to minimum capital will generate either the merger of existing banks, provision of additional capital from foreign investors, or the closure of banks that are not adjusted to legal standards.

The Federation of BiH Banking Agency (hereinafter: FBA), as an institution which performs supervision of banks, has prepared Information on Banking System in the Federation of BiH (as of December 31, 2000) based on the reports from banks, and other reports and information submitted by banks. Also, the Information contains results of off-site and on-site inspection findings performed by FBA's staff and other information related to potential problems in the banks' operations.

RECONSTRUCTION OF BANKING SYSTEM

Since stability and safety of banking system is a key element of financial stability in each country and a requirement of successful reconstruction of the economy as a whole, the principal task was to create adequate conditions for the reconstruction of the banking system in the Federation BiH as soon as Dayton Accord was signed and as soon as the war ended. The transition of the economy from a socialist type to a market economy set new requirements to us, which were essentially different from those we were facing before the war.

The banking system that we inherited from the past was in a very critical condition. The main characteristics of the system were insolvency, ineffectiveness and unsoundness. The banks' property was mostly held by the state. It was burdened by huge amounts of poor loans approved mostly due to political pressure and to beneficiaries who invested assets in unsound and uneconomical ventures. Some banks that were founded during the war or immediately after it did not have adequately trained staff, and their capital was too modest to operate normally with it.

Under such conditions, the points of departure for the reconstruction of banking system were as follows:

- elimination of problems inherited from previous system and of damage done by the war;
- transformation of the property structure by privatization of capital in state banks and selling it to mostly privately owned banks;
- increasing efficiency and prudence of banking operations, striving for market oriented economy, that is, accepting internationally recognized methods of organization, operation and supervision in banks.

Key goals of reconstruction were improvement of safety and efficiency of banking operations, strengthening capital base and solvency of each bank individually and the banking system as a whole.

BACKGROUND

The following steps have been taken towards successfully implementing reconstruction:

- enactment of Banking Law based on international standards for inception, operation and inspection of banks,
- enactment of decisions and other regulations related to supervision of banks' operations,
- enactment of Law on Bank Privatization and prompt and efficient privatization of state banks and state capital in other banks,
- enactment of Law regulating deposit insurance and providing funds for Agency for Deposit Insurance,
- enactment of Law on Collateral (mortgages and lien) and providing environment for prompt collection of pledged assets by the bank,
- enactment of Law on Protection of Depositors and larger and more specified responsibility of bank's debtor,

- internal payment system reconstruction,
- court reconstruction, that is, making legal procedures more efficient,
- enactment of regulations related to issuance and handling notes,
- establishment of a banking association.

LEGAL FRAMEWORK

During the period under review, we worked on formulating the legislation as a condition for creating a safe and sound banking system. The most important requisite for the reconstruction of the banking system was the enactment of legislation related to the privatization of banks. That legislation involves the Banking Law and the Law on the FBA. According to its authorization, the Managing Board of the FBA enacted numerous regulations, guidelines and decisions that represent a regulatory framework for the operation and supervision of banks in accordance with international standards.

Unfortunately, there still are obstacles that restrain the operation of banks, which impede reconstruction. Let us consider some of them:

- delays in the privatization of banks,
- slow legal processes, findings and implementation of courts decisions - non-enactment of collateral law,
- inefficiency on mortgage collection,
- inconsistency in enforcing regulations related to shareholders' responsibility to a bank with their personal property,
- inconsistency in enforcing regulations related to responsibility of banks' debtors, that is, warranting the debt with their personal property,
- legal obstacles related to establishing an association of banks.

RECONSTRUCTION OF THE SYSTEM

Subsequent to enactment of Banking Law in 1998 and mandating minimum capital of five millions KM paid in cash, number of banks was decreased by means of merging, liquidation of a few banks which did not adjust to minimum regulations, and/or due to severe problems in daily operations impairing banks' solvency, and, by starting receivership procedures in banks.

During 1999, after enactment of Banking Law, FBA did not receive any applications for founding new banks, and in 2000 FBA approved two banking licenses for foundation and operation of new banks. In reporting period, foreign investors showed increased interest by founding their banks or purchasing shares in existing banks in the F BiH and becoming owners or co-owners.

However, although number of banks decreased, deposits and capital of existing banks is still not adequate to support more significant development of economy in the Federation of BiH since banking system is still dispersed. There is an excessive number of banks in a relatively small area. Therefore, the Law on Changes and Additions to the Banking Law, enacted in September 2000, increased the minimum capital for the foundation and operation of a bank from 5 millions to 15 millions KM. See the required timetable for capital adjustments:

- Minimum capital of 7.5 millions KM beginning March 8, 2001,
- Minimum capital of 10 millions KM beginning June 30, 2001 and
- Minimum capital of 15 millions KM beginning December 3, 2002.

The aim of these new, more demanding capital standards (net capital amounts should have same amounts and adjustment deadlines, just as, share capital paid in cash, and new capital adequacy ratio is minimum 10%) is generation of a stronger and safer banking system with smaller banks adequately capitalized.

The number of banks in the F BiH will certainly continue to decrease. Preliminary information, as of end year, indicates that 11 banks did not adjust to new capital regulations applicable as of March 8, 2001. Four banks are in the process of finishing the acquisition of additional capital, and there were some indications of mergers. Inevitably, provisional administration and liquidation will be placed in some banks because they have not adjusted to minimum capital regulations.

Since new minimum capital requirements are to be applied as from June 30, 2001, it is reasonable to expect that a number of banks will not be able to adjust their capital by that time. It would probably result in an additional reduction in the number of banks.

BANKING AGENCY

Banking Agency of the Federation of BiH (FBA) is an independent institution established in the middle of 1996 in accordance with the Law on the Federation BiH Banking Agency. As an institution, it has been founded to supervise banks. The main tasks of FBA as determined by the Law, are as follows:

- Issuance of licenses for bank establishment and performance; license for every change in organizational structure, type of activity and approval for appointment of bank management;
- Bank supervision and taking measures in accordance with the Law;
- Revoke banking licenses in accordance with the Law;
- Management or supervision in rehabilitation and bank liquidation process, as well as initiation of bank bankruptcy process;
- Proclamation of decisions regulating bank performance;
- Evaluation on fulfilment of requirements and issuance of approval to banks to issue shares for next emission.

BASIC PRINCIPLES (BASLE) OF SUPERVISION OF BANKS

Existing legal framework for banks' operations is in agreement with international prudence standards, but it is to some extent adjusted to reasonable environment of banks in the Federation of BiH. Essentially, the legal framework contains international standards defined by the Basle Committee for Banking Supervision, which is based on the European Commission directives. Those standards are broadly accepted and known as Basle Principles. The Principles regulate Basic principles of bank supervision, that is, prudence standards for bank's operation.

Some of the Basic Basle Principles are as follows:

- defined responsibility of supervision, their independence; adequate legal framework, authorization to suggest legislation and implement standards for prudent business and legal protection of supervisor;
- business activities approved to banks should be clearly defined;
- the institution issuing banking licence, should have authority to establish licensing standards and authority to reject all unsatisfactory applications;
- licensing standards should contain minimum standards related to ownership, managers and other senior managerial staff in a bank, planning, internal control, capital;
- supervisory institution should be authorized to perform inspections, give approvals for acquisition or transfer of "significant assets" or "assets of major interest" in banks, and to monitor and control ownership stake earned by banks in another entities;
- bank supervisor should be authorized to define capital, its elements and detection if a bank is adjusted to a regulated minimum, depending on amount and risk structure in a bank;
- supervisors are obliged to execute rating of operational policies, procedures and execution of those in banks, especially in the loan sector, including procedures for rating of assets quality and reserves for loan losses;
- banks are obliged to provide systems that enable detection of risk concentration in their portfolios, also it is their duty to implement a risk management system that provides monitoring, review and inspection of risk and protection of capital;
- supervisors should not and cannot give guarantee that any bank would not fail, but they should have adequate systems for settlement of problematic situation in banks.

The Basic Basle principles listed above, and most of the other principles, are incorporated in our regulations, and FBA implements them the course of supervising the banks. That lays the ground for a stable and sound banking system.

LEGAL FRAMEWORK FOR THE OPERATION OF BANKING AGENCY AND BANKS IN THE FEDERATION OF BOSNIA AND HERZEGOVINA

Basic laws related to operation of Banking Agency and banks in the Federation BiH:

- Law on Banking Agency F BiH ("Official Gazette F BiH", number 9/96, 27/98 and 45/00),
- Law on Central Bank BiH ("Official Gazette F BiH", number 1/97),
- Banking Law ("Official Gazette F BiH", number 39/98 and 32/00),
- Law on Deposit Insurance ("Official Gazette F BiH", number 41/98, 13/00 and 29/00),
- Law on Financial Business ("Official Gazette F BiH", number 2/95, 13/00 and 29/00),

- Law on Internal Payments ("Official Gazette F BiH", number 2/95, 13/00 and 29/00),
- Law on Foreign Currency Payments ("Official Gazette F BiH", number 35/98),
- Law on Securities ("Official Gazette F BiH", number 39/98 and 8/00),
- Law on Money Laundry Prevention ("Official Gazette F BiH", number 8/00), Law on Notes ("Official Gazette F BiH", number 32/00),
- Law on Checks ("Official Gazette F BiH", number 32/00),
- Law on Payment Transactions ("Official Gazette F BiH", number 32/00); D Law on Obligatory Relations ("Official Gazette F BiH", number 2/95),
- Law on Economy Associations ("Official Gazette F BiH", number 23/99),
- Law Bankruptcy and Liquidation ("Official Gazette F BiH", number 23/98),
- Labor, Law ("Official Gazette F BiH", number 43/99),
- Law on Implementation Procedures ("Official Gazette F BiH", number 42/9$),
- Law on Registration of Legal Entities in Court Register ("Official Gazette F BiH", number 4/00),
- Law on Managerial Procedures ("Official Gazette F BiH"~ number 2/98 and 48/99),
- Law on Violations of Federal regulations ("Official Gazette F BiH", number 9/96 and 29/00),
- Law on Employment and Salaries of Governmental Staff in the F BiH ("Official Gazette F BiH", number 13/98),
- Law on Bank Privatization ("Official Gazette F BiH", number 12/98 and 29/00),
- Law on Opening Balance in Enterprises and Banks ("Official Gazette F BiH", number 12/98 and 40/99),

Regulations

- Decision on Supervision and Actions of FBA ("Official Gazette F BiH", number 47/98),
- Decision on Minimum Standards for Managing Capital in Banks ("Official Gazette F BiH", number 47/98, 46/99, 25/00 and 43/00),
- Decision on Minimum Standards for Managing Credit Risks and Assets Classification in Banks ("Official Gazette F BiH", number 47/98 and 46/99),
- Decision on Minimum Standards for Managing Risk Concentration in Banks ("Official Gazette F BiH", number 47/98),
- Decision on Minimum Standards for Internal and External Audit in Banks ("Official Gazette F BiH", number 47/98),
- Decision on Minimum Standards for Internal Control Systems in Banks ("Official Gazette F BiH", number 47/98),
- Decision on Minimum Standards for Managing Liquidity Risk in Banks ("Official Gazette F BiH", number 47/98 and 6/Ol),
- Decision on Minimum Standards for Managing Foreign Currency Risk in Banks ("Official Gazette F BiH", number 47/98),
- Decision on Minimum Standards for Operations with Related Entities of Banks ("Official Gazette F BiH", number 47/98),

- Decision on Minimum Standards for Credit Filing in Banks ("Official Gazette F BiH", number 47/98),
- Decision on Reporting on Non-performing customers Who Are considered Special Risk for a Bank ("Official Gazette F BiH", number 47/98),
- Decision on Minimum Scope, Type and content of Program and reports on Economical Audit in Banks ("Official Gazette F BiH", number 17/99),
- Decision on Reports' Format Submitted by Banks to the FBA ("Official Gazette F BiH", number 47/98, , 34/99, 46/99, 25/00 and 6/Ol),
- Decision on Conditions for Insolvency ("Official Gazette F BiH", number 17/ 99),
- Decision on Minimum Documentation and conditions for licensing a Bank ("Official Gazette F BiH", number 17/99),
- Decision on Minimum Standards for Licensing a Bank to Perform Internal Payment Procedures ("Official Gazette F BiH", number 47/99),
- Decision on Procedures related to Detection and distribution of Assets and Liabilities in the Liquidation Procedures ("Official Gazette F BiH", number 3/00 and 53/00),
- Criteria for Internal Rating of Banks by the FBA ("Official Gazette F BiH", number 54/00), 19. Regulation on Inception of Bank Privatization Unit ("Official Gazette F BiH", number 22/98),
- Regulation on Criteria for Licensing Participation in Bank Privatization

STATISTICAL TABLES

Number of Financial Institutions
(at year-ends)

Type of financial institution	1998	1999	2000
State banks	11	10	10
Private banks	44	34	28
Financial Institutions, total	**55**	**44**	**38**

Ownership Structure of Financial Institutions
on the Basis of Registered Capital (%)
(at year-end)

Item	Banks
State ownership	42,9
Other domestic ownership	30,9
Domestic ownership total	73,8
Foreign ownership	26,2
Financial Institutions, total	**100.0**

Ownership Structure of the Financial Institutions on the Basis of Registered Capital (%) (at year-ends)

Item	1998	1999	2000
State ownership	58	44,2	42,9
Other domestic ownership	42	41,5	30,9
Domestic ownership total		85,7	73,8
Foreign ownership - incl. in private		14,3	26,2
Financial Institutions, total	**100.0**	**100.0**	**100.0**

Development of off-balance sheet activities (off balance sheet items / balance sheet total) (%)

Type of financial institution	1998	1999	2000
Banks	20,35	23,86	18,20

The Structure of Assets and Liabilities of the Banking System (%) (at year-end)

Assets	1998	1999	2000
Cash and securities	26,8	40,4	40,5
Loans and other banks	0,3	0,2	0,8
Loans - net value	53,7	44,0	45,1
Premises & other fixed assets	12,9	11,1	11,1
Other assets	6,6	4,3	2,5
Liabilities	**1998**	**1999**	**2000**
Deposits	54,2	66,6	69,3
Borrowing from banks	1,8	0,7	0,3
Liabilities on borrowings	7,4	6,1	7,4
Other liabilities	4,5	2,8	3,2
Capital	32,1	23,8	19,8

Solvency Ratio of Financial Institutions (liabilities/assets)

Type of the financial institution	1998	1999	2000
Banks	67,9	76,3	80,2

Asset Portfolio Quality of the Banking System

Asset Classification	1998	1999	2000
A	32,1	47,4	80,4
B	4,5	4,8	9,9
C	2,2	1,9	3,8
D	1,4	1,5	5,5
E	59,8	44,4	0,4
Classified Total	**100**	**100**	**100**
Specific Reserves *	**N/A**	**4,3**	**94,5**

** % of needed*

The Structure of Deposits and Loans (%) (at year-end)

	Deposits	Loans
Households	27	28
Government sector	9	2
Corporate	43	65
Foreign	-	-
Other	21	**5**
Total	**100.0**	**100.0**

The Structure of Deposits and Loans (%) (at year-end)

Maturity of Deposits		Loans	
At sight	29,7	Long term loans	86,1
Within one year	4,7	Medium-term loans	-
Over one year	43,1	Short-term loans	12,5
Total	**100.0**	**Total**	**100.0**

Proportion of Foreign Exchange Assets and Liabilities (at year-ends)

Type of thefinancial institutions	FOREX Assets / Total Assets			FOREX Liabilities / Total Liab.		
	1998	**1999**	**2000**	**1998**	**1999**	**2000**
Banks	16,3	26,4	27,9	40,1	32,3	31,2

Structure of Revenues and Expenditures of Financial Institutions (at year-ends)

Revenues	1999	2000
Net interest margin	44	42 *
Fee income	56	
Expenditures	1999	2000
Reserves for p. loses	60	51
Salary & contr. expense	27	25
Fixed ass. & overhead	12	12
Other	26	24

**: of total income*

Structure of Registered Capital and Own Funds of Financial Institutions

Type of thefinancial institutions	Registered Capital	/Total assets	Own Funds	/Total Liab.
	USD	%	USD	%
Banks		19,9		1,7

2000 DEVELOPMENTS IN THE BULGARIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

As a result of increasing external demand and liveliness in Bulgaria's economy, real GDP growth in 2000 reached 5.8%. Exports continued to be the major element of this growth. Revenues from the sale of industrial output rose by 4.6%, which reflects high rates of export growth (20.1% on 1999). Balance of payments development in 2000 indicated a sustainable upward trend in foreign trade. A faster increase in exports compared with imports helped stabilize the balance of payments current account. The current account deficit stayed close to its 1999 level (-5.8% of GDP). This was attributable also to tourism, reporting increased net revenue of about USD 540 million.

By the end of 2000 inflation reached 11.4%, exceeding the projected rate. That was attributable mostly to the significant euro depreciation and price rises in energy inputs: oil and natural gas.

Domestic financial stability was sustained, backed by a surplus of the financial account. Direct investment in Bulgaria contributed significantly to that surplus, amounting to USD 1,002 million (8.4% of GDP): an increase of USD 183 million (22.3%) on 1999. That was the highest amount of direct investment reported since 1991.

Sustained macroeconomic stability in 2000 was to a large extent due to fiscal sector stability. The conservative budget contributed to non-performance of the planned deficit. 2000 the consolidated budget deficit reached BGN 269 million (-1% of GDP) against the projected BGN 355 million, i.e. a quarter less than the relevant law's provision.

Real sector reform continued and adjustment to changes in economic conditions under a fixed exchange rate directly affected the labour market: unemployment stayed firmly at about 18%. That process affected primarily the public sector and particularly the manufacturing industry, where the number of workers was halved. The bulk of that unemployment was attributable to the restructuring of this industry, including privatization of a significant number of industrial companies. The average number of private sector employees fell insignificantly: just by 0.8%.

During the year 2000 all monetary aggregates indicated sizeable growth, consistent with the increased values of the money multiplier, and enhanced money demand by economic agents. On a year-on-year basis credit aggregates also indicated certain growth. Despite growing credit to the real sector, it is still insufficient. Data on the reporting year indicate a higher ratio of broad money to GDP, and an unchanged ratio of real sector credit to GDP. Low values of claims on the non-government sector (at about 17% of GDP) reflect cautious commercial bank lending policies rather than a shortage of funds.

DEVELOPMENT IN THE BANKING SYSTEM

In 2000 return on assets (ROA) in the banking sector, accounting for 2.8% on an annual basis, almost matched the previous year's level (2.4%). Return on equity increased to 22.6% at current data from 1999 (20.9%). The slight increase is mostly associated with commercial bank intent to increase the share of interest-bearing (correspondingly earning) assets, and to improve their structure through prudent lending.

The three largest banks (Bulbank, DSK Bank and the United Bulgarian Bank) sustained their big share in total banking sector assets: approximately 50%, including 36% from lending, 61% from claims on banks and financial institutions, and 75% from securities in the investment portfolio. The top banks' share in placement of trading portfolio securities decreased from 56% by end-1999 to 44%. Those banks' capital and reserves accounted for 53% of the banking system total, and attracted 56% of the deposits from the non-financial sector and the public.

Structural reform in the banking system continued in conformity with the government's program and in coordination with international financial institutions. Privatization of Hebrosbank was finalized in early 2000, and Bulbank was sold to UniCredito Italiano and Allianz Insurance of Germany in the second half of 2000. As a result of that, state ownership in the banking system remained at 17.6% and municipal at 2.1%. The share of private banks in total bank assets rose from 53.4% at end-1999 to 80.3% at end-2000. As a result of privatization, the share of assets owned by foreign banks reached 56.5% against 18% in 1999. Together with the participation of other foreign investors in Bulgarian banks, the share of bank assets owned by foreign banks and investors accounted for 73.3%.

During 2000 no mergers between banks or banks and other financial institutions were reported in the Bulgarian market. As a result of sales, four of the biggest Bulgarian banks were included in international bank and financial groups between 1999 and 2000: Bulbank into UniCredito Italiano, the United Bulgarian Bank into the National Bank of Greece, Expressbank into Societe Generale, Hebros Commercial Bank into First Regent Group Ltd. The share of those banks in the banking sector assets accounted for 47.5%. That involved more international players on the market and has encouraged the consolidation of smaller local banks to improve their competitiveness.

By the end of 2000 total banking system assets significantly increased by 19% against 1999. In addition, structural changes took place in assets. They reflected the reduced minimum required reserves from 11% to 8% in the second half of 2000. Placements, mostly in foreign banks, indicated a sizable rise of over USD 450 million in volume and 34.9% in weight in banking sector assets. Granting of new credits was in line with a conservative banking policy. That involved reduction of securities in investment and trading portfolios. The manner of asset restructuring in 1999 and 2000 clearly indicated that banks intended to increase their revenue without taking additional risks.

Over the year accumulated deposits from non-financial institutions and the public grew modestly. In addition to restored depositors' trust, real growth in savings is seen as more essentials for the future increase in banks' accumulated funds, nowadays mostly short-termed. Low-income level is the main among the reasons behind the inability of banks to acquire more savings.

Banks remained strongly dependent on interest-bearing operations due to the insufficient volume of documentary payments on foreign trade transactions and other services offered. Despite the reported growth in net profit of the system and the interest rate spread of 4.9% proved insufficient to cover the operating expenses of the banking system. Limited opportunities and alternatives for profitable bank business reflect insufficient financing sources and instruments. High credit risk and lack of sound clients who have the potential to grow, have been limiting banking competition to a contest to win a small number of major clients.

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY

Recent changes of the legal and institutional framework for the operation and supervision of financial institutions.

The Law on Banks is the prime law on banking. Other laws, such as the Commercial Law, the Law on the Public Supply of Securities, the Law on Accounting, and the Law on Measures against Money Laundering, support it. BNB is both the licensing authority and the banking supervisor. It supervises banks through its Banking Supervision Department (BSD). Article 3 of the Law on the Bulgarian National Bank defines its supervisory task as follows: "The Bank shall regulate and supervise other banks' activities in this country for the purpose of ensuring the stability of the banking system and protecting depositors' interests". The laws and a number of detailed Regulations, issued by the BNB, provide minimum prudential standards that banks must meet. Banking laws and regulations have in recent years been frequently updated due to developments in the banking sector and to changes in international standards.

In the pursuit of a policy of adopting best international practice, the Banking Supervision Department's priorities involved adaptation of Bulgaria's banking laws and regulations with international standards and EU legislation, in compliance with the principles of prudent banking. The Banking Supervision Department improved its current work meeting the resolutions and recommendations for effective banking supervision of the Basle Committee on Banking Supervision. Applying those requirements and experience of them marked significant progress in 2000.

Based on the amendments to the licensing section in the Law on Banks in June 1999, a new Regulation No. 2 on the licenses and permits granted by the BNB was issued (published in the State Gazette, issue 14 of February 2000). The Regulation repeals the minimum capital requirement for a foreign bank's branch in Bulgaria. Branches operating within Bulgaria are obliged to publish annual financial statements of the foreign bank on an individual and consolidated basis, as well as an Auditor's report of the bank in at least one national Bulgarian daily newspaper. Basic definitions in the Regulation correspond with those in European legislation.

Regulation No. 8 of the BNB on the capital adequacy of banks was amended (State Gazette, issue 41 of May 2000) in connection with the new BNB Regulation No. 2 eliminating the capital requirement for foreign banks' branches. Synchronization of regulations concerning risk weights of balance sheet and off-balance sheet items was achieved.

With a view to monitoring and controlling the concentration of risk in accordance with BNB Regulation No. 7 and determining the amount of large exposures, the Banking Supervision Department issued new instructions on the preparation and submission of reports and notifications on the big exposures of banks. The latter cover assets and off-balance sheet commitments in a bank's exposure to an individual client or group of related persons.

The introduction of banking supervision on a consolidated basis is a step toward harmonizing Bulgarian legislation with European Law. BNB Regulation No. 12 regulating this area was adopted in July 2000 (State Gazette, issue 62 of July

2000). It regulates the conditions and procedure for exercising supervision on a consolidated basis over banks, bank groups and financial holdings based on their financial statements and supervisory solvency requirements. It determines the scope; the requirements for consolidated reporting and internal procedures, the conditions and methods of consolidating persons subject to consolidated supervision. It introduces the basic principles and requirements of Directive 92/30/EC on supervision of credit institutions on a consolidated basis.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

As a result of ongoing privatization and subsequent ownership transformations, significant structural changes evolved in the banking sector. In March 2000 a permit was granted to First Regent Group Ltd. to acquire 98% of the capital of Hebrosbank. With regard to the procedure for privatization of Bulbank, the National Bank of Greece was cleared by the BNB to acquire initially 90% and subsequently all voting shares in UBB. UniCredito Italiano was cleared to acquire 93% of Bulbank capital. Citibank N.A. of New York was licensed to conduct bank transactions in Bulgaria through a branch. Permits to open branches in Macedonia and Mongolia were granted to Bulgarian banks.

In view of the need to exchange supervisory information on the business and state of Bulgarian banks' branches abroad, and foreign banks' subsidiaries and branches in Bulgaria, two agreements on supervisory cooperation were signed with the banking supervision authorities of Austria and Cyprus. Discussions are underway on memoranda with other countries. There are no problems in having an informal exchange of information as well. The BNB is prepared to inform the host country supervisory authority of any significant problems arising in the parent bank.

During 2000 the Banking Supervision Department continuously improved its risk approach to off-site supervision over banks through the Early Warning System, based on a CAEL systematized rating set. A positive step toward improving the transparency of banks' financial performance is the periodical publication of reporting information, and aggregate information on selected banking system indicators in the new quarterly BNB bulletin, Commercial Banks in Bulgaria.

During the review year 20 comprehensive inspections were carried out encompassing banks from all classification groups. The improved ratings of some of these banks are a direct result from the positive steps taken by their management to overcome inconsistencies found by previous supervisory inspections. These measures centred on improved risk management systems, positive trends in the levels of income and capital, and efficient internal control systems.

The systems and procedures for credit risk assessment and management in most of the banks were implemented successfully. The share of non-performing credits was relatively low due to the increasing number of new credits extended in the past two years. Besides of this banks maintained a high proportion of earning assets with relatively good characteristics to ensure a steady return on assets and equity. In most of the examined institutions liquidity risk management was all right. They maintained sizeable high-liquid asset portfolios, seeking to expand and maintain a stable and diversified deposit base.

Supervisory inspections confirmed the findings of previous reporting periods that interest and foreign currency risks had little impact on results from commercial operations. Major reasons for this were a smooth and predictable base interest rate movement, and an increasing share of bank transactions in euros.

List of supervised for Compliance Main Acts and Regulations

Basic laws:

- Law on the Bulgarian National Bank, effective since June 1997, last improved in 1999;
- Law on Banks, effective since July 1997, last improved 2000;
- Law on Bank Deposit Guaranty, effective since 1998, last improved 1999;
- Law on the Measures against Money Laundering, effective since 1998;
- Law on the Public Supply of Securities, effective since 2000;
- Law on Information about Non-performing Credits, effective since 1997;
- Law on Accounting, since 1991, last improved 1999;

Prudential Regulations of the BNB:

- Regulation No. 1 on Bank Deposit Insurance;
- Regulation No. 2 on the Licences and Permits issued by the BNB;
- Regulation No. 3 on Payments;
- Regulation No. 4 on Foreign Currency Positions of Banks;
- Regulation No. 7 on the Large Exposures of Banks;
- Regulation No. 8 on the Capital Adequacy of Banks;
- Regulation No. 9 on Evaluation of Risk Exposures of Banks and Allocation of Provisions to Cover the Risk Related Thereto;
- Regulation No. 10 on Internal Inspection in Banks;
- Regulation No. 11 on Banks' Liquidity Management and Supervision;
- Regulation No. 12 on Consolidated Bank Supervision;
- Regulation No. 16 on Payments by Bank Cards;
- Regulation No. 17 on Art. 29 of Law on Banks and Credit Business (now Art. 30 of the Law on Banks);
- Regulation No. 20 on Issuance of Certificates under Art. 9, Para. 2 of the Law on Banks;
- Regulation No. 21 on the Minimum Required Reserves Maintained with the BNB by Banks;
- Regulation No. 22 on Central Credit Register of Banks;
- Regulation No. 23 on the Terms and Procedures for Payment of Insured Amounts on Deposits with Banks with Revoked Licenses;
- Regulation No. 26 on Foreign Exchange Transactions of Brokerage Financial Houses;
- Rules on Applying the Law on Measures against Money Laundering;

STATISTICAL TABLES

Number of Banks
(at year -ends)

Type of bank	1996	1997	1998	1999	2000
Top Banks	2	3	3	3	3
Large banks	8	4	4	4	4
Small and medium-sized banks	30	18	17	17	17
Foreign banks *	7	9	10	10	11
Banks, total	**47**	**34**	**34**	**34**	**35**

** Foreign banks' branches and subsidiaries established in Bulgaria. Existent and privatised Bulgarian banks by foreign investors remain in the other groups as of their size.*

Ownership Structure of Banks on the Basis of Registered Capital (%)
(at year-end)

Item	Top Banks	Large banks	Small and medium-sized banks	Total
State ownership	22.4	17.9	5.4	14.2
Other domestic ownership	1.1	5.0	41.8	17.7
Domestic ownership total	23.5	22.9	47.2	31.9
Foreign ownership	76.5	77.1	52.8	68.1
Banks total	**100.0**	**100.0**	**100.0**	**100.0**

Ownership Structure of Banks on the Basis of Registered Capital (%)
(at year-end)

Item	1997	1998	1999	2000	2000/1997
State ownership	15.0	42.6	44.9	14.2	-5.3
Other domestic ownership	50.2	14.0	8.5	17.7	-64.7
Domestic ownership total	65.2	56.6	53.4	31.9	-51.1
Foreign ownership	34.8	43.4	46.6	68.1	+95.7
Banks total	**100.0**	**100.0**	**100.0**	**100.0**	-

Distribution of Market Shares in Balance Sheet Total (%)

Type of bank	1996	1997	1998	1999	2000
Top Banks	48.1	56.2	51.5	51.7	49.9
Large banks	19.3	18.8	20.3	18.7	18.5
Small and medium-sized banks	7	17.1	17.4	16.3	17.7
Foreign banks *	2	7.9	10.8	13.3	13.9
Banks under conservatorship	23.6	-	-	-	-
Banks, total	**100**	**100**	**100**	**100**	**100**

** Foreign banks' branches and subsidiaries established in Bulgaria. Existent and privatised Bulgarian banks by foreign investors remain in the other groups as of their size.*

Structure of Assets and Liabilities of the Banking Sector (%)

Assets	1996	1997	1998	1999	2000
Cash in vault & funds in current account with BNB	8.2	12.8	10.6	11.2	7.6
Due from banks & other financial institutions	19.3	31.5	32.8	32.4	39.8
Securities in trading portfolio	20.0	20.6	16.7	12.7	10.9
Loans extended to non-financial institutions and other clients	45.8	15.3	24.6	29.2	30.9
Securities in investment portfolio	0.6	3.9	6.4	7.5	4.5
Fixed assets	1.4	3.6	4.4	4.3	4.2
Other assets	4.7	12.3	4.5	2.7	2.1
Total assets	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Liabilities and Capital					
Deposits by banks and other fin. institutions	31.9	9.5	7.6	7.7	7.6
Deposits by NFIs and other clients	39.1	67.7	69.2	69.9	65.7
Total deposits	71.0	77.2	76.8	77.6	73.3
Other liabilities	6.0	10.8	8.7	6.8	11.4
Subordinated Debt					
Capital	10.1	4.3	8.9	10.8	11.3
Reserves	12.9	7.7	5.6	4.8	4.0
Total liabilities & own funds	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Development of Off-balance Sheet Activities (%)
(off-balance sheet items / balance sheet total)

Type of bank	1997	1998	1999	2000
Top Banks	120	6.5	7.2	5.7
Large banks	31.5	4.7	7.7	7.2
Small and medium-sized banks	88.8	14.8	14	17.6
Foreign banks *	82.5	24.8	40.6	33.9
Banks, total	**94.2**	**9.6**	**13**	**12.1**

** Foreign banks' branches and subsidiaries established in Bulgaria. Existent and privatised Bulgarian banks by foreign investors remain in the other groups as of their size.*

Proportion of Foreign Exchange Assets and Liabilities (%)
(at year-ends)

Type of banks	FOREX Assets/Total Assets			FOREX Liabilities/Total Liab.		
	1998	**1999**	**2000**	**1998**	**1999**	**2000**
Top Banks	53.8	55.6	60.3	48.9	46.5	48.7
Large banks	46.8	46.2	55.8	51.2	51.1	58.9
Small and medium-sized banks	59.6	61.3	54.8	62	65	55.6
Foreign banks' branches	72.4	75.2	72.8	81.3	79.4	76.7
Banks, average	**54.6**	**56.4**	**59.1**	**54.2**	**54**	**54.8**

Structure of Revenues and Expenditure of Banks (at year-ends)

BGN in millions

Revenues	1997	1998	1999	2000
Interest earned	689	457	493	601
Net income from fees and commissions	63	96	135	166
Securities income/loss (net)	7	-156	78	306
Forex operations income/loss (net)	1,389	-18	103	32
Other banking operations revenues	351	52	132	30
Extraordinary revenues/expenses (net)	117	12	-2	11
Total revenues	**2,616**	**443**	**939**	**1,146**
Expenses				
Interest paid	464	132	134	187
General operating costs	254	360	443	412
Reserve and provisions creation/reintegration (net)	1,272	-332	53	82
Other operating costs	62	58	14	61
Total expenses	**2,052**	**218**	**644**	**742**
Pre-tax profit	**564**	**225**	**295**	**404**
Taxes	196	77	100	130
Net profit	**368**	**148**	**195**	**274**

The Structure of Deposits and Claims on Sectors (%) (at year-ends)

Item	Deposits	Claims	Deposits	Claims	Deposits	Claims	Deposits	Claims
	1997		1998		1999		2000	
Households	35.5	3.5	43.0	7.2	48.4	7.5	49.6	7.0
Government sector	9.8	9.6	7.1	23.7	4.5	17.6	3.2	12.8
Corporate	43.2	38.6	39.9	28.3	38.8	33.3	35.5	32.2
Foreign	10.5	46.3	8.7	40.5	7.2	41.2	10.5	47.6
Other	1.0	2.0	1.3	0.3	1.1	0.4	1.2	0.4
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

The Structure of Deposits and Claims by Maturity (%) (at year-ends)

Deposits	1997	1998	1999	2000	Claims	1997	1998	1999	2000
At sight	57.5	55.8	47.7	47.0	Short term	76.1	49.1	73.7	74.6
Within one year	35.6	39.5	49.7	49.2	Medium term	2.9	14.1	16.5	15.9
Over one year	6.9	4.7	2.6	3.8	Long term	20.3	13.6	9.0	8.0
					Other	0.7	23.2	0.8	1.5
Total	**100.0**	**100.0**	**100.0**	**100.0**	**Total**	**100.0**	**100.0**	**100.0**	**100.0**

Solvency Ratio of Banks

Type of banks	1996 *	1997	1998	1999	2000
Top banks	-	39.4	44.8	50	42
Large banks	19.3	18.7	29.7	28.8	27.4
Small and medium-sized banks	11.1	23.7	33.3	42.7	34.7
Foreign banks (subsidiaries)	36.2	17.2	27	21.4	24.9
Banks, average	**17.7**	**26.9**	**36.7**	**41.3**	**35.5**

* *Capital adequacy in % (excl. banks under conservatorship)*

Asset Portfolio Quality

Banking Groups	Classified Risk Exposures (gross)		Dec.1997	Dec.1998	Dec.1999 (1)	Dec.2000 (1)
Top 3 banks	**Amount in BGN Millions**			**3,177,462**	**3,659,686**	
	Standard	%			95.1	96.5
	Watch	%			2.3	1.4
	Substandard	%			0.7	0.6
	Doubtful	%			0.4	0.4
	Loss	%			1.4	1.0
	Provisions	***%***			***4.9***	***4.1***
Large banks	**Amount in BGN Millions**		**2,921,023**	**3,211,288**	**1,551,247**	**1,602,328**
	Standard	%	78.7	83.6	74.9	85.7
	Watch	%	2.2	3.6	4.3	3.8
	Substandard	%	1.8	1.0	0.7	0.9
	Doubtful	%	2.3	0.4	2.9	1.0
	Loss	%	15.0	11.4	17.2	8.7
	Provisions	***%***	***25.8***	***13.7***	***19.3***	***11.1***
Small & medium-sized banks (2)	**Amount in BGN Millions**		**488,917**	**661,662**	**1,320,040**	**1,461,647**
	Standard	%	76.2	76.8	87.0	85.7
	Watch	%	13.8	12.1	4.9	7.1
	Substandard	%	0.2	5.0	2.9	2.0
	Doubtful	%	1.1	2.7	1.6	2.5
	Loss	%	8.8	3.4	3.6	2.7
	Provisions	***%***	***14.6***	***11.9***	***8.1***	***7.5***
Foreign bank branches	**Amount in BGN Millions**		**395,561**	**688,176**	**528,190**	**696,714**
	Standard	%	83.0	89.6	89.7	92.6
	Watch	%	2.0	2.9	9.1	0.6
	Substandard	%	11.7	6.5	0.4	5.7
	Doubtful	%	1.5	0.3	0.0	0.0
	Loss	%	1.8	0.8	0.8	1.1
	Provisions	***%***	***10.1***	***6.0***	***4.1***	***4.2***
Total of the banking system:	**Amount in BGN Millions**		**3,805,501**	**4,561,125**	**6,576,939**	**7,420,375**
	Standard	**%**	**78.8**	**83.5**	**88.3**	**91.7**
	Watch	**%**	**3.7**	**4.7**	**3.8**	**2.9**
	Substandard	**%**	**2.7**	**2.4**	**1.1**	**1.4**
	Doubtful	**%**	**2.0**	**0.7**	**1.2**	**0.9**
	Loss	**%**	**12.9**	**8.6**	**5.5**	**3.0**
	Provisions	**%**	**22.7**	**12.3**	**8.9**	**6.3**

NOTES: 1) Banks classified into five groups.
2) 1999 & 2000 include groups III & IV as of the banks' classification in five groups.

Structure of Registered Capital and Own Funds of Banks

Type of Banks	Registered Capital	/Total assets	Own Funds	/Total Liab.
USD in thous.	%	USD in thous.	%	
Top Banks	148,595	6.4	374,497	19.3
Large banks	59,060	6.9	118,549	16.1
Small and medium-sized banks	135,273	16.5	167,292	25.6
Foreign banks*	44,103	6.9	48,061	8.1
Banks, average	**387,031**	**8.4**	**708,399**	**18.1**

** Foreign banks' branches and subsidiaries established in Bulgaria. Existent and privatised Bulgarian banks by foreign investors remain in the other groups as of their size.*

Consolidated Indicators of the Banking Sector (%) [1)]

Item	Dec. 1997	Dec. 1998	Dec. 1999	Dec. 2000
Equity capital leverage ratio	10.8	12.9	11.4	11.0
Share of risk weighted assets	29.2	34.7	35.3	38.9
Return on assets - ROA [2)]	5.0 [3)]	1.8	2.4	2.8
Return on equity - ROE [2)]	71.2 [4)]	14.4	20.9	23.2
Net interest margin	3.1	4.5	4.4	4.9
Net profit / earning assets ratio	6.0	8.9	5.5	8.5
Credits / deposts ratio	27.0	34.2	38.9	40.6

[1)] Year's last quarter average data
[2)] Calculated on year's base
[3)] 1997 the profit taxes of significant banks in privatisation procedure were reduced.
[4)] 1997 the high value of ROE was additionally effected by low capital base of the most banks as well.

2000 DEVELOPMENTS IN THE CROATIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The main characteristics of the Croatian economy during 2000 were as follows: a return to economic growth, fuelled by strong growth in consumption and net exports; substantial improvement in the current account thanks to a good tourist season and increased transfers; higher inflation, mainly due to increases in oil prices and excise taxes; fiscal consolidation and improved government financial discipline; strong growth in monetary aggregates and falling interest rates; and successful restructuring of the banking system.

During 2000, the Croatian economy emerged from recession and resumed economic growth. Real GDP increased by 3.7%, fuelled by strong growth in personal consumption and net exports. Personal consumption grew after falling in the previous two years. This was partly due to the delayed effect of wage increases during 1999 and a greater political stability. Fiscal consolidation meant that the contribution of government purchases of goods and services to GDP growth was actually negative. Investment also fell, mainly as a result of a decrease in the government capital spending.

Importantly, the current account deficit was severely reduced, particularly due to a successful tourist season and increased transfers. The value-added of exports grew strongly measured at constant prices in kunas (8.4%). Croatia's accession to the WTO (World Trade Organization) in 2000 was certainly helpful in this regard. In addition, a more favourable external political climate helped Croatia begin to overcome trade barriers, a process that will continue in 2001.

Inflation rose in 2000, reaching its highest level since the stabilization program of 1993. Retail price inflation was 6.2%, two percentage points above 1999's 4.2%. However, this increase in inflation was caused by one-time effect: increased oil prices in the world market coupled with the strengthening of the dollar, and increases in certain administrative prices and excise taxes. Thanks to a firm control of the exchange rate and relatively restrained wage increases, these one-off effects did not become ingrained.

Fiscal consolidation was a very important characteristic of 2000. For the first time, real government expenditure decreased. In addition, the government succeeded in settling a substantial portion of its arrears, thereby improving liquidity in the economy and improving financial discipline. Important changes were made in the tax system, including a 2 percentage points decrease in health fund contributions and increases in excise taxes on gasoline and tobacco. Fiscal consolidation also included efforts to decrease the government's wage bill.

Fiscal consolidation also created more room for monetary policy in 2000. The Croatian National Bank decreased its reserve requirement on kuna deposits by 2 percentage points. In addition, the Croatian National Bank took steps to simplify the reserve requirements by unifying the rate and accounting period on all types of deposits. Such developments, combined with the payment of government arrears, led to strong increases in deposits and bank liquidity. Much of this liquidity was invested in Ministry of Finance treasury bills (T-bills) and Croatian National Bank bills (CNB bills).

The rapid growth in deposits resulted in rapid growth in the monetary aggregates. Strong bank liquidity also resulted in substantial decreases in interest rates. The spread between average lending and deposit rates fell to 7 percentage points, far below the previous levels, even though the average lending rate was inflated by the high amounts of overdraft loans granted to individuals at very high interest rates.

BANKING SYSTEM

At the end of 2000, the banking system of the Republic of Croatia comprised 43 banks and one branch of a foreign bank, as well as 26 savings banks, including four housing savings banks. The share of bank assets in the total assets of the banking sector, which amounted to HRK 113.5bn at the end of 2000, was 98.6%, whereas that of savings banks stood at 1.4%. All banks and savings banks are structured, in compliance with the provisions of the Banking Law, as joint stock companies. Banks and savings banks (except housing savings banks) are of a universal type.

During 2000 the privatization and restructuring of the banking sector took major steps forward. Three large banks that had undergone government rehabilitation procedures were successfully sold to foreign strategic partners. Foreign investors also bought four small-to-medium-sized banks, in one case merging three banks into one and, in another, two into one. Additional mergers and liquidation or bankruptcy of several other banks brought down the number of banks from 53 in December 1999 to 44 in December 2000. More important than the simple decrease in the number of banks were the increase in the overall capital adequacy of the banking system and the considerable profits generated in the banking system as a whole.

The Balance Sheet Structure of Banks

The balance sheet structure of banks in 2000 showed an improvement in quality over that in the previous year. Following the 1998 banking crisis and the beginning of the recovery in 1999, the year 2000 saw significant strengthening in the deposit base and bank capital.

Total bank banking sector assets amounted to HRK 111.9bn at the end of 2000, which is a 20.5% increase over that at year-end 1999 when it stood at HRK 93.5bn. Loans to other clients (non-banking sector) grew by 11.4% compared to 1999. These loans displayed a downward trend of the share represented by loans in bank assets (51.2% in 1998, 48.5% in 1999, and 44.9% in 2000). Corporate loans accounted for 49%, whereas the share of household loans and all other loans accounted for 41 and 10%, respectively. The share of deposits with banking institutions in assets grew from 11.0% in 1999 to 15.8% in 2000. The investment portfolio of securities displayed a downward trend (18.3% in 1998, 16.4% in 1999, and 12.7% in 2000). This decline resulted from the redemption of a part of the bonds of the Republic of Croatia, as well as a sale (accelerated by bank privatization) of previously acquired shares of banks in companies. Deposits with the Croatian National Bank (mainly reserve requirements) amounted to 8.9% of total assets.

The share of total deposits in total bank liabilities moved upward (60.5% in 1998, 61.9% in 1999, and 65.0% in 2000). In 2000, 72.8% of all deposits were denominated in some foreign currency. Following a 1999 fall, deposits grew by 27.7% in 2000, amounting to HRK 72.8bn. Loans received (loans from financial institutions and other loans) moved lower, both in nominal terms and in terms of share in liabilities.

Bank Capital

At the end of 2000, bank capital amounted to HRK 12.2bn, which was a 15.4% increase compared to 1999 Capital increase showed a mild downward trend (11.4% in 1998, 11.3% in 1999, and 11.0% in 2000). Share capital amounted to HRK 8.6bn, a 4.2% increase compared to 1999.

Risk-based capital is a calculation category to measure a bank's capability to cover possible losses. At the end of 2000, risk-based capital in the banking system amounted to HRK 12.9bn, which is an 11% increase compared to 1999 when it amounted to HRK 11.1bn. According to the current regulations the capital adequacy ratio (the ratio between risk-based capital and risk-weighted assets), must not be below 10%. At the banking system level, the capital adequacy ratio amounted to 21% at the end of 2000.

Asset Quality

The CNB decisions, issued pursuant to the Banking Law, regulate in detail the classification of a bank's placements by risk categories and the calculation of the required specific reserves for identified potential losses. The assessment of assets quality is carried out for bank's placements (loans, placements to banks and the central bank, contingent liabilities, claims based on interest income and investment portfolio of debt securities).

Placements that are subject to assessment are classified into the following risk categories: A, B, C, D, and E, according to the degree of risk. Risk category A includes placements that do not involve the risk of non-payment. For other risk categories, specific reserves for identified losses are calculated relative to the degree of risk. The risk assets classified into category A accounted for 87.5% of total risk assets at the end of 2000 whereas other categories together comprised 12.5% of total risk. Specific reserves for identified and unidentified losses in 2000 amounted to HRK 9.3bn, i.e. 7.5% of total risk assets. A significant change occurred in 1999 when placements (as a result of a reduction in the number of banks) decreased, and reserves increased (due to the application of more strict criteria in assessing placements). Therefore, it can be asserted that the reduction in the share of reserves in placements in 2000 was a result of improved placement quality, which is confirmed by the increased share of categories A.

Bank Earnings

In 2000, banks reported a profit of HRK 1,306.7m. Thirty-five out of 44 banks earned profit amounting to a total of HRK 1,897.1m, whereas 6 banks incurred a total of HRK 590.4 in losses. Interest income in the overall banking system amounted to HRK 8,400.1m, a 7.4% increase over 1999 levels. Interest expenses stood at HRK 4,073.5m, a 3.8% growth compared to the previous year. Interest income and expenses did not reach their 1998 levels, when significantly more banks were operating and interest rates were higher. Net non-interest income fell by 1.8% from the previous year, since both non-interest income and non-interest expenses were somewhat lower. Accordingly, banks did not significantly increase their non-interest income bearing activities following the drop in 1999.

Loan loss provisions fell significantly (HRK 5,212.0m in 1998; HRK 1,898.4m in 1999; HRK 1,298,5m in 2000). In 1998, a considerable increase in loan loss provision expenses was recorded, but following the exit of problem banks from the market in 1999, these expenses significantly decreased. This trend continued in 2000. Realized profit against average assets increased from 0.7% in 1999 to 1.3% in 2000.

Bank Liquidity

In order to assure liquidity reserve, banks place part of their assets in securities bearing lower interest, which, however, can easily be changed into liquid assets. At the end of 2000, HRK 2,496.0m in CNB bills denominated in kunas were purchased (HRK 850.4m at the end of 1998, and HRK 1,348.7m at year-end 1999). HRK 1,692.7m in CNB bills denominated in foreign currency were also purchased (HRK 1,377.4m in 1998, and HRK 1,507.6m in 1999). At the end of 2000, CNB loans amounting to HRK 299.6m were utilized compared to HRK 1,044.1m at the end of 1999. The credit to deposit ratio was 71% in end 2000 (86% in 1998; 82% in 1999). The short-term assets to short-term liabilities ratio stood at 92.3% in 2000 (88.8% - 1998; 90.1% - 1999). Thus, bank liquidity has been continually improving over the past three years.

SUPERVISION OF BANKS AND SAVINGS BANKS

The Bank Supervision Division consists of the On-Site Supervision Department, Off-Site Supervision Department, and the Department for Improving Bank Supervision. The Foreign Trade Transactions Inspection Department is also within the organizational structure of the Bank Supervision Division.

Following its establishment in 1993, the Bank Supervision Division has been gradually developing within the Croatian National Bank and it grew with respect to organization and human resources. In 1999, the Division was reorganized (the Department for the Inspection of Compliance with Monetary and Foreign Exchange Policy Measures was merged with the On-Site Bank Supervision Department) and 24 new employees were recruited. At the end of 2000, the Bank Supervision Division consisted of a total of 73 employees[2].

The Legal and Institutional Framework

In 2000 there were no major changes of the legal and institutional framework of the operation and supervision of financial institutions. The basic supervisory regulations were mostly enacted in 1993 by adopting the Law on Banks and Saving Banks. Upon the enactment of the Banking Law, at the end of 1998, and the set of regulations based on that law, the process of adoption of the basic supervisory regulations has been completed. The new regulation in all significant aspects was harmonized with the International Accounting Standards, the BIS principles and recommendations for effective banking supervision. In 2000, several amendments

[2] The total number of employees does not include those employed with the Foreign Trade Transactions Inspection Department.

to the regulations were adopted as based on the Banking Law, which shall be applicable from 2001. The amendments were adopted for the purpose of eliminating certain misinterpretations that were observed when applying the decisions in practice.

In order to further improve and develop the legal and institutional framework and the banking supervision in the future, a plan for the enactment of a new law and regulations has been announced.

The Activities of the Banking Supervisory Authority in 2000

In 2000, the On-Site Supervision Department conducted a total of 45 examinations of banking operations (24 banks and 21 savings banks), 4 examinations of the implementation of measures for eliminating illegal and irregular activities (2 banks and 2 savings banks), as well as 6 examinations of exchange operations. The On-Site Supervision Department issued 34 examination findings based on the data on the implementation of monetary and foreign exchange policy measures. The Off-Site Supervision Department prepared 24 examination findings on the examination of a part of operations (16 for banks and 8 for savings banks). 43 orders for the improvement of conditions and the elimination of illegal and irregular activities were issued within the Bank Supervision Division (13 related to additions to, the prolongation and revocation of orders), as well as one order for determining insolvency.

In 2000, 42 charges were brought against banks (26 requests for initiating legal proceedings, 14 citations for business violations and 2 citations for infringement of currency regulations). In several banks and savings banks the intervention of the criminal and financial police was requested. In 2000 the Foreign Trade Transactions Inspection Department filed a total of 3,201 requests for initiating misdemeanour court proceedings for the infringement of currency regulations.

The Main Strategic Goals of the Banking Supervisory Authority in 2000 and in 2001

In 2000, as in the previous years, efforts were made regarding the ongoing training of employees, by continuing cooperation with the USAID technical assistance, and providing occasional internal training within the Division, as well as a joint training with other areas of the Croatian National Bank. The employees participated in various seminars and training courses in Croatia and abroad and were enrolled in postgraduate studies.

Further improvement in bank supervision quality is one of the strategic goals of the Croatian National Bank. Accordingly, special efforts have continued to be made to improve the compliance with the BIS Core Principles that lay down the minimum requirements for effective banking supervision, as well as to enhance the CAMELS method application, i.e. to introduce the CAMELS method into bank supervision, and to follow other European and world guidelines and standards, which themselves have constantly been improving.

In 2000 we started to publish the *Bulletin on Banks*, which presents an overview of the most important data on the banks' condition. The first set of data includes data on peer groups, while the second set of data includes data on individual banks. We believe that this publication will positively influence conduct of banks and the stability of the system.

The development of the early warning system is considered to be of utmost importance for banking supervision efficiency. The Research and Statistics Area of the Croatian National Bank has already designed a certain form of the early warring system, and it is our intention to further develop this system and use it within the Bank Supervision Division.

STATISTICAL TABLES

Number of Financial Institutions (at year-ends)

Type of financial institution	1998	1999	2000
Banks	60	53	44
Saving banks	36	34	26
Financial Institutions, total	**96**	**87**	**70**

Ownership Structure of Financial Institutions on the Basis of Registered Capital (%) (at year-end)

Item	Type of financial institution		Total
	Banks	**Savings banks**	
State ownership	8.9	0.0	8.6
Other domestic ownership	18.0	69.5	19.9
Domestic ownership total	26.9	69.5	28.5
Foreign ownership	73.1	30.5	71.5
Financial Institutions, total	**100.0**	**100.0**	**100.0**

Ownership Structure of Financial Institutions on the Basis of Registered Capital (%) (at year-ends)

Item	1998	1999	2000	2000/1998 (indeks)
State ownership	33.1	37.5	8.6	24.5
Other domestic ownership	53.6	31.6	19.9	35.2
Domestic ownership total	86.7	69.1	28.5	31.1
Foreign ownership	13.3	30.9	71.5	510.4
Financial Institutions, total	**100.0**	**100.0**	**100.0**	**94.6**

Distribution of Market Shares in Balance Sheet Total (%)

Type of financial institution	1998	1999	2000
Banks	98.8	98.5	98.6
Savings banks	1.2	1.5	1.4
Financial institutions, total	**100.0**	**100.0**	**100.0**

Development of Off-balance Sheet Activities (off balance sheet items/ balance sheet total) (%)

Type of financial institution	1999	2000
Banks	17.6	15.8
Savings banks	0.4	0.7
Financial institutions, total	**17.4**	**15.7**

Solvency Ratio of Financial Institutions

Type of the financial institution	1998	1999	2000
Banks	12.7	19.3	21.3
Savings banks	33.6	49.7	33.5
Financial institutions, average	**12.9**	**19.8**	**21.4**

** Capital adequacy ratio*

The Structure of Deposits and Loans (%) (at year-end)

Maturity of Deposits		Loans	
At sight	41.7	Long term loans	31.7
Within one year	46.2	Medium-term loans (1 to 3 years)	23.1
Over one year	12.1	Short-term loans	45.2
Total	**100.0**	**Total**	**100.0**

Asset portfolio Quality of the Banking System

in 000 HRK

Asset Classification	1998	1999	2000
A	97,227,857	92,061,485	108,490,148
B	6,377,832	4,507,036	3,723,007
C	5,574,783	3,749,932	3,090,824
D	2,718,117	3,393,648	3,833,998
E	2,359,643	3,903,318	4,808,766
Classified Total	**114,258,232**	**107,615,419**	**123,946,745**
Specific Reserves	**6,951,570**	**8,673,585**	**9,361,718**

The Structure of Assets and liabilities of the Banking System (%) (at year-ends)

Assets	1998	1999	2000
Money assets	0.8	1.3	1.3
Deposits with CNB	5.8	9.1	8.9
Deposits with banking institutions	11.8	11.0	15.8
Treasury bills and CNB bills	1.1	3.4	5.4
Trading portfolio of securities	0.3	1.1	2.2
Loans to financial institutions	0.9	1.3	1.0
Loans to other clients	51.2	48.5	44.8
Investment portfolio of securities	18.3	16.5	12.7
Investment in subsidiries and affiliated companies	2.9	1.9	2.2
Foreclosed and repossessed assets	0.4	0.5	0.6
Tangible assets and software	3.3	3.4	2.9
Interests, fees and other assets	3.9	2.8	2.8
General provisions	-0.7	-0.8	-0.6
Liabilities	**1998**	**1999**	**2000**
Borrowings from financial institutions	4.9	5.6	3.1
Giro and current account deposits	9.4	9.9	11.3
Savings deposits	14.0	14.6	15.8
Time deposits	37.1	36.5	37.9
Other loans	17.6	16.0	14.6
Debt securities issued	0.0	0.0	0.0
Additional capital	0.5	-	-
Subordinated debt instruments	-	0.1	0.2
Hybrid instruments	-	0.3	0.2
Interests, fees and other liabilities	6.8	5.2	4.9
Equity capital	9.2	8.8	7.7
Current year profit or loss	-1.7	0.5	1.0
Retained profit (loss)	0.0	0.1	0.3
Reserves	2.2	2.4	3.0

The Structure of Deposits and Loans in 2000 (%) (at year-end)

	Deposits	Loans
Households	65.6	40.6
Government sector	3.8	8.0
Corporate	22.1	48.7
Foreign	4.8	0.5
Other*	3.7	2.2
Total	**100.0**	**100.0**

** Financial sector is included*

Proportion of Foreign Exchange Assets and Liabilities (at year-ends)

Type of the financial institutions	FOREX Assets/Total Asset			FOREX Liabilities/ Total Liabilities		
	1998	1999	2000	1998	1999	2000
Banks	32.2	27.6	31.0	61.3	64.6	64.1
Savings banks	12.4	9.5	8.5	42.3	40.4	41.9
Financial Institutions, average	**31.9**	**27.3**	**30.7**	**61.1**	**64.3**	**63.8**

Structure of Revenues and Expenditures of Financial Institutions (at year-ends)

in 000 HRK

Revenues	1998	1999	2000
Interest Income	8,713,616	7,816,092	8,400,149
Non-Interest Income	4,507,072	2,962,411	2,878,903
Expenditures			
Interest Expense	4,339,212	3,922,690	4,073,543
Non-Interest Expense	2,877,410	926,877	898,226
General and Administrative Expenses	3,515,061	3,211,081	3,578,699
Provisions for Identified and Unidentified Losses	5,212,025	1,898,449	1,298,549
Income Taxes	179,841	104,782	123,303

Structure of Registered Capital and Own Funds of Financial Institutions

Type of the financial institutions	Registered Capital	/Total assets	Own Funds	/Total liab.
	000 USD	%	000 USD	%
Banks	1,067,079	7.8	1,634,254	13.5
Savings banks	41,716	21.6	30,097	18.4
Financial Institutions, average	**1,108,795**	**8.0**	**1,664,351**	**13.6**

2000 DEVELOPMENTS IN THE CZECH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The turnaround towards economic growth recorded in 1999 continued into 2000, confirming a lasting change in the Czech economy. This growth is founded on gradual structural changes on the supply side and a recovery for most items on the demand side. The economy faced external cost pressure in 2000 from a rise in energy raw material prices, exacerbated by the koruna's exchange rate against the dollar. Nevertheless, internal macroeconomic stability was successfully maintained. The growth in import prices associated with the cost shock was reflected more strongly in the external imbalance.

The 2.9% GDP growth in 2000 resulted from rises in all items of domestic demand except for government demand. The economic developments in 2000 confirmed that the growth of the Czech economy was based on firmer foundations resulting from the restructuring process, reinforced to a large extent by foreign direct investment. The massive investment inflow in 2000 created the preconditions for a continuation of this trend into 2001. The macroeconomic and monetary outlook simultaneously indicates that the economic growth should proceed in a stabilised macroeconomic environment. The expected moderate growth in domestic demand, the easing of external cost pressures, the wage and productivity trend and the persisting strongly competitive environment on the consumer market are creating conditions for sustained low inflation in 2001.

DEVELOPMENT OF THE BANKING SECTOR

As of 31 December 2000, there were 40 banks and foreign bank branches operating on the Czech financial market. The Czech Republic has fully adopted the principles of equal treatment in dealing with foreign investors. Thanks to the expansion of foreign banks and branches and to the privatisation of ÈSOB and Èeská spoøitelna, foreign capital from advanced countries has acquired a dominant role in the banking sector. In second half of 2001 with the privatisation of Komerèní banka, this share increased to nearly 90%.

In 2000 the problems of Investièní a poštovní banka challenged the stability of banking sector. In June 2000 the bank fell into an acute liquidity crisis and shareholders were not able to take the measures needed to resolve it. Therefore, on 16 June 2000 conservatorship was imposed on IPB in order to prevent destabilisation of the banking sector. This was followed on 19 June 2000 by the conservator 4"Ô "s decision to sell IPB 4"Ô "s assets and liabilities to Èeskoslovenská obchodní banka (ÈSOB), which is owned by Belgium based KBC.

The Czech banking sector has great potential. However, it is also sensitive to troubled situations in the overall economy, as has been the case in recent years.

Credit growth has slowed substantially since mid-1998, and the nominal volume of domestic credits has been flat since the second quarter of 1999, when the first signs of economic recovery emerged. The lack of profitable investment projects is the main reason for this situation. Nevertheless, it is becoming clear with the ongoing economic recovery and improving financial situation of industrial companies that the nominal stagnation in credit volume is associated with problems in the banking sector as well. In particular, the troubled large banks are suffering from a contraction in credit. Other segments of the banking sector have meanwhile been achieving credit growth, although not strong enough to fully offset the lower lending activity of the large banks.

In this context it is important that a substitute has been found for domestic credits in the form of inflow of FDI, which has reached massive proportions since 1998. For the meantime, then, the stagnation in domestic credits does not seem a serious obstacle to the economic recovery.

As of 31 December 2000, there were 45,512 people working in the Czech banking sector, 7.9% fewer than a year earlier. An analogous trend is visible for the number of banking units, which as of 31 December was down by almost one tenth (9.2%) from the previous year at 1,809 units. The rapid introduction of modern electronic banking services, which virtually all banks are starting to offer in one form or another, is also enabling banks to streamline their operations.

The performance of the Czech Banking sector in terms of net profits (measured by ROA and ROE) has been very poor over the past few years. It is important to stress, however, that the losses have been covered by the creation of additional reserves and provisions and by injections of fresh capital into the banking sector. As a result of these activities and a "clean-up" of the bad loan portfolio of the large banks, the banking sector as a whole finished last year (after three years of losses) substantially in the black (a CZK 14.9 billion net profit), with an ROA of 0.062 and an average capital adequacy ratio of almost 15%, well above the 8% Basel minimum.

Generally, the stabilisation of the banking sector as a whole progressed in 2000-2001, mainly because of the privatisation of the large banks state aid with the bad-loan portfolio.

NEW DEVELOPMENTS IN THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF BANKS

Legal and institutional framework of banking

Credit risk is the major banking risk in the Czech Republic. Legal loopholes in the legislation regulating creditors' rights have contributed considerably to the poor quality of many banks' loan portfolios. Closing of these loopholes is therefore of great importance for the stability of banking sector. Last year and at the beginning of this year some promising changes in legislation entered into force, namely:

- enhancing the right of pledge by the Act on Public Auctions;
- the Act and on Bailiffs and Distraint of Debtor's Property
- amendment of the Act on Bankruptcy

Enhancing right of pledge

The seizure and sale of collateral was previously complicated and lengthy owing to the loopholes in the Civil Code and Civil Procedures Code and also because until recently it was not possible to sell the collateral extrajudicially. A court ruling was indispensable. Effective 1 January 2001, the Act on Public Auctions substantially improved the rights of creditors. The act regulates public auctions and related rights and duties. In addition to court procedure, it enacted the possibility of selling pledged property extrajudicially.

The Act and on Bailiffs and Distraint of Debtor's Property

In January 2001 the new Act on Bailiffs and Distraint of Debtor's Property entered into force. This Act transferred some competencies from the courts to the bailiffs and authorised the Minister of Justice to appoint bailiffs. At the same time, the law enacted the competencies and responsibilities of the bailiff and the status of the Chamber of Bailiffs. To sum up: A bailiff carries out the court's order to distrain a debtor's property. This law is likely to become an effective tool of enforcement of creditor's rights. It enacts procedures that are – at least in terms of cost and the time spent – more efficient than the procedures that could be used before.

The Act on Bankruptcy

The current bankruptcy law was passed in mid-1991, when it was impossible to foresee the real effects of that law in the period of transformation from a centrally planned economy to a market one. Despite a number of amendments and adjustments to the act, many inherent problems still existed. Last year, an important amendment to the bankruptcy law came into force. Among other things, this established more accessible and more realistic conditions for settlement. During the 1990s, one serious problem was excessively long bankruptcy proceedings. The last amendment to the law created conditions for more effective bankruptcy proceedings and, at the same time, made improvements in the legal environment for creditors involved in bankruptcy and settlement. There has recently been a noticeable improvement in court bankruptcy proceedings.

In 2001, work began on a government bill for a completely new Act on Bankruptcy. It is envisaged that the new Act will resolve a significant portion of the economic and procedural problems and will also increase the effectiveness of the bankruptcy law.

New developments in regulatory framework

Towards full compatibility with international standards

During the period 2000 Q4 – April 2001, the IMF and World Bank mission performed a Financial Stability Assessment Programme in the Czech Republic. In banking supervision, the regime is either compliant or largely compliant with 20 of the 25 Basle Core Principles. On a solo basis, the regulatory framework is fully compatible with European law and other international standards. However, this is not the case for consolidated supervision. So, considerable progress has been made with harmonising the regulatory framework with European law, but important changes to banking laws and regulations have still to be introduced in this area.

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4. THE ACTIVITIES OF BANKING SUPERVISION IN 2000

The progress in developing the regulatory framework has helped to improve banking supervision at the operational level.

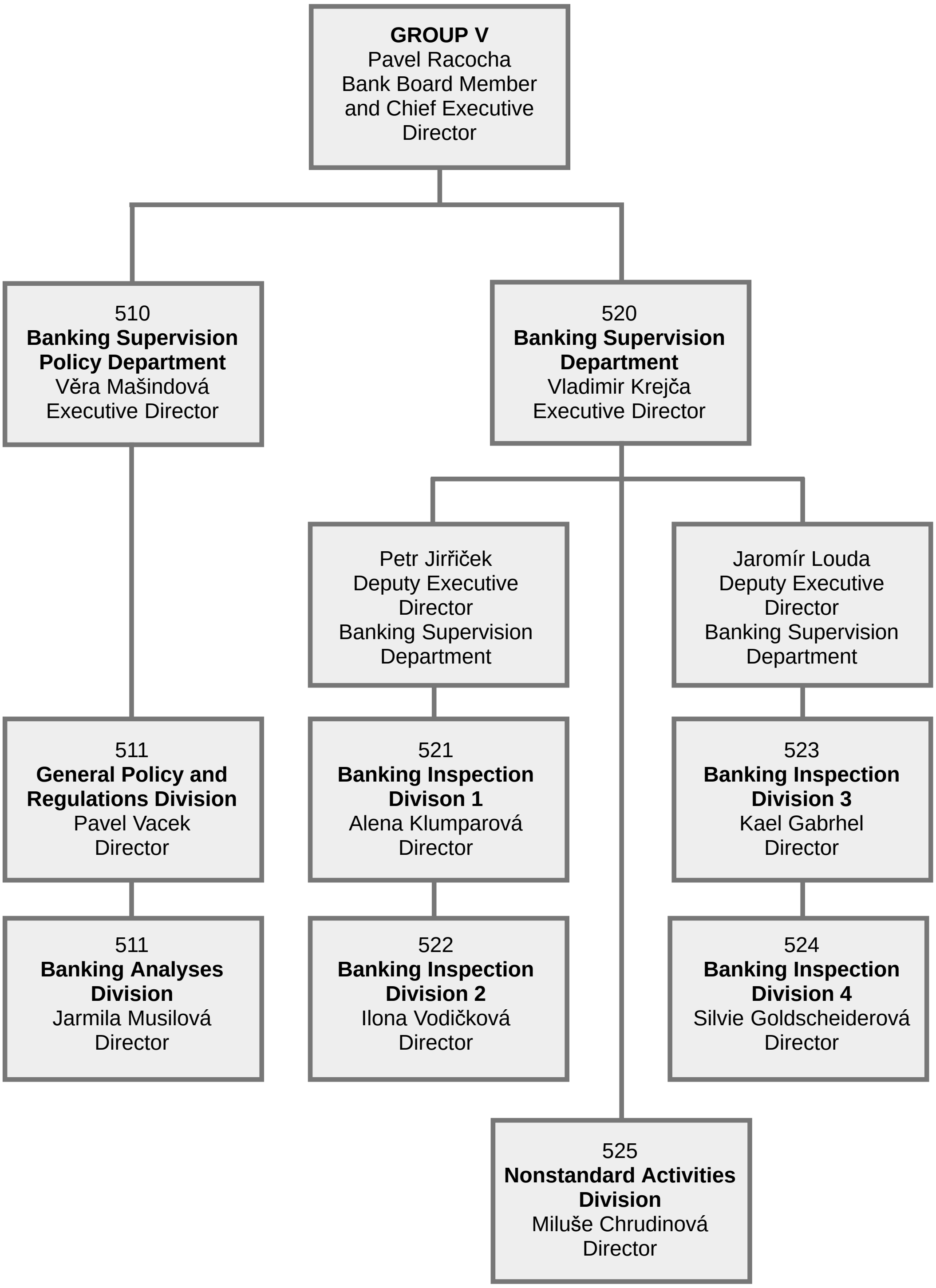
Off-site surveillance is based on the analysis of information from prudential statements and from informative visits, on-site examinations, auditors reports and other information obtained either directly from the bank or from public sources. The basic outputs consist of monthly information (an early warning system indicating unusual changes in financial indicators) and regular quarterly analyses of banks' financial situations. The financial analysis of banks involves evaluating indicators submitted generally monthly by banks in the form of statements and reports covering all their activities and focusing chiefly on prudential aspects of banking business. These data are entered into an automated information system producing standardised sets of fundamental indicators, comparisons of these indicators with those of other banks, changes relative to the previous period, etc. Also part of off-site surveillance is the issuing of decisions and consents to banks pursuant to the Act on Banks. In addition to remedial measures to counter shortcomings detected in a bank's activities, these include consent to acquisitions of holdings exceeding the limits set forth in the Act on Banks, changes in banking licences, approval of consolidated groups, approval of external auditors and approval of shareholder structure prior to general meetings.

The aim of on-site examinations is to assess banks risk management systems (particularly for credit and market risks), internal control systems and financial positions and to verify their reporting systems. The on-site examinations in 2000 were carried out in accordance with an annual plan based on a classification of banks by their importance for the banking sector and on the supervisors' capacities. Three complete inspection teams have been set up with a total complement of 18-24 people. Eleven on-site examinations were carried out in 2000, nine of which were in-depth and two partial. In addition to the inspection teams, specialised working groups started operation in 2000. These groups pool inspection team members by their specialisation - credit risks, market risks and internal control systems and internal auditing.

LEGAL COMPETENCE AND ORGANISATIONAL CHART OF BANKING SUPERVISION

According to the Act on Banks and Act on the CNB, the supervisory authority responsible for licensing and for prudential supervision of all banking institutions is the Czech National Bank, which fulfils the criteria of independence laid down by the Basle Core Principles for Effective Banking Supervision. With respect to organisation, the banking supervision is a group of the CNB divided into two sections. Each section includes two or more divisions. See organigram.

Organisational structure of the CNB Banking Supervision Group as of 31 December 2000



INTERNATIONAL ACTIVITIES OF BANKING SUPERVISION

The CNB made a considerable contribution to the activities of the BSCEE group. It hosted the regular annual BSCEE Conference, held in Prague on 22-23 May 2000. The main topics were “One regulator or co-operation among regulators” and “Exit of a bank from the banking sector.” In May 2001 a seminar on credit risk was held in Prague. Representatives of the CNB banking supervision took part in annual BSCEE conference, held in Vilnius in June 2001 as well as in other activities organised by the members of the BSCEE group.

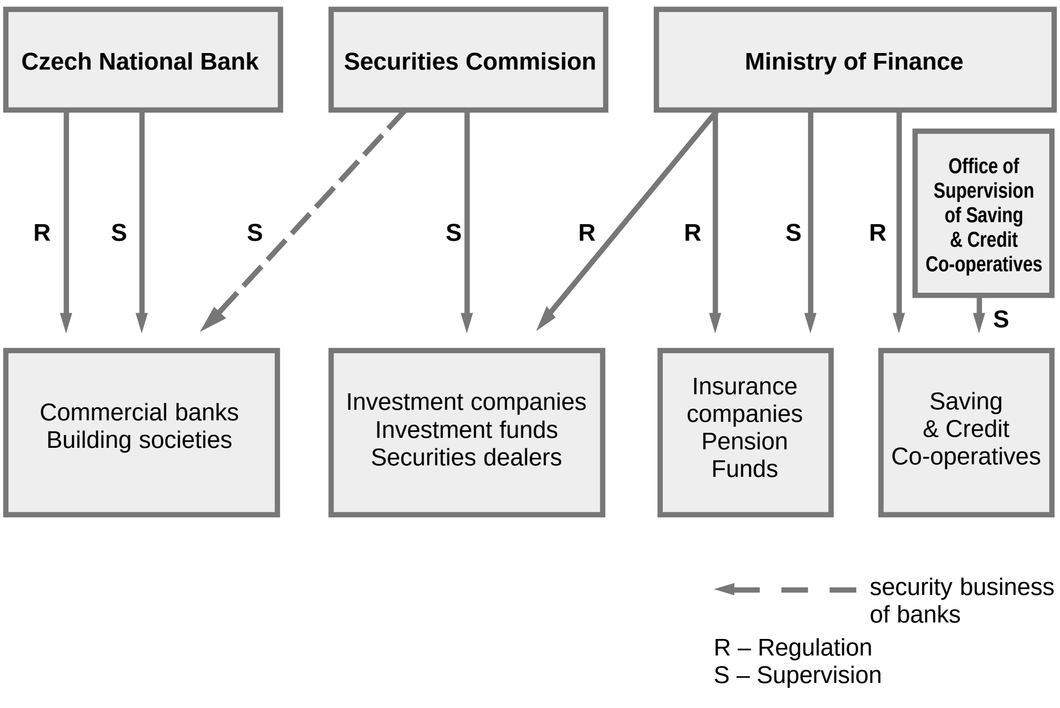
As regard to co-operation on the operational level, a Memorandum of Understanding was signed with the National Bank of Slovakia (NBS) in 1999. That agreement covers co-operation in licensing, exchange of important special information (such as significant shortcomings in banks in which the CNB and the NBS have a common interest), exchange of general information (such as regulations issued or amended) and co-operation in on-site inspections.

The CNB has addressed all the relevant EU banking supervisory authorities in order to open preliminary discussions on future bilateral co-operation. These contacts cover exchange of basic legal and regulatory norms relating to the banking sector. The CNB expects that the negotiations should lead to the signing of agreements on bilateral co-operation (Memoranda of Understanding) covering all the areas required by EU directives and international standards.

COOPERATION OF BANKING SUPERVISION WITH OTHER SUPERVISORY BODIES

As regards co-operation between domestic supervisors, an agreement on exchange of information between the Czech National Bank (banking supervision), the Czech Securities Commission (the capital market and its participants) and the Ministry of Finance (insurance companies and pension funds) was signed in July 1998.

Financial Sector Regulaltors and Supervisors



Since 1998 this co-operation has developed. In line with the agreement it includes:

- sharing of all information and findings that may be important for performance of supervision, unless such exchange of information and findings is restricted by law. The agreement specifies the scope of the information transmitted to another regulator without his request and by his request. Exchanged is information on licensing procedures, substantial changes to the shareholder structure of financial institutions, formal action taken by regulators and results of on-site examinations. At the same time the confidential nature of the information shared is protected and the purposes of use of the information are limited;
- co-operation in the area of on-site inspections;
- regular consultations of heads of agencies at least yearly and at a lower level at least every half year, and ad hoc consultations whenever is necessary.

MAIN STRATEGIC OBJECTIVES OF BANKING SUPERVISION IN 2000 - 2001

Banking supervisory activities have generally proceeded in harmony with the medium-term concept for the development of banking supervision approved by the CNB Bank Board. This comprehensive document expresses the basic objectives of banking supervision and the measures required for their accomplishment.

The last "Concept" was approved in 1998. Its primary aim was to create preconditions for the intensive development of on-site supervisory activity – one of the principal methods of banking supervision in the Czech Republic. To further improve the supervision of banks, an integrated information system was created. This provides the database needed for analysing a bank's financial condition and its adherence to the prudential rules. The system is used both for acquiring information on a bank's track record and for determining possible risk areas in the short and long run.

In April 2001, the Bank Board of the CNB discussed a new concept for the further development of banking supervision, which sets forth the following main objectives:

- a high degree of compatibility of the banking regulations with the *acquis* and international best practices,
- effective performance of banking supervision on a solo and consolidated basis,
- development of co-operation with other domestic supervisory authorities,
- development of co-operation with foreign supervisory authorities and conclusion of Memoranda of Understanding,
- development of co-operation with international organisations in the field of financial sector supervision,
- enhancement of Banking Supervision's transparency and communication with the public.

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STATISTICAL TABLES

Number of Financial Institutions *
(at year -ends)

Type of financial institution	1998	1999	2000
Large banks	5	5	4
Medium-sized banks	12	12	11
Small banks	12	9	8
Foreign bank branches	10	10	10
Building societies	6	6	6
Banks under conservatorship	0	0	1
Banks, total	**45**	**42**	**40**

** Banks with valid banking license, central bank (the Czech National Bank) is not included*

Ownership Structure of Financial Institutions in 2000*
on the Basis of Registered Capital (%)
(at year-end)

Item	Type of financial institution					
	large banks	medium-sized banks	small banks	building societes	banks under conservator.	Total banking sector
State ownership	40.8	8.9	8.1	-	-	23.6
Other domestic ownership	10.0	18.3	36.4	46.3	51.2	21.9
Domestic ownership total	50.8	27.2	44.5	46.3	51.2	45.5
Foreign ownership	49.2	72.8	55.5	53.7	48.8	54.5
Financial Institutions, total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

** Banks with valid banking license, central bank (the Czech National Bank) is not included*

Ownership Structure of Financial Institutions*
on the Basis of Registered Capital (%)
(at year-ends)

Item	1998	1999	2000	2000/1998
State ownership	25.1	27.0	23.6	0.9
Other domestic ownership	36.2	24.6	21.9	0.6
Domestic ownership total	61.3	51.6	45.5	0.7
Foreign ownership	38.7	48.4	54.5	1.4
Financial Institutions, total	**100.0**	**100.0**	**100.0**	**1.0**

** Banks with valid banking license, central bank (the Czech National Bank) is not included*

Distribution of Market Shares in Balance Sheet Total (%)

Type of financial institution	1998	1999	2000
Large banks	66.0	65.0	61.9
Medium-sized banks	16.9	17.4	19.6
Small banks	3.4	1.7	2.0
Foreign bank branches	9.5	11.4	11.1
Building societies	4.2	4.5	4.8
Banks under conservatorship	0.0	0.0	0.6
Financial Institutions, total	**100.0**	**100.0**	**100.0**

The Structure of Assets and Liabilities of the Banking System (%)

Assets	1998	1999	2000
Liquid assets	27.42	29.60	30.56
Deposits in other banks	20.95	22.79	21.73
Credits	42.57	37.56	34.98
Securities in trading and investment portfolios (excl. bills)	8.00	7.86	10.66
Other assets	1.06	2.19	2.07
Liabilities			
Clients´deposits	51.31	52.31	51.72
Banks´ deposits	21.45	19.58	17.93
Sources from central bank	2.25	1.34	0.67
Equity	2.97	3.46	3.27
Reserves, reserve and capital funds	9.06	10.05	12.72
Other liabilities	22.02	23.31	26.40

Development of Off-balance Sheet Activities (%)
(off balance sheet assets/ balance sheet total)

Type of financial institution	1998	1999	2000
Large banks	50.7	54.6	58.0
Medium-sized banks	159.6	150.7	142.3
Small banks	7.9	14.9	19.0
Foreign bank branches	203.6	185.4	324.4
Building societies	2.6	3.5	5.2
Banks under conservatorship	-	-	516.8
Financial Institutions, total	**80.4**	**82.3**	**103.8**

Solvency Ratio of Financial Institutions*

Type of financial institution	1998	1999	2000
Large banks**	10.5	12.1	13.7
Medium-sized banks	17.4	17.7	16.3
Small banks	22.9	21.6	21.6
Building societies	15.2	15.8	17.7
Financial Institutions, average ***	**12.1**	**13.6**	**14.9**

* *capital adequacy in %*
** *excl. Konsolidaèní banka*
*** *excl.banks under conservatorship*

Asset Portfolio Quality of the Banking System

CZK in mil.

Asset Classification*	1998	1999	2000
Standard	717,508	614,331	607,995
Watch	58,721	92,124	85,341
Substandard	33,427	39,379	54,064
Doubtful	35,538	38,433	27,488
Loss	130,318	121,125	89,154
Classified Total	258,004	291,061	256,047
Specific reserves and provisions	**107,995**	**103,783**	**77,144**

** Gross loans officially presented (without Konsolidaèní banka, banks under conservatorship and the loan to Slovenská inkasní jednotka)*

The Structure of Deposits and Loans (%) (at year-end)

	Deposits	Loans
Households	66.2	9.4
Government sector	4.6	5.1
Corporate	21.5	66.4
Small business	3.3	2.6
Public sector	2.9	9.2
Other	1.6	7.2
Total	**100.0**	**100.0**

The Structure of Deposits and Loans (%) (at year-end)

Maturity of Deposits		Loans	
At sight	35.8	Long term loans	44.0
Within one year	46.8	Medium term loans	19.6
Over one year	17.4	Short term loans	36.5
Total	**100.0**	**Total**	**100.0**

Proportion of Foreign Exchange Assets and Liabilities (%) (at year ends)

Type of the financial institution	FOREX Assets/Total Assets			FOREX Liabilities/Total Liabilities		
	1998	**1999**	**2000**	**1998**	**1999**	**2000**
Large banks	14.7	16.2	14.0	13.9	13.4	10.7
Medium-sized banks	30.4	30.0	31.1	27.1	27.7	29.1
Small banks	20.0	23.2	19.8	18.0	22.4	19.2
Foreign bank branches	40.6	37.5	39.4	34.2	31.6	38.2
Building societies	0.0	0.0	0.0	0.0	0.0	0.0
Banks under conservatorship	-	-	0.0	-	-	0.0
Financial Institutions, aver.	**19.1**	**20.1**	**19.3**	**17.4**	17.1	16.7

Structure of Registered Capital and Own Funds of Financial Institutes

Type of the financial institution	Registered Capital	/Total Assets	Own Funds	/Total Liab
	USD in mil.*	%	USD in mil.*	%
Large banks	1,197	2.7	4,182	9.4
Medium-sized banks	511	3.6	1,139	8.1
Small banks	181	12.5	160	11.1
Foreign bank branches	-	-	224	2.8
Building societies	114	3.3	262	7.6
Banks under conservatorship	354	76.3	430	92.6
Financial Institutions, aver.	**2,357**	**3.3**	**6,397**	**8.9**

** Rate of exchange CZK/USD= 37,81*

Structure of Revenues and Expenditures of Banks* (at year-end)

CZK in mil.

Revenues	1998	1999	2000
Interest earned	253,206	198,727	228,980
Fees and commissions earned	16,949	19,959	22,853
Receivables sold revenues	3,640	11,353	29,938
Other banking operations revenues	688,539	550,767	525,692
Extraordinary revenues	2,967	2,700	-24,917
Expenses			
Interest paid	186,277	140,394	176,908
Fees and commissions paid	4,071	5,187	5,538
Receivables sold costs	15,232	37,949	52,135
Other banking operations costs	670,243	531,827	516,194
Reserve and provisions creations (net)	14,067	87	-37,379
Receivables written off costs	29,350	25,324	9,308
General operating costs	47,520	51,067	52,601
Taxes	3,072	1,085	-2,100
Net profit	-7,231	-5,572	14,901

** Banks with valid licence as of 31. 12. 2000 excl. Konsolidační banka*

2000 DEVELOPMENTS IN THE ESTONIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2000 the external environment for the Estonian economy was among the most favourable in recent years – high global growth rates accompanied by growing trade flows secured rapid growth in external demand. Estonian GDP grew at a rate of 6.9% last year and despite of worsening outlooks of world economy continues to grow in a relatively strong path.

The main factor lying behind strong economic performance was export growth - for example merchandise exports grew nearly 50% in 2000. Although much of it contributes to exports of subcontracting, which consists little value added, Estonian direct exports and exports of services performed well, too.

Current slowdown in external demand has dampened mainly the growth rates of foreign trade and subcontracting, while the domestic demand continues to perform well. One of the problems originating in the year 2000 is the assessment of the investment level from the perspective of sustainable economic growth. In 2000 the share of investments kept growing throughout the year but did not exceed 25% of GDP. Moderate recovery in investment activity kept the deficit of trade and service balance at 5% of GDP in 2000.

External and cyclical factors have influenced Estonian inflation rate more visibly. Economic recession in 1999 resulted in relatively long period of slow rise in CPI (annual rise of 3.1% in the first half of 2000). Acceleration in consumer prices took place since the Q3 2000 and, like in Eurozone, inflation peaked in Q2 2001 with CPI annual rate at 6.7%. Further slowdown in the rise of consumer prices is expected due to weaker pressures from world oil prices, USD/EUR exchange rate and food prices.

Throughout the year 2000 the money supply growth rate was relatively high, reflecting continuously high propensity to save. Several types of deposits maintained significant growth. Such a development enabled to finance domestic borrowing primarily from domestic savings. The growth rates of domestic loans and bonds and broader money supply exceeded 30% at the end of 2000.

The government sector performs in the sustainable path. Huge fiscal deficit was achieved in 1999 (4,7% of GDP), but further improvement has been achieved both in expenditure control and revenue collection. Government ran a fiscal deficit of -0.7% of GDP in 2000, but achieved a surplus already in the beginning of 2001.

DEVELOPMENT OF THE BANKING SYSTEM

At the end of 2000, six credit institutions; one branch of a foreign credit institution and three representative offices of foreign credit institutions pursued their activities in Estonia. In November 2000 there was closed the representative office of Leonia Corporate Bank Plc. due to the acquisition of a qualifying holding AS Optiva

Pank by Sampo Leonia Group. At the end of 2000, non-residents owned 83.9 % of the share capital of the banking sector and Estonian residents owned 16.1 %. Most of the non-resident shareholders were foreign credit institutions. During 2000 their share in the Estonian banking sector increased from 52.6 % to 67 %. We can regard 2000 as a year of reforming the Estonian banking system, since Eesti Pank (Bank of Estonia) does not own holdings in any of the Estonian credit institutions. Eesti Pank sold its 57.9 % ownership in AS Optiva Pank to Sampo Leonia Group. The sale of the holding to a strong strategic owner will definitely strengthen competition on the Estonian banking market. We can point out that in the Estonian banking sector the amount of deposits and loans increased significantly in 2000. There did not occur any substantial changes in the division of market shares of the Estonian credit institutions, AS Hansapank and AS Eesti Ühispank occupied 83 % of the balance capacity of the banking sector. Considering the introduction of new products to the banking market and access to foreign resources the bigger banks keep enjoying their strong positions. The branch of the Finnish bank is their significant competitor with regard to banking products. Concerning AS Sampo Pank, we can expect its increasing integration in the sale of banking and insurance products. Small banks are more concentrated on the niche services, products and clients.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS

The legal framework of the Estonian banking environment is provided for in the Credit Institutions Act (hereinafter CIA) (adopted in 1999, amended in 2000 and its latest amendments are in the pipeline), on the basis of the CIA Eesti Pank issues decrees and guidelines. Some issues of banking supervision are regulated in the Bank of Estonia Act, too. CIA provides for the notion of a credit institutions and a financial institution, the acts and operations credit institutions are permitted to conclude, the procedures of founding a credit institution, a branch or a representative office, requirements concerning the holders of qualifying holdings in the banks, fit and proper requirements for the managers of credit institutions, merger issues, prudential requirements, accounting and reporting provisions, supervision issues, moratorium and liquidation procedures. One chapter of CIA is devoted to co-operative banks, too. Estonian banking legislation is almost to the full extent compliant with the EU banking instruments.

Today banking supervision is conducted by the Banking Supervision Department of the Bank of Estonia. By January 2002 the tasks of the Banking Supervision Department, Insurance Inspectorate and Securities inspectorate will be merged and a unified Financial Supervision Authority will be founded. Supervision authority conducts both off-site and on-site supervision.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

With regard to off-site supervision, monthly monitoring of the financial situation of banks was conducted in order to find out the fields most vulnerable to risks. The issues that emerged in the course of monitoring were very important for planning the on-site inspections. On the basis of consolidated reporting, analyses were carried out on quarterly basis, and liquidity was monitored daily. As for Capital Adequacy Regulation, a working group was set up to analyse the relevant EU provisions, BIS materials and pieces of foreign legislation on the issue in order to amend the existing methodology for calculating capital adequacy.

In the framework of the PHARE Project, foreign experts analysed the conformity of the provisions of the relevant Estonian legislation with the EU instruments. The conclusions of the study proved that conformity is guaranteed in the overwhelming majority of cases.

The key function of on-site supervision is to execute on-the-spot verification over most significant risk areas. On-the-spot verification focuses on detailed and complex control of the credit institution and business undertakings belonging to its consolidated group. Inspection is limited not only to verifying the regulatory compliance but assesses also the overall risk strategy. On-site inspection provides an overview of the adequacy of credit institutions' internal management systems, soundness of strategies and policies as well as of the correctness and quality of reporting by the credit institutions inspected. Pursuant to the Money Laundering Prevention Act enforced in 1999, the on-site supervision division assumed a new responsibility in 2000 to evaluate the measures to prevent money laundering in credit institutions.

The Banking Supervision Department has drafted guidelines for on-the spot verification and in 2000 the work continued at improving internal inspection guidelines in order to make on-the-spot verification more efficient. On-site inspection followed a quarterly plan in 2000, which was devised according to major risk areas identified during off-site monitoring of credit institutions' activities. According to Article 100, Section 2 of the CIA, the Banking Supervision Department shall carry out on-the-spot verification in credit institutions at least once every two years. A total of 15 on-the-spot verifications took place during the year 2000.

The General Supervision Department is in charge of legal counselling of the Banking Supervision Department, managing registers and international co-operation, analysing and compiling regulations, giving legal opinions on the results of on-site inspections, analysing the articles of associations of credit institutions, assessing whether the managers of credit institutions are meeting the fit and proper requirements, processing the applications for permissions. The Banking Supervision is administering data collection on credit institution according to CIA and the Bank of Estonia Act. This data collection is managed by the general supervision department and consists of data on the credit institutions, their subsidiaries, branches and representative offices, persons having close links with credit institutions, foreign credit institutions having branches and representative offices in Estonia and the reports of the external auditors on credit institutions. Additionally the General Supervision Department is managing the registry of bureaux de charge and the registry of the data on the fit and proper analysis and economic interests of the managers of credit institutions.

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY

The Banking Supervision Department of the Bank of Estonia exercises supervision over the activities of credit institutions pursuant to the procedure provided for in the Bank of Estonia Act and legislation issued on the basis thereof. In order to organise and exercise supervision, the Bank of Estonia has the right, on the basis prescribed in CIA or the Bank of Estonia Act, to issue regulations, guidelines and resolutions and to provide recommendations and explanations.

The Banking Supervision shall monitor the activities and situation of credit institutions on a regular basis and verify the compliance of credit institutions and consolidation groups thereof with the prudential rules. If necessary, the Banking Supervision may engage independent experts for off-site and on-site supervision.

The supervision activities of the Banking Supervision cover all Estonian credit institutions, the subsidiaries, branches and representative offices of Estonian credit institutions in foreign states if they are not supervised by foreign supervisory bodies or if mutually agreed with a foreign supervisory body, the subsidiaries, branches and representative offices of foreign credit institutions in Estonia, unless otherwise agreed with the supervisory body of the respective foreign state and companies belonging to the same consolidation group as a credit institution.

The Banking Supervision has the right to co-operate with foreign banking supervision authorities and other competent supervisory authorities and to exchange information necessary for supervision activities. In 2000 memoranda of understanding were concluded in the field of banking supervision with the Bank of Latvia and the Finnish Financial Supervision Authority. In 2001 a memorandum of understanding was concluded with the Bank of Lithuania.

On the basis of co-operation agreements entered into with foreign banking supervision authorities, the Banking Supervision may authorise a foreign banking supervision authority to audit a subsidiary, branch or representative office of a credit institution of the respective state in Estonia.

The Banking Supervision Department is entitled to receive information from persons engaged in the management and daily operation of credit institutions as well as receive information from and co-operate with insurance and securities supervision authorities regarding issues related to supervision.

The Banking Supervision has the right to issue precepts if violations of the requirements of the Act, of legislation established on the basis thereof or the articles of association of the credit institution are discovered in the course of supervision. The purpose of such precepts is to prevent offences if the risks taken by a credit institution increase significantly or if other circumstances exist which endanger the activities of the credit institution or damage the interests of depositors, other clients or creditors.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

The Banking Supervision Department of the Bank of Estonia consists of 23 employees. The department is divided into 3 sections: on-site supervision, off-site supervision (including an IT-specialist) and general supervision (legal counselling). The Banking Supervision is managed by the Head and Deputy Head and they are assisted by an Assistant and Legal Counsellor.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN THE COURSE OF LAST YEAR

International co-operation in the field of banking supervision has advanced, since in 2000 memoranda of understanding were concluded with the Bank of Latvia and Finnish Financial Supervision Authority. In February 2001 a memorandum of understanding was concluded with the Bank of Lithuania. A memorandum to be concluded with the Swedish Financial Supervision Authority is being negotiated now. In order to improve the prevention of money laundering, the Banking Supervision Department participated in preparing amendments to the Money Laundering Prevention Act in 2000.

STATISTICAL TABLES

Number of Financial Institutions (at year-ends)

Type of financial institution*	1998	1999	2000
-Banks	5	6	6
-Foreign Bank's branch	1	1	1
Financial Institutions, total	**6**	**7**	**7**

** Number of banks's and foreign bank's branch*

Ownership Structure of Financial Institutions on the Basis of Registered Capital (%) (at year-end)

Item	Type of financial institution
	Bank's
State ownership	0,0063
Other domestic ownership	16,0828
Domestic ownership total	16,0891
Foreign ownership	83,9109
Financial Institutions, total	**100.0**

Ownership Structure of the Financial Institutions on the Basis of Registered Capital (%) (at year-ends)

Item	1998	1999	2000	2000/1998
State ownership	13,5902	11,6421	0,0063	-13,5839
Other domestic ownership	30,9183	26,1210	16,0828	-14,8355
Domestic ownership total	44,5085	37,7631	16,0891	-28,4194
Foreign ownership	55,4915	62,2369	83,9109	28,4194
Financial Institutions, total	**100.0**	**100.0**	**100.0**	

Development of Off-balance Sheet Activities (%) (off balance sheet items / balance sheet total)

Type of financial institution	1998	1999	2000
- Banks (off-balance sheet liabilities / balance sheet total)	23,03	27,64	23,29

The Structure of Assets and Liabilities of the Banking System (%) (at year-end)

Assets	1998	1999	2000
Cash and claims on central bank	11,52	12,97	12,19
Claims on credit institutions	7,32	7,00	8,75
Claims on customers	58,30	56,65	59,24
Allowance for uncollectible claims	-2,32	-1,65	-0,92
Securities	15,48	16,46	14,40
Intangible assets	3,32	2,59	1,45
Tangible assets	2,96	2,94	2,12
Other assets	1,25	1,25	1,20
Accrued income and prepaid expenses	2,71	1,77	1,58
Liabilities	**1998**	**1999**	**2000**
Amounts owed to central bank	0,04	0,02	0,01
Amounts owed to credit institutions	13,03	13,23	10,83
Amounts owed to customers	52,37	56,15	60,14
Government lending funds and counterpart funds	1,35	1,15	0,78
Issued debt securities	9,57	7,49	8,98
Other liabilities	2,82	2,15	3,32
Accrued expenses and deferred income	1,46	1,90	1,46
Provisions	0,30	0,00	0,11
Subordinated liabilities	2,82	2,44	1,78
Equity capital	16,24	15,47	12,59

Solvency Ratio of Financial Institutions (%)

Type of the financial institution	1998	1999	2000
- Banks	16,99	16,05	13,21

Asset Portfolio Quality of the Banking System (quality of the loans)

Asset Classification	2000
Indefinite	5,80
Pass	80,72
Special mention	8,19
Substandard	2,26
Doubtful	1,74
Loss	1,28
Classified Total	**100,00**
Specific Reserves	

The Structure of Deposits and Loans (%) (at year-end)

	Deposits	Loans
Households	42,93	19,87
Government sector	7,71	2,52
Corporate	40,54	44,85
Foreign		
Other	8,82	67,24
Total	**100.0**	**100.0**

The Structure of Deposits and Loans in (%) (at year-end)

Maturity of Deposits		Loans	
At sight	61,00	Long term loans	45,56
Within one year	32,46	Medium-term loans (1-5 years)	40,67
Over one year	6,54	Short-term loans	13,77
Total	**100.0**	**Total**	**100.0**

Structure of Registered Capital and Own Funds of Financial Institutions

Type of the financial institutions	Registered Capital	/Total Assets	Own Funds	/Total Liab
	USD	**%**	**USD**	**%**
- Banks	115 093 757	3,35	432 750 713	12,59

Proportion of Foreign Exchange Assets and Liabilities (at year-ends)

Type of the financial institutions	FOREX Assets/Total Assets			FOREX Liabilities/Total Liab.		
	1998	**1999**	**2000**	**1998**	**1999**	**2000**
- Banks (balance sheet items and off balance sheet items/balance sheet total)	71,98	66,96	72,74	63,28	51,38	58,85
- Banks (only balance sheet items)	50,09	59,04	60,56	43,72	40,59	43,67

Structure of Revenues and Expenditures of Financial Institutions (at year-ends)

Revenues	1998	1999	2000
Interest income	64,5%	66,15%	64,45%
Income from financial investments	0,45%	2,52%	0,62%
Commission income	14,49%	15,56%	16,61%
Profit on financial operations	19,14%	9,57%	12,99%
Value adjustments of claims and off-balance sheet commitments (income)	0,88%	2,22%	3,88%
Value adjustments of financial assets (income)	0,00%	1,63%	0,17%
Other operating income	0,43%	2,36%	1,27%
Extraordinary income	0,12%	0,00%	0,00%
Expenditures	**1998**	**1999**	**2000**
Interest expense	32,05%	38,50%	34,87%
Commission expense	4,31%	5,40%	4,92%
Loss on financial operations	21,77%	1,96%	4,80%
Administrative expenses	20,23%	28,35%	26,43%
Value adjustments of tangible and intangible fixed assets (expenses)	5,27%	12,04%	12,86%
Value adjustments of claims and off-balance sheet commitments (expenses)	12,79%	10,09%	10,50%
Value adjustments of financial assets (expenses)	0,91%	0,74%	2,69%
Other operating expenses	2,60%	2,91%	2,93%
Extraordinary expenses	0,07%	0,00%	0,00%
Profit of the reporting period (thous. EEK)	**-498 543**	**665 078**	**613 077**

2000 DEVELOPMENTS IN THE HUNGARIAN BANKING SYSTEM

PÉNZÜGYI SZERVEZETEK
ÁLLAMI FELÜGYELETE

MACROECONOMIC ENVIRONMENT

The external (macroeconomic and international) environment had different effects on the individual segments of the financial sector in 2000. Although the macroeconomic indicators were favourable, some elements of uncertainty appeared. The 5.2 percent real growth of the GDP is significant even by international standards. However, the pace of growth decreased from quarter to quarter partly as a consequence of the gradual increase of the base value.

In spite of the increasing consumption, the economic growth was driven mainly by the export. The budget deficit increased at a moderate rate of 5.8% in nominal terms. As a result, the ratio of public deficit to the GDP declined from 3.7% in 1999 to 3.4% in 2000. (This trend has held since then.) In 2000, the deficit of the current balance of payment has not changed significantly, it amounted to EUR 1.62 billion (EUR 0.36 less than a year earlier).

The average rate of inflation decreased from 10 percent to 9.8 percent, much less then projected earlier. The increase of oil prices and the following rise of the producer price index generated inflationary pressure on the supply side, which might put a break on growth. At the same time inflationary pressure was also given a boost by the demand side through the fast economic growth, the higher rate of employment and the increasingly credit financed retail consumption. Parallel to these phenomena the declining trend of interest rates stopped.

The increase of the savings of households continued at a declining rate due partly to the low or even negative real yields on financial investments and partly to the growth of consumption and housing expenditures. Within the financial wealth a clear restructuring of the instruments was experienced. The role of money market instruments decreased further to 62% (the proportion of banking assets is below 50%) while capital market instruments, insurance bonds and pension schemes have strengthened up to 38% in total financial wealth.

DEVELOPMENT IN THE BANKING SYSTEM

Both the activity and the profit in the Hungarian banking sector grew further at a remarkable rate. By the end of the year 2000 the credit stock increased by 33% compared to the end of 1999, the growth of credits to the retail sector was much higher than that of the corporate sector. The strengthening of the business activity was accompanied by a very moderate growth of deposits. The source of the crediting activity was the result of the restructuring of the asset side of the banks' balance sheets at the expense of assets with the central bank and interbank money market. Despite of a clear shift towards the riskier assets, the quality of credit portfolios improved in 2000. The better figures of quality resulted from the growing share of new loans in the portfolios that are problem-free by their nature. Taken as a whole, net provisioning costs, influencing the profit directly, decreased from HUF 51 billion in 1999 to HUF 31 billion in 2000.

The pre-tax profit of the banking sector grew by 162% during 2000 and peaked at HUF 107 billion. (According to the non-audited figures, the sector achieved HUF 83 billion pre-tax profit in the first half of 2001 which indicates that the favourable process is continuing.) Most elements of the profitability encouraged that development. The net interest income increased in 2000, however, to a smaller extent than the balance sheet total. As a result, interest margin decreased from 4.1% in 1999 to 4.0% in 2000. The growth of overheads remained below that of the balance sheet, the cost efficiency of the sector improved. As it was mentioned earlier, also the declining costs of net provisioning contributed to the remarkable development of profitability.

This development is also reflected by the indicators of profitability. Return on assets increased from 0.55% in 1999 to 1.25% last year, while ROE grew from 6.36% to 13.84%. The reinvested profit encouraged the growth of both own capital and regulatory capital. As a consequence, the level of capitalisation of the sector improved, the capital adequacy ratio of the 42 banks grew to 15.2%.

Similar tendencies could be observed at savings co-operatives, however, the source of growing activity was the increase of deposits. Due to the large share of 'special mention' category the quality of the credit portfolios of the savings co-operatives is weaker than that of banks. (It is worth mentioning here that savings co-operatives follow a very cautious classification practice; they automatically classify some sorts of credit as 'special mention' without taking into account the debtor's good qualification.) The capital adequacy ratio of 15.11% was close to those of the banks and far above the regulatory minimum of 8%, however, considering the risks and the range of activities, a somewhat higher ratio would be desirable.

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

The legal and institutional framework changed at several points during the reporting period.

The concept of supervision changed to a risk-oriented, pro-active, transparent and consolidated supervision. In order to provide the best possible supervisory structure to this target, the former three supervisory authorities, the Hungarian Banking and Capital Market Supervision, the Pension Fund Supervision and the State Supervisory Authority of Insurance were merged and the new supervisory body, the Hungarian Financial Supervisory Authority (HFSA) was established on April 1st 2000. In the Hungarian case the ever-growing presence of financial groups with combined business activities on the domestic market clearly motivated the decision. This organisational set-up excludes the sub-sectoral bias and may lead to a more harmonised approach in the supervision of different institutions, in licensing or in handling consumer complaints. Obviously no unified standards can be applied to different sectors, however, the underlying supervisory philosophy should be the same. The HFSA is now in a better position to initiate legislative changes.

The Act CXII of 1996 on Credit Institutions and Financial Enterprises (the Act) was amended in December 2000. The main changes focused on the EU harmonisation and covered the fields as follows: outsourcing, consolidated supervision of financial and mixed groups, introducing the trading book. The harmonisation with the EU standards required only steps that could come into force on the day of joining the Union. These (cross-border activities of Hungarian banks in the EU, etc.) are included in the Act with a later relevance. The paragraphs concerning consolidated supervision of banking groups is supplemented with the definitions and principles of consolidated supervision of non-banking groups and the guidelines on consolidated capital adequacy methodology. The concept and methodology of the trading book – introduced as of January 1st 2001, applied as of April 1st 2001 – is quite similar to the European requirements.

Since in Hungary the foreign exchange position of banks had had two interpretations (one for accounting and another for monetary policy purposes), the trading book would have introduced a third definition. In order to avoid a confusing situation, the definitions for monetary policy and supervisory purposes were unified. (As further steps, banks were obliged to create special provision for country risk by the end of March 2001. As of April 1st 2001 this requirement changed to a capital requirement.)

The amendment of the Act has prohibited anonymous depositing.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY LAST YEAR

As part of setting up the new integrated supervision, the HFSA introduced several changes in supervisory methodology while performing its core functions - on- and off-site inspections, licensing and consumer protection - at a higher level of quality.

Concerning methodological issues, the HFSA evolved a coherent system of supervisory strategies and practices based on the Operational Principles of the HFSA. In order to lend support to the Supervision's internal operation and to the core supervisory activities the objectives defined in the Principles are made specific in the internal policy, in the methods and procedures that could be deduced from that as well as in the inspection manuals that are prepared on their basis. The HFSA elaborated and introduced an institutional relationship system following the very same principles in case of each type of supervised organisation. The 'market monitoring' system was introduced in October 2000. The definition of the supervisory requirements towards the supervised institutions has been summarised in 'good practice' recommendations on different important topics such as asset-liability management and market risk management of credit institutions, internal control system of financial institutions, preventing of money laundering, management of credit risk, etc.

In the process of inspections, the Supervision intends to meet its responsibilities efficiently, therefore, it takes the weight of any given individual institution within the sector into consideration, just as the risks projected on the entire financial system by the institutions or phenomena under investigation. Accordingly, the Supervision meets its obligations required by law in the framework of a certain 'risk weighted supervision', preventing a situation whereby its resources would be significantly tied up by developments that have rather minute effects on the sector as a whole, or on its concerned segment, while significant institutional or activity related risks remain hidden.

Concerning off-site inspections, a fundamentally reshaped monitoring and rating system was introduced for banks and other supervised institutions. Internal supervisory ratings are prepared quarterly about all institutions that carry systemic risks.

Regarding on-site supervision, 51 inspections were conducted in the banking sector in 2000, of which 13 were comprehensive, 36 special, and 2 follow-up inspections. As a consequence of the extremely high growth rate of borrowing, the examinations focused on the classification and provisioning practices of the banks.

The inspections paid special attention to money laundering, capitalisation, fulfilment of consumer protection requirements. During the reporting period comprehensive on-site inspections were completed at 8 bank groups, during which asset and income redistribution between group members enjoyed special consideration.

The financial sector as a whole was characterised by mergers and acquisitions. There was only one new bank entering the market.

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY

The HFSA is responsible for the supervision of all types of financial activities and institutions within the financial sector of the country. The HFSA has no regulatory power, it cannot issue legally binding regulations, however, the Act on the HFSA provides the right to issue 'good practice' recommendations to the sector, otherwise it fulfils its functions on an institutional basis.

The HFSA is empowered with the authority of licensing financial institutions, their branches and fields of activities. Also prudential supervision belongs to the responsibilities of the Authority – both in the form of off-site and on-site inspections. For cases of breach of law a wide range of sanctions are at the disposal of the Supervision (from imposing a fine to appointing a supervisory commissioner). In the case of serious operational distortions or violation of the law, the HFSA has the right – with the agreement of the National Bank of Hungary – to withdraw the license of the bank.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

See the enclosed sheet.

INTERNATIONAL ACTIVITIES OF THE AUTHORITY

As to the international activities developing an active international policy and starting to put that into practice were the most important tasks in 2000. Maintaining bilateral relationships with foreign partner institutions became a regular matter and the co-operation with the supervisory bodies of our partner-countries was formulated in Memoranda of Understanding. Focusing more on the intensive exchange of information and on-the-job training possibilities, the HFSA established good connections with the British FSA in order to learn about new supervisory methods and consolidated supervisory techniques.

Regarding multilateral international relationships, the joint study of the IMF and the World Bank (Financial Sector Assessment Programme = FSAP) painted a precise and favourable picture of the Supervision, and simultaneously provided concrete recommendations on continued strengthening of supervisory autonomy, securing the right of disposal, and the practical application of cross-border supervision. As a result of the positive experiences of the IMF, some colleagues of the HFSA were invited to participate as experts in similar surveys conducted in other countries.

Similarly favourable conclusions were drawn by the country report of the OECD. In connection with the new capital adequacy framework developed by the Basle

Committee on Bank Supervision the HFSA participated in consultations and in international forums. The HFSA not only participates in the Group of Central and Eastern European Banking Supervisors, but also performs the tasks of its permanent secretariat in Budapest.

The activities conducted in preparation for joining the European Union is of outstanding importance. The Supervision informs the European Commission on supervisory topics. For that reason the Supervision provided information for the Commission's regular annual report, participated in the meetings of the Hungary–EU Joint Committee and provided professional opinion and background information to help in formulating the Hungarian negotiating position.

Several studies, principles and recommendations issued by the HFSA are also available in English. The colleagues of the Supervision were often invited to make presentations at national and international conferences on the experience and practice of the newly formed authority.

CO-OPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

As the HFSA is an integrated supervision striving to become a consolidated supervision, the co-operation with other financial supervisory bodies has no relevance in its case.

However, some aspects of co-operation with other authorities are included in the respective acts. Additionally, the HFSA has Memoranda of Understanding in place concluded with the most important partner authorities in Hungary, such as the State Tax Office, the Consumer Protection High Inspectorate, the Competition Office and the National Bank of Hungary.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2000 AND IN 2001

The main strategic objective was to establish a professional, market-oriented, sector-neutral, functionally organised, risk-oriented, proactive and transparent supervisory organisation, which is independent from the government to the extent possible. Within this general framework special attention was paid to the introduction of a consolidated supervisory practice and the strengthening of the international orientation of the activities.

The general overview of the legal and regulatory framework started in 2000 with the aim of harmonising it with the international and first of all with the EU standards and directives. The unification of the different IT systems of the former supervisory authorities and the establishment of a reasonable, well-structured new system is in the focus of the technical support to the supervisory activity. The implementation of these programmes requires long term efforts from the staff.

PRESIDENT

- Chief Supervisory Advisors
- Secretariat of the President
- Secretariat of the President
- Internal Audit
- Department for International Relations
- Public Relations Department
- Human Resources Department
- Economic Controlling and Management of Premises
- Hungarian Insurance Council
  - Insurance Supervisory Commission
  - Commission for Vehicle Liability Insurance
  - Private Pension Funds' Council

VICE-PRESIDENT

Chief Supervisory Advisors

- Chief Supervisory Advisor for Money Market Organizations
- Chief Supervisory Advisor for Capital Market Organizations
- Chief Supervisory Advisor for Insurance Organizations
- Chief Supervisory Advisor for Pension Funds

Directorate for Information Technology

- Process Management Department
- Application Systems Supervisory Department
- Central Register of Pension Funds SupervisoryDepartment
- Infrastructure Supervisory Department
- Department for IT Methodology

Directorate for On-Site and Off-Site Financial Supervision

- Banking Supervision Department
- Credit Cooperative Supervision Department
- Specialized Credit Institution and Financial Enterprise Supervision Department
- Capital Market Supervision Department
- Investment Fund and Issuer Supervision Department
- Insurance Activities' Control Department
- Fund Supervision Department
- Department of Coordination of Supervisory Control

Directorate for Analysis and Methodology

- Department for Strategy and Methodology
- Monitoring Department
- Department for Analysis
- Actuarial Department

Directorate for Licensing and Legal Enforcement

- Money Market Licensing Department
- Capital Market Licensing Department
- Insurance Licensing Department
- Fund Licensing Department
- Department for Regulation and Codification

Directorate for Consumer Relations and Records

- Money and Capital Markets' Consumer Relation Department
- Insurance Consumer Relations Department
- Fund Consumer Relations Department
- Record Management and Control Department for Financial Organizations' Products
- Customer Services Department
- Department of Administration of Funds

STATISTICAL TABLES

Number of Financial Institutions (at year-ends)

Type of financial institution	1998	1999	2000
Banks and specialised credit institutions	44	43	42
Savings co-operatives	236	209	192
Credit co-operatives	8	8	7
Financial Institutions, total	**288**	**260**	**241**

Ownership Structure of Financial Institutions on the Basis of Registered Capital (%) (at year-end)

Item	Type of financial institution			Total
	Banks	Savings co-operatives	Credit co-operatives	
State ownership	21.3	15.6	0.0	21.0
Other domestic ownership	12.0	84.3	100.0	15.0
Domestic ownership total	33.3	99.9	0.0	36.0
Foreign ownership	66.7	0.1	0.0	64.0
Financial Institutions, total	**100.0**	**100.0**	**100.0**	**100.0**

Ownership Structure of the Financial Institutions on the Basis of Registered Capital (%) (at year-ends)

Item	1998	1999	2000	2000/1998
State ownership	20.9	19.7	21.0	125.7
Other domestic ownership	18.7	18.2	15.0	100.4
Domestic ownership total	39.6	37.9	36.0	113.8
Foreign ownership	60.4	62.1	64.0	132.6
Financial Institutions, total	**100.0**	**100.0**	**100.0**	**125.1**

Distribution of Market Shares in Balance Sheet Total (%)

Type of financial institution	1998	1999	2000
Banks	94.5	94.2	94.0
Savings co-operatives	5.4	5.7	5.9
Credit cooperatives	0.1	0.1	0.1
Financial Institutions, total	**100.0**	**100.0**	**100.0**

The Structure of Assets and Liabilities of the Banking System (%) (at year-end)

Assets	1998	1999	2000
Cash and settlement accounts	6.5	7.0	8.2
Securities for trading purposes	10.6	6.9	6.9
Securities for investment purposes	10.7	8.9	8.8
Central bank and inter-bank deposits	24.4	25.4	18.1
Credits	39.6	44.4	51.3
Proprietary interests	2.6	2.4	2.3
Own assets	2.6	2.4	2.2
Other assets	2.9	2.6	2.2
Balance sheet total	**100.0**	**100.0**	**100.0**
Liabilities	**1998**	**1999**	**2000**
Deposits	60.8	63.5	63.7
Interbank deposits	11.3	9.2	9.6
Borrowing	10.6	9.3	8.8
Debt securities	1.4	1.5	1.6
Subordinated liabilities	1.9	2.0	1.8
Special provisions	1.1	1.2	1.1
Own capital	8.7	8.6	9.3
Other liabilities	4.3	4.7	4.1
Balance sheet total	**100.0**	**100.0**	**100.0**

Development of Off-balance Sheet Activities (off balance sheet items / balance sheet total)

HUF million

Type of financial institution	1998	1999	2000
Banks	2,830,526	3,173,659	3,532,018
Other credit institutions	3,767	6,193	12,401
Financial Institutions, total	**2,834,293**	**3,179,852**	**3,544,419**

Solvency Ratio of Financial Institutions (%)

Type of the financial institution	1998	1999	2000
Banking sector	16.51	15.02	15.21
Savings co-operatives	23.06	18.67	15.11
Financial Institutions, average	**16.73**	**15.16**	**15.21**

Asset Portfolio Quality of the Banking System* (%)

Asset Classification	1998		1999		2000	
	HUF billion	%	HUF billion	%	HUF billion	%
Problemfree	6 219	89.4	7 120	91.1	8 382	91.5
Special mention	391	5.6	406	5.2	522	5.7
Problem	344	4.9	286	3.7	253	2.8
- substandard	*100*	*1.4*	*72*	*0.9*	*79*	*0.9*
- doubtful	*125*	*1.8*	*119*	*1.5*	*97*	*1.1*
- bad	*119*	*1.7*	*95*	*1.2*	*76*	*1.0*
Classified Total	**6 954**		**7 812**		**9 157**	
Specific Reserves	**96**		**157**		**144**	

Banks, excluding other credit institutions.

The Structure of Deposits and Loans%)
(at year-end)

	Deposits	Loans
Households	51.4	9.7
Government sector	4.9	4.6
Corporate	28.4	69.9
Foreign	13.7	7.2
Other	1.6	8.6
Total	**100.0**	**100.0**

The Structure of Deposits and Loans (%)
(at year-end)

Maturity of Deposits		Loans	
At sight	31.2	Long term loans	63.0
Within one year	61.3	Medium-term loans	
Over one year	7.5	Short-term loans	37.0
Total	**100.0**	**Total**	**100.0**

Note: the Hungarian reporting system separate only two types of maturity of lending: short-term (within one year) and long-term (longer than one year)

Proportion of Foreign Exchange Assets and Liabilities
(at year-ends)

Type of the financial institutions	FOREX Assets/Total Assets			FOREX Liabilities/Total Liabilities		
	1998	1999	2000	1998	1999	2000
Banks	35.91	36.25	36.39	36.74	35.88	36.52
Savings co-operatives	0.00	0.04	0.04	0.00	0.00	0.002
Credit co-operatives	0.00	0.00	0.00	0.00	0.00	0.00
Financial institutions, average	**35.91**	**36.25**	**36.39**	**36.74**	**35.88**	**36.52**

Structure of Revenues and Expenditures of Financial Institutions (at year-ends)

HUF billion

	1998	1999	2000
- net interest income	293.3	304.1	342.5
- profit from commission activities	55.6	64.2	84.1
- gross profit	348.9	334.5	434.1
Overheads	262.2	295.2	323.0
- net provisioning	-225.9	-76.8	-52.0
- pre-tax profit	-127.4	40.9	101.6
- ROA	-2.1	0.6	1.2
- ROE	-23.1	6.7	13.9

Financial institutions, including the co-operative sector.

Structure of Registered Capital and Own Funds of Financial Institutions

Type of the financial institutions	Registered Capital	/Total Assets	Own Funds	/Total Liab
	USD million	**%**	**USD million**	**%**
Banks	1394	4.7	2748	9.3
Co-operative financial institutions	44	2.3	128	6.8
Financial institutions, average	**1437**	**4.6**	**2876**	**9.1**

2000 DEVELOPMENTS IN THE LATVIAN BANKING SYSTEM

LATVIJAS BANK

MACROECONOMIC ENVIRONMENT

In 2000, all major economic indicators evidenced rapid economic growth related to a marked increase in exports and foreign investment. Enacted economic reforms and macroeconomic policy reinforced the positive trends. Therefore results were better than projected and were above the average level in the region.

The average annual rate of inflation remained at the low level (2.6%) and was mainly associated with an increase in administratively regulated prices in Latvia and rising world market prices of oil.

Strong GDP growth of 6.6% was provided by expansion in the services sector along with the goods-producing sector. The unemployment rate continued to follow a downward trend and was 7.8% at the end of 2000.

Economic growth ensured larger tax revenues and a decrease in a fiscal deficit of the general government consolidated budget. The fiscal deficit did not exceed 2.8% of the GDP and was 34.0 million lats smaller than in 1999. This confirmed positive trends in the Latvian economy.

Favourable economic environment contributed to strengthened investor confidence and increased direct investments. The deficit in the balance of payments current account was reduced because merchandise deficit was compensated by growth of export of services. The share of the EU member states reached 64.6% of Latvia's exports.

Monetary policy was designed and implemented to maintain stability of national currency and promote a downward trend in money market rates. National currency is backed by gold and convertible foreign currencies. The stability of the exchange rate of the lats was maintained through fixing it to the SDR basket of currencies. Lats fluctuated against the foreign currencies in line with movements in the global foreign exchange market. Thus lats depreciated against the US dollar and appreciated against the euro at the end of 2000.

The rating agencies *Moody's, Fitch IBCA* and *Standard&Poor's* reiterated the previously assigned ratings and confirmed country's good future growth prospects.

DEVELOPMENTS IN THE BANKING SYSTEM

At the end of 2000, there were 39 credit institutions, out of which 21 banks, 17 credit unions, the Riga Branch of *Merita Bank Plc.*, and the representative office of *Dresdner Bank AG*.

At the end of 2000, the total paid-up share capital of credit institutions amounted to 201.6 million lats (a year-on-year decrease of 3.4%). The reason for this was the registration of the JSC *MeritaNordbanken Latvia* as an undertaking other than a credit institution. The share of foreign investment in banks' paid-up share capital increased, reaching 69.9% at the end of the year. During 2000 foreign investment was made in five banks.

At the end of 2000, in 12 banks foreign shareholders held over 50% of the share capital, and six of these were subsidiaries of foreign banks. Government held shares in only 2 banks and these holdings in total accounted for 3.7% of paid-up share capital of banks.

In 2000 sustainable growth of the Latvian banking sector continued which was evidenced by increase of all major indicators of banking activities: assets (excluding managed assets) increased by 37.5% (to 2 698.5 million lats), loans by 27.8% and deposits by 44.5%.

The audited banking sector's profit for 2000 totalled 38.3 million lats as compared to 12.8 million lats in 1999.

The capital adequacy ratio of the banking sector, which in accordance with the Law "On Credit Institutions" may not fall below 10%, was 14% at the end of the reporting year.

At the end of 2000, the structure of banks' assets was slightly different from that at the end of 1999. The share of claims on credit institutions in the OECD countries increased by 5.1 percentage points (to 24.4% of banks' assets) and that of fixed-interest securities expanded by 3.5 percentage points (to 8.2% of banks' assets), while the share of loans decreased by 3.1 percentage points (to 40.3% of banks' assets).

At the end of 2000, banks' liquid assets (vault cash, claims on the Bank of Latvia and credit institutions, government securities) reached 44.2% of total assets, and this amount was adequate to meet depositors' claims. Of liquid assets, 55.3% was claims on credit institutions in the OECD countries. At the end of 2000, the ratio of banks' liquid assets to current liabilities was 67% (in accordance with the Bank of Latvia's regulations, this ratio may not fall below 30%).

Loans to domestic enterprises and private persons accounted for 82.8% of total loans. The bulk of loans went to trade, manufacturing, and transport, storage and communications (26.3%, 22.6% and 12.6%, respectively).

The maturity profile of the loan portfolio continued to show positive development trends. The share of medium-term loans (1 year to 5 years) increased from 49.5% to 50.7%, as did that of long-term loans (over 5 years), from 15.3% to 22.2%. The share of short-term loans declined from 35.2% to 27.1%.

At the end of 2000, total non-bank deposits received by banks amounted to 1 864.6 million lats, confirming public confidence in the Latvian banking sector. In total deposits, the share of deposits received from domestic private persons increased from 19.2% to 21.2%. The maturity structure of deposits continued to show positive trends. The share of demand deposits declined (from 68.3% to 65.1%), while those of short-term deposits (up to 1 year) and medium-term deposits (1 year to 5 years) increased (from 28.1% to 29.0% and from 2.8% to 5.1%, respectively).

LEGAL AND INSTITUTIONAL FRAMEWORK FOR OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

Harmonization of banking regulations with the requirements of EC banking directives and the Basle Core Principles for Ef-fective Banking Supervision continued.

"Regulation for Calculating Capital Adequacy", implementing EU directive 93/6 "On Capital Adequacy of Investment Firms and Credit Institutions", was approved. This was the last EU banking directive not implemented in Latvia. The Regulation imposes capital requirements for market risks, including capital requirements for foreign exchange risk, which is inherent in all activities of a credit institution, and position, commodities, settle-ment and counter-party risks, which are inherent in a credit institution's trading book (to be observed by credit institutions, whose trading book exceeds the estab-lished thresholds).

The introduction of capital requirements for market risks in the "Regulation for Calculating Capital Adequacy" necessitated the revision and ex-pansion of the "Regulation for Compliance with Restrictions on Exposures" (the new version took effect on July 1, 2000). Credit institutions have to prepare reports, the format of which is differentiated depending on the scale of trading activities. Credit institutions, whose trading book exceeds the limits established in "Regulation for Calculating Capital Adequacy" have to prepare reports, where exposures in the banking and trading books are evaluat-ed and stated separately. To derive more information for supervision purposes, a new reporting form, "Report on Exposures Exempt from Restrictions on Exposures", has been introduced.

To achieve full compliance with the Basle Core Principles for Effective Banking Supervision, the "Regulation for Compliance with Liquidity Requirements" was amended (the new version took effect on July 1, 2000). The Regulation details requirements to credit institutions' liquidity management policies.

"Regulation for the Pre-paration of Credit Institution Investment Reports" lays down procedures for preparing and submitting credit institution investment reports. Likewise, it stipulates that restrictions on investments are not applicable to invest-ments in financial instruments of the trading book. To receive information on the movement of investments in the intra-reporting period (reports are to be submitted twice a year), credit institutions are required to inform in writing the Bank of Latvia's Credit Institutions Super-vision Depart-ment about acquiring a qualifying holding in the share capital of an under-taking, a credit institution, a financial institution or ancillary undertaking 30 days prior to acquiring such holding.

To follow the requirements of the Law "On the Prevention of Laundering of Pro-ceeds Derived from Criminal Activity", "Guidelines for Developing Procedures for Identifying Suspicious Financial Transactions" were approved, which lay down core principles to be observed by credit institutions when working out and - by January 1, 2001 - adopting internal control procedures for identifying and avoiding suspicious financial transactions.

In 2000, the Bank of Latvia conducted a self-assessment of the compliance of its regulations and supervisory practices with the Basle Core Principles for Effective Banking Supervision. The assessment followed the Core Principles Methodology in structuring and presenting information for evaluating compliance. Upon the Bank of Latvia's request, the IMF experts conducted an independent evaluation of self-assessment. The evaluation confirmed that the information provided in the Bank of Latvia's self-assessment is correct, relevant and adequate.

EXAMINATIONS OF BANKS

In 2000, the Bank of Latvia's staff conducted 47 on-site inspections, including 35 in banks. As in previous years, attention was mainly directed at the evaluation of risk assets, and analysis of internal control systems and internal audit.

In view of a substantial increase in loans granted during 2000, in bank examinations attention was increasingly paid to the assessment of borrowers' financial standing and solvency so as to detect in time the difficulties that might arise in repaying loans.

The banks' assets increased, the number of bank customers grew, and the banks expanded their services. Hence, the importance of banks' internal inspection systems, their enhancement and improvement was highlighted to provide for a prudent manage-ment of traditional and new risks.

In 2000, the focus was on the analysis of credit institution performance indicators, and the main effort was to detail and expand the process of analysis.

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY

In 2000 banking supervision was carried out by the Bank of Latvia as set in Article 10 of the Law "On the Bank of Latvia". Rights and responsibilities of supervisor are further specified in the Law "On Credit Institutions". Practical supervision was carried out by the Credit Institutions Department of the Bank of Latvia. It was established in 1992. A qualitatively new stage of banking supervision was achieved after banking crisis in 1995. Banking supervision is recognised internationally and enjoys domestic confidence.

On June 1, 2000, the Saeima (parliament) approved the "Law on Financial and Capital Market Commission", establishing a single independent supervisory authority for the financial sector as of July 1, 2001. The Financial and Capital Market Commission will take over responsibilities of the Bank of Latvia Credit Institutions Supervision Department, Insurance Supervision Inspectorate and Securities Market Commission (the later two are currently under the auspices of the Ministry of Finance).

INTERNATIONAL ACTIVITIES

In 2000 cooperation, exchange of expertise and information with foreign supervisory authorities continued. Technical assistance from international financial organisations and foreign central banks took the form mainly of participation in seminars and courses organised and consultations provided by these institutions. Within the framework of technical assistance programs Credit Institutions Department employees participated in a number of courses held by the IMF Institute and the Joint Vienna Institute, as well as seminars organised by the Federal Reserve System, *Õsterreischiche Nationabank, Banque de France.*

Major challenge in 2000 was implementation of the most sophisticated of the EU banking directives, namely capital adequacy directive (CAD). Training on relevant topics was provided to supervisory staff and employees of commercial banks. Within the framework of technical assistance, a weeklong training course by an IMF expert took place. The Bank of Latvia signed an agreement with Arthur Andersen on methodological assistance on a wide spectre of issues related to CAD implementation, including training and consulting provided by Arthur Andersen's London office experts.

As a member of the BSCEE, the Latvian Banking Supervision takes part in group's activities (annual conferences, workshops, etc.) and evaluates highly the possibilities of sharing experience and upgrading supervisory skills the BSCEE membership provides.

To enhance quality of cross-border supervision, Memoranda of Understanding (MoU) are signed with foreign supervisory authorities. By the end of 2000, four MoUs had been signed (with Financial Supervision of Finland, Bank of Estonia, Bank of Lithuania and Federal German Supervisory Office), and two more MoUs were in the pipeline.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2000 AND IN 2001

Supervision is carried out to ensure soundness, stability and development of the banking sector. To attain these strategic objectives a wide range of supervisory tools is used, including setting prudential rules and regulations, on-site examinations and off-site analysis.

Latvia's system of banking supervision has been recognised internationally. Latvia was one of the first countries to have received a positive evaluation by the IMF experts regarding compliance of its legal framework and supervisory practices with the Basle Core Principles for Effective Banking Supervision. The main priority, however, is to maintain domestic confidence in the Latvian banking sector. This objective is achieved by ensuring that market participants are well informed about the supervisory system and developments in the banking sector.

Preparatory work has begun to ensure smooth transition to the new supervisory authority for the whole financial market as of July 1, 2001. This includes budgeting, staffing issues and elaboration of strategy of Financial and Capital Market Commission to ensure a qualitatively new level of supervision.

STATISTICAL TABLES

Number of Financial Institutions (at year-ends)

Type of financial institution	1998	1999	2000
Banks	27	23	21
Credit unions	7	9	17
Foreign bank branches	1	1	1
Financial institutions, total	**35**	**33**	**39**

Ownership Structure of the Financial Institutions on the Basis of Registered Capital (%) (at year-end)

	Type of financial institution		Total
	Banks	**Credit unions**	
State ownership	3.8	0.0	3.8
Other domestic ownership	26.2	100.0	26.4
Domestic ownership total	30.1	100.0	30.2
Foreign ownership	70.0	0.0	69.8
Financial Institutions, total	**100.0**	**100.0**	**100.0**

Ownership Structure of the Financial Institutions on the Basis of Registered Capital (%) (at year-ends)

	1998	1999	2000	2000/1998
State ownership	4.9	3.7	3.8	77.5
Other domestic ownership	27.4	30.1	26.4	96.2
Domestic ownership total	32.3	33.8	30.2	93.3
Foreign ownership	67.7	66.2	69.8	103.2
Financial Institutions, total	**100.0**	**100.0**	**100.0**	**100.95**

LATVIJAS BANK

Distribution of Market Shares in Balance Sheet Total (%)
(at year-ends)

Type of financial institution	1998	1999	2000
Banks	98.28	98.31	96.82
Credit unions	0.03	0.03	0.04
Foreign bank branches	1.69	1.66	3.14
Financial institutions, total	**100.00**	**100.00**	**100.00**

Development of Off-balance Sheet activities (%)
(off balance sheet items/ balance sheet total)
(at year-ends)

Type of financial institutions	1998	1999	2000
Banks	20.2	18.6	20.3
Credit unions	0.0	0.0	1.1
Foreign bank branches	53.6	30.9	44.3
Financial institutions, total	**20.8**	**19.7**	**21.1**

Solvency Ratio of Banks (%)
(at year-ends)

	1998	1999	2000
Solvency ratio of banks	17.4	16.0	14.0

The Structure of Assets and Liabilities of the Banking System (%)
(at year-ends)

Assets	1998	1999	2000
Cash and balances with the Bank of Latvia	9.4	9.4	6.3
Claims on credit institutions	18.8	22.4	28.3
Loans	43.5	43.4	40.3
Bonds and other fixed interest securities	14.1	15.7	17.7
Shares and other variable yield securities	4.0	1.1	1.3
Participating interest and other financial investments	0.5	0.5	0.3
Other assets	9.7	7.5	5.8
Liabilities	**1998**	**1999**	**2000**
Amounts owed to the Bank of Latvia	3.3	3.2	1.6
Amounts owed to credit institutions	13.4	12.2	11.5
Deposits	61.8	65.8	69.1
Other liabilities	6.4	5.4	7.2
Provisions	3.5	3.6	2.2
Total capital	11.6	9.8	8.4

LATVIJAS BANK

Asset Portfolio Quality of the Banking System (%)
(at year-ends)

Asset Classification	1998	1999	2000
Standard	91.2	92.3	95.8
Watch	4.1	3.2	1.3
Substandard	1.8	1.8	1.5
Doubtful	1.5	1.4	0.6
Lost	1.4	1.3	0.8
Specific Reserves	4.3	4.0	2.5

The Structure of Deposits and Loans (%)
(at year-end)

	Deposits	Loans
Households	21.2	14.6
Government sector	2.6	3.4
Corporate	23.5	66.7
Foreign	51.9	13.5
Other	0.8	1.8
Total	**100.0**	**100.0**

The Structure of Deposits and Loans by Original Maturity (%)
(at year-end)

Maturity of Deposits		Maturity of Loans	
At sight	65.1	Short-term loans (up to 1 year)	27.1
Within one year	29.0	Medium-term loans (1-5 years)	50.7
Over one year	5.9	Long term loans (over 5 years)	22.2
Total	**100.0**	**Total**	**100.0**

Proportion of Foreign Exchange Assets and Liabilities (%)
(at year-ends)

Type of financial institution	FOREX Assets / Total Assets			FOREX Liabilities / Total Liabilities		
	1998	**1999**	**2000**	**1998**	**1999**	**2000**
Banks	59.7	65.9	65.4	56.8	65.2	66.1
Credit unions	5.5	4.7	14.5	6.2	5.7	10
Foreign bank branches	63.3	56.4	57.0	63.3	67.7	69.4
Financial institutions, average	**61.7**	**65.8**	**65.1**	**59.0**	**65.3**	**66.2**

LATVIJAS BANK

Structure of Revenues and Expenditures of Banks (%) (at year-ends)

Revenues	1998	1999	2000
Interest income, incl.:	58.0	55.5	55.8
interest on loans	31.2	37.2	34.3
interest on deposits with credit institutions	9.4	6.4	11.1
interest on bonds and other fixed income securities	17.2	11.7	9.9
Dividends	0.2	0.1	0.1
Commission received	22.8	23.5	23.8
Profit loss from securities and currencies trading	10.8	10.2	9.2
Other	8.2	10.7	11.1
Expenditures	**1998**	**1999**	**2000**
Interest expense	17.5	22.2	28.1
Commission paid	4.3	3.9	4.8
Operating expenses (incl. salaries)	30.1	40.9	40.2
Depreciation	5.8	7.7	7.5
Loan loss provision expense	19.1	17.9	15.2
Other	23.2	7.4	4.2

Structure of Registered Capital and Own Funds of Financial Institutions

Type of financial institution	Registered Capital	/ Total Assets	Own Funds	/ Total Liabilities
	USD	%	USD	%
Banks	328,862,718	7.7	336,476,346	7.9
Credit unions	469,060	28.0	549,522	32.8
Foreign bank branches	-	-	-	-
Financial institutions, average	**329,331,778**	**7.7**	**337,025,868**	**7.9**

2000 DEVELOPMENTS IN THE LITHUANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT IN YOUR COUNTRY

Signs of recovery after the 1999 recession could be traced in the Lithuanian economy in 2000. The real GDP increased; particular growth was recorded in the output of mining, quarrying (8.7%) and manufacturing (10.2%), the overall exports of domestic goods and services intensified (20.5%). The bulk of the country's exports was orientated towards EU markets despite the unfavourable decline in the exchange rate of the euro against the US dollar, to which the national currency is pegged to. CIS export share was shrinking last year, just as in previous years. The intensifying exports favourably affected the development of the transport and communications sector, in which the overall value added generated increased by approximately 10.5%, to account for 12.2% of GDP. Mineral products (21.2% of the total exports of goods in 2000) and textile and textile articles (18.6%, respectively) represented the highest exports. Imports of goods increased at a lower pace (augmented by about 9.3%), yet they were more closely related with the Russian and other CIS markets.

With the recovery of producers, the country's Government continued the tight fiscal policy it started in 1999, owing to which the current account deficit was successfully diminished to 6% compared to 11.2% in late 1999. Saving of public expenditure was implemented through lessening the financing of investment projects, cutting social programs and education expenses. As a result, the gross value added created in sectors like construction (-17.2%), health and social services (-3.8%), and education (-2.4%) decreased in 2000.

Compared to the development of the main exporting branches of economy, consumption on the domestic market remained relatively low, although signs of an upturn are noticeable. The population allocated more funds for saving, an illustration to which was increase in bank deposits. In 2000 producers expanded their output through increasing labour efficiency and not by creating new jobs. Consequently, the rate of unemployment went up from 10% to 12.6% over a year. This, in turn, had a negative effect on the growth of average earnings and a more notable solvent demand in the domestic market. Limited demand hindered the increase in consumer prices: the year 2000 was characteristic of low inflation (of around 1.4%), although it was higher compared to 1999 (0.3%).

The banking sector operated smoothly, the ratio of bank assets to the country's gross domestic product continued to increase. Banks increased their share capital, attracted more deposits and long-term financial resources from foreign banks and financial institutions. Interest rates dropped, more favourable borrowing possibilities appeared for both economic entities and the population in the domestic market. Although credit possibilities were not used to the full, the recovering economy allows for expecting a more active development.

In May 2001, the international credit rating agency Fitch, having assessed the country's progress in narrowing fiscal deficit, implementing structural reforms and stabilising the financial system, increased Lithuania's credit rating for long-term loans in foreign currencies, which had not changed since 1997, from BB+ to BBB-.

DEVELOPMENTS IN THE BANKING SYSTEM

In 2000, the banking system underwent substantial structural developments, which formed the background for further growth and strengthening of this component of the financial sector. During this period, the first merger process of two private banks and the privatisation of the first state-controlled bank were completed, foreign investment, particularly from Scandinavian countries, in domestic banks was growing further and new credit units emerged.

At the end of 2000, ten commercial banks, three foreign bank branches and five representative offices, the joint-stock company Turto bankas regulated by a special law, as well as 38 credit unions operated in Lithuania. The network of 159 bank branches functioned in Lithuania at the end of 2000. Due to the changes in Turto bankas statute, according to which the bank was reorganised into a close stock company, on 19 July 2001, the Board of the Bank of Lithuania revoked the licence of the joint-stock company Turto bankas.

Throughout the year 2000, foreign banks demonstrated increasing interest in the development of the Lithuanian market and investment possibilities in the operating banks. In April, the Board of the Bank of Lithuania registered a Vilnius Branch of the Finnish Merita Bank Plc., owned by the Scandinavian banking group MeritaNordbanken Group. The branch purchased the business from the French bank Société Générale and started to function in Lithuania. The Société Générale Vilnius Branch was liquidated and in October 2000 removed from the Register of Enterprises of the Republic of Lithuania.

In May 2000, according to a decision of the Board of the Bank of Lithuania, yet another foreign bank representative office founded by the German bank VEREINS-UND WESTBANK AG was registered in Lithuania. The above bank submitted its request and appropriate documents for establishing a branch to the Bank of Lithuania at the end of the year, and in January 2001 the Board of the Bank of Lithuania gave its permission to establish the VEREINS –UND WESTBANK AG Vilnius Branch. The branch has already commenced activities.

In early 2000, the Bank of Lithuania issued permission to a group of legal entities and individuals (comprising AS "Parekss-banka") of the Republic of Latvia for the acquisition and (or) management of over 2/3 of the joint-stock company Industry Bank block of shares. When the transaction was concluded the Industry Bank became fully owned by foreign investors and in October 2000 its name was changed into the Joint-Stock PAREX BANKAS in compliance with the decision made by the new shareholders.

In September 2000, the Lithuanian Development Bank changed in status. Having functioned on the basis of a special law, it henceforth developed into a commercial bank with LTL 41.04 million share capital and the right to perform operations prescribed by the Law on Commercial Banks of Lithuania and the Statutes of the Bank, excluding operations with securities and the purchase and sale of precious metals. The Lithuanian Development Bank succeeded in finding a strategic investor – the Finnish Insurance Company Sampo Oyj. In January 2001 the Meeting of the Lithuanian Development Bank shareholders elected a new council and board, and approved a decision to change the Bank's name into Close-Stock Company Sampo Bankas.

Early in 2000, the Joint-Stock Company Vilniaus Bank completed its merger with the Joint-Stock Company Bank HERMIS and became the largest bank in

Lithuania. It issued LTL 4.4 million of shares, which were acquired by HERMIS shareholders by exchanging their shares into those from the new issue. In September 2000, the Board of the Bank of Lithuania issued permission to the Swedish bank Skandinaviska Enskilda Banken (SEB) – the main shareholder of the Vilniaus Bank – to acquire and manage over 2/3 of the Joint-Stock Company Vilniaus Bank block of shares. By the end of the year SEB issued a mandatory official proposal and purchased the remaining Vilniaus Bank shares. Thus, at the start of 2001, the shares of the JSC Vilniaus Bank were removed from the Official Trade List of the National Stock Exchange of Lithuania.

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

The credit institution supervision system consists of several parts, including licensing, off-site supervision and on-site inspection. In 2000, credit institution licensing procedures were further improved. Keen attention was paid to the improvement of legal acts.

In 2000, the Department participated actively in preparing other draft amendments to the Law on Commercial Banks of Lithuania, which were adopted in January 2001. The amendments provide possibilities for foreign natural and legal persons to participate in establishing banks in the Republic of Lithuania without restrictions (to date, it was allowed for foreign banks only). Moreover, uniform requirements for the minimum number of founders and shareholders of a bank were set irrespective of whether it is a foreign bank or a bank registered in the Register of Enterprises of the Republic of Lithuania that establishes a subsidiary or acquires a controlling interest in a bank. These provisions shall enter in effect as of the date of Lithuania's accession to the EU. Another important amendment is that banks will have more freedom to invest in the shares or capital of enterprises engaged in activities other than crediting or financial. Having supplemented the Law on Commercial Banks of Lithuania in March 2000, foreign bank branches were granted a right to establish their other subdivisions in the country.

At the end of 2000, additional proposals on the improvement of bank bankruptcy procedures and acceleration of a prolonged liquidation process were prepared as increasing administrative expenses of banks under liquidation reduce liquid assets of these and lessen the possibilities for satisfying creditors' claims at the same time. The amendments of the Law on Commercial Banks of Lithuania adopted on 11 July 2001 include provisions that allow speeding up bankruptcy proceedings.

In 2000, the Department drafted improvements to other legal acts for the regulation of activities of credit institutions and risk management, and tightening the requirements. The provisions of weighting country risk were revised in March. Having considered the recently noticeable uptrend in non-resident liabilities to domestic commercial banks, the Board of the Bank of Lithuania approved new criteria for the establishment of country risk, among which greater importance is attached to the country rating established by recognised international rating agencies. Depending on established ratings, the countries in which banks invest their assets are classified into several categories and a different degree of asset risk is applied to them. With the introduction of new principles for the establishment of country risk, the Regulations for the Classification of Doubtful Assets were adjusted accordingly, including partial tightening of provisions on calculating the demand for specific provisions.

In order to make banks master advanced risk management practices based on the effectively functioning system of internal inspection, responsible supervision and credit institution management's reporting, the Board of the Bank of Lithuania approved the revised General Provisions Pertaining to the Organisation of the Internal Audit of the Bank. This legal act covers a number of additional aspects to ensure the establishment of a versatile mechanism for managing new bank risks and control, which have not been considered earlier. The Provisions emphasise the role of a bank's Council, i.e. the managing body representing the owners of the bank, in establishing an effective internal inspection system and ensuring its functioning. The Board of a bank bears direct responsibility for the establishment of this system, which would enable identifying and assessing the bank's operational risk, and must monitor its efficiency on an on-going basis.

Although banking, by nature, covers a wide range of risks, most problems so far seem to occur due to the improper management of credit risk. In this regard, the Board of the Bank of Lithuania made supplements to the Prudential Requirements for Banks and prescribed that a bank may not incur large exposures, which in total exceed 800% of its capital. The large exposure requirement shall be applicable not only to a parent bank but to the whole bank group as well. Simultaneously, the methodology of calculating maximum exposure to a single borrower and large exposure requirements was adjusted, which now provides a wider definition of the borrower than that previously used. The new methodology allowing more accurately evaluating and limiting loan concentration in banks became applicable in the second half of 2000.

Since preparation for EU accession negotiations is a major national priority, the Department, within its competence, participated in the process of harmonising legal acts with EU directives in 2000. Last year, the Department completed a PHARE-financed project, implemented jointly with consultants of the international audit firm Arthur Andersen, for the preparation of new Regulations on Calculating Capital Adequacy consistent with the requirements of EU directives CAD I and CAD II. The fact that domestic banks, raising additional financial resources, start operating more rapidly in international markets and perform trading operations also contributed to the adjustment of the existing calculation procedure. The new Rules for Calculating the Capital Adequacy that were approved in December 2000 allow evaluating the market risk assumed by commercial banks and establish the additional demand for capital (Tier III capital) to amortize it. With this end in view, banks will have to identify and separate banking and trading activities, and to set their trading policy, including the development of market risk management procedures. As the implementation of the new rules is a rather complicated process requiring certain preparation on banks' side, the decision was to start applying the new rules as from 31 December 2001.

ACTIVITIES OF CREDIT INSTITUTIONS SUPERVISION DEPARTMENT IN 2000; ITS LEGAL COMPETENCE

In 2000, the Bank of Lithuania, implementing the supervision of credit institutions, continued to gear its efforts to fostering the growth of a stable and competitive banking system in Lithuania that would ensure the provision of high quality financial services and proper management of the risk assumed.

The new version of the Law on the Bank of Lithuania, adopted in March 2001, clearly defines the content of credit institution supervision performed by the country's central bank. Currently there are two type credit institutions – banks and credit unions – operating in Lithuania, the supervision of which is implemented by a structural unit of the Bank of Lithuania, Credit Institutions Supervision Department, based on the internationally recognised supervisory methods set forth in the Core Principles for Effective Banking Supervision of the Basle Committee on Banking Supervision.

The aim of the supervision was to ensure that banks followed the standards of safe and sound banking practices, had an effectively functioning internal control system, and accumulated a sufficient amount of capital to amortize potential losses; that accounting in banks was based on proper methods and reports presented for supervisory purposes and for the public reflected actual information on the financial standing of a bank.

An important role in the credit institution supervision system in 2000 accounted for off-site and on-site inspection functions. Like before, the financial condition of credit institutions was analysed and assessed on a periodic basis, making use of the Early Warning System, financial statements submitted by credit institutions, operational business plans for the current year and other documents. In 2000, the Department's activities in this area included improvement of bank rating methodology, looking for possibilities to explore more efficiently the possibilities of the Early Warning System, analysis and assessment of business risk management in banks. In order to enhance the urgency of the analysis, the terms for submitting bank statements were revised and made shorter; the statement forms themselves were adjusted, which allowed reflecting and assessing bank operations more accurately. With the intensification of the activities of foreign bank branches, the list of statements to be submitted by these to the Bank of Lithuania for supervisory purposes was extended. The veracity of statements submitted to the Bank of Lithuania was checked along with other issues during on-site inspections of banks. In line with the plans, last year all banks licensed by the Bank of Lithuania were once inspected on-site according to the full-scope on-site inspection program covering the assessment of major bank business areas based on the CAMELS system. Each time on-site inspection findings were presented to the bank management and in the event certain deficiencies were traced, banks were obliged to submit an action plan in order to eliminate these deficiencies, the implementation of which was closely monitored. Moreover, seeking to better regulate the organisation procedures of the entire on-site inspection process, the Department prepared the Regulations on the Inspection of Credit Institutions and the Procedure for the Inspection of Banks in 2000.

The Department also participated in the development of the legal basis for the regulation of activities of credit unions, commented on the draft amendments to the Law of the Republic of Lithuania on Credit Unions and the draft Law on the Central Credit Union that were later approved by the Seimas of the Republic of Lithuania, and simplified the requirements for credit unions seeking permission for carrying out operations in foreign currency.

INTERNATIONAL ACTIVITIES, CO-OPERATION WITH OTHER SUPERVISORY BODIES

In 2000, relations with other supervisory authorities of the financial sector were strengthened inside the country and closer contacts made with the respective supervisory authorities of foreign states, the banks of which establish their subdivisions in Lithuania. A tripartite Agreement on Co-operation between the Bank of Lithuania, Securities Commission and the State Insurance Supervisory Authority under the Ministry of Finance was prepared and signed at the end of the year to help closer co-ordinate the actions of these authorities and to interchange information on the essential changes in the activities of supervised institutions. In 2000, the Bank of Lithuania signed 3 new agreements on co-operation in the area of credit institution supervision with the respective foreign institutions – the Bank of Latvia, the Finnish Financial Supervision Authority, and the National Bank of Poland. These agreements establish the principles of co-operation while performing the joint supervision of banks operating internationally, including licensing requirements and capital owners' control, inspection, subsidiary control, application of prudential requirements, mutual information exchange principles and joint actions while performing the supervision of a bank or its branch established in one of these countries. Similar agreement was earlier signed with the Central Bank of Russia.

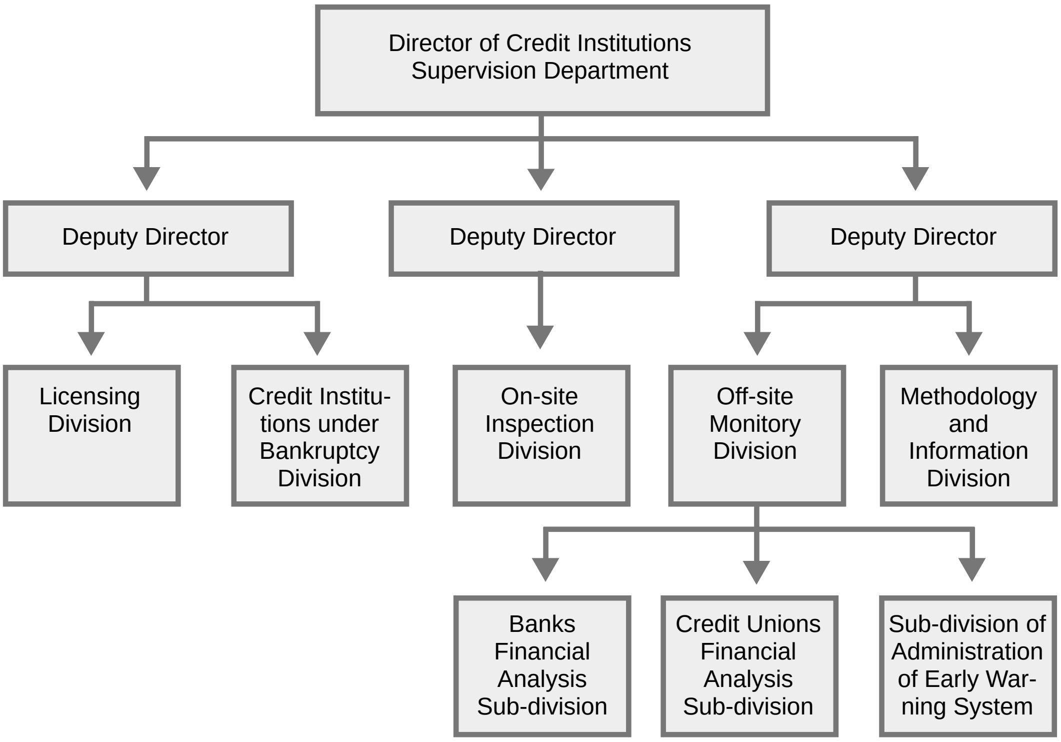
MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2000 AND IN 2001

In order to ensure effective supervision of credit institutions, the Department set the following major objectives in 2000:

- to proceed with the implementation of the Core Principles for Effective Banking Supervision recommended by the Basle Committee on Banking Supervision, to improve legal acts regulating the activities of credit institutions and credit institution licensing procedures, and the calculation methodology of prudential requirements;
- to analyse and assess the activities of banks and their compliance with prudential requirements, to summarise the trends in the development of the banking system;
- to ensure that every bank was inspected on site at least once a year;
- to expand co-operation with supervisory authorities of foreign credit institutions;
- to participate in the program for national legal acts harmonisation with EU requirements, to finalise preparations for the implementation of EU Directive 93/6/EEC "On the Capital Adequacy of Investment Firms and Credit Institutions" in domestic banks.

In 2001, the supervisory activities are to be continued and prudential requirements for credit institutions improved taking into consideration the following changes in the banking system: provision of new banking services, the use of new financial instruments, expansion of investment, the process of establishing subsidiaries. It is planned to further improve inspection procedures, to maintain close relations with representatives of international audit firms, to expand and strengthen relations with foreign supervisory authorities. The Department will further seek to ensure professional and effective supervision of credit institutions, encourage banks to master advanced risk management practices based on the effectively functioning system of internal control, disclose more information to the public, and seek operating transparency.

The Structure of Credit Institutions Supervision Department of the Bank of Lithuania at the end of 2000



STATISTICAL TABLES

Number of Financial Institutions (at year-ends)

Type of financial institution	1998	1999	2000
Commercial banks	10	10	10
Foreign bank branches	2	3	3
Banks operating under special laws	2	2	1
Credit unions	28	33	38

Ownership Structure of Financial Institutions on the Basis of Registered Capital (%) (at year-end)

Item	Type of financial institutions				Total
	Commercial banks	Foreign bank branches*	Banks operating under special laws	Credit unions	
State ownership	28.6	-	100.0	-	27.2
Other domestic ownership	13.7	-	-	100.0	12.9
Domestic ownership total	42.3	-	100.0	100.0	40.1
Foreign ownership	57.7	100.0	-	-	59.9
Financial institutions, total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

* *registered capital of a foreign bank branch is funds of this branch received from the headquarter with the purpose to commence the branch operations*

Ownership Structure of Financial Institutions on the Basis of Registered Capital (%) (at year-ends)

Item	1998	1999	2000	2000/1998
State ownership	39.6	36.9	27.2	-42.6
Other domestic ownership	19.1	17.8	12.9	-43.6
Domestic ownership total	58.7	54.7	40.1	-43.0
Foreign ownership	41.3	45.3	59.9	+27.6
Financial institutions, total	**100.0**	**100.0**	**100.0**	**-14.7**

Distribution of Market Shares in Balance Sheet Total (%) (at year-ends)

Type of financial institution	1998	1999	2000
Commercial banks	80.2	80.5	89.1
Foreign bank branches	1.8	2.6	3.7
Banks operating under special laws	2.4	2.1	7.1
Credit unions	0.07	0.09	0.1
Financial institutions, total	100.0	100.0	100.0

The Structure of Assets and Liabilities of the Banking System (%) (at year-ends)

Assets	1998	1999	2000
Cash in hand	3.3	3.4	2.9
Claims on banks and other financial institutions	12.5	23.6	24.8
Securities	19.2	14.7	19.8
Loans granted*	44.9	49.5	42.1
Other assets	20.1	8.8	10.4
Liabilities	**1998**	**1999**	**2000**
Liabilities to banks and other financial institutions	14.5	16.4	14.4
Deposits and L/C	59.8	61.7	65.6
Other liabilities	13.5	10.2	10.0
Bank capital	12.2	11.7	10.0

** Carrying amount*

Development of Off-balance Sheet Activities (Off-balance Sheet Items/Balance Sheet Total) (%) (at year-ends)

Type of financial institution	1998	1999	2000
Commercial banks	20.9	12.9	10.8
Foreign bank branches	33.2	1.6	13.1
Banks operating under special laws	13.2	6.1	-
Credit unions	-	-	-
Financial institutions, total	20.8	12.4	11.3

Solvency Ratio of Financial Institutions (%)
(at year-ends)

Type of financial institution	1998	1999	2000
Commercial banks	23.8	17.4	16.3
Foreign bank branches*	-	-	-
Banks operating under special laws	14.4	9.1	13.6
Financial institutions, average	23.4	17.1	16.3

** solvency ratio of foreign bank branches is not calculated*

Asset Portfolio Quality of the Banking System (%)
(at year-ends)

Asset Classification	1998	1999	2000
Standard loans	67.8	64.3	56.7
Watch loans	19.7	23.8	32.5
Substandard loans	4.4	4.4	4.4
Doubtful loans	2.1	3.7	3.7
Bad loans	6.0	3.8	2.7
Classified total (LTL million)	**4735.7**	**5569.2**	**5519.1**
Specific Reserves (LTL million)	**280.5**	**249.1**	**205.9**

The Structure of Deposits and Loans (%)
(at year-end)

	Deposits	Loans
Households	57.6	10.4
Government sector	10.4	12.1
Corporate	26.1	67.3
Foreign	3.9	5.0
Other	2.0	5.2
Total	**100.0**	**100.0**

The Structure of Deposits and Loans (%)
(at year-end)

Maturity of Deposits		Loans*	
At sight	50.4	Long-term loans**	14.5
Within one year	47.0	Medium-term loans***	24.9
Over one year	2.6	Short-term loans****	60.6
Total	**100.0**	**Total**	**100.0**

** net value*
*** over 3 years*
**** 1-3 year*
***** 1 year and less*

Proportion of Foreign Exchange Assets and Liabilities (%) (at year-ends)

Type of financial institution	FOREX Assets/Total Assets			FOREX Liabilities/Total Liabil.		
	1998	1999	2000	1998	1999	2000
Commercial banks	40.6	48.1	52.4	45.3	52.9	58.5
Foreign bank branches	90.6	88.3	86.3	89.9	87.3	96.0
Banks operating under special laws	61.0	60.0	69.3	53.1	63.8	69.9
Financial institutions, average	**42.2**	**49.6**	**54.8**	**46.4**	**54.2**	**57.7**

Structure of Revenues and Expenditures of Financial Institutions (%) (at year-ends)

Revenues	1998	1999	2000
Interest income	59.9	71.8	70.3
Profit from operations in foreign exchange	12.2	5.0	6.7
Other bank income	1.3	1.3	2.5
Other income	26.6	21.9	20.5
Total revenues	100.0	100.0	100.0
Expenditures	1998	1999	2000
Interest expenses	27.2	30.3	34.7
Operational expenses	43.2	36.9	36.1
Expenses for specific provisions	5.5	11.9	9.5
Other expenses	24.1	20.9	19.7
Total expenses	100.0	100.0	100.0
Net profit (loss), LTL million	**88.6**	**14.9**	**52.7**

Structure of Registered Capital and Own Funds of Financial Institutions (at year-end)

Type of financial institution	Registered Capital	/Total assets	Own Funds	/Total Liabilities
	USD million	%	USD million	%
Commercial banks	204.0	6.5	329.3	11.7
Foreign bank branches	15.5	11.7	13.4	11.3
Banks operating under special laws	2.2	0.9	2.2	0.9
Credit unions	0.6	16.0	0.7	20.8
Financial institutions, average	**222.3**	**6.3**	**345.6**	**10.9**

2000 DEVELOPMENT IN THE MACEDONIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Significant macroeconomic developments were registered in 2000, turning it into one of the most successful years for the Macedonian economy. The most significant macroeconomic achievement in 2000 was the preservation of price stability, taking into account the circumstances that acted towards spiralling of the inflation. At the same time, the process of structural reforms intensified in almost all sectors of the economy in 2000. The above-mentioned conclusion is not only ours, but as well as of some other relevant international financial organizations. Hence, according to the "Transition Report" of the European Bank for Reconstruction and Development, in 2000 the Republic of Macedonia made significant progress in the implementation of the reforms in the banking sector, privatization of the state-owned capital, price liberalization, and the liberalization of foreign-trade and foreign exchange flows. Together with the pronounced reform course of the fiscal policy, these developments resulted in an adequate growth rate of GDP, as well as the creation of a realistic basis for intensified economic growth on the long run.

In 2000, a set of unfavourable circumstance acted towards acceleration in the inflation in the Republic of Macedonia, which was preserved at a stable and predictable single-digit level in previous years. The surge in the crude oil prices in 2000, together with the appreciation of the US Dollar, had an adequate reflection on the general level of prices in the Republic of Macedonia, taking into account the importance of this input in the Macedonian economy. The influence of these factors resulted in a certain uphold in the price level and on December basis, the inflation rate, measured through the increase in the costs of living, equalled 6.1%.

In 2000, the GDP of the Republic of Macedonia registered a real growth rate of 5.1%, which represents a continuation of the positive developments in the previous five years and simultaneously represents an indicator of the intensified economic activity. The efforts for the creation of a favourable investment climate, through the creation and preservation of the macroeconomic stability, as well as through the intensified reforms in the real, fiscal and financial sectors, had a full impact in 2000. Namely, the investments in fixed assets in the Republic of Macedonia in 2000 compared to the previous year, increased by 52.0% in real terms, while simultaneously significant inflow of foreign capital was registered.

In line with the predetermined goals and objectives, the monetary policy in 2000 was directed towards the maintenance of the price stability through the preservation of a stable exchange rate of the Denar against the Deutsche mark, as a nominal anchor in the economy.

The intensified export activity, together with the inflow of foreign exchange on the basis of foreign investments and donations, resulted in continuation of the trend of favourable developments on the foreign exchange market. The above-than-planned net-purchase of foreign currency from the foreign exchange market resulted in an increase in the gross foreign exchange reserves of National Bank of the Republic of Macedonia (hereinafter: NBRM) by US Dollar 235 million. Consequently, their level as of December 31, 2000 reached US Dollar 714 million, which represents an equivalent of 4.1 months of imports.

The good coordination of the monetary and fiscal policy was reaffirmed in 2000. Namely, the monetary effects of the foreign exchange transactions of the Central Bank were neutralized through the increase in the Government deposits with the NBRM, which was the main flow of reserve money withdrawal during 2000. As a result of the increased inflow of funds in the budget on the basis of the introduction of the Value Added Tax and the more efficient collections of taxes in 2000, the Government deposits were continuously increasing. Such developments in the fiscal sector resulted in a budget supplement and the adoption of a program for the spending of the budget surplus at the end of the year. As of December 31, 2000, the reserve money reached Denar 12,089 million and compared to their level at the end of the previous year, they were higher by significant Denar 3,574 million, or by 42.0%.

The increase in imports in the first quarter of 2000, prior to the introduction of the value added tax, had a permanent effect on the balance of the foreign trade of Republic of Macedonia. Namely, the more intensive increase in imports relative to exports in 2000 resulted in a foreign trade deficit in the amount of US Dollar 766 million. Such developments in the foreign trade of Republic of Macedonia resulted in a balance of payments deficit of 3.0% of GDP, close to its level in the previous year. On the capital account of the balance of payments, it is important to note the inflow of foreign direct investments in the amount of US Dollar 170 million, which is the highest level registered so far and is a primarily due to the sale of few economic enterprises to strategic foreign investors.

The signing of arrangements with the international financial organizations is of exceptional importance for covering the financial gap in the balance of payments, as well as for the credibility of the country in the world. Hence, after a short time period, in the last months of 2000, the Republic of Macedonia concluded arrangements with the International Monetary Fund (IMF) and with the International Bank for Reconstruction and Development (IBRD).

One improvement of the instruments of monetary policy was the shift to indirect market instruments, which is expected to enable more efficient monetary regulation and improved performances of the banking sector. Also, other big challenge for NBRM in the medium-term, in coordination with the Ministry of Finance, is the development of the equity market and the beginning of open market transactions with Government securities.

At the same time, the reforms of the payment system in the Republic of Macedonia, which were significantly intensified during 2000, are expected to be finalized in 2001, when the existing system will be replaced with a RTGS system (Real Time Gross Settlement System) with the Central Bank.

DEVELOPMENTS IN THE BANKING SYSTEM

Structure of the Macedonian Banking System

As of December 31, 2000, the banking system of the Republic of Macedonia consisted of 22 commercial banks and 19 savings houses; 17 banks have authorization for foreign payment operations and credit activities abroad, while 5 banks are allowed to perform only domestic banking activities.

The basic structural characteristics of the banking system of the Republic of Macedonia are analysed from several aspects:

- Size of the banking institutions;
- Ownership structure;
- Regional structure

Size of the banking institutions

From the aspect of their size, the banking institutions are analysed according to three criteria: 1/ The scope of activities, or the market share; 2/ Total assets and 3/ Capital strength, i.e. total amount of own funds of the banking institutions.

The scope of activities represents total balance sheet and off-balance sheet activities of banks and indicates their market share in the banking system in the Republic of Macedonia. According to these criteria, market share of the five largest banks in the Republic of Macedonia at the end of 2000 was 73.7%, and only, the share of the largest bank was 37.2%.

According to the total assets of the Macedonian banks, as of 31.12.2000, the five largest banks held 72.4% of the total assets.

According to the capital strength, at the end of 2000, the five largest banks held 51.8 % of the total capital of the banks in the Republic of Macedonia. Compared to the end of 1999, the share of the five largest banks in total capital of the Macedonian banks increased by 2.9 percentage points. This increment was much higher (9 percentage points) compared to 30.06.2000, which is mainly due to the new capital infusion by strategic investors in two of the five largest banks during the second half of 2000.

Ownership Structure

The ownership structure of the Macedonian banks can be analysed from two aspects: 1/ level of privatization of the banks; and 2/ participation of the foreign capital.

The level of privatization of the banks of the Republic of Macedonia at the end of 2000 was 83.5%, which is an increment of 6.7 percentage points compared to 31.12.1999. If Macedonian Bank for Development Promotion, as a 100% state owned bank, is excluded from the analysis, at the 31.12.2000 the level of privatization of Macedonian banks was 87.8%. Analysed by individual banks, the ratio of the level of privatization ranges from 61.5% to 100%. Six banks are 100% privatized.

At the end of 2000, the share of foreign capital in the total capital of the banks in the Republic of Macedonia equalled 40.8%, which presents an increment of 19.3% compared to 31.12.1999. The amount of total capital investments[3] in Macedonian banking system during 2000 was DEM 217 million.

Thus, 2000 was marked as a year with the highest amount of foreign investments in the banking system since the independence of the Republic of Macedonia. Significant capital investments by foreign investors in the Macedonian banking system during 2000 reflect remarkable structural changes in the shareholder structure of the Macedonian banks.

Regional Structure

The analysis of the regional aspects of the banking system structure of the Macedonian confirms its asymmetry and concentration. Out of the total number of

[3] Acquisition of existing capital and capital injection.

the banking institutions in the Republic of Macedonia, only 6 banks and 5 savings houses are located outside the capital city. Only 3 banks are authorized to perform international payment operations and credit activities. The total assets of these eleven institutions participate with 11.6% in the total assets of the banking system of the Republic of Macedonia. The asymmetry and oversize in the supply of financial services is to a certain extent mitigated with the relatively wide network of branches, windows, business units and representative offices.

PERFORMANCE OF THE BANKING SYSTEM OF THE REPUBLIC OF MACEDONIA

As a result of the reforms in the banking sector, strengthened supervisory standards and activities, stable macroeconomic environment as well as the revival of the economy, the banks in the Republic of Macedonia registered a trend of improvement in their performances in 2000. The improvement can be observed in relation to one of the basic problems the banks face with, the low level of the assets quality. In 2000, the basic indicators of bank assets quality registered an upward trend, which at the end of 2000 resulted in their approach to the level registered before the Kosovo crisis. At the end of 2000, the share of placements in risk categories C, D and E equalled 34.8% of the total credit exposure, which is by 10 percentage points less compared to the maximum level reached immediately after the Kosovo crisis. It should be emphasized that this upward trend of the quality of banks' credit portfolio in 2000, was achieved in the light of increased credit placements by 10.5%, which indicates the improvement of the internal credit procedures and practices of banks.

The new capital injected in Macedonian banks during 2000, contributed to further strengthening of their solvency position. Namely, the average capital adequacy ratio of the Macedonian banks equalled 36.7% as of 31.12.2000, which is by 8 percentage points more compared to the same period of the previous year.

The upward trend registered in the banks' deposit potential is of an exceptional importance for the operations of the banks in the Republic of Macedonia and the further acceleration of the economic growth in the long run. Namely, the resolving of the problem of the so-called "frozen" foreign exchange savings by issuing Government bonds in September 2000, the improvements in the legal framework considering the coverage of deposits by the Deposit Insurance Fund, as well as the strengthened supervisory function, resulted in a gradual strengthening of the confidence in the banking sector. This can be seen from the growth rate of 23.1% of the non-Government deposits registered in 2000, while the households' deposits increased by 40.4%.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS

During 2000, further improvement of the banking regulatory framework continued. In that regard, a new Banking Law was adopted, and intensive process of revision of other supervisory by-laws has begun. This process of revision of the regulatory framework is based on accomplishing further compliance with the European Directives on banking and the 25 Core Principles for Effective Banking Supervision.

The new Banking Law introduces new aspects, according to which the following is expected to be accomplished: higher attractiveness of the banking system of the Republic of Macedonia for foreign investors, especially foreign banking institutions; improvement of the prudent standards and practices in bank activities; improvement of the corporate governance in banks; enforcement of the supervisory function of the NBRM, especially in the area of imposing corrective actions against banks with identified irregularities.

With respect to the banking regulatory framework, during 2000, other important laws were adopted, such as: Securities Law, Deposit Insurance Fund Law, Law on Consensual Mortgage and Law on Amendments to the Law on Executive Procedure.

THE LEGAL COMPETENCE AND THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

NBRM, as an authorized supervisory body, performs its supervisory function at the following levels: 1/ licensing function, by processing the submitted applications for issuing licences and approvals, in compliance with the regulations; 2/ examination of the operations of the banks and savings houses; and 3/ undertaking corrective actions against banks and savings houses.

Licensing Function

Within the framework of the licensing activities, during 2000, NBRM issued a licence for founding two savings houses and one representative office of the International Commercial Bank of the Republic of China –Taiwan.

In the area of issuing approvals on various bases, in 2000, NBRM performed the following activities: issuing approvals for appointing an executive body of the banks; for changes in the ownership structure of the share with management right above certain limits; for issuing approvals for changes in the Statute; for issuing approvals for purchasing shares in other bank; for establishing a brokerage company and etc.

After the enactment of the new Banking Law in July 2000, as well as due to the obligation of registering the banks in the Trade Registry, in the second half of 2000, the activities for issuing approvals for new Statute, as well as for appointing executive body of the banks were intensified.

Examination of the Operation of the Banks and Savings Houses

Within the framework of the on-site examination, in 2000, 55 on-site examinations were carried out, out of which 23 full-scope examinations and 32 targeted examinations. The on-site examinations covered the overall operations of 14 banks and 9 savings houses, while targeted examinations were carried out in all banks and 8 savings houses.

In the first half of the year, the independent auditing house Arthur Andersen prepared diagnostic studies for the four largest banks in the Republic of Macedonia, after Stopanska Banka a.d. Skopje, upon request of the World Bank, within the framework of FESAL II arrangement. Based on these studies, the banks were given certain recommendations, which should improve banks operational practices and procedures.

Undertaking corrective action towards banks and savings houses

NBRM is mandated to undertake corrective actions against banks and savings houses, in which certain irregularities have been identified based on on-site and off-site supervisory function, in order to protect the stability and soundness of particular banking institutions, as well as the stability and soundness of the overall banking system.

In 2000, NBRM imposed 38 decisions with corrective measures towards 14 banks and 5 savings houses, filed 5 offences and 2 criminal charges. The most usual corrective measures and actions undertaken towards banks and saving houses are as follows: revocation of an approval for executive body; prohibition of lending to certain shareholders; ban on performing all or certain banking operations within a certain period of time; ban on taking deposits of legal entities; action for reducing the credit exposure within the prescribed limits; action for bank exclusion from foreign exchange market; action for exclusion of the net debtors from the bank's Management Board; ban on lending to clients classified in risk categories C, D and E; action for allocation of compulsory reserve of banks aimed at preserving the daily liquidity, and other corrective measures.

In addition, in 2000 the Unit for Conservatorship, Monitoring and Enforcement Actions within the Supervision Department was established. This Unit is responsible for monitoring of the institutions, which require special supervision. At the end of 2000, 8 banks were placed in this Unit, which registered considerable risk concentration and they were subject to strengthened supervision.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

The Supervisory function is carried out through separate organizational part. The Supervision department operates within the framework of NBRM. Its organizational chart is enclosed.

COOPERATION WITH OTHER DOMESTIC AND FOREIGN SUPERVISORY BODIES

Several years ago, NBRM and Central Bank of the Russian Federation (Bank of Russia) signed an Agreement on cooperation in supervising the activities of credit organization. The goal of the agreement is to promote bilateral ties in banking supervision and achieving mutual understanding on issues related to banking regulation and cooperation in supervising the activities of credit organizations, registered on the territories of the both countries.

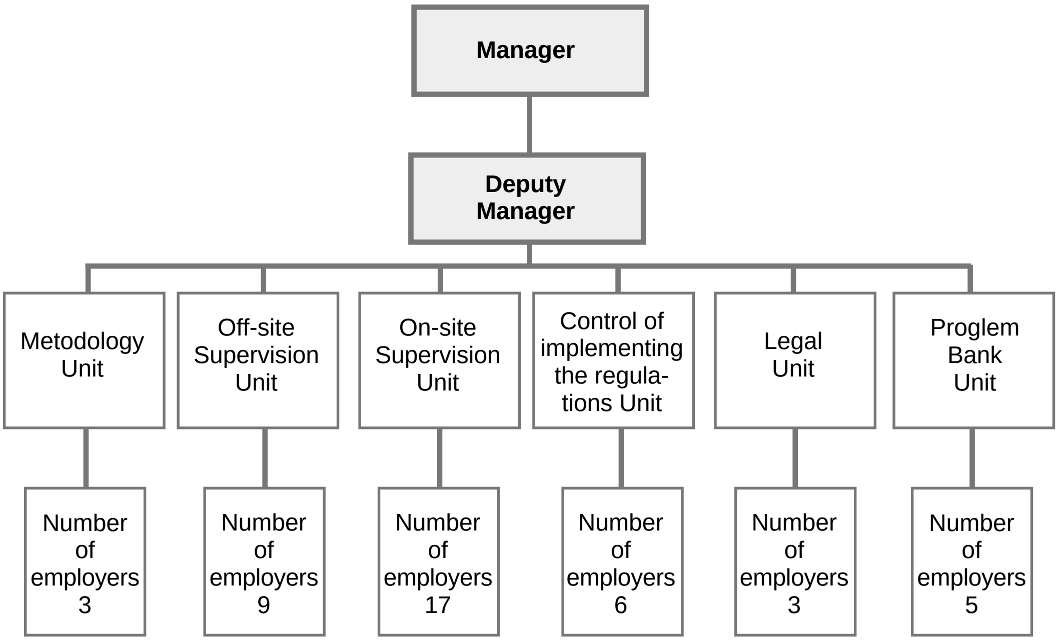
Also, during 2000, discussions regarding the improvement of the cooperation with supervisory bodies from other countries began, and we expect them to be realized in 2001. Regarding domestic supervisory bodies, there is no formal cooperation, i.e. the cooperation is performing on case-by-case base. Namely, beside Supervision Department as Supervisory Authority for banking institutions, there are two other domestic authorities. Ministry of Finance is in charge for examination of insurance companies and Security Commission is in charge for regulation of Investment Funds.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2000 AND 2001

The main objectives of the Supervisory Authority in 2000 and 2001 are focused on the following two aims:

- Further improvement of the regulatory framework; and
- Intensifying the consolidation process of the banking system through mergers and acquisition.

Supervision department organizational chart



STATISTICAL TABLES

Number of Financial Institutions (at year-ends)

Type of financial institution	1997	1998	1999	2000
Banks	22	24	23	22
Savings houses	20	18	16	19
Deposit insurance funds	1	1	1	1
Insurance companies	5	5	5	4
Stock Exchange	1	1	1	1
Money Market Broker	1	1	1	1
Financial Institutions, total	**50**	**50**	**47**	**48**

Ownership Structure of Financial Institutions on the Basis of Registered Capital (%) (at year-end)

Item	Type of financial institution *	Total
	Banks	
State ownership	4.90	4.90
Other domestic ownership	50.10	50.10
Domestic ownership total	55.00	55.00
Foreign ownership	45.00	45.00
Financial institutions, total	**100.00**	**100.00**

Note: Savings Houses are not included due to their marginal participation in the total registered capital
** Data for the other financial institutions are N/A*

Ownership Structure of Financial Institutions on the Basis of Registered Capital (%) (at year-ends)

Item	1998	1999	2000	2000/1998
State ownership	6.14	6.47	4.90	0.80
Other domestic ownership	81.51	82.07	50.10	0.61
Domestic ownership total	87.65	88.54	55.00	0.63
Foreign ownership	12.35	11.46	45.00	3.64
Financial institutions, total	**100.00**	**100.00**	**100.00**	

Distribution of Market Shares in Balance Sheet Total (%)

Type of financial institution	1998	1999	2000
Banks	98.70	99.00	98.60
Savings houses	1.30	1.00	1.40
Financial institutions, total	**100.00**	**100.00**	**100.00**

Development of the Off-balance Sheet Activities (off balance sheet items/balance sheet total) (%)

Type of financial institution	1998	1999	2000
Banks	24.94	19.39	17.07
Financial Institutions, total	**24.94**	**19.39**	**17.07**

The Structure of Assets and Liabilities of the Banking System (%)

Assets	1999	2000
Cash and balance with NBRM	7.90	8.20
Securities rediscounted by NBRM	2.40	5.30
Debt securities	11.50	9.40
Placements to other banks	31.00	33.30
Placements to clients	33.70	33.40
Accrued interest and other assets	5.90	3.40
Capital investments	1.90	1.30
Fixed assets	5.70	5.70
Total assets	**100.00**	**100.00**
Liabilities		
Deposits of banks	4.24	6.04
Sight deposits	38.37	39.86
Short-term deposits up to one year	11.46	13.28
Short-term borrowings up to one year	6.88	2.86
Other liabilities	3.73	3.10
Long-term deposits over one year	5.14	3.74
Long-term borrowings over one year	7.97	6.68
Provisions for off-balance sheet liabilities	1.54	1.14
Owned funds	20.67	23.30
Total liabilities	**100.00**	**100.00**

Note: Due to balance sheet structure changes data for 1998 is not comparable

Solvency Ratio of Financial Institutions

Type of financial institution	1998	1999	2000
Banks	25.89	28.67	36.73
Savings Houses	55.82	45.81	N/A
Financial institutions, average	**26.15**	**28.79**	**36.73**

Asset Portfolio Quality of the Banking System

in (000) denars

Asset Clasification	1998	%	1999	%	2000	%
A	20,358,281	40.76	21,617,057	42.69	21,529,559	42.57
B	13,173,761	26.38	8,083,135	15.96	11,432,165	22.60
C	7,787,624	15.59	8,217,902	16.23	6,121,207	12.10
D	7,074,593	14.17	9,174,895	18.12	7,122,007	14.08
E	1,549,809	3.10	3,541,401	6.99	4,371,554	8.64
Clasified Total	**49,944,068**	**100.00**	**50,634,390**	**100.00**	**50,576,492**	**100.00**
Provisions	**8,119,429**		**11,359,719**		**10,842,231**	

The Structure of Deposits and Loans (%)
(at year-end)

	Deposits	Loans
Households	26.20	5.80
Public sector	9.76	1.16
Corporate	47.29	47.77
Domestic Banks	0.98	4.78
Foreign	8.66	37.83
Other	7.11	2.66
Total	**100.00**	**100.00**

The Structure of Deposits and Loans (%)
(at year-end)

Maturity of Deposits		Maturity of Loans	
At sight	72.83	Long term loans*	30.77
Within one year	21.14	Medium term loans	
Over one year	6.03	Short term loans**	69.23
Total	**100.00**	**Total**	**100.00**

** In the amount of Long term loans, the amount of Non-performing loans is included*
*** In the amount of Short term loans, the amount of Past-due loans is included*

Proportion of Foreign Exchange Assets and Liabilities (%)
(at year end)

Type of the financial institution	Forex Assets/Total Assets (%)			Forex Liabilit./Total Liabilit. (%)		
	1998	**1999**	**2000**	**1998**	**1999**	**2000**
Banks	45.70	55.46	55.29	40.16	39.63	42.16
Fin. institution, average	**45.70**	**55.46**	**55.29**	**40.16**	**39.63**	**42.16**

Structure of Revenues and Expenditures of Financial Institutes
(at year-end)

in (000) denars

Revenues	1998	1999	2000
Interest income	5,410,493	4,809,470	5,165,359
Other incomes	4,415,021	5,563,471	5,109,455
Expenditures	**1998**	**1999**	**1999**
Interest expenses	2,134,513	2,664,626	2,571,715
Provisions for potential loan losses	2,824,333	3,412,630	2,921,778
Other expenses	3,572,056	3,628,687	3,972,418
Income tax	194,532	164,085	163,729

Structure of Revenues and Expenditures of Financial Institutes (at the year-end)

in (000) denars

	1999	2000
Interest income	4,809,470	5,165,359
Interest expenses	2,664,626	2,571,715
Net interest income	2,144,844	2,593,644
Net provisions	3,412,630	2,921,778
Net interest income after provisions	(1,267,786)	(328,134)
Net fees and commission income	1,707,325	1,866,031
Dividends	20,761	23,441
Net income, regarding the securities	50,932	3,313
Net capital income	(72,528)	(424,706)
Net fx income	925,291	601,908
Other income	2,931,690	3,039,468
Operating expenses	2,642,558	3,084,330
Other expenses	986,129	888,088
Gross income	666,998	808,903
Tax income	164,085	163,729
Net income	**502,913**	**645,174**

Note: Due to balance sheet structure changes according IAS, data for 1998 is not comparable

Structure of Registered Capital and Own Funds of Financial Institutions

Type of financial institutions	Registered capital	/Total assets	Own funds	/Total liabilities
	USD*	**%**	**USD**	**%**
Banks	286,377	22.82	292,405	23.30
Fin. Institutions, average	**286,377**	**22.82**	**292,405**	**23.30**

** Calculated by the exchange rate of NBRM on December 31, 2000*

2000 DEVELOPMENT IN THE MOLDAVIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Despite facing natural calamities that displayed scepticism about economic growth, the national economy of the Republic of Moldova succeeded to produce positive results.

The gross domestic product amounted (as according to estimates) to 15979.5 mil lei[*] in current prices, exceeding the 1999 level by 1.9% in real terms.

Industrial output amounted to 8750.4 mil lei in current prices and exceeded the 1999 level by 2.3% in previous year average prices.

The global agricultural output gained in 2000 was estimated at 8070 mil lei, or 97.4% in comparable prices of the 1999 value, the decrease being caused by the decline in animal output by 8.9%.

Fixed capital investments directed to national economy during the year amounted to 1511.1 mil lei, exceeding by 1.0% the value of the previous year.

Retail trade of goods through all types of sales outlets increased as compared to 1999 (by 0.1%) and amounted in 2000 to 5770.2 mil lei.

The amount of paid services rendered to the public decreased in comparable prices by 0.6 %, and achieved the level of 2512.9 mil MDL.

The average monthly wage of employees in the national economy in 2000 was 407.9 lei. As compared to 1999, that value is by 2.0% higher in real terms.

The increase in consumer prices in 2000 slowed to the end of the year and reached 18.4%, as against 43.7% in 1999.

Exports (FOB) were worth 476.6 mil USD, or by 0.1% less than in the previous year. Imports (FOB) – rose by 28.5% above 1999 and made up 783.2 mil USD in value. The trade balance deficit totalled 306.2 mil USD.

DEVELOPMENT IN THE BANKING SYSTEM

There were 20 commercial banks on the territory of the Republic of Moldova as of 31 December 2000, including 4 branches of foreign banks authorised by the National Bank of Moldova to perform financial activities. The total number of institutions of commercial banks of the republic totalled 572, including 146 branches, 176 representative offices and 250 agencies.

The assets of the banking system rose during 2000 by 1466.41 mil MDL or by 45.81% and amounted to 4667.7 mil MDL as of 31.12.200. Credits and net financial leasing held the largest weight in total assets – 43.36%; securities constituted 8.69%, money means owned by banks - 16.43%, money means owned by NBM - 8.54%, means placed overnight – 4.08%, cash – 3.47% and other assets – 15.43%.

* 1 USD = 12.4 MDL as of 31.12.2000

The total amount of credits and financial leasing amounted to 2023.88 mil MDL as of 31.12.2000 and increased during the year by 724.25 mil MDL or by 55.73%. At the same time, the value of overdue credits and credits not bearing interest declined as compared to the beginning of the year by 10.9 mil MDL or by 3.11% and totalled 339.41 mil MDL as of 31.12.2000, or 14.8% of total credit portfolio.

During the reported period, the quality of the credit portfolio registered a slight improvement, characterized by a 8.7-percentage point lower weight of unfavourable credits (substandard, doubtful and compromised) and by 8.7% higher weight of standard and supervised credits. The value of latter credits constituted 79.36% of total credit portfolio as of 31.12.2000. The ratio between credit loss provisions and total credits was 11.72%.

The total regulated capital of the banking system amounted to 1400.4 mil MDL as of 31 December 2000, it and increased as compared to 31.12.1999 by 481.5 mil MDL or by 52.4%. The average of risk weighted capital adequacy in the banking system constituted 48.56% against the minimal level of 12%.

The share of foreign investments in the banking system capital increased during the reported period by 10.73% and constituted 59.61% as of 31.12.2000.

Liabilities of commercial banks totalled 3238.67 mil MDL as of 31.12.2000 and increased from the beginning of the year by 962.63 mil MDL or by 42.29%.

Deposits held the largest weight in total liabilities of commercial banks – 76.85%, including 29.83% - deposits by natural persons, 42.6% - deposits by legal entities and 4.42% - banks' deposits. Other loans and liabilities held 15.53% and 7.62% respectively.

The net income gained by commercial banks of the Republic of Moldova during the year totalled 288.92 mil MDL, which is by 147.47 mil MDL or by 104.26% more than in the previous year. The efficiency of assets constituted 7.36%, of share capital – 24.99%.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS

Today the Republic of Moldova has a two-tier banking system.

The National Bank of Moldova is placed on the first level. The NBM works out and promotes the monetary and foreign exchange policy of the state. The National Bank is responsible for licensing, supervising and regulating the activity of financial institutions; supervising the payments system of the country and ensuring an efficient operation of the interbank payments system. The National Bank of Moldova is the sole issuer of the national currency; it holds and manages the state foreign exchange reserves.

On the second level there are 20 commercial banks, which are organized in form of joint stock societies and which act on competitive basis.

The National Bank and the commercial banks of Moldova perform their activity following the Law on the National Bank of Moldova and the Law on Financial Institutions. These laws are worked out in accordance with the international standards and serve as legal background for a stable and durable financial system. Banks are supervised according to basic principles of efficient banking supervision elaborated by the BASLE Committee.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2000

In 2000 a new bank was granted the authorization to perform financial activities and one bank was withdrawn same license.

Every bank was subject to complex control during the year. Banks with worrying problems were subject to more frequent and more diversified thematic controls. Following these, a number of banks were submitted remedy documents and current remedy documents were modified and amended. The fulfilment of stipulations provided in these documents contributed to the restructuring of assets of the banking system: the weight of highly-risk assets reduced, current risks were sufficiently covered by own capital, the required level of liquid means was ensured. Following the implementation of remedy measures, many banks created new mechanisms of internal control, which operation is based on internal procedures and is directed towards the control of insufficiently prudent activities of the bank. In a number of cases, the remedy documents issued by the National Bank directly forbade the excessively risky activities of some banks, like operations in foreign currency, provision of credits, and investment in corporate state securities. Such interdictions contributed to the cease of increasing excessive risks till the liquidation of drawbacks within internal mechanisms for preparation and performance of relevant operations. In cases when banking problems could become a real danger for banks' depositors and creditors, the National Bank forbade the relevant banks to attract deposits until improvement of financial situation.

In order to consolidate the banking system during the reported year, the National Bank undertook a number of measures directed towards the further improvement of the banking supervision mechanism and of the methods of its influence upon the process to eliminate negative phenomena in banking and strengthen the protection of depositors' interests, of deposit secrecy, the non-admittance of excessive risks in the financial system, the promotion of a strong, reliable and competitive financial sector and facilitating market forces in the process of rendering financial services.

The National Bank of Moldova continued its effort to improve banking stability in the republic by increasing requirements towards minimal required capital. Thus, starting with 30.06.2000, the minimal required capital was set at the level of 24 mil MDL and, starting with 31.12.2000, at the level of 32 mil MDL.

The consolidation of the banking system is highly important for the assurance of a good functioning of the banking sector of the country based on a strong and competitive system directed towards market relationship. To achieve that goal, NBM set rules and procedures used by commercial banks implicated in merging or association processes. NBM set also restrictions for the dominant positions on the banking market with reference to total assets and deposits by natural persons of the succeeding bank: according to this provision, this level should not surpass 30% of total assets and deposits by natural persons in the whole banking system respectively. Such limits are set with the view to avoiding the domination of the financial market of one financial institution during its activity and following the merging or association of two or more economic entities.

A tougher market discipline and a stronger banking sector may be achieved through promotion of banking transparency and exposure to risk. Within this context, NBM set criteria and methods to disclose relevant, correct and complete information related to bank's financial activity. More information needs to disclosed to the public to obtain higher confidence in the banking system.

Efficiency in banking largely depends on the quality of banks' management; that is why the approval of future banks' administrators is made following a thorough examination of their experience. Taking into account the risks in banking and to lessen difficulties that may appear in the process of nominating a person for the position of administrator, NBM set concrete criteria on whose ground to reject unsuitable candidates. Those criteria allow the selection of persons who influence the financial situation of banks via their decisions.

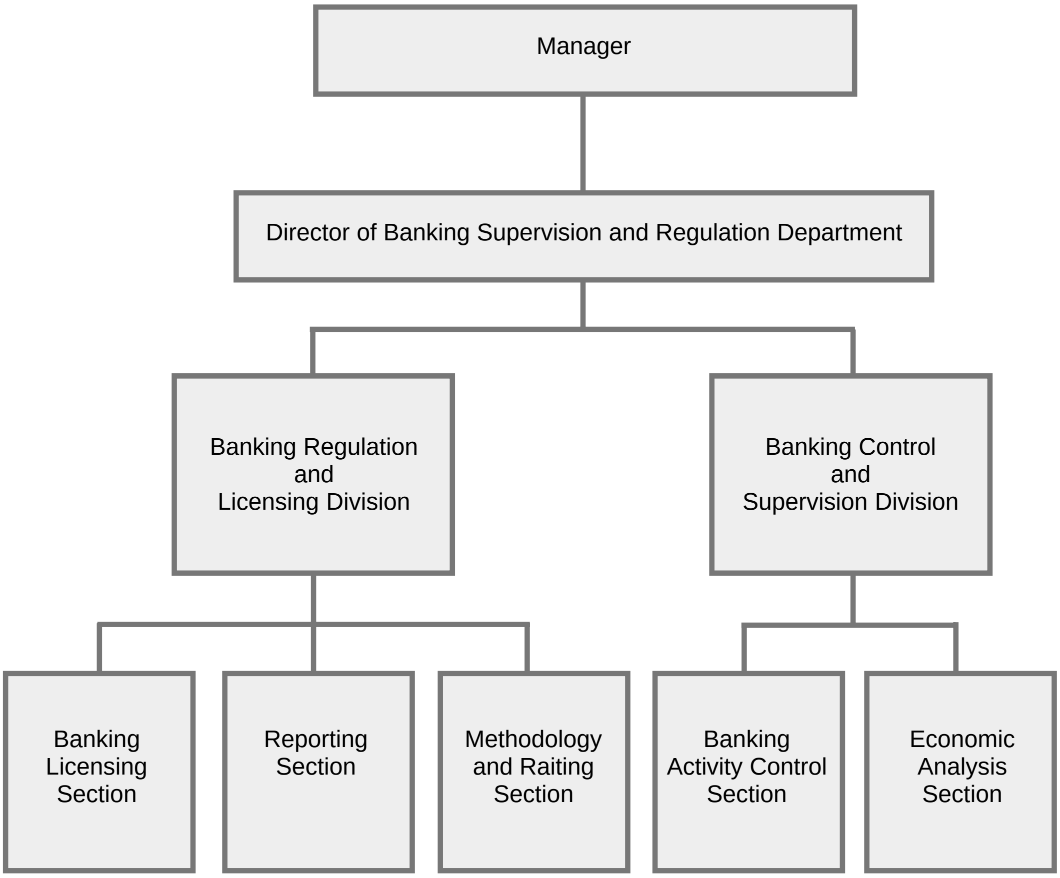
To avoid excessive evaluation of assets and incomes, NBM set requirements about the assets acquired in exchange of credit reimbursement. The posting of assets acquired in exchange of credit reimbursement provides the reflection of the lowest value – credit amount or market value of acquired assets. If these assets are not commercialized during a year, their value is posted under losses. At the same time, the value of assets classified as losses is posted in the memorandum account for their evidence and further commercialization.

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY

The basic stipulations of the Law on Financial Institutions and of the Law on the National Bank of Moldova which include the rights of banking supervisory authorities are as follows:

- To issue necessary normative acts and to take relevant measures to exercise the rights and mandates stipulated in the laws mentioned above by issuing licenses to financial institutions and by working out standards for their supervision, to set out the way for the implementation of normative acts and of the above-mentioned measures;
- To control all the banks and to examine their registers, documents and accounts, conditions under which banks perform their activity and the fulfilment by banks of legislative stipulations;
- To require from every employee of the bank to submit to the National Bank the necessary information so that it could supervise and regulate the activities of financial institutions;
- To take remedial measures if the bank, its owners or its administrators violate the current legislation, the normative acts issued by the National Bank, licensing conditions, fiduciary obligations or if the bank, its owners or its administrators have entered risky or doubtful operations that have as result the following:
  – issuance of warning note;
  – conclusion of an agreement that provides remedy actions;
  – issuance of order to cease violations, to undertake remedy measures;
  – application and indisputable perception of penalties;
  – discharge of bank’s administrator;
  – suspension of activity of the financial institution;
  – license withdrawal.
- To perform and control the process of banks’ liquidation.

Organizational chart of the banking supervisory authority



INTERNATIONAL ACTIVITIES

In September 1999 the National Bank of Moldova and the Central Bank of the Russian Federation signed the Agreement on Cooperation in the field of Supervision of Credit Institutions' Activity.

In July 2001 the National Bank of Moldova and the National Bank of Romania signed the Agreement on Cooperation in the field of Banking Supervision.

The necessity of these agreements was especially determined by the international character of banking operations performed in the Republic of Moldova, the majority of operations being performed with these countries. Such documents are provided to create the relevant legal framework required to reach efficient levels on consolidated basis.

COOPERATION WITH OTHER SUPERVISORY BODIES FROM THE REPUBLIC OF MOLDOVA

To study the effect of savings and loan associations upon the banking system, NBM performs analysis of information received from the State Service of Supervision quarterly with regard to savings and loan association.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2001

The main strategic objective of the National Bank of Moldova for 2000 is the further consolidation of the banking system, having as target the further improvement of the operation of banks; a higher security of banking activity and increased banking capacity to satisfy demands of national economy and the public.

To reach that target and based on market rules, the National Bank of Moldova creates all incentives to promote processes directed towards banking consolidation. Each bank follows same directions separately and within the banking system in general.

The National Bank of Moldova stimulates the consolidation of each separate bank via measures directed towards the reduction of risks related to active operations of the bank, the increase of risk coverage level with own capital, the improvement of methods applied to manage assets and liabilities, the development of the internal control system and of the management activity.

Within the banking system in general, the National Bank of Moldova supports the consolidation process through restricting or suspending the activity of problematic banks with regard to attraction of deposits from the financial market, creating in such a way favourable conditions to concentrate means that are temporary available on the financial market within banks with high prudential level. NBM supports also banking mergers and association, allowing banks to become more competitive on the market. In case banks admit deviations from legislative stipulations and other banking norms that result or may result in losses and substantial or total decrease in capital, NBM withdraws their licence. At the same time, the National Bank maintains efficient prudential requirements with regard to bank licensing, having as target the formation of new banks that at the moment of licensing do not have any symptoms of possible further problems. In such a way the National Bank of Moldova promotes the consolidation of the banking sector based on commercial initiatives submitted by the banks.

STATISTICAL TABLES

Number of Financial Institutions (at year–ends)

Type of financial institution	1998	1999	2000
Banks, total	**23**	**20**	**20**

Ownership Structure of the Financial Institutions on the Basis of Registered Capital (at year–end)

Item	(%)
State ownership	3.9
Other domestic ownership	36.49
Domestic ownership total	40.39
Foreign ownership	59.61
Banks, total	**100.0**

Ownership Structure of capital of the Financial Institutions on the Basis of Registered Capital (%) (at year–ends)

Item	1998	1999	2000	2000/1998
State ownership	0.98	4.16	3.9	3.98
Other domestic ownership	59.61	46.96	36.49	0.62
Domestic ownership total	60.59	51.12	40.39	0.67
Foreign ownership	39.41	48.88	59.61	1.51
Banks, total	**100.0**	**100.0**	**100.0**	

Distribution of Market Shares in Balance Sheet Total (%)

Type of financial institution	1998	1999	2000
Commercial banks	93.48	95.67	95.05
Foreign branches	6.52	4.33	4.95
Banks, total	**100.0**	**100.0**	**100.0**

The Structure of Assets and Liabilities of the Banking System (%) (at year–ends)

	1998	1999	2000
Assets			
Cash	2.56	2.95	3.47
Due from banks and BNM	19.41	27.02	24.97
Net loans and financial leasing	53.39	40.60	43.36
Total securities	6.90	9.53	8.69
Others	17.74	19.9	19.51
Total assets	**100**	**100**	**100**
Liabilities			
Deposits by natural persons	17.85	19.29	20.7
Deposits by legal persons	21.53	30.31	29.55
Others	32.91	21.50	19.13
Shareholder capital	27.71	28.9	30.62
Total liabilities and shareholder capital	**100.0**	**100.0**	**100.0**

Development of Off–balance Sheet Activities (%) (off balance sheet items/balance sheet total)

Type of financial institution	1998	1999	2000
Banks, total	**N/A**	**N/A**	**5.11**

Solvency Ratio of Financial Institutions

Type of financial institution	1998	1999	2000
Commercial banks:	media	media	media
Short-term liquidity	26% (N≥20%)	39% (N≥20%)	35% (N≥20%)
Long-term liquidity	0.40 (N≤1)	0.44 (N≤1)	0.40 (N≤1)

Asset Portfolio Quality of the Banking System

(thou MDL)

Asset Classification	1998	1999	2000
Standard	525173.39	621281.08	1122290.55
Supervised	679553.67	507695.84	697311.83
Substandard	309615.16	221441.41	324214.08
Doubtful	174736.36	213821.72	139339.04
Bad	82345.13	33395.40	9510.09
Classified total	1771423.71	1597635.45	2292665.59
Specific Reserves	350808.75	298004.13	268781.56

The Structure of Deposits and Loans (%) (at year–end)

Deposits		Loans	
Natural persons	38.8	Credits to agriculture and food industry	27.2
State budget and local budgets	4.7	Credits for real estate, construction	8.6
Legal persons	50.7	Consumer credits	3.5
Banks' deposits	5.8	Credits to the Government	1.3
		Credits to energy and fuel industry	5.4
		Credits to industry/commerce	45.4
		Credits for road construction and transportation	2.5
		Other credits	6.1
Total	100.0	Total	100.0

The Structure of Deposits (at year–end)

Maturity of Deposits	thousand lei	%
Sight	1463328.51	58.8
Time and long-term	1025528.57	41.2
Total	**2488857.08**	**100**
Inclusive in foreign currency	1235341.29	49.63

Proportion of Foreign Exchange Assets and Liabilities (%) (at year ends)

Type of the financial institutions	FOREX Assets/ Total Assets			FOREX Liabilities/ Total Liabil.			Off/balance FOREX sheet items/ Total Liabil.
	1998	1999	2000	1998	1999	2000	2000
Banks	54,4	55.7	52,3	71	74.2	67	7.37

Structure of Revenues and Expenditures of Financial Institutes (at year–ends)

(thou MDL)

Revenues	1998	1999	2000
Total Interest Income inclusive:	522044.12	486054.22	588147.04
interest income on credits and financial leasing	426725.07	383376.08	445151.45
interest income from securities	69506.33	64206.21	65089.37
interest income from other assets	25812.72	38471.93	77906.22
Total Income non-interest	176768.97	304760.28	378904.66
Expenditure			
Total interest expenditure	202700.62	183223.16	203153.35
Total non-interest expenditure	224834.85	322821.06	428262.11
Provision for loan losses	157236.78	117097.47	18952.16
Total net income	101204.66	141466.67	288921.25
Net income / Average Assets	3.96	4.17	7.36

Structure of Registered Capital and Own Funds of Financial Institutions

Type of financial institutions	Registered Capital	/Total assets	Own Funds	/Total Liab.
	thousand USD	%	thousand USD	%
Banks	**60807.01**	**16.13**	**115400.1**	**44.1**

2000 DEVELOPMENTS IN THE POLISH BANKING SYSTEM

NBP

MACROECONOMIC ENVIRONMENT

Preliminary figures put Poland's GDP in 2000 at some 690.4bn zloty, giving annual growth of 4.1%, as in 1999. However in GDP growth slackened each quarter (6.0%, 5.2%, 3.3% and 2.4%). An important driver of GDP growth were exports, which were up 7.3% on 1999 (in dollar terms), while import payments rose just 1.7%. As a consequence, Poland's current account deficit in 2000 was lower than in 1999 and amounted to US$ 9,892m.

As of the fourth quarter of 1999, domestic demand growth (in terms of both consumer and investment demand) ran lower than GDP growth. This weakening of domestic demand growth constrained the expansion of industrial output, which was up 7.1% but output growth slipping from 10.7% year-on-year in Q1 to 3.2% in Q4. Construction output was down 2.1%.

From August onwards, annualised CPI inflation trended downwards. At year end, twelve-month consumer price growth (December-on-December) stood at 8.5%, down 1.3 points on December 1999. Annualised average price growth (2000-on-1999) came to 10.1%.

The unemployment rate went up to 15% (as against 13.1% at year end 1999). Average employee earnings in the corporate sector (gross) went up 1.2% in real terms (compared to 3% in 1999), while the real level of employee old age and disability pensions dropped 2.3%.

The pre-tax profits in the corporate sector were over twice as high as in 1999 (rising from 8.8bn zloty to 18.4bn) but many companies reported much worse performance than the year before.

The most significant event for Poland's financial markets during the year was the full float of the zloty on April 12. The Monetary Policy Council raised base interest rates on two occasions (by 1 point in February and another 1.5 points in August), which resulted in an increase in both nominal and real rates on the markets.

THE BANKING SECTOR IN 2000

In 2000, the total number of commercial banks conducting operations decreased from 77 at the end of 1999 to 73. The number of cooperative banks declined from 781 to 680. The number of banks controlled by the Treasury remained the same (7) but their share in the total assets of the banking sector declined to 22.9%. The number of banks with majority foreign equity increased by 7 to 46 and their share in total assets within the Polish banking sector increased to 69.6% (from 47.2% at year end 1999). The cooperative banks held 4.2% of the total assets of the whole banking sector.

The commercial banks brought 171 branch offices into operation in 2000 (raising the total number of branches to 2,406), and the cooperative banks opened another 100 (to total 1,148). Total staffing dropped slightly to 171,235 (down 2.0%) due to corporate restructuring, often associated with planned or actual mergers. Total staffing at the commercial banks dropped to 145,541 (by 4,097).

The total assets of the banking sector amounted to 430bn zloty, an increase of 18.4% (9.1% in real terms). The ratio of banking sector assets to GDP went up to 62.3%, from 59.4% at year end 1999. Growth in outstanding loans to the non-financial sector (which totalled 185.7bn zloty) slowed in 2000 (to 17.7%, as against 26.1% in 1999), which was the result of declining loan demand due to slacker economic growth and investment and of high real interest rates. Companies with sound credit capacity also accessed external funding by borrowing from foreign banks and by issuing commercial paper. The interest shown in consumer loans was also lower than a year before. Furthermore, the banks pursued more selective lending policies. With lending growth flagging and a small supply of Treasury securities (which totalled 95.0bn zloty), banks placed the surplus funds they had on the interbank market (which totalled 80.3bn zloty), both at home and abroad.

Growth in total non-financial sector deposits (which totalled 254.3bn zloty) was slightly slipping from 17.3% to 15.3%. However, due to increase in interest rates, personal deposits climbed fast (to reach 189.6bn zloty), showing year-on-year growth of 20.8%.

The year 2000 once again saw deterioration in loan portfolio quality at the banks. At year-end, adverse classifications had risen to 14.7% of the total claims on the non-financial sector (as against 10.5% in 1998 and 13.3% in 1999). The major increase in irregular classifications over the last two years is related to the rapid growth of non-financial sector borrowings in the preceding years. One of the factors exerting a negative impact on loan portfolio quality was the financial condition of corporate borrowers involved in the distributive trades and construction. The decline in asset quality was also linked to the problems being encountered in servicing consumer loans, which had been taken out en masse in previous years. A consequence of the deterioration in asset quality was a 23.0% increase in the specific provisions established at the banks to 11.5bn zloty. However, the banks fully protected themselves from the risk posed by their irregular loans, as the specific provisions established were higher than required.

At year end 2000, total off balance sheet items had soared 113.1% to 633.5bn zloty, which is mainly attributable to the surge in the banks' derivative trading; the value of outstanding derivative contracts more than trebled compared to 1999 (to stand at 386.2bn zloty, as against 120.7bn).

Liquidity risk diminished, as demonstrated by the narrowing of the liquidity gap in the maturity band to one month (of key importance in terms of the safety of the banks), and by the faster growth of liquid investments than of the shortest-term liabilities. In addition, the stability of the deposit base further increased.

By year-end, the total capital base (total core and supplementary capital) of the banks had risen 14.6%, a similar rate of growth to that recorded in 1999, to stand at 35.5bn zloty. The principal source of capital growth was the retention of 1999 earnings. Direct appropriations of retained earnings increased the total capital of the commercial banks by 7.8%. The adjusted capital base (eligible capital) of the banks rose 19.3% to 30.7bn zloty. The vast majority of the banks conducting operations reported risk-based capital above the minimum 8% requirement. Six commercial banks and 27 cooperative banks reported risk-based capital ratios of less than 8%.

The pre-tax earnings of the commercial banks totalled almost 5.8bn zloty, an increase of 20.9% on the previous year. However, on a comparable basis (adjusted to exclude exceptional, non-recurring events in 2000), the growth in earnings came to just 12.8% (2.5% in real terms).

Net interest income (NII) grew 22.4% to total 15.6bn zloty, while the contribution of NII to net income from core operations again diminished, coming down 2.2 points to 60.8%. The relatively restrained growth of NII compared to other components of core income, despite interest rates being raised twice in the course of 2000, can be ascribed to competitive pressure squeezing interest margins. A positive influence on growth in pre-tax earnings, on the other hand, was the slower increase in general expense as a result of reduced staffing (down 2.7%).

The net earnings reported by the commercial banks, at 4.1bn zloty, was 37.7% higher than in 1999. However, this robust growth largely stemmed from factors outside the control of the banks themselves.

The operating efficiency of the commercial banks, as measured by their profitability ratios, worsened due to the higher amount of provisioning charges expensed against income. Only 27 of the banks achieved an ROE above the rate of inflation (as against 40 the year before). On the other hand measures of operating efficiency at the cooperative banks were markedly better than in 1999 but weaker than in the years 1996 and 1997.

The legal and the institutional framework of the operation and supervision of financial institutions, new developments.

At present there is no provision in Polish Banking Act, which defines the term "financial institution". But the Polish Parliament currently considers amendments to the Banking Act. After planned provisions come into force, the definition of "financial institution" will appear in the Banking Act. According to the provisions, a financial institution is a non-bank entity, which gains at least 75 % of its income in areas of economic performance listed in the Banking Law (e.g. buying and selling shares, leasing activity, buying and selling debts or providing services in assets management).

The supervisory authority will be empowered to require any information concerning activity of the financial institution and its subsidiaries if at least one of its subsidiaries is a bank. Nevertheless, the banking supervision will not encompass the entire activity of financial institutions.

PRINCIPAL AREAS OF ACTIVITY OF THE COMMISSION FOR BANKING SUPERVISION

All of the measures instituted by the Commission for Banking Supervision in 2000 were directed towards the best possible performance of the statutory objective of banking supervision, which is to ensure the safety of funds held on bank accounts and compliance by the banks with the provisions of the Banking Act, the Act on the National Bank of Poland, their articles of association, and the rulings issued on authorisation to establish those banks.

However, the activity of the Commission in 2000 did not just focus on the performance of its statutory responsibilities and strategic objectives, but had an eye on the ongoing situation in the banking sector.

Banking supervision was a participant in various processes impacting the Polish banking system, undertaking numerous measures to maintain the safety and soundness of the system. A series of actions were carried out with a view to ensuring the stability of Invest-Bank SA (which in previous years had been connected with the failed Bank Staropolski SA). Measures were taken to achieve the acquisition of equity control by Deutsche Bank AG, via its Polish subsidiary, over the BWR SA group, which had found itself in financial distress. The Commission for Banking Supervision managed to prevent a permanent loss of liquidity by Bank Czestochowa SA, placing it under administration and securing BRE Bank SA as a strategic investor.

In order to avert a crisis situation, the Commission was also compelled to appoint administrators to Wielkopolski Bank Rolniczy SA, Kalisz, given that the shareholders there proved incapable of resolving the bank's problems on their own.

The year 2000 again brought changes within the ownership structure of the banking sector, as privatisation processes were finalised. As a result, only 3 banks remained under the direct control of the Polish Treasury (PKO BP SA, BGZ SA and BGK).

Further consolidations took place within the banking industry, with the active participation of foreign investors. The globalisation of world markets and mergers among financial institutions triggered similar processes in Poland. Once these are completed, the ten largest banks will hold over 80% of the industry's assets.

Nor did the process of consolidation bypass cooperative banks. Consolidations in this sector were associated with the statutory requirements for these banks to increase their capital base.

At year-end 2000, there were 73 commercial banks operating in Poland (27 with majority Polish equity and 46 with majority foreign equity), and also 680 cooperative banks. Compared to 1999, the number of commercial banks had declined by 4, while the number of cooperative banks had fallen by 101.

At the same time, the banks were engaged in strengthening their market position by expanding their retail networks. The number of full branches of commercial banks increased by 171, and the number of other offices by 627; however, thanks to the application of new IT technologies, this expansion did not result in higher staffing. Indeed, the number of staff employed decreased by 4,097.

In 2000, the differentiation in the financial condition of the banks grew sharper. Those banks particularly prone to difficulties were small commercial banks with majority Polish equity, which will be forced to gain a strategic investor or to amalgamate with more strongly capitalised banks if they are to survive.

The slowdown in Polish economic growth and narrowing of the profit margins reported in certain industries (including sugar refining, mining and car manufacture) also affected the development of the banks and the earnings they recorded.

Although asset growth was faster than a year before (growth in 2000 came to 18.4%, or 9.2% in real terms, as against 14.0% and 3.9%, respectively, in 1999), the pace of this growth slackened from one quarter to the next. Due to a contraction in domestic demand, lending growth waned. Weaker corporate sector earnings and slower growth in real personal incomes led to a deterioration in loan portfolio quality.

The pre-tax earnings of the banking sector were up 22.7% on 1999 (11.4% in real terms). However, the earnings generated by the banks would have been higher had it not been for the additional expense they incurred in connection with the failure of Bank Staropolski SA (a difference of around 8%) and also provisioning expense (a difference of around 60%).

In consideration of the process of integration with the European Union, globalisation and deregulation of the financial services sector, a particularly important aim of the activity undertaken by the Commission for Banking Supervision in 2000 was bringing Polish legal regulations fully into line with the directives in force in the EU.

It can generally be said that, thanks to the steps taken, by year end 2000, implementation had already been carried out of the overwhelming majority of the principles of prudential supervision set out in the EU directives and the recommendations of the Basle Committee on Banking Supervision. It should be stressed that, in selected areas, Polish prudential regulations are stricter than the aforementioned, due to the heightened risk of the economic environment in which banks in Poland are operating.

As part of the work under way to incorporate within Poland's legal system the totality of regulations necessary for effective banking supervision, two bills designed to adjust Polish banking legislation to EU standards were drafted at the National Bank of Poland, in collaboration with the Commission for Banking Supervision. These bills were accepted by the NBP Management Board, and subsequently, having been endorsed by the Commission, were referred to the Ministry of Finance and the Office of the Committee for European Integration for further legislative processing.

The first of these bills comprised amendments to the existing Banking Act, while the second was the "accession law".

In the course of further work on these bills, they were combined into one, as draft amendments to the Banking Act, and in December 2000 this bill was approved by the Council of Ministers and then submitted to the Sejm of the Polish Republic.

From the standpoint of banking supervision, the key issues addressed in these draft amendments include:

- the introduction of consolidated supervision,
- modifications to the provisions concerning cooperation and exchange of information with other domestic financial regulators and foreign bank regulators,
- a modification of the provisions concerning the risk-based capital ratio, and the furnishing of a basis for the Commission to specify principles for bank compliance with capital requirements against particular kinds of risk, including market risk,
- the definition, for supervisory purposes, of the terms "financial institution", "financial holding company", "mixed-activity holding company", "parent undertaking", "significant influence" and "close links",
- an expansion of the range of supervisory sanctions available to the Commission for Banking Supervision,
- a modification to the provisions concerning control over transfers of share ownership in joint-stock banks.

The draft amendments also contain provisions necessary for the full implementation of the freedom to provide banking services, including, in particular:

- the definition of the terms "credit institution", "branch of a credit institution", "branch of a domestic bank" and "provision of cross-border services",
- a specification of the principles relating to the taking up and pursuit of business by EU credit institutions in Poland and domestic banks in the EU,
- a specification of the principles applicable to the supervision of branches of EU credit institutions operating in Poland,
- a definition of the responsibilities of the Commission arising from Poland's accession to the EU.

This section of the amendments is to come into force as of the day Poland joins the European Union.

Given the need to issue regulations providing mortgage banks with a real possibility of commencing full-scale operations, the Commission for Banking Super-

NBP

vision approved a bill amending the Act on Mortgage Bonds and Mortgage Banks. The provisions of this bill contain such proposals as:

- allowing a mortgage bank to advance funds prior to formally taking mortgage security against the loan extended,
- allowing a mortgage bank to carry out other banking operations ancillary to the performance of its basic operations,
- detailing the status of depository, taking into consideration the need for this to correspond to EU requirements.

Following its approval by the Commission, the bill was forwarded to the Ministry of Finance, as the agency having the right of legislative initiative.

The year 2000 saw the continuation of work begun in 1999 on a bill concerning the operations of cooperative banks, their affiliation and affiliating banks. Banking Supervision participated in the work leading to this bill being enacted by the Sejm of the Polish Republic on December 7, 2000. Among other things, the new law regulates the procedure for the affiliation of cooperative banks and adjusts capital requirements in line with those in force in the European Union.

As part of the activity outlined above, banking supervision also developed its position regarding the consultative paper issued by the Basle Committee on Banking Supervision entitled “A New Capital Adequacy Framework”. This position was discussed with the banking community via consultations with the Polish Banking Association, directly with the banks, with experts from GARP (the Global Association of Risk Practitioners), and with other groups interested in the proposed development of banking supervision.

The final position of Poland’s banking supervisors was then adopted by the Commission and in March 2000 forwarded to the Base Committee.

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY

The activity of banks, branches and representative offices of foreign banks, is subject to supervision conducted by the Commission for Banking Supervision. The responsibilities of the Commission include, in particular: setting out principles for the conduct of banking activity that ensure the safety of the funds held by the customers at banks, supervising compliance by the banks with statute, their articles of association and other legal regulations, and also with mandatory financial standards, performing periodic assessments of the financial condition of banks, and evaluating the impact of monetary, tax and supervisory policies on the development of banks, giving its opinion on the organisational structure of banking supervision and establishing procedures for the performance of such supervision.

The Commission for Banking Supervision consists of the President of the NBP (the Chairperson of the Commission), the Minister of Finance or a delegated representative thereof, this being a Secretary or Under-secretary of State at the Ministry of Finance (the Deputy Chairperson of the Commission), a representative of the President of the Polish Republic, the President of the Management Board of the Bank Guarantee Fund, The Chairperson of the Securities and Exchange Commission, or a deputy thereof, a representative of the Minister of Finance, The General Inspector of Banking Supervision. A representative of the Polish Banking Association participates in meetings of the commission concerning matters relating to supervisory regulations, with consultative vote.

The decisions of the Commission for Banking Supervision, together with the responsibilities it assigns, are carried out and co-ordinated by the General Inspectorate of Banking Supervision, a separate organisational unit within the structure of the NBP.

The main goals of banking supervision are described in the Art. 133 of the Banking Act. According to the provision, the objective of supervision is to ensure:

- the safety of funds held on bank accounts,
- compliance by banks with the provisions of the Banking Act, the Act on the National Bank of Poland, their articles of association, and the rulings issued on authorisation to establish those banks.

INTERNATIONAL ACTIVITIES OF YOUR AUTHORITY

In 2000, the General Inspectorate of Banking Supervision (GIBS) consulted European Commission Internal Market Directorate General document "A Review of Regulatory Capital Requirements for EU Credit Institution and Investment Firms" concerning credit risk including his mitigation, role of market discipline and supervisory review process. The GIBS also submitted its comments on the New Capital Adequacy Framework issued by Basle Committee for Banking Supervision.

In 2000 GIBS co-operated with services of International Monetary Found and World Bank in preparing the FSAP Report for which the Polish side prepared the Self-Assessment on Core Principles of Effective Banking Supervision drawn up by Basle Committee for Banking Supervision.

The representatives of GIBS participated also in activities of association institutions. These included in particular The EU-PL Subcommittee on Internal Market where questions of implementation of Polish obligations and perspectives for future co-operation with the Community were discussed.

In December 2000 the Commission for Banking Supervision (CBS) signed the Memorandum of Understanding with Bank of Lithuania. At present negotiations on underwriting further MoU's with other foreign banking supervisory authorities are being continued.

COOPERATION WITH OTHER SUPERVISORY BODIES IN POLAND

The Commission for Banking Supervision may provide the Securities and Exchange Commission, the Agency for the Supervision of Pension Funds and the State Agency of Insurance Supervision with information that is necessary for those agencies to perform their responsibilities in supervising legal compliance and fair trading on the securities market, in the operations of pension funds and on the insurance market. The principles and procedure applicable to providing such information shall be specified in an agreement between the Commission for Banking Supervision and the aforementioned regulatory agencies.

So far the Commission for Banking Supervision has concluded such agreement with the Agency for Supervision of the Pension Fund and the Securities and Exchange Commission.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2000 AND 2001

The main objective of Polish banking supervision is to ensure the safety of funds held on bank accounts and compliance by the banks with the provisions of the Banking Act, the Act on the National Bank of Poland, their articles of association, and the rulings issued on authorisation to establish these banks.

In the view of Poland's accession to the EU the new challenge for banking supervision is to adapt the Polish law to Community law.

In 2000 the General Inspectorate of Banking Supervision elaborated Resolution No. 2/2000 of the CBS of November 8, 2000, on the establishment of a normative limit for permissible foreign exchange risk in banking activities.

This Resolution is a next stage of adopting supervisory regulation to EU requirements and introducing more sophisticated tools of managing banking activities. The new regulation abandons old methodology of capital adequacy measurement only in relation to credit risk (solvency ratio) in favour of methodology; based on capital requirement for credit and market risk. In practice this means necessity to possess a capital base in amount no less than the total of capital requirements for separate categories of risk in bank activity. The fundamental element of this resolution is a definition of capital requirement for foreign exchange risk.

According to the resolution, the capital requirement for foreign exchange risk can be calculated by standard method or value at risk method or by a combined method incorporating elements of both standard and value at risk method.

Despite higher capital requirement in transition period than required in the *acquis*, solutions included in the resolution are convergent with methodology of CAD Directive. The CAD Directive defines target level of the capital requirement for foreign exchange risk as 8% of the excess of absolute value of overall foreign exchange position over the amount of 2% of the bank's own funds.

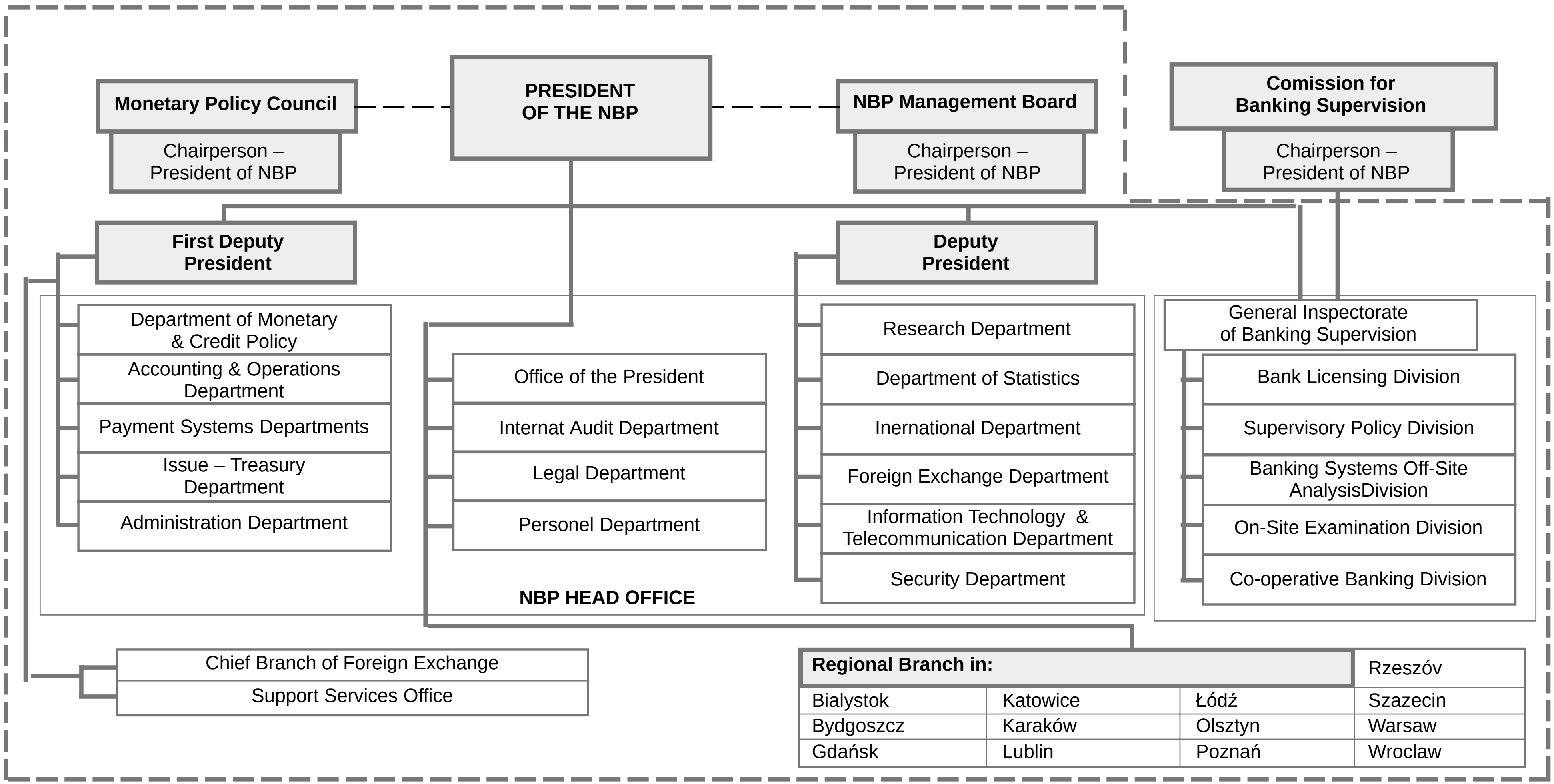
Resolution No. 2/2000 entered into force on March 31, 2001.

In 2000, General Inspectorate of Banking Supervision undertook to prepare prudential regulation introducing next capital requirements: for commodities risk, equity risk, specific risk of traded debt instruments and general risk of interest rates. The new regulation will be the next step of incorporating methodology to reduce market risk governed by the present Banking Act. The new regulation would take effects in 2002.

At the same time, GIBS undertook to prepare implementing regulations of the amended Banking Act. During these activities GIBS prepared the first draft of the CBS resolution fully implementing CAD Directive.

The GIBS has also worked to transfer the responsibility to prepare of implementing regulations on specific provisions (from the Accounting Act) to the Ministry of Finance.

Organizational Chart of the National Bank of Poland



NBP

STATISTICAL TABLES

Number of Financial Institutions
(at year-ends)

Type of financial institution	1998	1999	2000
Commercial banks	83	77	73
Cooperative banks	1189	781	680
Banking system	**1272**	**858**	**753**

Ownership Structure, Commercial Banks
on the Basic of Registered Capital (%)
(at year ends)

Item	1998	1999	2000	2000/1998
State ownership	23,4	17,7	14,9	71,6
Other domestic ownership	9,6	11,9	17,4	61,7
Domestic ownership total	33,0	29,6	32,3	110,0
Foreign ownership	49,7	56,0	56,6	128,5
Dispersed holdings	17,3	14,4	11,1	72,0
Total commercial banks	**100,0**	**100,0**	**100,0**	**x**

Distribution of Market Shares in Balance Sheet Total (%)

Type of financial institution	1998	1999	2000
Commercial banks	95,3	94,9	95,0
Cooperative banks	4,7	5,1	5,0
Banking system	**100,0**	**100,0**	**100,0**

Development of Off-balance Sheet Activities (%)
(off balance sheet items / balance sheet total)

Type of financial institution	1998	1999	2000
Commercial banks	62.1	85.2	153,5
Cooperative banks	4.0	5.5	6,0
Banking system	**59.6**	**81.8**	**147,3**

The Structure of Assets and Liabilities of the Banking System (%) (at year-ends)

Assets	1998	1999	2000
Cash and balance with Central bank	7.8	4.6	3,8
Interbank deposits	13.2	14.2	18,4
Due from non-financial and government entities	42.7	47.8	45,2
Securities	26.9	23.8	22,2
Other assets	9.4	9.6	10,4
Liabilities	**1998**	**1999**	**2000**
Borrowing from Central bank	2.0	1.6	1.3
Interbank deposits	11.1	9.3	10.8
Deposits from non-financial and government entities	62.1	64.0	63.0
Bonds	0.5	0.4	0.5
Other liabilities	15.9	16.4	16.1
Capital and reserves	8.4	8.3	8.3

Solvency Ratio of Financial Institutions*

Type of the financial institution	1998	1999	2000
Commercial banks	11.7	13.2	13.0
Cooperative banks	11.8	12.8	12.8
Banking system	**11.7**	**13.1**	**12.9**

** Arithmetic mean %.*

Asset Portfolio Quality of the Banking System (%)

Asset Classification	1998	1999	2000
Consumer loans classified satisfactory	x	17.3	18,1
Special mention claims	x	6.3	6,3
Irregular claims, of which:			
substandard	3.9	5.1	4,4
doubtful	1.9	3.4	5,1
loss	4.7	4.8	5,5
Classified Total	**10.5**	**13.3**	**15,0**
Specific Reserves (mln zl)	**7,287.8**	**9,356.9**	**11,747.3**

The Structure of Deposits and Loans (%) (at year-end)

	Deposits	Loans
Households	70,2	23,5
Government sector	5.9	2,9
Corporate	20.6	67,7
Foreign*	16,4	0,8
Other	3.3	5,9
Total	**100.0**	**100.0**

** Deposits are included in others items.*

NBP

The Structure of Deposits and Loans (%)

Maturity of Deposits(from non-financial sector)		Loans(for non-financial sector)
At sight	23.7	14,7
Within one year	73.2	24,6
Over one year	3.1	60,7
Total	**100.0**	**100.0**

Proportion of Foreign Exchange Assets and Liabilities (at year-ends)

Type of the financial institutions	FOREX Assets / Total Assets			FOREX Liabilities / Total Liab.		
	1998	**1999**	**2000**	**1998**	**1999**	**2000**
Commercial banks	18.8	21.4	23,1	18.5	19.9	17.9
Cooperative banks	0.0	0.0	0,0	0.0	0.0	0.0
Banking system	**18.0**	**20.5**	**22,1**	**17.7**	**19.0**	**17.1**

Structure of Revenues and Expenditures of Financial Institutions* (at year-ends)

million zloty

Revenues	1998	1999	2000
Commercial banks	61,783.2	76,304.0	119,454.4
Cooperative banks	2,632.4	2,609.0	3,568.4
Banking system	**64,415.6**	**78,913.0**	**123,019.8**
Expenditures	**1998**	**1999**	**2000**
Commercial banks	57,413.0	71,537.4	113,908.8
Cooperative banks	2,347.3	2,285.5	3,087.1
Banking system	**59,760.3**	**73,822.9**	**116,995.9**

** Indicating profitability, provisioning of financial institutions included in the table or separately*

Structure of Registered Capital and Own Funds of financial institutions (at year-end)

Type of thefinancial institutions	Registered Capital	/Total assets	Own Funds	/Total Liab.
	million USD	**%**	**million USD**	**%**
Commercial banks	1,938.8	2.0	8,167.2	8.2
Cooperative banks	80.9	1.9	386.0	8.9
Banking system	**2,019.7**	**2.0**	**8,553.2**	**8.3**

2000 DEVELOPMENTS IN THE ROMANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Economic policy had to deal with a dual challenge during 2000. The domestic environment called for the breakaway from past years' downturn and putting the economy back on a sound sustainable upward path, along with a significant cut in inflation rate. Externally, the positive performance in 1999 had to be reinforced by keeping the current account deficit below 4% of GDP and bolstering official reserves in an attempt to regain foreign investor confidence and re-enter private capital markets. These goals were to be accomplished in a domestic environment fraught with unavoidable constraints due to the election year, which brought about disruptions to the mix of macroeconomic policies.

On the whole, the performance in 2000 may be viewed as positive. The 1.6% GDP growth came after three years of successive falls. The inflation rate of 40.7%, albeit off the original target, was over 14 percentage points lower than a year earlier amid domestic and external shocks. Both the consolidated budget deficit and the current account deficit amounted to 3.7% of GDP. The central bank's international reserves rose to USD 3.4 billion and Romania re-entered the private capital market after more than three years by launching two bond issues worth EUR 150 million each. The unemployment rate also took a turn for the better, dropping from 11.8% at year-end 1999 to 10.5% at year-end 2000.

Co-ordination between fiscal policy and monetary and foreign exchange policies resulted in a 13.2% reduction in nominal terms of government credit, net (on account of extra-budgetary funds and the Eurobond issue), an almost 58% increase in net foreign assets of the National Bank of Romania and in slashing the average real interest rate on government securities launched in 2000 to 8.1% from 16.6% in 1999. Wage policy was not acting as a drag on the macroeconomic equilibrium, although the particulars of an election year rendered it ambiguous.

DEVELOPMENTS IN THE BANKING SYSTEM

As of 31 December 2000, the Romanian banking sector comprised 33 commercial banks, established as Romanian legal entities (out of which 4 banks with majority public capital) and 8 foreign bank branches.

Compared to the beginning of 2000, the composition of private banks changed in favour of foreign-owned banks (from 63% to 71% of total banks) while the number of state-owned banks remained unchanged. Out of the eight banks with majority Romanian private capital, three banks were fully owned by domestic private investors, and of the twenty-one Romanian banks with majority foreign capital, nine were fully owned by foreign investors.

In 2000, the total volume of Romanian banks' capital rose in nominal terms by almost 36% mainly as a result of capital increases by 30 April 2000 in order to fulfil minimum capital requirements (at least ROL 100 billion).

State-owned banks experienced sweeping changes during 1999-2000: privatisation of two commercial banks and the financial restructuring of the two largest majority state owned commercial banks. These changes reduced the market share held by majority state-owned banks by roughly 25 percentage points compared to the beginning of 1999. In spite of the fact that state-owned banks held a large share of the domestic market (46.1%), at end-2000 they were outrun by foreign-owned banks (50.88%).

In April 2001, the privatization process of another state owned bank was finalized and for the three remaining banks that process will finish by the end of 2002.

THE DEVELOPMENT OF THE LEGAL AND INSTITUTIONAL FRAMEWORK FOR THE OPERATION AND SUPERVISION OF BANKS

The NBR reorganisation finalised in September 1999 aimed at the improvement of its institutional and administrative capacity with a view to fulfilling its objectives, respectively national currency stability and carrying out banking sector supervision. The final goal of this reorganisation was the implementation of the *acquis communautaire* and bringing the functions and activities of the central bank in line with international practices.

With a view to bringing the Romanian legislation in line with the European and international one, in the course of 2000 new regulations were enacted on the following aspects:

- classification of loans granted to banks and non-banks, of interbank investments, as well as the setting-up, regularisation and use of provisions for credit risk;
- banks' obligation to rise both the share capital and own funds to at least ROL 150 billion by 31 May 2001 and to at least ROL 250 billion by 31 May 2002. These provisions were aimed at achieving two main objectives: preserving the minimum capital in domestic currency of banks, Romanian legal entities, and the start-up capital of foreign bank branches above the minimum capital requirements set by EU directives (EUR 5 million) and, at the same time, maintaining banks' own funds at least at the same level as the minimum share capital by law;
- procedures regarding the granting, collateralisation and carrying out of mortgage loans, the calculation method of indicators to assess the creditworthiness of the legal persons that apply for mortgage loans as well as the advisable levels of these indicators;
- the conditions and the authorisation procedure applied by the NBR in the case of merger or spin-off of banks licensed pursuant to Banking Act, and of the ensuing bank/banks;
- changes in banks' position in terms of prudential supervision.

In the course of 2000, the concern for the soundness of the banking system also extended to credit cooperatives whose licensing, regulation and supervision was incumbent on the NBR. The licensing of credit co-operatives started in 2001 and the NBR will take charge of their supervision when the process is completed.

The present legal framework governing the activity of these institutions was in the most part adapted to the banking legislation. Up to now the NBR issued authorization norms and minimum capital requirements of these institutions. The processes of issue of the other prudential norm are in progress.

The continuation of the community directives implementation is the objective for the short term in the field of banking regulation. In this sense in the period 2001-2002 the NBR shall have in view:

- the elaboration of accounting and prudential regulations, regarding the minimum level of obligatory reserves, and payment and compensation systems for credit cooperative organizations;
- the issue of new regulations regarding the supervision of the foreign currency position of banks, prudential norms in the domain of derivative financial instruments, norms regarding asset and liability management for credit institutions, as well as norms which will cover minimum requirements for procedures of internal control for credit institutions;
- the continuation of the process of harmonization in the domain of accounting through: the issue of regulations referring to the consolidation of accounts and term financial accounting instruments, the elaboration of regulations for the harmonization of accounting legislation with International Accounting Standards (IAS), by the end of the year 2001. At the same time, during 2001 accounting norms applicable to credit cooperative organizations will also be elaborated.

ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2000, the supervisory authority focused on improving the soundness of the Romanian banking system, initiated a year earlier, in order to bring it in line with EU accession objectives.

Against such background, the NBR further implemented a consistent programme for the consolidation of the banking system. The programme was in correlation with the government's activity and was drafted along the line agreed upon with international financial institutions aiming chiefly at the strengthening of every stage of prudential supervision of banks, starting with enhanced severity in licensing new banks and managers amendment of regulations improvement of bank monitoring and the creation or streamlining of some instruments to provide indirect support to supervision, namely Credit Risk Bureau, Payment Incident Bureau, and the Bank Deposit Guarantee Fund.

After the broad-based restructuring of banking supervision activity initiated in 1999, the central bank's activities that were aimed at increasing its efficiency focused mainly on the following directions:

- Modernisation of the Bank Uniform Rating System (CAAMEL) implemented in 1999 for the efficient promotion of banking supervision in line with international practices and standards. To that effect, in the last quarter of 2000, a new component was introduced, namely the quality of the shareholders, which is essential in establishing banks' risk profile, development policies and strategies and in complying with prudential requirements. Particular attention is devoted to the quality of management, a distinct element in assessing the banks in the system.
- Greater importance of the role and frequency of talks with the managers of troubled banks, with the main shareholders, independent auditors, the Ro-

manian Banking Association and with the supervisory authorities in the countries of capital origin.

- Reducing the cycle of inspections at the banks' head offices to twelve months thanks to better organisation and sizing of bank supervision staff. As a result, during 2000, each bank was subjected to on-site inspections. In addition, the annual inspection programme approved by the NBR Board for 2000 was supplemented throughout the year by a series of special control actions (such as how the measures decided in the wake of on-site inspections were implemented, availability of sources to increase share capital, sharp deterioration of some indicators) or initiated following some written complaints.

In the process of further improving the soundness of the banking system, in 2000, changes were required in the legal framework regarding the activity of the Bank Deposit Guarantee Fund, with reference particularly to setting the amount of the special contribution to be paid by banks.

The lack of a centralised source of information regarding loans that were granted by banks to their clients and the track record of debtors as well as the need to monitor bank lending called for the establishment of Credit Risk Bureau.

The newly established Credit Risk Bureau started operations in 2000. This is an entity within the NBR that specialises in collecting, storing and centralising information on the exposure of each Romanian bank to those debtors that received loans cumulatively exceeding the ROL 200 million reporting threshold.

The Payment Incident Bureau is an entity that manages information related to payment incidents from a banker's standpoint (overdraft) and from the social point of view (theft, counterfeiting of cheques, bills of exchange, promissory notes). Information is sent to the Payment Incident Bureau electronically. Information in the database of the Payment Incident Bureau is primarily used by the NBR in its supervisory activity.

LEGAL COMPETENCE OF NBR IN THE AREA OF BANKING REGULATION AND SUPERVISION

According to the banking legislation, the NBR is the authority vested with the power and responsibility to licence, regulate and supervise the banking system in Romania. In order to ensure the viability of the banking system, the NBR is empowered:

- to issue regulations, to take measures, to impose the observance of regulations and to apply the legal penalties for non-observance; and
- to control and verify, based on the reports submitted by the banks, and by on site inspections, the registers, accounts and any other documents of the authorised banks, to the extent it considers necessary for the fulfilment of its supervisory functions.

COOPERATION WITH OTHER SUPERVISORY BODIES

During the second half of the preceding year, the NBR began negotiations for the conclusion of agreements with supervisory authorities from the countries of origin of banks and branches of foreign banks opened in Romania as well as with those supervisory authorities from host countries of banking entities opened by

Romanian banks abroad. Acting in that spirit, the Board of Directors of the NBR approved a draft cooperation agreement in the field of banking supervision on 08.08.2000.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2000 AND 2001

On the basis of the Economic Development Strategy for Romania on the medium term, the NBR has elaborated a Medium Term Development Strategy for the banking system which, arising from the actual situation and from the recent evolution recorded in this structure, established the medium term development objectives and measures which shall be imposed in view of realizing this strategy.

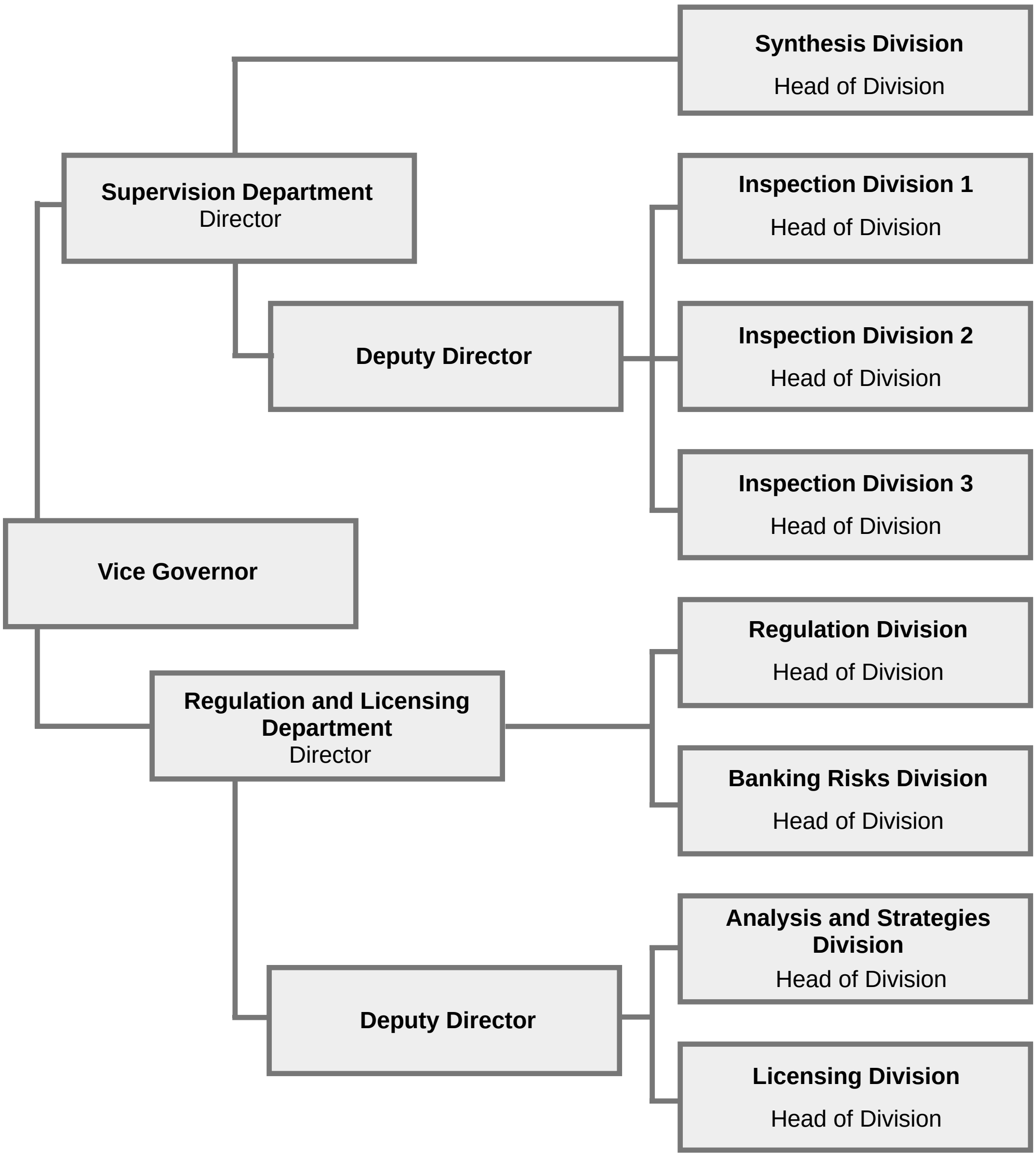
The general objectives established by the strategy refer in principal to:

- The creation of a sector formed of powerful banks, capable to assure financial intermediation on the criteria of efficiency and profitability
- The realization of this objective presupposes the taking of corresponding measures, oriented toward:
  - the resizing of the banking sector;
  - the improvement of procedures of solving the situation of insolvent banks;
  - the strengthening of prudential supervision activities;
  - the finalization of the process of privatization of banks with state capital;
  - the bringing of credit cooperatives under the regulation and supervision of the NBR;
  - the earning of public trust in the banking system and, implicitly, the encouragement of the savings, through the growth of the Deposit Guaranty Fund of the Banking System;
  - the strengthening of the cooperation with other authorities of national and foreign supervision.
- The diversification and growth in the quality of financial-banking services

  That objective will focus on:
  - the integration of banking services with those furnished by operators on the financial market;
  - the creation of conditions for the development of products and services in concordance with market requirements also for the implementation of modern products and services of the type of hybrid financial instruments, derivative financial instruments, and services of the *"e-banking"* type.
- The growth of competitiveness in the banking system:

  In that sense the following considerations will be taken into account:
  - the development of the markets in which banks operate (monetary, foreign currency, and capital);
  - the growth of autonomy of the National Bank of Romania in the quality of regulatory and supervisory authority;
  - the elimination of any existing discriminatory treatment in the banking sector.

Supervision Department and Regulation & Licensing Department Organization Structure



STATISTICAL TABLES

Number of Financial Institutions (at year-ends)

Type of Financial Institutions	1998	1999	2000
Commercial Banks	36	34	33
Branches of Foreign Banks	9	7	8
Total Banking System	**45**	**41**	**41**

Ownership Structure of Financial Institutions on the Basis of the Registered Capital (%)

Item	Type of Financial Institution
	Commercial Banks
State Ownership	38.37
Other Domestic Ownership	7.85
Domestic Ownership, Total	46.22
Foreign Ownership	53.78
Total Banking System	**100**

Note: *The National Bank of Romania has exclusive competence for granting banks the operation license and is responsible for the prudential supervision of the banks it authorized to operate in Romania, according to the provisions of the Banking Law.*

Ownership Structure of Financial Institutions on the Basis of Registered Capital (%) (at years ends)

Item	1998	1999	2000	2000/1998 (Index)
State Ownership	52.15	41.06	38.37	179.36
Other Domestic Ownership	12.06	17.19	7.85	158.78
Domestic Ownership, Total	64.21	58.25	46.22	175.50
Foreign Ownership (Including the Foreign Banks Branches)	35.79	41.75	53.78	366.33
Total Banking System	**100**	**100**	**100**	**243.80**

Distribution of Market Shares in Balance Sheet Total (%)

Type of Financial Institutions	1998	1999	2000
Commercial Banks	94.31	92.93	92.23
Branches of Foreign Banks	5.69	7.07	7.77
Total Banking System	**100**	**100**	**100**

The Structure of Assets and Liabilities of the Banking System (%) (at year ends)

Assets	1998	1999	2000
Cash and Claims on Banks	31.03	38.32	41.23
Net Loans	43.66	33.39	32.45
Securities	17.43	17.91	16.22
Fixed Assets	7.01	9.37	9.30
Other Assets	0.87	1.01	0.80
Total Assets	**100**	**100**	**100**
Liabilities	**1998**	**1999**	**2000**
Due to Other Banks and Financial Institutions	19.62	14.53	11.81
Due to Clients	66.30	72.79	71.28
Other Liabilities	2.88	2.88	4.99
Own Capital	11.20	9.80	11.92
Total Liabilities and Capital	**100**	**100**	**100**

Development of Off-balance Sheet Activities (off-balance sheet items/balance sheet total) (%)

Type of Financial Institution	1998	1999	2000
Commercial Banks	69.47	52.48	36.89
Branches of Foreign Banks	0.05	7.37	10.23
Total Banking System	**65.52**	**49.29**	**34.82**

Solvency Ratio of Financial Institutions

Type of Financial Institution	1998	1999	2000
Commercial Banks	10.25	17.90	23.79
Branches of Foreign Banks	-	-	-
Total Banking System	**10.25**	**17.90**	**23.79**

Asset Portfolio Quality of the Banking System

mil. USD

Asset Classification	1998	1999	2000	
			Loans Classification	Loans, Placements to Other Banks, and Off-balance Sheet Items Classification *)
Standard	764	800	2584	5296
Watch	968	742	32	34
Substandard	803	562	37	43
Doubtful	471	218	20	28
Loss	3104	934	86	127
Classified Total	6110	3256	2759	5528
Specific Reserves	2005	537	102	135

**) Beginning with October 2000, the asset portfolio which is classified includes not only loans, but also placements to other banks and off-balance sheet items (NBR Regulations no. 2/2000)*

The Structure of Deposits and Loans (%) (at year-end)

	Deposits	Loans
Households	43.14	3.99
Government Sector	3.86	29.72
Corporate	45.62	64.22
Foreign	3.81	-
Other	3.57	2.07
Total	**100**	**100**

The Structure of Deposits and Loans (%) (year-end)

Maturity of Deposits		Loans	
At Sight	32.11	**Short-term Loans**	68.68
Time Deposits	67.89	Medium and Long-term Loans	31.32
Total	**100**	**Total**	**100**

Proportion of Foreign Exchange Assets and Liabilities (at year-ends)

Type of Financial Institutions	FOREX Assets/Total Assets			FOREX Liabilities/Total Liab.		
	1998	**1999**	**2000**	**1998**	**1999**	**2000**
Commercial Banks	44.00	44.14	43.28	38.74	40.59	41.05
Branches of Foreign Banks	73.41	81.96	82.41	68.34	79.01	77.16
Banking System	**45.67**	**46.81**	**46.32**	**40.43**	**43.30**	**43.86**

Structure of Revenues and Expenditures of Financial Institutions (at year-end)

Revenues	1998	1999	2000
Interest Income	44.58	34.18	22.29
Income from Securities Transactions	12.71	16.32	11.55
Recoveries from Provisions	8.74	11.68	23.12
Income Not Derived from Interest	31.51	37.68	42.75
Extraordinary Income	2.46	0.14	0.29
Expenditures	**1998**	**1999**	**2000**
Interest Expenses	41.09	35.01	22.88
Expenses for Securities Transactions	0.23	0.55	0.26
Provisions Expenses	22.18	19.69	27.05
Expenses, Other Than Interest	31.96	41.43	48.17
Extraordinary Expenses	0.70	0.37	0.17
Profit Tax	3.84	2.95	1.47

Structure of Registered Capital and Own Funds of Financial Institutions

Type of the Financial Institution	Registered Capital	/Total Assets	Own Funds	/Total Liab.
	Mil. USD	**%**	**Mil. USD**	**%**
Total Commercial Banks	502	6.05	900	10.85

2000 DEVELOPMENTS IN THE RUSSIAN BANKING SYSTEM

MACROECONOMIC DEVELOPMENT

In 2000 the Russian economy continued to register growth, which reached the highest level since the beginning of reforms. Gross domestic product (GDP) that year expanded by 8.3% against 5.4% in 1999, industrial production increased by 9.0% and fixed capital investment rose by almost 18%. Year-on-year household real money income in 2000 increased by 10.2%.

As the economy grew, inflation slowed down considerably against the background of a strong balance of payments. The easing of inflationary pressure was ensured by a balanced monetary policy, smooth rouble exchange-rate dynamics, and the continued competitiveness of production, growth in labour productivity and a deficit-free federal budget.

Inflation in 2000 met on the whole the target set for it. Consumer price growth last year amounted to 20.2% against 36.5% in 1999 and industrial producer price growth was 31.6% against 67.3% in 1999.

Net exports of goods and services in 2000 increased due to a favourable situation in world commodities markets that made up the bulk of Russian exports. The trade surplus in 2000 amounted to $60.7 billion, an increase of almost 70% on the previous year. The current-account surplus rose to $46.3 billion, an absolute record since 1992.

Overall, the results of 2000 showed that conditions were emerging to be conducive to further economic growth, risk reduction and the improvement of Russia's investment image.

BANKING SECTOR DEVELOPMENT

By the end of 2000 the Russian Government and the Bank of Russia resolved on the whole the problem of cleaning the banking sector from insolvent banks, preserving its viable core and helping credit institutions resume the provision of basic banking services. The dynamics of major parameters characterising the banking sector show that banking in Russia has recovered and is making progress.

The scale of banking activities continued to expand in 2000. Banking sector assets in current prices rose in that period by 49%. It should be noted that rouble assets grew faster than foreign currency assets. As a result, the share of currency assets in aggregate banking sector assets contracted from 49% as of January 1, 2000, to 42% as of January 1, 2001.

Growth in assets was registered in 75% of operating banks. By the end of 2000 assets had almost reached 90% of the pre-crisis level (mid-1998) in real terms.

The capitalisation of the banking sector continued: in 2000 aggregate capital of operating banks increased by 119 billion roubles, or 70%, and amounted to 286.4

billion roubles as of January 1, 2001. Aggregate capital of operating banks has now reached almost 85% of the pre-crisis level in real terms.

The improvement of the financial standing of enterprises in the real sector, growth in household money income and a rise in the activity of the interbank lending market encouraged the flow of funds to the banking sector. Funds attracted by banks from resident enterprises and organisations in 2000 increased in nominal terms by 76.4% in roubles and 32.8% in foreign currency. At the same time, almost half of all credit institutions saw the value of these funds more than double.

Household deposits in the banking sector in the year under review increased by 49.0% in roubles and 45.8% in foreign currency. The value of rouble deposits in banks, excluding the Savings Bank (Sberbank), rose by 73.1% and foreign currency-denominated deposits increased by 31.9%. The increment was the result of the increased public confidence in banks amid growth in real income.

Net balance-sheet profit made by operating credit institutions in 2000 amounted to 17.2 billion roubles (a loss of 3.8 billion roubles was registered in 1999). The share of profit-making banks in assets and in the total number of operating banks exceeded 90% last year.

From July 1, 1998, to January 1, 2001, the Bank of Russia revoked 254 banking licences; including 33 licences in 2000. Licences were recalled from practically all credit institutions when there were legal grounds for licence revocation. The share of financially sound banks in assets and in the total number of operating credit institutions has now reached almost 90%.

Regional banks played an important role in the process of stabilising the banking sector. In 2000 their share in aggregate banking sector assets expanded. The availability of banking services improved in most of Russia's economic regions.

Foreign-controlled banks, which bring to the Russian market advanced banking technologies, new financial products and international banking experience, expertise and standards, increased their influence on the Russian banking sector.

The Savings Bank (Sberbank) continues to play a special role in the banking sector. It holds more than one-quarter of aggregate banking sector assets and over 75% of household deposits.

At the same time, a high credit risk, which is caused by both internal and external causes, prevent the banking sector from increasing its functional role in the economy. These factors are as follows: a slow rate of structural reforms in the economy, low liquidity, undercapitalisation, inadequate reporting made by some national enterprises and poor transparency of many of them, a low level of monetisation of the economy, the absence of a legal framework for the protection of secured creditors' rights, serious flaws in the judicial system, inadequate legislative support for banking supervision and Russia's low country rating.

A separate factor hampering the expansion of active long-term operations by banks is the structure of their resource base, which is dominated by short-term liabilities and has an obvious shortage of medium- and long-term resources. This is the result of a low level of accumulation in the economy. The situation in this sphere will improve as real income grows and public confidence in credit institutions increases.

A factor of systemic instability is also a legal risk, which is caused by inadequate legislative protection of creditors' rights, including serious drawbacks in law enforcement, and insufficient legal support for the possibilities of banking supervision.

Among the internal factors are incompetent management in many credit institutions, including inefficient risk management and internal control, the non transparent ownership structure and the lack of advanced banking technologies.

It should also be noted that about 72% of operating banks have a small capital, an equivalent of less than 5 million euros, and almost one-third of banks have a capital of less than 1 million euros. In addition, capital is often of low quality, which is the result of underestimation of risks and liabilities, inadequate loan loss provisions and overestimation of assets.

LAWS AND REGULATIONS ON PRUDENTIAL BANKING SUPERVISION

The list of documents that constitute the legal framework of prudential banking supervision can be found in the Bank of Russia's website in the Internet at www.cbr.ru.

ACTIVITIES OF BANKING SUPERVISION UNIT IN 2000

The banking supervision system in 2000 was designed to tackle the task of increasing stability, creating conditions for normal development of the banking sector and protecting the interests of bank creditors and depositors.

A major contribution to the improvement of banking supervision was made by the amendments made to the applicable legislation in June 2001, which created the basis for solving the most urgent problems of bankruptcy and liquidation of credit institutions, the access of institutions to the banking services market, licensing of banking activities and consolidated prudential banking supervision.

The Bank of Russia continued to redirect the banking supervision system to the substantive aspects of banking activities, especially the problem of risks assumed by credit institutions, including credit, market, operational and other risks, and the state of management, accounting, reporting and internal control.

To this end, the Bank of Russia established the procedure for creating reserves for possible losses, which included such instruments and risks for which banks were required to create reserves for possible losses as off-balance operations, forward deals and securities acquired for investment. An additional criterion was introduced, which broadened the range of credit institutions required to calculate market risks (the aggregate balance value of the trade portfolio is more than 5% of the balance sheet value).

Significant changes were made in the 1997 procedure for evaluating the extent of financial stability of credit institutions. The introduction of a new methodology helped improve the quality of evaluation of the financial state of credit institutions by the Bank of Russia regional branches.

A great deal of work was carried through to promote the practice of supervisory response. Emphasis was made on creating a system of early detection of problems in credit institutions and taking urgent corrective measures with regard to problem credit institutions and also credit institutions in which the emergence of problems was considered likely.

One of the measures aimed at providing the best possible solution to this problem was improving the set of tools used in analysing the activities of credit institutions. The method of analysing the financial standing of credit institutions, developed by the Bank of Russia, made it possible to implement a series of organisational and methodological decisions for the detection of substantial trends in the change of the financial condition of a bank. This method is based on the evaluation of risks regulated by the Bank of Russia and aims at making a comprehensive off-site analysis of the financial state of a bank on the basis of its reports and other sources of official information on its activities.

MAIN TASKS OF BANKING SUPERVISION UNIT IN 2001

The strategic priority is the development of a system of requirements for credit institutions, which implies a consistent transition from formal restrictions and regulations to risk regulation by taking into account to the fullest possible extent such parameters as substantiality of risks, the quality of intrabank risk management and control systems and the adequacy of the credit institution's assessment of the real risk level. The Bank of Russia is to continue this work in the following main areas:

- upgrading the system of mandatory standards by enhancing their efficiency;
- raising the minimum capital adequacy requirements;
- upgrading requirements to internal control in credit institutions;
- spreading the practice of evaluating risks on a consolidated basis for banking groups and bank holding companies;
- working out requirements for bank holding companies to present and publish consolidated reports;
- introducing for the purpose of banking supervision criteria of assessment of the standard of corporate governance in credit institutions;
- supervising the introduction and use of Internet-banking and related risks.

LEGAL STATUS OF BANKING SUPERVISORY AUTHORITY IN RUSSIA

Organisational structure of supervisory authority

Banking supervision in Russia is exercised by the Central Bank of the Russian Federation. The legal status of the Central Bank is established by the Constitution of the Russian Federation, the Federal Laws "On the Central Bank of the Russian Federation (Bank of Russia)" and "On Banks and Banking".

The supervisory unit of the Bank of Russia central office is comprised of the Prudential Banking Supervision Department, Banks Rehabilitation Department, Credit Institutions on-site Inspection Department, Department for Licensing Banking and Auditing Activities, Foreign Exchange Regulation Department and Foreign Exchange Control Department. The Bank of Russia supervisory unit is controlled by the Banking Supervision Committee. The Bank of Russia implements its supervisory and regulatory policy through its regional branches and national banks.

INTERNATIONAL ACTIVITIES OF BANKING SUPERVISION UNIT

The Bank of Russia continued to co-operate with international financial institutions, such as the International Monetary Fund (IMF), International Bank for Reconstruction and Development (IBRD) and Bank for International Settlements (BIS) and other organisations.

A major area of co-operation between the Bank of Russia and international financial organisations was the work aimed at increasing transparency of activities and observing international standards and codes in implementing economic and financial policy, which are designed to strengthen the international financial system. In connection with the IMF initiative to prepare "test transparency reports", the Bank of Russia and the IMF carried out work to evaluate Russia's compliance with the Code of good practices in ensuring transparency of monetary and financial policy and assess the extent of conformity of the Russian practice of disseminating information with the requirements of the Special Data Dissemination Standard (SDDS).

Within the framework of the IMF-IBRD joint programme for assessing the state of the financial sector, the Bank of Russia began in the year under review to compile indicators characterising the state of the banking sector and payment system.

The Bank of Russia in 2000 continued to co-operate with international financial organisations within the framework of the Inter-Agency Co-ordinating Committee for Banking Sector Development (ICC), set up in 1999 under the aegis of the Bank of Russia with the participation of Russian legislative and executive power structures, the IMF, IBRD and other organisations. Among the questions discussed within the framework of the ICC were the upgrading of the banking system, banking supervision and bank reporting, accounting, the development of financial infrastructure and bank operations.

In addition, within the framework of the ICC, the Bank of Russia is implementing, in collaboration with the US Agency on International Development (USAID) and the European Union, two projects related to "Assistance to Accounting and Reporting Reform" aimed at introducing international accounting standards (IAS) in Russian accounting and supervisory practices. Consultations were also held on issues relating to the implementation of the TACIS programme for advanced training of the Bank of Russia personnel.

Bank of Russia representatives took part in the meetings of working groups of the Basle Committee on Banking Supervision, including its regional banking supervision groups (the Group of Banking Supervisors from Central and Eastern Europe and the Transcaucasia and Central Asia Regional Group).

CO-OPERATION WITH BANKING SUPERVISORY AUTHORITIES OF OTHER COUNTRIES

Co-operating with supervisory authorities of other countries, the Bank of Russia in the year under review exchanged supervisory data with bank supervisors of a number of foreign countries. With some countries such exchange was conducted within the framework of agreements on co-operation (memoranda of understanding) in the field of banking supervision.

Such agreements (memoranda) have been signed with supervisory authorities of 12 countries, mostly CIS members. Arrangements have been reached on co-operation on an unofficial basis with some European Union member countries (Austria and Germany).

STATISTICAL TABLES

Number of Financial Institutions (year-ends)

Type of financial institution	1998	1999	2000
Total number of operating credit institutions of which:	1,476	1,349	1,311
Banks	1,447	1,315	1,274
Non-bank credit institutions	29	34	37

Structure of Assets of Credit Institutions by Kind of Investment

Assets	1.01.99		1.01.00		1.01.01	
	billion rubles	%	billion rubles	%	Billion rubles	%
Funds, precious metals and gemstones	22.3	2.1	43.0	2.8	47.1	2.0
Accounts with Central Bank	56.5	5.4	137.0	8.6	273.6	11.6
Correspondent accounts in banks	64.2	6.1	158.3	10.0	236.3	10.0
Securities acquired by banks of which:	265.5	25.4	318.9	20.1	465.8	19.8
– government debt obligations	179.7	17.2	213.7	13.5	310.6	13.2
Debt on loans	497.6	47.5	726.7	45.8	1,082.7	45.9
Other assets	140.5	13.4	200.6	12.6	251.7	10.7
Total assets	**1,046.6**	**100.0**	**1,586.4**	**100.0**	**2,357.3**	**100.0**

Structure of Liabilities of Credit Institutions by Sources of Funds

Liabilities	1.01.99		1.01.00		1.01.01	
	billion rubles	%	billion rubles	%	Billion rubles	%
Funds and profits of banks	128.1	12.2	226.8	14.3	331.7	14.1
Loans received by banks from Central Bank	8.2	0.8	14.2	0.9	11.1	0.5
Bank accounts	25.7	2.5	62.4	3.9	119.3	5.1
Interbank loans and deposits	195.7	18.7	173.4	10.9	179.4	7.6
Clients' funds	506.7	48.4	796.6	50.2	1,223.9	51.9
of which:	0.0		0.0		0.0	
– funds drawn from corporate clients	283.2	27.1	468.8	29.6	722.3	30.6
– household deposits	199.8	19.1	297.1	18.7	445.7	18.9
Debt obligations issued by banks	49.9	4.8	116.5	7.3	200.8	8.5
Other liabilities	132.3	12.6	196.5	12.4	291.1	12.3
Total liabilities	**1,046.6**	**100.0**	**1,586.4**	**100.0**	**2,357.3**	**100.0**

Credit Portfolio Quality Structure (%) (according to general financial statements of banks)

Quality of loan	As of 1.01.99	As of 1.01.00	As of 1.01.01
Standard	75.4	78.8	87.2
Substandard	7.2	7.8	5.1
Doubtful	6.0	2.7	2.5
Bad	11.3	10.7	5.2

Credit Portfolio (%)

Indicator	As of 1.01.99	As of 1.01.00	As of 1.01.01
Loans to government	4.6	4.8	1.6
Loans to banks	13.2	14.3	10.8
Loans to private individuals	4.4	4.2	4.5
Loans to legal entities	76.4	74.8	81.9
Other	1.5	1.8	1.2

Dynamics of Risk-Weighted Bank Assets

billion rubles

Risk-weighted assets	1.01.99	1.01.00	1.01.01
Group 1 (Ar 1) (risk ratio=2%)	0.4	0.9	0.9
Group 2 (Ar 2) (risk ratio=10%)	17.2	23.1	30.8
Group 3 (Ar 3) (risk ratio=20%)	29.4	59.5	73.1
Group 4 (Ar 4) (risk ratio=70%)	21.6	48.0	76.0
Group 5 (Ar 5) (risk ratio=100%)	547.9	724.5	1,160.1
Total risk-weighted assets of credit institutions	**710.0**	**856.0**	**1,340.9**

Income and Expenditure Structure of Operating Credit Institutions (%)*

Income, total	1.01.99	1.01.00	1.01.01
	100.0	**100.0**	**100.0**
of which:			
- interest received for loans extended	11.65	9.09	11.43
- income received from operations with securities	11.13	6.68	8.02
- income received from operations with foreign exchange and other currency values	64.59	63.85	40.11
- dividends (except shares)	0.62	0.00	0.00
- fines and penalties	0.42	0.34	0.23
other incomes	11.60	20.03	40.20
of which:			
- recovery of sums from accounts of funds and reserves	7.20	13.32	33.53
- commission received	2.27	2.35	2.92
Expenditure, total	**100.0**	**100.0**	**100.0**
of which:			
- interest paid for loans taken	2.20	1.18	0.91
- interest paid to legal entities for borrowed funds	3.48	1.83	2.16
- interest paid to private individuals on deposits	6.49	6.51	6.03
- expenditures on operations with securities	10.41	2.88	2.68
- expenditures on operations with foreign exchange and other currency values	54.13	59.94	39.75
- administration expenditures	2.51	2.33	3.30
- penalties and fines	0.19	0.12	0.05
- other expenditures	20.58	25.21	45.12
of which:			
allocations to funds and reserves	12.21	17.90	37.61
commission paid	0.35	0.25	0.26

** According to the Profit-and-Loss Report of Credit Institutions (F.102)*

Dynamics of Share of Foreign Currency Assets and Liabilities in Aggregate Banking Sector Assets and Liabilities

	1.01.99	1.01.00	1.01.01
Foreign currency assets as % of total assets	56.1	48.9	41.9
Foreign currency liabilities as % of total liabilities	47.0	37.6	32.8
Difference in ratio of foreign currency component of assets and liabilities, percentage points	9.1	11.3	9.1

2000 DEVELOPMENTS IN THE SLOVAKIAN BANKING SYSTEM

MACROECONOMIC CIRCUMSTANCES

The development of the Slovak economy in the year 2000 was characterised by continued macroeconomic stabilisation, which was reflected in the favourable course of inflation, accompanied by a decrease in the current account deficit of the balance of payments and the fiscal deficit in relation to GDP, whilst the exchange rate of the Slovak crown remained relatively stable. The positive economic results and the gradual introduction of liberalisation measures contributed to Slovakia 's admission to OECD. At the same time, conditions were created for further development of financial markets and the banking sector, which were connected with loan portfolio restructuring at selected commercial banks and the ongoing privatisation process.

Economic growth in the countries of our major trading partners and the slowdown in the rate of decline in domestic demand led to a 2.2% increase in real GDP compared with 1.9% in 1999. Economic revival is expected to continue in 2001, especially in the area of domestic demand, with GDP growth reaching 2.8% to 3.0%.

The increase in consumer prices slowed down considerably in 2000 compared with the previous year. The 12-month rate of inflation fell year-on-year by 5.8 percentage points, to 8.4%, due, to some extent, to the relatively low purchasing power of households, but in the main, to the fact that the effect of the increase in regulated prices in the summer of 1999 had dissipated. As the rate of inflation was significantly affected by price regulation, the statistical evaluation of inflation was extended to include core inflation (with effect from 1 January), which is corrected for the effects of adjustments to regulated prices and changes in indirect taxes and subsidies. Core inflation in 2000 was characterised by a downward trend, with the year-on-year dynamics reaching 4.6% at the end of the year (compared with 7.0% in 1999). The favourable price development was achieved despite the appreciation of the US$ in relation to the Sk and the increase in oil prices, which was reflected in fuel prices and the production costs. On the other hand, the low level of effective demand and growth in competition on the domestic market were factors dampening the year-on-year dynamics of both headline and core inflation.

The National Bank of Slovakia assumes that the process of disinflation will continue in 2001, with core inflation ranging from 3.6 to 5.3% and headline inflation reaching 6.7 to 8.2%.

The ongoing stabilisation of the macroeconomic environment resulted in a fall in the share of the current account deficit in GDP from 5% in 1999 to 3.7% in 2000. The surplus in the capital and financial account, the amount of which was determined by the inflow of foreign direct investment, was sufficient to cover the current account deficit several times. The increase in the volume of foreign direct investment in 2000 was connected with the implementation of the Government's privatisation projects.

The course of foreign trade in the first months of 2001 indicates that the deficit in the balance of trade and the current account is growing. The NBS assumes that the ratio of the current account deficit to GDP may reach 5.7%, due mainly to growth in the import of technology in connection with revival of the economy. The current account deficit is expected to be fully covered by foreign direct investments. The development of other items in the capital and financial account may well lead to an increase in the level of the foreign exchange reserves of the NBS.

During 2000, the National Bank of Slovakia implemented its monetary policy using a new set of instruments. The favourable development of the economy made a shift from quantitative to qualitative monetary policy control possible. The change in monetary policy instruments was due to the need to harmonise NBS instruments with those of the European Central Bank. On 1 February, the National Bank of Slovakia introduced interest rates for overnight sterilisation and refinancing operations and, with effect from May, a limit rate for two-week REPO tenders. The introduction of official rates by the NBS made a significant contribution to the stabilisation of interbank rates and to a fall in the overall level.

The improvement in economic development during the year made a gradual reduction in key NBS rates possible, and a consequent fall in primary interest rates for both deposits and loans. The level of interest rates on new loans fell by more than 5 percentage points and gradually approached the overnight refinancing rate of the NBS.

In connection with the harmonisation of monetary-policy instruments with those of the European Monetary Union, the NBS reduced the ratio of required reserves from 8.0% to 6.5% with effect from 1 July, and subsequently, to 5.0% with effect from 1 January 2001. By 2004, the NBS will have reduced the ratio of required reserves to 2%, which is the rate in the European Monetary Union, and which will do much to raise the level of competitiveness of domestic banks to that of foreign banks.

The development of monetary aggregates in 2000 was in line with the projections of the Central Bank. The rate of year-on-year growth in the money supply at fixed 1993 exchange rates reached 14.2%. A pro-growth effect on the money supply was exerted by foreign resources, in the form of an inflow of foreign direct investments, and domestic resources, in connection with the development of the fiscal deficit and the release of funds from privatisation into the economy.

The exchange rate of the Slovak crown vis-à-vis the reference currency (EUR) was relatively stable over the course of the year and depreciated by 3.76%. During the year, the NBS was active on the foreign exchange market where activities were focused mainly on moderating short-term volatility in the exchange rate of the crown and/or preventing unacceptable appreciation in the light of economic performance.

In 2001, the National Bank of Slovakia will focus its monetary policy on meeting the main objective set out in the amended NBS Act, i.e. the maintenance of price stability. The Monetary Programme for 2001 was drawn up in accordance with this objective; furthermore the Revised Monetary Programme respects the criteria of the Statement of Economic Policies, which is the basic document of co-operation between the Slovak Republic and the International Monetary Fund as part of the Staff-Monitored Programme.

DEVELOPMENT OF THE BANKING SECTOR

During 2000, the Slovak Banking sector faced the first effects of banking reform in three main areas:

- Restructuring and privatisation of the country's three largest state-owned banks,
- Programme and strategy of handling small and medium-sized banks,
- Deposit Protection Scheme reform,
- Improvements in regulation and carrying out of banking supervision.

In the largest state-owned banks, some crucial steps were taken in the second half of 1999 and the first half of 2000 to bolster capital adequacy levels and improve loan portfolios. These measures enabled the banks to reach common capital adequacy standards and reduce the share of classified loans below 20%.

The restructuralisation of the three biggest banks involved decisive and vital steps; in addition to an Sk 18.9 billion of fresh capital injected into the banks, they were helped by a two-step transfer of risky loans valued at total of Sk 105 billion. However, restructuring will not be complete before the banks' corporate clients have also been through the process of restructuring, and that has only just begun.

Slovakia's economic performance and bank restructuring efforts have already resulted in an upgrade in its long-term forex and koruna liabilities (FITCH rating agency).

The restructuring process is continuing hand-in-hand with privatisation, which is the next step in the banking sector reform with the assistance of J.P. Morgan financial consultants and legal advice from the White & Case agency. Over the year, the preconditions were created for a strategic investor to step into Slovenská sporiteľňa and into Všeobecná úverová banka.

The strategy of the Banking Supervision of the National Bank of Slovakia concerning small and medium-sized banks is based on a financial analysis of the situation and trends in individual banks during 1999, as well as on their track records in complying with the NBS regulations and positions demonstrated by their investors in 2000. The strategy quantified and suggested solutions to accumulated problems, in particular the following:

- a large and still rising share of classified loans inadequately covered by provisions and reserves,
- growing credit loss depleting banks capital and affecting their performance,
- valuing collateral and guarantees for loans,
- compliance with prudential banking regulations and deteriorating liquidity in some banks.

The measures adopted by the Banking Supervision of the NBS were preceded by an assessment of the situation in individual banks through on-site supervision and external audit. Their inspection prompted the NBS to put Slovenská kreditná banka, a.s., Bratislava, and Dopravná banka, a.s., Banská Bystrica under forced administration on 19 April 2000 and 1 July 2000, respectively. Together with AG Banka, a.s., Nitra, whose license was revoked on 13 April 2000, the mentioned banks were put under special regime of operation. On 13 April 2000, the Bratislava Regional Court opened bankruptcy proceedings involving AG Banka's assets. On 4 July 2000, Slovenská kreditná banka was declared bankrupt what meant the end of the forced administration and the loss of its banking license. Before long, the forced administration period at Dopravná banka, also came to an end, when bankruptcy proceedings were opened by Banská Bystrica Regional Court on 22 August 2000.

Banking sector performance in 2000

At 31 December 2000, the Slovak banking sector consisted of 23 banking entities, thereof 21 banks, two branches of foreign banks and ten representative offices of foreign banks. Of the 21 banks, two are state financial institutions, three are specialised banks - home savings banks and six banks are authorised to conduct a mortgage business.

According to its application, the NBS granted ČSOB stavebná sporiteľňa, a.s. (a home savings bank) a banking license, effective from 24 October 2000, to perform activities defined in Article 4, paragraph 3, of Act No. 21/1992 as amended, and Article 2, paragraph 2, of Act No. 310/1992 on home savings schemes as amended. ČSOB stavebná sporiteľňa, a.s., opened for business on 1 December 2000.

The Bratislava representative office of the Prague-based J&T Banka, a.s. was registered in April 2000. On the request of ČSOB, a.s., Prague, which had acquired Investiční a poštovní banka, a.s., Prague, the representative office of the latter was cancelled on 30 September 2000.

Total subscribed equity in the Slovak banking sector (excluding the NBS), including permanently provided funds of branches of foreign banks, totalled Sk 53,997.6 million on 31 December 2000, with subscribed equity capital accounting for Sk 49,169.4 million and funds permanently provided by foreign head offices to their branches in Slovakia representing Sk 4,828.2 million. The share of foreign investors in the total subscribed equity of banks and permanently provided fund to branches of foreign banks totalled Sk 15,153.4 million on 31 December 2000, equal to a slight annual increase of 3.5 percentage points, from 24.6% to 28.1%. The increase resulted from both new foreign investors entering the banking sector and existing investors increasing their shares in banks, with the State progressively reducing its holdings.

In the banking sector, 2000 was marked as a year of recovery in most financial indicators, including improvement in compliance with prudential rules, as compared to the end of 1999 and earlier.

The total assets of banks operating in the Slovak money market recorded a rise in 2000, an increase of Sk 77.2 billion (10.03%) to Sk 847 billion from the previous year.

The quality of the banking sector's loan portfolio had improved by the end of the year. Classified loans fell by Sk 30.7 billion and totalled Sk 88.6 billion (a decline of 25.74%). A considerable improvement was also recorded in the share of classified loans to total outstanding loans, which fell year-to-year from almost 40% in September 1999 to 21.70% on 31 December 2000. Excluding Konsolidačná banka (state financial institution), classified loans fell by Sk 31.7 billion and totalled Sk 56.5 billion (a decline of 35.92%), which represents a 15.32% share on total loans.

The progress of restructuralisation of banking sector (in particular the transfer of non-performing loans from restructured banks), capital market transactions and a reduction in bank lending activity resulted in increase of the share of earning assets on total assets (year-to-year by Sk 116.3 billion to Sk 749.1 billion). Earning assets made up 88.45% of total banking sector assets on 31 December 2000. Share of earning assets increased on year-to–year basis by 6.24%.

The liability side reported notable growth in primary funds by Sk 89.3 billion, i.e. 17.62%, which almost covered the asset expansion.

The banking sector as a whole recorded a return to profit, amounting to Sk 4.4 billion in the year ending 31 December 2000, after reporting a sizeable loss of Sk 29.5 billion on 31 December 1999. The rebound in 2000 was due mainly to the completed restructuring of Všeobecná úverová banka, Slovenská sporiteľňa and

Investičná a rozvojová banka. These three banks were able to transfer to their earnings a considerable part of their provisions and reserves formerly held for transferred loans, thereby improving the result of the sector as a whole.

On 31 December five banks reported loss, i.e. four less than a year ago (nine banks recorded a loss in 1999).

Financial result of banking sector at 31 December 2000 and its development are determined by return ratios calculated on the basis of profit and loss compensation, average asset value and equity capital.

Return on equity (ROE) in %	31.12.1999	31.12.2000
banking sector as a whole	-61.20	8.90
banking sector excluding Konsolidačná banka	-36.54	25.16
Return on assets (ROA) in %	31.12.1999	31.12.2000
banking sector as a whole	-3.99	0.54
banking sector excluding Konsolidačná banka	-2.34	1.48

THE LEGAL FRAMEWORK

Reinforcement of regulation and of banking supervision conduct

In the year 2000 the preparations for amendments to existing legislation started to take place, leading to the adoption of, or proposals for, brand-new legislation or revisions to existing laws.

In September 2000, the National Council of the Slovak Republic passed the Act on the Financial Market Authority, amending certain other laws (No. 329/2000 Z.z.). Apart from the establishment of a government agency – the Financial Market Authority – to supervise the capital market and the insurance industry, the Act defines its scope of activity and the procedures to be followed in performing state supervision. The Authority reports to the Slovak Government, presenting activity reports for the previous calendar year together with an analysis of the current state of Slovakia's capital market and insurance sector. As the law stipulates, the Authority will work together with the Ministry of Finance to create and implement financial policy, in particular to prepare capital market and insurance sector analysis, their development planning, and generally binding secondary legislation concerning this particular area. The Act came into force on 1 November 2000.

On 8 December 2000, the Bank Board of the National Bank of Slovakia approved a new Banking Act proposal drawn up with the assistance of responsible Ministry of Finance departments.

The new Banking Act aims at harmonising the Slovak banking legislation with relevant EU directives, at implementing the World Bank and the International Monetary Fund recommendations and at increasing the National Bank of Slovakia's banking supervisory authority.

The law incorporates the Core Principles of effective banking supervision specified by the Basle Committee for Banking Supervision. Further, it sets out requirements for the operation of banks and branches of foreign banks, including prudential rules, and extends the liability of supervisory board members and directors for poor economic performance of their banks. A legislative framework for banking supervision on a consolidated basis is also included. The law makes it easier to impose prompt corrective action on problem banks, for instance if their capital adequacy falls below the specified limit, and is more specific about forced administration matters. In addition, the law specifies stricter requirements for bank auditors to co-operate with the National Bank of Slovakia. The law incorporates proven standards of accounting, protection of bank secrecy and disclosure of banking information, and lays down the rights and obligations of banks regarding protection against illegal bank operations. Also included are provisions designed to promote mortgage banking.

Secondary legislation – the NBS Decrees

The NBS issued six new or revised decrees last year, coming into effect on 31 March 2000, to enforce prudent banking behaviour by regulating capital adequacy, credit exposure, and liquidity in banks and branches of foreign banks, open foreign exchange positions in banks, procedures for classifying claims and off-balance sheet liabilities, and the submission of regulatory reports of banks and branches of foreign banks to the NBS.

In December 2000, the NBS Bank Board adopted a decree specifying the criteria and details of applications for prior approval under Article 16, paragraph 1, of the Banking Act, to acquire or increase the specified thresholds in the bank's registered capital or voting rights, for the acquisition, merger, spin-off or closure of a bank; for an increase or decrease in a bank's registered capital other than a loss-related decrease, and for the sale of a bank or a branch of a foreign bank, which took effect on 1 February 2001.

Co-operation with foreign banking supervisors

During 2000, the NBS banking supervisors took part in several events organised by the regional group of banking supervisors of Eastern and Central Europe (e.g. the seminar in Bratislava in June 2000 to discuss the 25 Basle Core Principles of effective banking supervision). The NBS banking supervisors also regularly attend conferences organised by this particular regional group (May 2000 in Prague).

Negotiations are now underway with German banking supervisors, as part of the bilateral agreements on co-operation in banking supervision. A working meeting also took place in November 2000 in Rome with Italy's banking supervisors. Meetings with Austrian supervisors were held in August 2000 in Vienna and March 2001 in Bratislava. In late March 2001, NBS supervisors met their counterparts from the Czech National Bank at a regular meeting held under a Banking Supervision Co-operation Agreement signed by both central bank Governors in July 1999.

EVALUATION OF PRUDENTIAL BANKING BEHAVIOUR

Currently, there are five NBS decrees in place, which regulate prudential banking behaviour; all are based on the internationally recognised principles and recommendations of the Basle Committee for Banking Supervision.

This review draws on information from bank accounting records and their regulatory reports on capital and reserves, capital adequacy, asset and liability classification, credit exposure, liquidity and open foreign exchange positions, submitted to the NBS Banking Supervision Division.

The information system of the Banking Supervision Division serves by applying a set of ratios to review and monitor tendencies in the performance of individual banks, groups of banks and the banking sector as a whole.

The Banking Supervision of the NBS conducts assessment of the banking sector development and compliance with prudential banking rules also by ongoing on-site inspections. In 2000, seven on-site inspections were carried out (four overall, and three targeted inspections).

Capital and capital adequacy

According to Article 3 of the NBS Decree No. 6/2000 of 14 February 2000, requiring banks and branches of foreign banks to submit certain information to the National Bank of Slovakia, banks must file quarterly reports on capital and reserves and monthly capital adequacy reports. The NBS Decree No. 2/2000 of 14 February 2000 on capital adequacy of banks, replacing the NBS Decree No. 5 of 16 May 1997, requires banks to maintain a minimum capital adequacy ratio of 8%.

The Slovak banking sector's capital adequacy ratio has stabilised over the year and, excluding Konsolidaèná banka, reached 12.48% on 31 December 2000. Two banks fell short of the determined capital adequacy ratio at the end of the year.

Classification of banks assets

The NBS Decree No. 6/2000, which stipulates information to be reported by banks and branches of foreign banks to the National Bank of Slovakia, introduced a revised form of reports on asset and liability classification. Classification reports must now contain information about existing provisions as at the date of preparation of financial statements. The amount of provisions may decrease during the year due to their release, cession or pay-off of claims, and the like. Additional provisions may also be set aside during a year to account for accrued interest, past-due interests or other expenses incurred in claim enforcement process, and the like. Legal reserves cannot be applied to cover credit risks, as they are a capital component. Other reserves may be used to cover off-balance sheet liabilities in favour of debtors, local government authorities or other funds.

The uncovered estimated loss of the Slovak banking sector fell by Sk 591,892 thousand (down by 98.13%), from Sk 603,183 thousand at 31 December 1999 to the amount of Sk 11,291 thousand at 31 December 2000. Two banks reported uncovered estimated loss for the period under review.

Credit exposure

The revised NBS Decree No. 3/1994 on the credit exposure of banks, as amended by the NBS Decree No. 4 of 14 February 2000, sets the following bank exposure limits: 25% of a bank capital for exposure to a single customer or a group of economically related customers; 125% of a bank capital for exposure to a Slovak bank or a bank incorporated in a zone A country; 20% of a bank capital for exposure to persons with a special relationship to the bank, and the aggregate amount of all net individual exposures greater than 10% of the reporting bank's capital not to exceed 800% of its capital. The revised NBS decree stipulates that credit risk be measured by reference to capital calculated on the basis of the annual financial statement.

Compared to 1999, there was a general improvement in compliance with applicable credit exposure limits, resulting in less non-complying banks. As at 31 December 2000, ten banks violated the limits on exposure to non-bank customers; two were overexposed to other banks, and ten exceeded the limit for persons with a special relationship to the bank. Three banks breached the aggregate net exposure limit.

Liquidity

The NBS Decree No. 3/2000 on the liquidity of banks and branches of foreign banks lays down two limits – the monthly liquidity in a bank or a branch of a foreign bank must not fall below 0.9, and the ratio of the sum of fixed and non-liquid assets to a bank's own funds and reserves must not exceed 1.0.

Development of compliance with monthly liquidity limits has been improving throughout the year. The number of banks failing to meet the monthly liquidity limit (excluding Konsolidačná banka) was falling progressively to one at 31 December 2000. Eight banks have not complied with the limit for the ratio of the sum of fixed and non-liquid assets to a bank's own funds and reserves.

Open foreign exchange positions

The NBS Decree No. 5/2000 on limits on open foreign exchange positions in banks sets a limit of 10% of a bank's capital on positions in euro, British pound, U.S. dollar, Swiss franc and Czech crown, and a 5% limit on other foreign currencies, and the overall open foreign exchange position must not exceed 25% of a bank's capital.

Compliance with limits of open foreign exchange positions has improved; as at 31 December 2000, the overall open foreign exchange position limit was exceeded by two banks, selected currencies limits (EUR, GBP, USD, CHF, CZK) by four banks, and limits on other currencies by one bank.

A list of the NBS provisions in effect as to 30 June 2001:

- NBS Provision No. 3/1995 on rules of evaluating banks' claims and off-balance sheet liabilities according to the risks contained therein and of reserving funds in order to provide against those risks (Bulletin 4/1995);
- NBS Provision No. 2/2000 on capital adequacy of banks (Bulletin 4/2000);
  - NBS Provision No. 8/2001 which amends and augments the NBS Provision No. 2/2000 on capital adequacy of banks (Bulletin 16/2001);
  - NBS Provision No. 3/2000 on liquidity rules for banks and foreign banks' branches (Bulletin 4/2000);
  - NBS Provision No. 9/2001, which amends and augments the NBS Provision No. 3/2000 on liquidity rules for banks and foreign banks' branches (Bulletin 16/2001);
  - NBS Provision No. 7/2001 on rules for restricting bank property concentration towards other entities (Bulletin 16/2001);
- NBS Provision No. 5/2000 on limits for open foreign exchange positions of banks (Bulletin 4/2000)
- NBS Provision No. 1/2001 which amends and augments the NBS Provision No 5/2000 on limits for open foreign exchange positions of banks (Bulletin 1/2001)
- NBS Provision No. 3/2001 on information disclosure by banks and foreign banks' branches (Bulletin 3/2001)
- NBS Provision No. 10/2001 on data reporting by banks and foreign banks' branches (Bulletin 16/2001)

In line with the draft of the new Banking Act, a set of new NBS provisions is being prepared, which will come into effect after the above law becomes effective. Currently, there are considered seven NBS provisions, as follows:

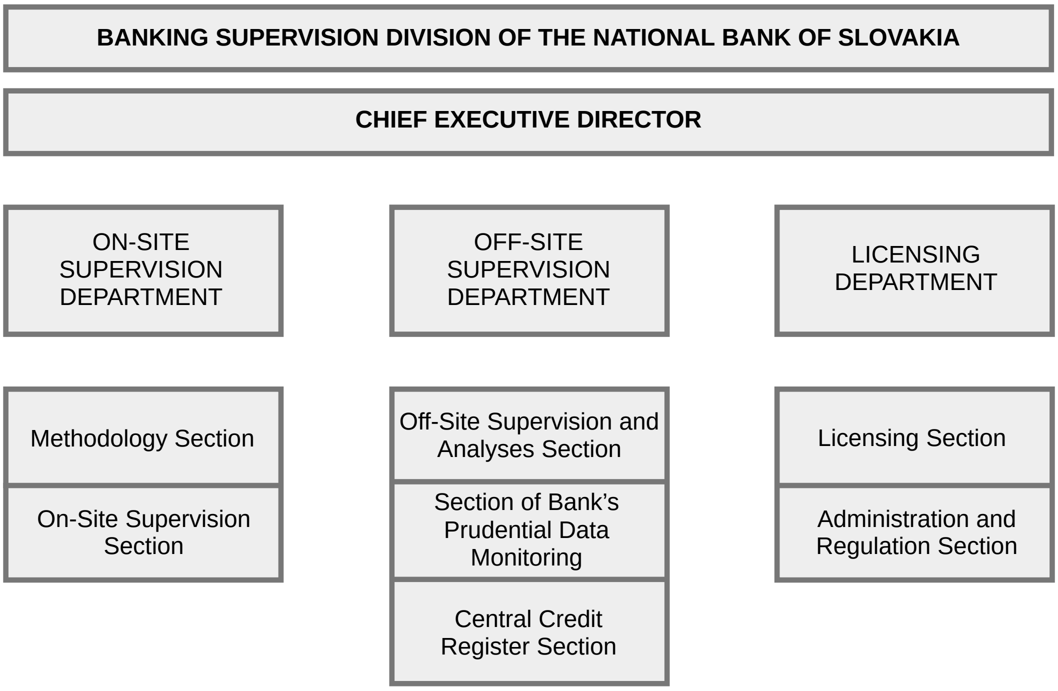
- Provision on own resources adequacy of banks; it will replace the currently effective provision on capital adequacy of banks and provision on limits for open foreign exchange positions of banks. The new provision will also take into account market risks;
- Provision on property exposure of banks; It will replace the current provision on the rules for restricting the bank property concentration towards other entities;
- Provision on liquidity of banks and foreign banks' branches; it will replace the current provision on liquidity rules for banks and foreign banks' branches;
- Provision on rules of prudential banking and safe operation of banks and foreign banks' branches; The section on the rules of safe operation for foreign exchange transactions has constituted a part of the provision on limits for open foreign exchange positions of banks. A new part - the rules of safe operation for other business activities of banks - will be introduced. The section on the rules of prudential banking has been a part of the provision on liquidity rules for banks and foreign banks' branches;
- Provision on scale and manner of disclosure of quarterly data and annual reports by banks and foreign banks' branches which operate in the territory of the Slovak Republic; It will replace the current provision on information disclosure by banks and foreign banks' branches, while complementing it with a new part on the manner of the annual report disclosure;
- Provision on property and liabilities classification, on evaluation of property and liabilities according to risks and anticipated losses, and on creation and dissolution of reserves; it will replace the current provision on the rules of evaluating banks' claims and off-balance sheet liabilities according to risks contained therein and of reserving funds in order to provide against those risks;
- Provision on reporting (incoherent with material measures); it will partially replace the current provision on data reporting by banks and foreign banks' branches.

On-Site Inspections

Banking supervision provided in the year 2000 four comprehensive on-site inspection (two in medium-size banks, one in falling - debt crises bank, one in problem bank) and three targeted on-site inspection.

ORGANIZATIONAL STRUCTURE OF THE BANKING SUPERVISION AUTHORITY

The construction of the banking supervision division was influenced by developments in legislation, in particular the most recent revision of Law 21/1992 Coll. on Banks as well as the gradual fulfilment of basic principles of banking supervision known as the Basle Core Principles.



STATISTICAL TABLES

Number of Financial Institutions (at year-ends)

Type of financial institution	1998	1999	2000
Banks	**25**	**23**	**21**
– Joint stock companies	21	19	16
– State financial institutions	2	2	2
– Building savings banks	2	2	3
Branches	**2**	**2**	**2**
Financial Institutions, total	**27**	**25**	**23**

Ownership Structure of Financial Institutions on the Basis of Registered Capital (%) (at year-end)

Item	Type of financial institution				Total
	Joint stock companies	State financial institutions	Building savings banks	Branches	
State ownership	45,0	5,9			50,9
Other domestic ownership	19,5		1,5		21,0
Domestic ownership total	64,5				71,9
Foreign ownership	15,9		3,3	8,9	28,1
Financial institutions, total	**80,4**	**5,9**	**4,8**	**8,9**	**100,0**

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

Item	1998	1999	2000	2000/1998
State ownership	27,8	53,0	50,9	1,8
Other domestic ownership	34,9	22,4	21,0	0,6
Domestic ownership total	**62,7**	**75,4**	**71,9**	1,2
Foreign ownership	**37,3**	**24,6**	**28,1**	0,8
Financial Institutions, total	**100,0**	**100,0**	**100,0**	

Proportion of Foreign Exchange Assets and Liabilities (%) (at year ends)

Type of the financial institutions	Foreign Exchange Assets / Total Assets				
	1996	**1997**	**1998**	**1999**	**2000**
Joint stock companies	31.50	41.40	46.03	34.96	18.00
State financial institutions	0.50	0.70	0.77	0.50	3.17
Building savings banks	0.70	0.40	0.41	0.35	0.35
Branches	40.60	47.70	44.63	27.02	36.74
Financial institutions, average	15.70	20.30	22.11	15.96	18.32

Type of the financial institutions	Foreign Exchange Liabilities / Total Liabilities				
	1996	**1997**	**1998**	**1999**	**2000**
Joint stock companies	31.70	38.60	43.96	32.54	16.02
State financial institutions	0.30	0.50	1.00	1.81	6.03
Building savings banks	0.00	0.00	0.02	0.00	0.03
Branches	44.80	50.00	49.57	31.64	32.12
Financial institutions, average	16.50	19.60	21.80	15.38	16.30

Income Statement - Revenues and Expenses

in th. SKK

Ratios	1996	1997	1998	1999	2000
Net interest income from interbank operations	-1 292 283	551 184	36 233	1 101 515	1 987 502
Net interest income from client operations	14 068 322	13 879 445	7 394 139	-1 366 606	2 139 301
Net interest spread	**12 776 039**	**14 430 629**	**7 430 372**	**- 265 091**	**4 126 803**
Income from FX operations	3 710 099	5 542 139	5 500 738	5 394 107	5 234 124
Income from securities operations	6 666 074	7 320 978	12 997 398	15 490 047	17 058 237
Income from banking operations (core activities)	**23 152 212**	**27 293 746**	**25 928 508**	**20 619 063**	**26 419 164**
Other operational income	2 769 390	3 032 599	5 503 243	1 556 322	2 544 706
Operational expenses	15 148 319	17 816 376	19 510 886	19 928 013	20 764 022
Income from current operations	**10 773 283**	**12 509 969**	**11 920 865**	**2 247 372**	**8 199 848**
Net expenses from provisions and reserves	9 938 781	10 730 585	12 076 481	26 166 948	-5 246 640
Net losses from irrecoverable debt	2 172 060	1 871 323	1 962 648	4 323 559	9 665 757
Extraordinary income	1 857 830	1 029 834	1 157 643	623 957	2 314 257
Extraordinary expenses	2 720 008	853 386	879 394	1 112 765	936 356
Net icome from extraordinary operations	**- 862 178**	**176 448**	**278 249**	**- 488 808**	**1 377 901**
Applicable income taxes	597 279	1 425 023	1 838 300	789 773	781 072
Net icome/loss	**-2 797 015**	**-1 340 514**	**-3 678 315**	**-29 521 716**	**4 377 560**

Structure of Registered Capital and Own Funds of financial institutions (at year-end)

Type of the financial institutions	Registered Capital	/Total Assets	Own Funds	/Total Liabilities
	in mil. USD	%	in mil. USD	%
Joint stock companies	916.09	5.62	1834.46	10.26
State financial institutions	66.62	15.72	187.69	44.29
Building savings banks	54.87	4.76	250.52	21.72
Branches	0.00	0.00	169.38	9.83
Financial institutions, total	**1037.57**	**5.81**	**2442.05**	**13.66**

SKK/USD = 47.389

Distribution of market shares in balance sheet total (%)

Type of the financial institutions	1996	1997	1998	1999	2000
Joint stock companies	81.02	82.08	65.07	79.96	81.54
State financial institutions	4.76	3.07	0.03	4.84	2.37
Building savings banks	3.48	4.50	33.87	6.65	6.45
Branches	10.74	10.35	1.03	8.55	9.64
Financial institutions, total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Development of off - balance sheet activities (%) (off-balance sheet liabilities / balance sheet total)

Type of the financial institutions	1996	1997	1998	1999	2000
Joint stock companies	46.49	51.49	58.32	53.84	56.71
State financial institutions	1.36	0.37	1.67	3.70	3.56
Building savings banks	0.00	0.67	2.23	3.42	3.75
Branches	5.68	5.97	8.45	5.43	3.88
Financial institutions, total	**53.53**	**58.50**	**70.66**	**66.39**	**67.89**

Risk Based Capital to Risk-Weight Assets (%)

Type of the financial institutions	1996	1997	1998	1999	2000
Joint stock companies	7,25	9,10	7.15	11.05	12.12
State financial institutions	23,55	22,43	25.39	21.44	34.80
Building savings banks	36,54	44,85	40.71	26.45	13.56
Branches	0	0	0.00	0.00	0.00
Financial institutions, average	7,73	10,03	8.70	12.63	12.48

The Structure of Assets and Liabilities of the banking system (at year-ends)

in mil. SKK

Assets	1996	1997	1998	1999	2000
Cash	12116	12828	12447	15024	13523
Deposits and credits with NBS	31213	40541	34349	43629	68567
of which minimum reserves requirements	28798	37564	32406	41428	37365
Deposits and credits with banks	149060	172099	182932	149234	163897
of which: current account	7301	6927	8218	7830	5659
term deposits	135657	160019	161771	124741	141693
granted credits	5048	5077	12555	15437	15676
T - bills	29255	41938	19764	15448	956
NBS - bills	15	0	0	0	0
Granted credits	321688	353793	361884	360695	339722
of which: to clients	314419	346147	353633	352341	331070
to state and municipal autorities	7269	7646	8251	8354	7728
Securities	84149	98711	86261	80059	136465
of which: bonds	78031	94347	80323	77922	133472
shares	5335	3921	3645	1527	1436
Bank participations (investments)	3511	3926	2998	2444	60660
Tangible and intangible assets	27930	30214	30527	30999	31361
Other assets	57659	22802	68831	72232	31804
Total assets	**716596**	**776852**	**799993**	**769764**	**846955**
Liabilities	**1996**	**1997**	**1998**	**1999**	**2000**
Resources from NBS	40224	51607	61527	40741	37401
Deposits and credits from banks	139798	160991	159932	113337	91556
of which: current account	5756	5701	3063	3281	3145
term deposits	101550	117104	110885	89999	68479
received credits	32491	38185	45984	20057	17570
Received deposits	407498	437567	453257	497096	596301
of which: from clients	367185	400435	421271	466797	563863
from state and municipal autorities	34407	31916	28018	23247	24229
deposit certificates	5906	5216	3968	7052	8209
Bond issue	11950	13141	11817	8516	6776
Reserves	27046	34914	39241	47171	21594
Reserve funds	13004	12399	13017	12878	12823
Capital funds	8707	7391	8679	8744	8919
Initial capital	23469	26963	30113	48242	49169
Retained profit	1711	-8959	-13511	-20250	-47761
Current year profit	2588	-1340	-3678	-29522	4378
Other liabilities	40601	42178	19009	17253	65799
Total liabilities	**716596**	**776852**	**796265**	**769764**	**846955**

Asset Portfolio Quality of the Banking System

in mil. SKK

Asset Classification	1996	1997	1998	1999	2000
Substandard	7760	7910	14319	13664	6880
Doubtfull	10371	9780	11843	13820	9015
Loss	92128	101514	118962	102194	72725
Classified Total	110259	119204	145123	129678	88620
Specific Reserves	56902	66342	70195	90462	70968

The Structure of Deposits and Loans (%) (at year-end)

	Deposits	Loans
Households	63.1%	14.3%
Government sector	11.7%	2.0%
Business sphere	24.1%	83.2%
Foreign	0.5%	0.4%
Other	0.5%	0.04%
Total	**100.0%**	**100.0%**

The Structure of Deposits and Loans (%) (at year-end)

Maturity of depostis		Maturity of loans	
At sight	53	Long term loans	27
Within one year	30	Medium-term loans	38
Over one year	16	Short-term loans	35
Total	**100**	**Total**	**100**

2000 DEVELOPMENTS IN THE SLOVENIAN BANKING SECTOR

BANKA SLOVENIJE

MACROECONOMIC ENVIRONMENT

Economic activity in the international environment has been slowing down. According to the estimate made by the International Monetary Fund in May 2001, global economic growth is expected to reach 3.2%, while economic growth in the EU is expected to be 2.4%.

Following trends in the international environment, the dynamics of economic growth in Slovenia has been going down. Last year's growth of real gross domestic product averaged 4.6% despite a considerable drop in the last quarter of 2000. Mainly driven by exports, first-quarter growth in 2001 decreased to 3.1%. Only government consumption has slightly exceeded other components of domestic consumption although it has been below GDP growth rate. Household spending has been rather flat despite a relatively fast rise in wages and salaries, while investments have actually taken a downward turn. Although foreign demand has slackened, the growth of exports has remained rather high.

Inflation has been below 10% over the past year. High growth in consumer prices during this period has been fuelled mostly by exogenous factors and a rise in government-regulated prices. Exogenous factors pushing up domestic prices have been primarily oil price hike in world markets, accelerated inflation abroad and a high exchange rate of the US dollar against the euro.

The current account of the balance of payments has been improving and during the first five months of 2001 a slight deficit was posted. Exporters have managed to make up for weaker demand from the EU Member States by exporting to the markets of former Yugoslavia and the former Soviet Union. Due to low domestic consumption, growth in imports has been equally modest.

In spite of high financial inflows on the account of foreign direct investment, the rise in foreign exchange rate has been relatively stable. These foreign exchange inflows have been the main reason for accelerated growth of broad money.

During the first half of the year, monetary policy was moderately restrictive. The Bank of Slovenia purchased excess supply of foreign exchange arising from inward capital flows and sterilised it by issuing bills denominated in tolars.

DEVELOPMENT OF THE BANKING SYSTEM

The figures illustrating the performance of the Slovenian banking system in 2000 and in the first half of 2001 reveal adequate soundness and stability of the banking system. In 2000, some positive trends were recognised. Stability and confidence in the banking sector may best be seen through a rise in long-term deposits placed by clients and this figure has grown more vigorously in the group of long-terms deposits than in any other segment.

During the period under review, the structure of the banking system and the number of banks operating in Slovenia remained unchanged. Although the ratification of the Europe Agreement between the Republic of Slovenia and the European Union and the promulgation of the Banking Act have opened up the domestic banking environment, the number of foreign banking institutions has not increased. Despite expectations, the process of consolidation of the banking system has not gained momentum and its full blast is likely to reach us in the second half of 2001 and in 2002 when mergers and acquisitions should pick up pace judging by the intensity of the activities already launched in this direction. The concentration of banks remains unchanged, and the share of the leading seven banks continues to be 73%. The first phase of the bank privatisation has already started, but the first and the second largest bank of the system are still controlled by the state. Considering the pace of activities carried out by the government, it is to be expected that privatisation-related activities will gain full momentum over the next business year.

Nominal growth in total assets posted by the banks in 2000 totalled 18.8%. When inflation is taken into account, real growth notched 9.1% - a considerably higher growth rate in comparison to 1999. Furthermore, growth achieved in the banking sector outpaced growth rates of other sectors of the national economy. The share of aggregate assets of the banking sector in GDP at the end of 2000 was approximately 81%.

Inflationary movements were unfavourable throughout 2000 and in the first half of 2001 mainly as the result of a sharp rise in prices of crude oil in international markets and the soaring exchange rate for the US dollar. In 2000 and the first half of 2001, the inflation rate varied between 8 and 10% causing also a rise in the base interest rate and spilling over to lending and deposit interest rates. A hike in interest rates and a higher 'inflation' profit also pushed up interest margin, which after becoming thinner for three-years (from 4.9% in 1997 to 4.0% in 1999) took an upward turn and hit 4.5% in 2000. At the end of June 2001, interest margin fell again and landed at 4.1%. Since operating costs, which accounted for 3.4% of average total assets, remained unchanged in comparison to the previous year, the banking system generated a record high 69.8 billion tolars in net income (after two years of falling in real terms, it jumped by 50% year-on-year). High net income enabled making additional provisions against potential losses. Thus the banking sector in 2000 earmarked a hefty amount of 37.2 billion tolars for additional net provisions or by 10.8 billion tolars more than in 1999. Setting aside funds for additional provisions is undoubtedly a positive sign that the banks are fully aware of the risks they are exposed to in the normal course of business, even though the corporate (real) sector enjoyed good results in 2000. The Bank of Slovenia played an important role in the processes of making the banking institutions wary of the fact that the bulk of problematic lending dates back to the periods of prosperity. A large chunk of assets allocated to additional provisions did not prevent the banking system from generating 32.6 billion tolars in profit and a sound 1.1% return on average assets i.e. 11.3% return on average equity.

Capital adequacy of banks continued decreased during the period under review, but the decline was below the figures posted over the past six years. Capital adequacy ratio was 13.5% at the end of the year (in 1999: 14.0% and in 1998: 16.0%) and still remains well above minimum regulatory requirement set at 8%.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS

Several supervisory authorities are responsible for individual segments of the financial system in Slovenia.

The Bank of Slovenia (the central bank) derives authority and responsibility to supervise credit institutions from the 1991 Law on the Bank of Slovenia and the 1999 Banking Act.

The responsibility for the implementation and enforcement of the Bank of Slovenia's supervisory function is conferred upon the Banking Supervision Department.

The Securities Market Agency is a self-governing and independent legal entity with full power to supervise stock-broking companies, management companies, investment funds, as well as some other institutions.

The Insurance Supervisory Agency became operational on 1 June 2000 as a self-governing and independent legal entity whose responsibility is the supervision of insurance companies, reinsurance companies, companies and agents who engage in insurance-related activities, as well as some other institutions (insurance operations carried out by the Slovene Export Corporation, Nuclear Pool, Institute for Health Insurance – Voluntary Health Insurance Unit, and Pension Investment Fund. Prior to the establishment of the Insurance Supervisory Agency, the above-mentioned institutions were under the scrutiny of the Insurance Supervision Authority of the Republic of Slovenia operating within the framework of the Ministry of Finance.

According to the Strategic Plan of the Banking Supervision Department 2000 – 2003, the banking supervision will be carried out by the central bank - the Bank of Slovenia.

The Bank of Slovenia is an independent, autonomous institution that has the necessary financial resources in order to carry out its tasks and exercise its powers in the sphere of banking supervision.

A legal framework enabling the Bank of Slovenia supervision of the banks' compliance with the risk management rules and the adoption of measures in the event of violation of such rules is in place.

Legal protection of supervisors is based on the general principles of compensation law. However, the Bank of Slovenia has no additional security measures to protect its activities in the event of the defence thereof. By taking into consideration the legal practice and the rule of the law in the country, no additional security measures are necessary.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2000

The ongoing supervision and surveillance of credit institutions is conducted by means of reports submitted by banking institutions on a regular basis to analysts who verify the data, as well as by performing on-site examinations. In other words, the supervisory process is conceived upon the so-called four-eye principle where analysts and examiners share responsibility for monitoring operations of individual banks and savings banks.

The role of the analysts working at the Banking Supervision Department is to deal with many facets of the Department's responsibility. They participate in the evaluation of operating results posted by banks and savings banks, they put forward propositions with regard to granting or modifying authorisations for operations of credit institutions, they also assess proposals of new system solutions and advise in relation to the implementation of rules and standards for safe and sound banking operations. In addition, the analysts monitor compliance with limits for safe and sound business, and they take care that efficiency of operations is monitored in a continuing basis by screening statutory returns and other data at least once a month. Furthermore, they participate in preparations for on-site examinations in banks and savings banks and discuss supervisory issues with directors and senior officers of banking as well as other financial institutions, and they prepare reports, proposals, analyses and other papers for the bodies of the Bank of Slovenia. In the case where findings reveal that a respective bank or a savings bank does not operate in compliance with laws and regulations, the responsible analyst notifies immediately the examiners and the management of the Banking Supervision Department of the irregularity, and a decision is taken whether an on-site examination of that bank, i.e. savings bank would be appropriate.

When a case of non-compliance has been confirmed in the respective bank, i.e. savings bank, the analyst and the examiner(s) sit down to discuss appropriate remedial measures and continue to watch the delinquent bank, i.e. savings bank in order to make sure that the corrective measure is duly implemented.

The Strategic Plan drawn up by the Banking Supervision Department for the period from 2000 to 2003 sets that the number of full-scope examinations in the bracket between seven and nine inspections a year, while targeted examinations of particular segments of banking operations conducted by banks and savings banks are to increase to thirty a year. Within this blueprint plan, a certain bank or a savings bank could be examined several times a year as it has been practised so far. Each bank or a savings bank should be examined once a year even if that means a targeted examination only. The decision as to which operating areas should be examined is made by taking into account a number of factors, but the assessment of risks associated with information technology will certainly be high on the list of operating segments to be screened. Through targeted examinations, i.e. by screening a particular business area, it is possible to conduct in-depth examination of those business segments where there is a higher than usual degree of inherent risk or where the Bank of Slovenia does not have adequate information.

Since credit risk is seen as the most serious threat to Slovenian banks and savings banks, the focus of examinations is on appropriate classification of on-balance sheet assets and off-balance sheet items. Particular attention is being paid to consolidated supervision - examination of a bank and all persons connected with it. The examiners of the Bank of Slovenia sift through financial statements of the connected persons, the bank's policy (current and future) regarding connected persons, the quality of its assets - investments, its management and relations with the bank, as well as risks arising from business operations. Furthermore, the examiners check among other things whether the allocated provisions and value adjustments made for the exposure of the bank to the connected persons arising from lending and equity investments are adequate.

In 2000, the examiners of the Bank of Slovenia carried out 28 full-scope examinations in banks and savings banks, and took under scrutiny either the full range of operations (6 examinations carried out in four banks and two savings banks) or screened one or more business areas (23 examinations in 13 banks and in two savings banks). The examiners of the Banking Supervision Department together with colleagues from other departments of the Bank of Slovenia also participated in supervisory visitations aimed at verifying compliance with the criteria laid down for the migration of payment operations into the banking environment.

During the first half of 2001, full-scope on-site examinations were performed in five banks and one savings bank. In addition, the examiners of the Banking Supervision Department conducted 24 targeted examinations of banks, savings banks, savings and loan undertakings and other companies. As many as 18 examinations were conducted in banks.

Regular annual meetings are organised with directors and senior officers of banks and savings banks either at the end of a full-scope examination or on an *ad* *hoc* basis. The purpose of such meetings is primarily to evaluate operating results and the state of affairs of the respective banking institutions, along with getting insight into its development strategy. By exchanging views and information, both supervisors and directors of banks and savings banks will benefit from timely and appropriate behaviour should a bank or a savings banks be faced with difficulties in the course of business.

In accordance with the Banking Act, the Bank of Slovenia has a mandate to oversee operations carried on by legal entities connected with a bank, should that result as necessary for the purpose of supervision of the respective bank's operations. In 2000, the examiners of the Bank of Slovenia conducted the examinations of the connected persons independently, while the examinations of three banks and stock-broking companies were a joint operation of the examiners of the Securities Market Agency and the central bank staff. In the first half of 2001, the examiners of the Bank of Slovenia were on their own when carrying out targeted examinations of operations of four banks, including the screening of operations of selected companies wholly owned by the four parent banks.

In line with the mandate to the Bank of Slovenia to supervise those undertakings reasonably suspected of carrying on banking services without authorisation of the Bank of Slovenia, its examiners conducted in 2000 five on-site examination of the companies not registered as banks in co-operation with the former Ministry of Economic Affairs, i.e. with the Market Inspectorate General of the Republic of Slovenia. In the first half of 2001, two such examinations were performed.

In addition to the exchange of opinions and sharing data with other supervisory authorities, co-operation also continued with banking supervisors at the international level.

In 2000, in accordance with the Memorandum of Understanding the first on-site examination of the subsidiary of the largest Slovenian bank in the U.S.A. was performed by a supervisory team composed of the examiners of the Bank of Slovenia and their colleagues from the State of New York Banking Department and Federal Deposit Insurance Corporation. Although a formal memorandum of understanding has not been signed with Banca d'Italia, as early as in 1998 the on-site examination of the branch of the largest Slovenian bank in Italy was agreed and performed.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

See enclosure.

The Banking Supervision Department was established at the beginning of July 1992 within the framework of the Bank of Slovenia. The Department comprises three separate units:

- Licensing
- Off-site supervision of banking operations
- On-site supervision of banking operations

The nucleus of the Banking Supervision Department was a 17-strong staff that increased by the end of June 2001 to 46 people. The breakdown of the headcount at end-June 2001 shows that there were 8 people in the executive and administrative section, 16 employees were working in the off-site supervision section, 19 people were engaged in on-site examinations, and 3 employees handled licensing issues.

BANKA SLOVENIJE

INTERNATIONAL ACTIVITIES OF THE BANK OF SLOVENIA

Globalisation of financial activities calls for closer co-operation with foreign supervisory institutions; hence during the period under review, in addition to the Memorandum of Understanding signed with the State of New York Banking Department, a Memorandum of Understanding was concluded with Austria's Federal Ministry of Finance (Bundesministerium für Finanzen), Germany's Bundesaufsichtsamt and the National Bank of Macedonia. There are activities under way to conclude a formal statement of co-operation with Bosnian, French and Italian supervisory authorities.

COOPERATION WITH OTHER SUPERVISORY BODIES IN SLOVENIA

In line with the Banking Act, the Code of Practice for the Co-operation between Supervisory Authorities was adopted in 1999. Prior to the effectiveness of the Code of Practice, terms of co-operation between the Bank of Slovenia and other supervisory authorities were detailed in protocols. The Code of Practice articulates the scope and method of co-operation among the Bank of Slovenia, the Securities Market Agency and the Insurance Supervisory Agency. This co-operation covers the following areas:

- strategic development issues, annual planning of joint actions to be endorsed by the steering committee and monitoring the implementation of the Memoranda of Understanding, signed by domestic supervisory authorities,
- sharing information necessary in the course of supervision of financial institutions with other supervisory authorities,
- exchange of information necessary in the process of granting authorisations,
- exchange of information on facts and events in relation to connected persons and which may have an impact on financial position or operations of the entity, which is being examined by another supervisory authority,
- dissemination of information necessary in the course decision-making with regard to other individual issues,
- organisation of joint examinations,
- sharing information on irregularities, which a supervisory authority finds out in the course of the examination, provided such findings are important for the work of other supervisory authorities,
- other joint activities, which contribute to the harmonised supervision, boost effectiveness of supervisory authorities and enhance effectiveness of the financial market.

In line with the aforementioned Code of Practice, a steering committee was set up. The steering committee consists of Minister of Finance, the Governor of the Bank of Slovenia, the President of the Council of Experts of the Securities Market Agency and the President of the Council of Experts of the Insurance Supervisory Agency.

The Code of Practice provides a formal basis for signing Memoranda of Understanding. The Bank of Slovenia has already signed Memoranda of Understanding with the Securities Market Agency and the Insurance Supervisory Agency. A liaison group is responsible for the implementation of Memoranda of Understanding signed by supervisory authorities and tasks adopted by the steering committee. The liaison group meets at least every three months. The liaison group is composed of the Deputy Governor of the Bank of Slovenia, i.e. director of the Banking Supervision Department of the Bank of Slovenia, director of the Securities Market Agency, and director of the Insurance Supervision Agency.

The co-operation with supervisory authorities has been going on smoothly in line with Memoranda of Understanding in the form of regular exchange of information and data and dissemination of designated information upon the request of other supervisory authority. As a precondition for the exchange of information under the Banking Act, supervisors have the obligation of professional secrecy and shall honour confidentiality of information. Supervisory authorities have responsibility to inform other supervisory authority on irregularities detected, which fall within the framework of its jurisdiction. Supervisory authorities co-operate also in joint examinations.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2000 AND 2001

The focus on the high standard of banking supervision in 2000 and 2001 took the centre stage of the activities carried on at the Banking Supervision Department, *viz.*:

- Consistent implementation of the recommendations arising from the FSAP report,
- Raising the degree of compliance with the Core Principles for Effective Banking Supervision,
- Keeping abreast with international developments in the area of banking supervision and its implementation in the domestic banking practice,
- Professional training of participants in financial markets with focus on the significance of financial stability and oversight of banking operations,
- Enhancing supervision of financial institutions connected to banks in the country and abroad,
- Evaluating corporate governance for the entire banking group,
- Continuing to upgrade supervisory practices in relation to market risks,
- Implementing ‘stress’ tests throughout the country’s banking system,
- Paying more attention to oversight of electronic banking,
- Putting more weight on management and control of all kinds of banking risks, including operational risk and effective internal controls systems within the framework of on-site examinations,
- Organising professional training for people working in or connected with the banking sector,
- Continuing to build co-operation with other domestic supervisors,
- Signing a statement of co-operation or a memorandum of understanding with supervisory authorities of those foreign countries where there is mutual interest for co-operations,
- Monitoring the progress of alignment of savings and loan undertakings with the provisions of the Banking Act,

- Continuing with a pro-active human-resources policy in accordance with the strategic orientation endorsed by the Banking Supervision Department, and
- Hosting a seminar or a workshop on risk management.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN 2000 AND 2001

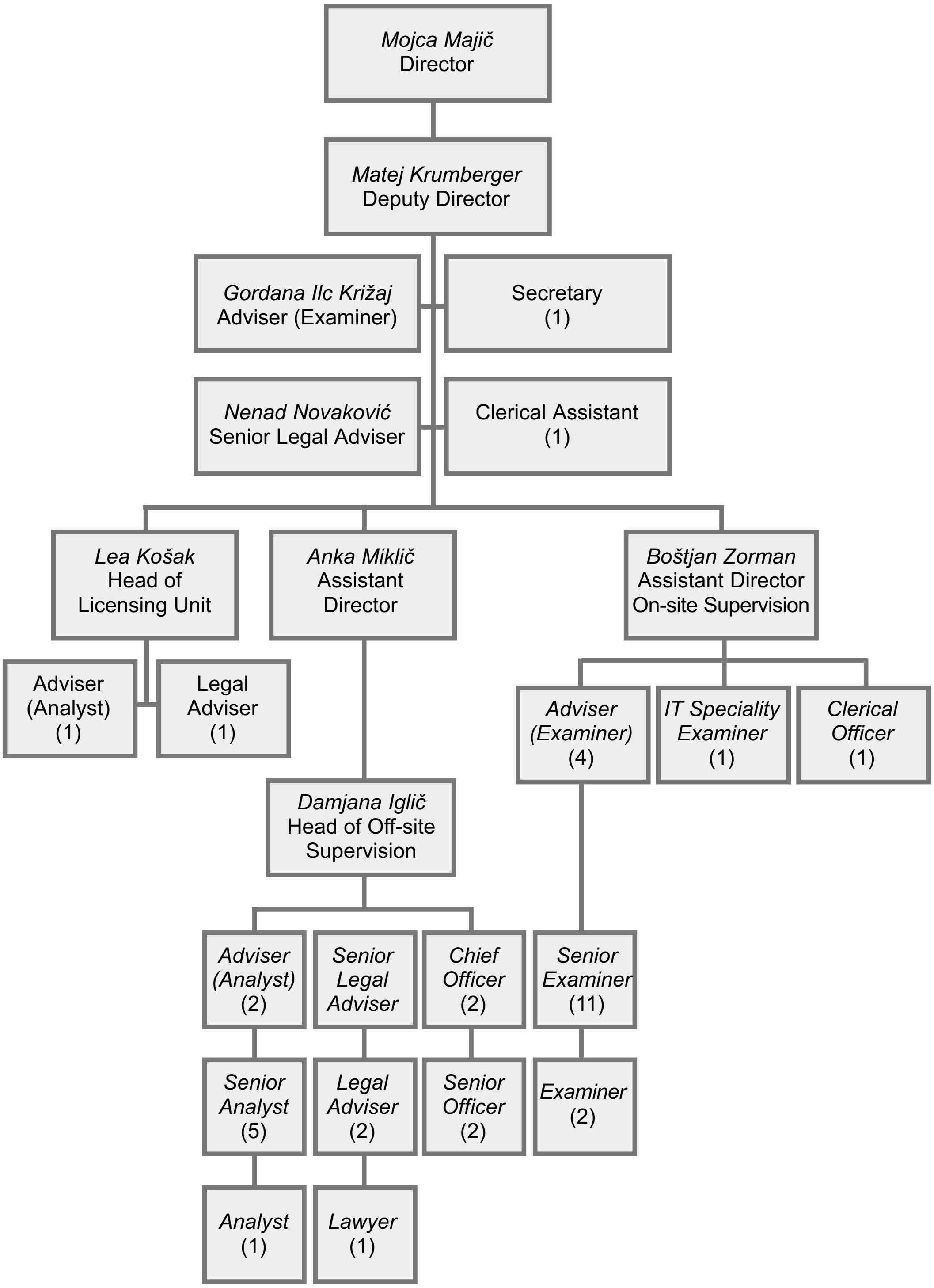
Slovenia was assessed in November 2000 under the Financial Sector Assessment Program (FSAP) jointly conducted by the International Monetary Fund and the World Bank. We wish to refer here to the main findings under the FSAP, which concludes that the Slovenian banking sector has developed into a sound and safe system endowed with adequate capital, and apparently robust to a range of external shocks and does not create significant macroeconomic risk. The findings that Slovenia is compliant or largely compliant with the majority of the Core Principles have grossly confirmed the findings of the self-assessment made already in 1999. Observance of the Core Principles, i.e. addressing the business areas where the degree of compliance is assessed as partial, are regarded as a priority task and the line for development in near future. At the same time, the FSAP team also revealed certain weaknesses of banking supervision and the banking system, primarily in relation to relatively high exposure to connected persons, consolidated supervision, and market risks. The recommendations arising from the FSAP assessment have fallen on the fertile ground resulting in additional time-bound actions being launched at the Bank of Slovenia. Thus the larger part of the recommendations made are already in place. Full implementation and compliance with the Core Principles is expected to be achieved by the end of 2002.

The members of the FSAP team warned among other things against certain weaknesses of the Banking Act; hence the Bank of Slovenia has also included in its existing action plan a motion to amend the Banking Act. A task force responsible for the preparation of modifications and/or amendments to the Banking Act was formed in the Bank of Slovenia. The task force drafted a bill within a short period of time and also included other modifications and amendments not pointed out by the FSAP team but essential in the opinion of the Bank of Slovenia professional services, since they would also address some weaknesses, which have come up during the short time the Banking Act is in force.

The law amending the 1999 Banking Act entered into force in August 2001.

BANKA SLOVENIJE

Organisational structure of the banking supervision deparment
as at 31 December 2000



BANKA SLOVENIJE

STATISTICAL TABLES

Number of Credit Institutions*
(at year-ends)

Type of credit institution	1997	1998	1999	2000
Banks (operating banks)	28	24	25	25
Savings banks	6	6	6	3
Savings and loan undertakings	70	70	68	64
Credit institutions, supervised by the Bank of Slovenia	**34**	**30**	**31**	**28**

** The amount of initial capital for banks is set at SIT 1.1 billion (approximately EUR 5 million), the amount of initial capital for savings banks and savings and loan undertakings is set at SIT 220 million (approximately EUR 1 million).*

Ownership Structure of Banks on the Basis of Shareholders' Equity (%)
(at year-ends)

Item	1997	1998	1999	2000
State ownership[1]	34.1	39.2	41.4	36.8
Other domestic ownership	54.1	49.6	47.3	51.2
Domestic ownership total	88.2	88.8	88.7	88.0
Foreign ownership	11.8	11.2	11.3	12.0
Banks, total	**100.0**	**100.0**	**100.0**	**100.0**

Distribution of Market Shares in Balance Sheet Total (%)

Type of credit institution	1997	1998	1999	2000
Banks	98.0	97.8	97.9	97.8
Savings banks	0.4	0.4	0.4	0.4
Savings and loan undertakings	1.6	1.8	1.7	1.8
Credit institutions, total	**100.0**	**100.0**	**100.0**	**100.0**

The Structure of Assets and Liabilities of the Banking System (%)
(at year-end)

Assets	1997	1998	1999	2000
Cash and balances with CB	3.7	3.6	3.3	3.1
Loans to banks	10.6	9.7	9.4	11.4
Loans to customers	42.7	47.2	51.7	51.3
Securities	34.1	30.4	26.4	24.8
Other assets	9.0	9.2	9.3	9.4
Liabilities	**1997**	**1998**	**1999**	**2000**
Deposits from banks	10.1	9.5	11.5	12.5
Deposits from customers	69.8	71.0	69.2	67.6
Liabilities from securities	2.6	2.5	1.7	2.2
Capital and subordinated liabilities	11.3	10.9	11.4	11.1
Other liabilities	6.2	6.2	6.3	6.6

Development of Off-balance Sheet Activities (%) (off balance sheet items / balance sheet total)

Type of credit institution	1997	1998	1999	2000
Banks	18.9	21.4	21.2	22.0
Savings banks	0.5	1.0	0.8	0.3

Solvency Ratio of Credit Institutions

Type of Credit Institution	1997	1998	1999	2000
Banks, average	19.0	16.0	14.0	13.5
Savings banks, average	14.5	13.4	14.4	11.3

Asset Portfolio Quality of the Banking System

in millions of Tolars

Asset Classification	1997	1998	1999	2000
- A	2,067,463	2,442,371	2,751,937	3,264,438
- B	100,241	137,094	196,315	277,864
- C	53,040	56,335	63,123	77,144
- D	40,352	50,155	46,511	58,682
- E	32,885	41,023	51,794	58,352
Classified Total	**2,293,981**	**2,726,978**	**3,109,680**	**3,736,480**
Specific Provisions	**91,285**	**104,885**	**136,835**	**167,654**

The Structure of Deposits and Loans (%) (at year-end)

	Deposits	Loans
Households	60.0	29.6
Government sector	7.9	9.2
Corporate	20.5	57.4
Foreign	2.7	1.0
Other	8.9	2.8
Total	**100.0**	**100.0**

The Structure of Deposits and Loans (%) (at year-end)

Maturity of Deposits		Loans	
At sight	33.6	Long term loans	42.1
Within one year	57.6	Medium-term loans	
Over one year	8.8	Short-term loans	57.9
Total	**100.0**	**Total**	**100.0**

BANKA SLOVENIJE

Proportion of Foreign Exchange Assets and Liabilities (at year-ends)

Type of Credit Institution	FOREX Assets / Total Assets			FOREX Liabilities / Total Liab.		
	1998	**1999**	**2000**	**1998**	**1999**	**2000**
Banks	29.7	30.2	32.8	30.6	31.2	34.1
Savings banks	0.2	0.1	0.2	0.0	0.0	0.0

Structure of Revenues and Expenditures of Banks and Savings Banks

in millions of Tolars

	Banks	Savings Banks
Net interest income	123,298	420
Net fees and commissions	37,858	331
Net financial operations	13,355	3
Net other	-4,666	-67
Gross income	**169,845**	**687**
Operating expenses	100,041	466
- labour costs	49,085	210
Net income	**69,804**	**220**
Net provisions and write-offs	-37,233	-63
Profit before taxation	**32,571**	**157**

Structure of Registered Capital and Own Funds of Credit Institutions

Type of the Credit Institution	Registered Capital	/Total assets	Own Funds	/Total Liab.
	USD	**%**	**USD**	**%**
Banks	326,8	2.3	1,142,3	8.1
Savings banks	3,4	6.4	5,1	9.4

2000 DEVELOPMENTS IN THE UKRAINEN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT IN UKRAINE

The year 2000 has become a turning point in the economic dynamics of Ukraine. After the long-term depression, a marked growth has been achieved in macroeconomic and industrial indicators in the development of the national economy.

In 2000, the country managed to overcome the negative tendency for the reduction of the gross domestic product (GDP). The 6% growth of real GDP is a result of the revival in economic development owing to the effective use of favourable external conditions by Ukrainian exporters and the increase in domestic demand for products of domestic industry.

In 2000, the industrial production rose by 13%. During the whole year, the positive trend to monthly growth of the industrial production as compared with the respective period of the previous year was observed.

In 2000, the amount of cash settlements between the enterprises increased, while barter operations decreased. The positive dynamics of barter decrease and the growth of receipts from production took place in all basic industries.

During 2000, the volumes of fixed capital investments tended to further develop. As compared with the previous year, construction investments rose by 11%. The growth of investment activity was marked in the majority of Ukraine's regions.

Over two thirds of fixed capital investments were made at the expense of own funds of enterprises and they were made into the industrial construction.

The balance of payments position of Ukraine was rather stable during 2000. Restructuring of Ukrainian debts to the private T-bill holders, which was arranged by the Ministry of Finance in April, has averted the expected default. Since that period, the exchange rate remained stable amounting to about 5.4 hryvnia per US dollar. This situation was achieved despite of the less than expected funds from the IMF and other foreign creditors, and with all those processes going on, the National Bank of Ukraine has essentially enlarged its gross foreign exchange reserves. The current account surplus tripled and amounted to 8% of GDP in 2000.

The system of government finance management has been improved, in particular, the state budget expenditures.

The financial system rehabilitation was favoured by a considerable reduction of the offset transactions and bill payments to the budget. This beneficially affected the increase in cash earnings.

In 2000, Ukraine made an important progress towards the gradual reduction of the state debt as it was anticipated by the economic and social development strategy for 2000-2004. The share of total state debt within GDP fell from 63% to 50%, and it is not crucial currently. Such results were achieved owing to the constructive policy of the National Bank of Ukraine and the successful restructuring of external debts to the private creditors made at the beginning of 2000.

In 2000, the total nominal money income of individuals grew by 40% as compared with the previous year. Real money income of households, excluding mandatory payments and voluntary contributions and taking into account the inflation influence, grew by 6%.

A notable event has become the acknowledgement of Ukraine by the European Union as a market economy country.

Therefore, an essential potential has been formed for the Ukrainian economy growth which under conditions of adequate economic policy and stable economic situation can ensure tangible improvement both in the general development of the economy and in the welfare of people.

DEVELOPMENT OF THE BANKING SYSTEM

As of 1 January 2001, the State Bank Register numbered 195 banks, including 31 banks with foreign capital participation, 7 of them with 100% foreign capital.

In 2000 the characteristic feature of the banking system of Ukraine was the growth of commercial banks' capital. During the year, its total amount rose by 10.5 per cent. The capital increase primarily resulted from the replenishment of the authorized capital.

In 2000, the total authorized capital paid in by commercial banks of Ukraine grew by 26 per cent.

The tendency towards increase in the average authorized capital paid per one operating bank has preserved and in 2000, its amount rose by 34 per cent.

The number of banks with regulatory capital of over 5 million euros has more than doubled.

The total liabilities within the system of banks rose by 53 per cent in 2000. A major share of bank liabilities is formed by funds of the economic entities, which grew by 51 per cent on a whole.

The deposits of individuals appear to be one of the main sources for establishing the resource base of commercial banks. During 2000, the balances of current and deposit accounts of individuals grew almost by 54 per cent. More than half of deposits of individuals are made in the domestic currency. On the one hand, it is an evidence of rather active bank policy on attracting funds of individuals aimed at the establishment of the bank resource base; on the other hand, it testifies to the increase of people confidence in the banking system of Ukraine.

Balanced growth of commercial bank assets and improvement of their quality is one of the necessary conditions for stable operation of the banking system and its positive influence on the development of the Ukraine economy.

During 2000, the total assets within commercial bank system rose by 43 per cent, primarily, owing to the credit activity.

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

Legal Competence of Banking Supervisory Authorities in Ukraine

The Laws of Ukraine "On the National Bank of Ukraine" and "On Banks and Banking Activities" provide the legal basis for banking activity in Ukraine.

According to these Laws, the National Bank of Ukraine exercises banking regulation and supervision of the bank activities in the form of administrative and indicative regulation.

Supervisory authorities of the National Bank are extended to the banks as well as to the persons related to their activity and affiliated and associated persons of these banks on the territory of Ukraine and abroad.

The main objective of banking regulation and supervision is to promote a stable development of the banking system, to protect interests of depositors and creditors related to the safe keeping of the clients' funds on the bank accounts.

The National Bank of Ukraine exercises a permanent supervision of the compliance of banks with the banking legislation, regulations of the National Bank of Ukraine, mandatory reserve ratios, economic ratios, established ratios of provisions to cover risks for active banking operations.

Should the banks violate the banking legislation, regulations of the National Bank of Ukraine, effect high-risk transactions endangering their solvency and interests of depositors and creditors, the National Bank has the right to apply enforcement actions to a violating bank.

To organize the banking regulation and supervision, the National Bank of Ukraine issues normative acts and regulations on the matters within its competence.

In 2000 the Banking Supervision Service of the National Bank of Ukraine, executing the functions of banking regulation and supervision, was guided by the following normative acts and regulations:

- Regulations on the Procedure for the Commercial Banks Establishment and Registration;
- Procedure for Granting Licences to Perform Banking Operations;
- Instructions on the Order of Regulation and Analysis of Commercial Bank Activities;
- Regulations on the Procedure for Formation and Use of Reserves to Cover Possible Losses on Credit Operations of Commercial Banks;
- Regulations on the Procedure for Calculating Reserves to Cover Possible Losses on the Commercial Bank Operations with Securities;
- Regulations on the Procedure for Formation and Use of Reserves to Cover Possible Losses on Commercial Bank Receivables;
- Regulations on Enforcement Actions Applied by the National Bank of Ukraine to Commercial Banks and Other Financial and Credit Institutions for Violation of Banking Legislation;
- Methodical Instructions on Bank Inspection in Ukraine;
- Regulations on the Order and Use of Complex Rating Estimation of Commercial Banks' Activities According to the CAMEL System;
- Methodological Instructions on the Procedure for Reorganization and Registration of Commercial Banks;
- Methodology for Temporary Administration and Liquidation of Commercial Banks.

In 2000, the new Law of Ukraine "On Banks and Banking Activities" was adopted. According to its final provisions, the National Bank is to ensure its realization within six months. To fulfil this, it is necessary:

- to prepare proposals to put the laws of Ukraine in compliance with the Law "On Banks and Banking Activities";

- to adjust the NBU normative acts and regulations with this Law;
- to adopt a range of regulations necessary for this Law implementation.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITIES LAST YEAR

The banking system of Ukraine has entered a new period of its development, the main task of which is to strengthen and raise its role in economic transformation processes. Proceeding from this, the main task of banking regulation and supervision, performed by the National Bank of Ukraine under the current legislation, is safety and financial stability of the banking system of Ukraine, protection of interests of investors and creditors.

The tasks and functions of the banking supervision of the National Bank of Ukraine are determined by the tasks and functions of the National Bank of Ukraine related to pursuing a single state policy of money circulation, crediting, monetary unit strengthening, organizing the interbank settlements and coordinating the banking system activities as a whole.

The banking supervision of the National Bank of Ukraine fulfils the above tasks by performing control and supervisory functions over the banks' compliance with Ukraine's current legislation, normative acts and regulations of the National Bank of Ukraine and by ensuring the banks' functioning on the principles of safety and stability of their activities.

In the year 2000, the banking supervisory service worked on implementing the Core Principles for Effective Banking Supervision developed by the Basel Committee on Banking Supervision, in particular some standard documents were developed which laid the methodological foundation for the banks' activities regulation.

One of the directions in the activities of the NBU banking supervisory service in 2000 was registration of banks and banking institutions, granting or extending licences for banks to perform banking operations; control of banks' compliance with licence requirements, in particular related to capital accumulation. Over 2000, one commercial bank was registered in Ukraine, whereas nine banks were expelled from the State Register.

Due to the National Bank of Ukraine's tight policy related to commercial banks' capital accumulation, the number of banks whose capital exceeds 5 million euros increased two times and the number of banks whose standard capital reaches 3 million euros decreased four times.

The banking supervisory service of the National Bank of Ukraine carried out permanent monitoring of banks' financial standing; on the basis of the reports daily and monthly it controlled the banks' compliance with economic ratios (the economic ratio system was improved simultaneously).

While supervising the banks' activities, the National Bank of Ukraine implemented the System of Evaluation Coefficients of early warning on the basis of which early warning coefficients were monthly calculated and analysed, tendencies for each bank financial state were monitored, problems in these banks' activities were revealed at early stages in order to prevent losing their liquidity and solvency. That information was used for planning inspections and adequate response, as well as for taking measures for banks' financial standing improvement.

The National Bank of Ukraine continuously paid attention to the quality of banks' assets and the state of their respective provisions.

In particular, the work on improving the estimation procedure of the banks' assets quality and limiting the active operation risks was steadily carried out. The

National Bank of Ukraine developed and implemented the mechanisms of formation and use of loan loss provisions, reserves to cover receivables and potential losses on operations with securities.

In 1999, the National Bank of Ukraine established intensified control and supervision over the seven largest banks as the most influential sector of Ukraine's banking system and in 2000, the National Bank of Ukraine continued to control the fulfilment by these banks of the Programs aimed at their long-term viability (restructuring).

Moreover, in 2000, the National Bank of Ukraine continued its fruitful cooperation with TACIS advisors, bank consultants and large banks under EU/TACIS technical assistance project "Support of Three Largest Banks' Restructuring". The National Bank of Ukraine arranged a number of working meetings on interaction between expert groups of ABN AMRO, Raiffeisen Investment AG and ING Barings Institutional and Government Advisory related to technical assistance for Ukrainian banks.

Another direction in the banking supervisory service activities were inspections of banks' and banking institutions' activities, the results of which were used for rating the banks under the CAMEL system and if necessary for using the adequate preventive and enforcement actions to prevent worsening these banks' financial situation.

During 2000, the banking supervisory service of the National Bank of Ukraine organized more than 600 inspections of banks' and banking institutions' activities. In particular, complex inspections were organized in almost two-thirds of the banks licensed by the National Bank of Ukraine to perform banking operations.

In order to ensure further steady development of Ukraine's banking system, as well as higher efficiency of the banking supervision of the National Bank of Ukraine, the President of Ukraine signed the Decree ¹891/2000, dated July 14, 2000, "On Measures of Strengthening the Banking System of Ukraine and Raising its Role in Economic Transformation," which defined strategic goals of further building of the banking system and respective mechanisms and instruments capable to provide financial needs of the economic growth, namely:

- growing the level of bank capital concentration;
- encouraging the foreign capital inflow;
- forming the conditions for crediting growth in the real sector of the economy;
- increasing the commercial banks' resource base;
- stimulating the household deposit growth and extending the guarantees of such investments' safety;
- improving the banking legislation.

Under the new conditions of the banking supervision service functioning, the fulfilment of the measures stipulated by the above President's Decree will bring the banking system to the level adequate for the present economic growth in Ukraine and higher welfare of the population.

MAIN STRATEGIC OBJECTIVES FOR BANKING SUPERVISION DEVELOPMENT

The banking system of Ukraine is instrumental in the formation of market relations, creation of a proper infrastructure, strengthening of stabilization processes and accomplishment of structural transformation of the economy. Therefore, the future of the banking sector will determine to a great extent the results of the reform implementation, as well as the ways for further socio-economic development of the country.

Our main goal is to form efficient and developed banking supervision that would meet the best international standards. The development of a sound and safe banking system able to serve the needs of the national economy and households and, at the same time, to ensure safety of the money entrusted to the system is impossible without such a supervision service. On such grounds only, Ukraine will have a chance and the right to be a member of the union of European states.

Therefore, in the shortest possible time, we try to do our best to comply with the Core Principles for Effective Banking Supervision of the Basel Committee on Banking Supervision.

Over the last two years, legislative acts were adopted in Ukraine that determine the guidelines and underlying principles for long-term development of the banking system taking into account its current situation and problems.

Among them the most important are:

- Decree No. 891/2000 of the President of Ukraine, dated July 14, 2000, "On Measures for Strengthening of the Banking System of Ukraine and Promotion of Its Role in Economic Transformation Processes," which determines strategic directions in banking sector development and ways of their fulfilment;
- The new Law of Ukraine "On Banks and Banking", in force from January of 2001, which takes into account local experience, international banking standards and the Basel principles for effective banking supervision. The law contains a series of new principles of banking legal regulation.

The above-mentioned legal acts should promote steady development of the banking system, creation of adequate competitive environment, protection of bank depositors' and creditors' interests, reduction of risks in banking, improvement of investment conditions and creation of favourable conditions for an increase of credits to the economy.

The National Bank of Ukraine exercises the supervision functions it is vested with, based on the available banking supervision infrastructure, which is constantly transformed depending on changes within the banking sector. A set of the documents constituting a methodological framework for regulation of bank activities has been elaborated. The banks are rated in accordance with the CAMEL system generally accepted all over the world. Permanent control of observance of mandatory economic ratios is exercised (the ratios being constantly improved). A specific system has been created for supervision of big and problem banks. Problematic features have been defined and methods of their early detection have been worked out. Enforcement actions to the banks and their managers, when they violate the legislation, are improved.

The National Bank of Ukraine pursues a comprehensive, coordinated, balanced and consistent supervision policy, which enables to forecast and promptly react to the changes in the economic environment. Therefore, there are grounds to consider well realistic the strategic objective of the banking supervision in Ukraine - to comply in full with the Basel principles.

In pursuance of the above Decree of the President of Ukraine, at the end of 2000, the banking supervision of the National Bank of Ukraine was restructured; in particular, the General Banking Supervision Department was created. It determines an integrated strategy of further development and policy of banking supervision, single methodological approach. The new organizational structure is oriented towards larger independence and efficiency of banking supervision and envisages a more accurate distribution of functions, as well as their concentration within one structural unit with the purpose of duplication and dissipation exclusion.

Taking into account the tasks of banking sector development and the bank activity problems which existed and still exist, the Board of the National Bank of Ukraine determined the top priority tasks to improve the banking supervision in the period of 2001-2003, including:

- preparation of new drafts of the NBU normative acts and regulations and adjustment of those currently in force to the new Law of Ukraine "On Banks and Banking" taking into account the Basel Core Principles for Banking Supervision;
- review of commercial bank licences according to the Law of Ukraine "On Banks and Banking" over the current year;
- stiffening the requirements regarding capital adequacy and solvency of commercial banks;
- elaboration and introduction of a system for operative management of banks' liquidity;
- improvement of the criteria for assessment of financial situation of a bank;
- introduction of efficient monitoring and a system for operative diagnostics and early warning with regard to possible problems in activities of banks;
- creation of the automated data base of the NBU banking supervision;
- ensuring full integration of the processes of on-site supervision, off-site control and system analysis with simultaneous improvement of their implementation procedures;
- implementation of banking supervision on a consolidated basis including bank affiliates and insiders both on the territory of Ukraine and abroad;
- more efficient application of the procedures for reorganization, restructuring and liquidation of financially unstable banks;

In addition to the determined directions for development and strengthening of the banking system, the problem of preventing the influence of unfavourable external factors should be solved.

The following top-priority measures in this area should be taken:

- operative response to the changes in the activities of big banks, which influence to great extent the general situation of the banking sector;
- elaboration of a plan of emergency actions for unpredicted developments in the economy;
- coordination and consistency in actions of different governmental departments under crisis conditions.

The fulfilment of the projected actions will enable to fortify favourable trends in banking sector development, promote supervision improvement and elevation of capitalization, liquidity and reliability of banks, strengthening of confidence in them, creation of a stable, highly developed and capitalized banking system that could meet the requirements of economic development, as well as the core principles of the Basel Committee.

MAIN BSCEE GROUP EVENTS OF THE YEAR 2000

THE 13TH ANNUAL CONFERENCE OF THE GROUP OF CENTRAL AND EASTERN EUROPEAN BANKING SUPERVISORS

The 13th Conference of the Group of Central and Eastern European Banking Supervisors was held in Prague, between the 22-23 of May, 2000. The President of the BSCEE Group was Pavel Racocha in the year 2000.

Two main topics of the conference:

- Questions of cooperation between institutions supervising different financial sectors in the various countries; and
- The legal and procedural questions of bank liquidation in the various countries.

The Group invited the representatives of two European Union. Mr. Colin Miles delivered a speech on behalf of the **British FSA**, while **the bank supervision department of the De Nederlandsche Bank** (the Dutch National Bank) was represented by Mr. Jan Brockmeijer. The selection of the two countries was not accidental; the intention was to demonstrate potentially different institutional solutions in two countries with strong and consolidated supervisory practices. It is well known that the British FSA has been supervising the entire financial sector as a unified supervisory authority since 1997. The so called Dutch model, preserved the independence of the three main financial areas and created the council of consolidated supervisors above them, with the participation of the representatives from all sectors. Through which, cross-sector, consolidated supervision can be ensured both for products and services, together with the necessary flow of information.

The representative of the Hungarian Financial Supervisory Authority (HFSA) outlined the objectives of the Hungarian supervisory merger and the emerging experiences of the new Supervision in the course of a separate presentation.

Mr. Miles provided a detailed presentation on the experiences gathered so far by the British FSA, the European pioneer of integrated supervision. His key conclusions were the following:

Supervision has four fundamental goals defined by law:

- Maintaining the market's confidence in the financial sector;
- Influencing public opinion, informing the public about the particular features of financial markets;
- Protecting consumers;
- Fighting financial crime.

The core principles of good supervision at the FSA:

- Efficiency and cost saving;

- Efficient corporate management / FSA's management is not "shadow management";
- Proportionality / No need to over-regulate;
- Create room for and do not hinder innovation in the sector;
- The international competitiveness of the British financial sector must be strengthened;
- One must remain neutral yet provide incentives to competition.

The scopes of responsibilities are clearly separated between the FSA, the Ministry of Finance and the Bank of England:

- The Ministry of Finance provides the legal framework;
- The FSA is responsible for regulating the supervised institutions within the legal bounds;
- The Bank of England watches over system risks and intervenes, if necessary, to preserve liquidity, and secure budgetary funding;
- The Ministry of Finance sanctions the use of public funds.

Other features:

- The FSA is a private corporation;
- The Ministry of Finance appoints the top management;
- Independent budget, the costs of operation are covered from the fees paid by the supervised institutions;
- Reports annually both to the Parliament and to the Ministry of Finance;
- Its Annual Meeting is open to the public;
- The FSA's organization is based on three pillars: licensing, supervision, and enforcement;
- Integrated IT background;
- Modern headquarters for each FSA section;
- Key motive: consolidated supervision;
- Strategic objectives: further development of risk based supervision and cross-sector supervision.

Key supervisory tasks for 2000:

- The challenges of e-commerce;
- The effects of low inflation;
- Requirements concerning money laundering and customer identification;
- Fair treatment of costumers after contract conclusion;
- Influencing market forces in order to reduce direct regulatory intervention.

Looking back on the experience of three years, Mr. Miles reflected on the consolidation of British supervisions as a successful move. The teams that cross over the evolved sectors, the unified perspective taken up within the organization, the unhindered flow of information, and the independence all seem to contribute to stronger and more efficient consolidated supervision. At the same time Mr. Miles admitted that the unified financial services act (**Financial Services and Markets Act 2000**), which was to replace sector specific, caused quite some problem in Great Britain.

The representative of the Dutch central bank said that in their view to provide efficient consolidated supervision institutional integration was not a must amongst increasingly intertwined financial sectors in a world undergoing globalization. The solution referred to by Mr. Brockmeijer as the "Dutch models" assigns priority to the specific characteristics of the sectors. Its dominant element is extremely forceful coordination and cooperation among the participating supervisions with centuries of tradition. Starting from that, while leaving the sectors' supervisions independent, in 1999 they created the **Council of Financial Supervisors**, which is an important decision-making and policy coordinating body in all issues affecting more than one of the sectors. Its membership is made up of high-ranking officials of three supervisory institutions, and its presidency is provided by the heads of the three supervisions in rotation order. As a small an open country the Netherlands was among the first to see the appearance of cross-sector financial conglomerates. The blurring of the sectors' boundaries goes also together with the appearance and spread of mixed products, such as in case of unit-linked life insurance combined with a mortgage. Such mixed and complicated financial products require that consumers be provided with more complete and thorough information. Thus the issue of consumer protection also becomes a key element of comprehensive supervision.

Following the review of the advantages and the disadvantages of the Netherlands deliberately opted to follow a path different from that of Great Britain, the Scandinavian countries, or lately Hungary for finding an efficient solution to provide consolidated, cross-sector supervision with reinforced institutional backing.

Responding to the invitation the Hungarian delegation (László Balogh, head of department, and László Seregdi, head of department) also reported on the creation of the HFSA. The objectives and tasks set forth in the founding legislation, the institution's organizational structure, and on the most important challenges the new organization would have to face.

Today the Hungarian example is regarded unique in the Central Eastern European region, even though Slovakia, Estonia, and Lithuania are thinking about similar supervisory introduction. Slovakia is already past the theory as there is a government decision on the merger of the insurance and securities supervisions as of July 1, 2000, and the banking supervision will also be merged into the Financial Market Supervision from 2002. However, an important precondition for that is a high degree of independence must be guarantee to the new consolidated supervision to fulfill their tasks following the amendment of the constitution. According to the Estonian delegation, the political decision about the desirability of the integrated supervisory model had essentially been made in their country as well. It must also be added that in each of the BSCEE countries (with the exception of Hungary) the banking supervision function is together with the central bank's organization therefore, it generally enjoys the independence that central banks normally have.

Problems Related to the Liquidation of Credit Institutions

The topic of the second day of the conference was about the liquidation of credit institutions, and the related problems, the regulatory background, and the implementation of liquidation procedures in practice. Mr. Warren Coats from the IMF, and Mr. Marc Vereecken representing the EU delivered speeches on the topic, furthermore, individual member states reported on their own regulatory and liquidation practices.

Mr. Warren Coats emphasized that credit institutions fulfilled a special role, and because of the peculiarities of their operation general liquidation rules were not sufficiently evident. Depositors can quickly withdraw their deposits, indeed, since they have little information on the banks' financial position, it may easily happen, that they also withdraw their deposits from a good bank because of a problem that emerged at a bad one. The procedure conducted according to general liquidation rules often produces the results that by the end of the process the assets owned by the bank worth a lot less, than at the time of starting the procedure.

A critical element of shutting banks down is that immediate intervention is required when all, or at least most of the depositors' money can be paid. General liquidation rules allow corporations to prepare a liquidation plan and agree with their creditors. In case of credit institutions the likelihood of reaching such an agreement is little, as there are just too many creditors. Supervisory authorities often opt for continued operation with some changes precisely because of the problems of liquidation procedures. Normally the basis of continued operation is taking the control of the bank over and the appointment of a liquidator. In the US the **FDIC** has developed and frequently employs a method for the quick takeover and shutdown of banks so that for the public the process may be completed in a day, or over a weekend. The depositors do not feel that they could not access their deposits; at the most the bank's name changes overnight. However, presently such a procedure can only be implemented in very few countries.

Continued operation of insolvent banks is also dangerous, because generally the management tries to regain solvency by undertaking additional risks, thus generating further losses. If there are insolvent banks in the system, then the margin between lending and deposit rates widens, and the allocation of savings will not be efficient either.

In practice two version of liquidation procedures for banks developed: the European and the American. The European practice is closer to a formal civil law proceeding, while the American is based rather on public administration procedures (i.e. on supervisory intervention). Recent years' practices suggested that crisis management moves into that direction in an increasing number of countries.

In case of banks generally the following problems arise with respect to liquidation procedures:

- There may be a delay between the revocation of the banking license and the launch of the liquidation procedure, and the quick withdrawal of deposits may start, decreasing the amount of assets that can be distributed among the depositors, and thus increasing their losses.
- During general liquidation procedures the bank's future income is not automatically included among the assets that may be distributed, therefore, these revenues will not be given to the depositors, rather to the owners, unless the law provides for compulsory capital restructuring.
- Any loss that may be incurred by the bank in the course of the liquidation would burden the depositors and not the owners.

The speaker drew the conclusion from the above that the banks' liquidation should be differentiated from general liquidation procedures. There is no point giving a chance to rescue schemes (bankruptcy procedures) lead by the depositors, and lenders, as the likelihood of an agreement between those affected is little.

As a distinction from the general liquidation procedures recommended, depositors should not be allowed to initiate a liquidation procedure against the bank, this right should be preserved for the supervisory authority. In order to prevent a rush at and depletion of the bank the supervisory authority must be given the right to suspend the payment of deposits, and the acceptance of new liabilities.

Mr. Marc Vereecken, representing the EU, delivered a talk primarily on the liquidation related problems related to internationally active credit institutions. At the time of liquidating such credit institutions fundamentally one of two principles must be followed: either the principle of uniformity, or the principle of territoriality.

The principle of uniformity means that all branch offices, and subsidiaries of the credit institution that operates in several countries are liquidated in one and the same procedure by the same liquidator, and the procedure is based on one generally applicable liquidation statute. Under such circumstances the depositors are treated equally in all of the countries, i.e. even if the bank operated prudently in one of the countries, the losses generated in others will spill over.

According to the principle of territoriality when an internationally active credit institution is liquidated the laws of the individual countries are to be followed in each of the countries affected. Under such circumstances a liquidator is appointed by the court of each country, and the procedure will be governed by local regulations. Under such circumstances depositors may be satisfied to different degrees from country to country, depending on the bank's assets and liabilities in the given country.

As the operation of credit institutions is increasingly becoming international inn character, the EU also endeavors to minimize the amount of problems arising from potential statutory differences in the course of liquidation procedures.

In light of that advances have been planned in four important areas in the EU:

1. *Insolvency regulation*

   It will not appear as a directive, rather as regulation (i.e. individual countries do not have to adopt it for their own legal systems, rather it will become directly effective within the EU). It has not been accepted yet, but they are not far from it. It will be applied to corporations and will employ both the principle of uniformity and the principle of territoriality.

2. *On **EU Directive 98/26** on settlement finality**

   An important element of the Directive is that it requires individual member states to make netting agreements legally enforceable even in if a liquidation procedure has been initiated. The Directive forbids recalling transfer orders already issued. The Directive also states that the start of the liquidation procedure may not influence the rights and obligations of the corporation prior to the start of the liquidation procedure retroactively.

3. *Draft directive on cross-border collateral*

   At present the directive is still being drafted, for the time being no official proposal has been tabled. The aim of the directive is to make access to covers deposited in other countries easier, and to harmonize procedures for collateral enforcement in the individual member states.

4. *Draft directives on the liquidation of credit institutions and insurers*

   The fundamental principles pertaining to the liquidation of credit institutions and insurers would be similar. The directive would cover reorganization and liquidation procedures as well, but it would not mean legal harmonization, rather the mutual recognition of the individual member states' procedures. The directives would fundamentally be based on the principle of

* Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems

uniformity, that is, the liquidation should always be implemented according to the mother country's laws, and institutions would be liquidated in the EU in a single liquidation procedure. The reason for applying the principle of uniformity is that this creates in accord with the supervisory principle of the mother country, and ensures equal treatment for depositors and lenders. At the same time the directive would also provide when the principle of territoriality should be applied, which, among others, include employment contracts, netting agreements, or agreements concerning property titles. The Parliament is likely to pass the directive this year, and the member states will have three years for its implementation.

It was clear from the reports of the individual countries that in those countries, where liquidation procedures were launched against banks, these lasted for a very long time, and the depositors received little money back from their deposits. Hungary is the only country where liquidation is conducted by a public interest company founded by the Supervision. In the other countries the supervisory authorities could normally make a proposal as to which the liquidation should be conducted by, although the courts not always took that into consideration in practice. There are relatively few countries where separate, non-general statutes are in place for the liquidation of banks. In each country the supervision received the licenses that are essential elements of crisis management (revoking licenses, or appointing liquidators). Finally, in some of the countries, the ratio of banks under liquidation is very high.

WORKSHOP OF THE BASEL RECOMMENDATION ON THE NEW CAPITAL ADEQUACY FRAMEWORK - PRAGUE, 17-18 JANUARY, 2000.

The workshop of the Group of Central and Eastern European Banking Supervisors (BSCEE) there were 15 member states present out of the 17, as well as the representatives of the **Basel Committee on Banking Supervision**. They presented the **New Capital Adequacy Framework** of June 1999, and their own positions and opinion. The event was organized by the **Czech National Bank** in Prague. Mr. Charles Freeland, Deputy Secretary General, represented the Basel Committee among others.

In the course of several different presentations Mr. Freeland distributed additional parts of the material, specifically that were either left out of the original proposal in June, or were not sufficiently elaborated. New elements emerged with respect to the question of **market discipline**, that represents pillar three of the system, however, new details had been worked out concerning pillar two, in relation with the question of **supervisory review**, as well. Mr. Freeland said that almost three hundred specialists had been working on elaborating the details, deciding on various interpretation of the issues. Various working committees and expert groups had been working on finalizing further parts of the recommendation since the publication of the Recommendation last June.

Excerpts from the Report

- Among those participating in the work of the Basel Committee, the opposition to the involvement of rating agencies is greater, than expected. Although a consensus appears to be emerging. Instead of the so called **"club" approach**, based on OECD membership, it would be desirable to develop some kind of more objective classification method.

- The most important international financial institutions eagerly looking for using the internal rating mechanisms legitimately for capital adequacy to manage risk weights.
- Although, the Recommendation itself, talks about internationally active banks, as the future users of the new rules on capital adequacy, practically there is already a tacit consensus that except for small, local banks the proposed system should be extended to all of the banks.
- There is great opposition related to corporate ratings, a marked European - American contrast is noticeable, primarily because of the different degree of the rating practice's prevalence in the two major markets.
- Several criticisms have been directed at the part of the Recommendation. Altogether there would be five risk grades be introduced for the calculation of capital adequacy weights (0%, 20%, 50%, and 150%), and in all probability, this classification can become more differentiated with the introduction of two, or even three more risk bands. These would include the 10% and the 30% weights as well.
- The Basel Committee conducted a survey among the 30 most important banks operating in the G-10 countries, each of which employs a rating system precisely in order to review this banking practice and methodology. As a general conclusion, this study has also substantiated that among other things, the five level scale, recommended by the Basel Committee is not yet sufficient. (There was a bank that used a twenty-two level scale.)
- The debate about weighting the debts is also intense. Today risk provisions must be generated from debts with a term over one year. Some strongly urge introducing the six-month limit.
- The Recommendation is adopted, the rules will also be binding for the Basel Committee's member states and at this point, those in Basel expect relatively quick implementation of it, although with the insertion of a short transitional period. Although the application of the rules will not be compulsory for countries outside of the G-10, and will be articulated merely as guidelines to be followed, it is assumed that the IMF will gradually enforce their actual introduction.
- Criticism have been directed at the so called pro-cyclical effect of the Recommendation, namely, that it makes it difficult for countries and financial institutions in deteriorating economic climate, through the cycle to access external resources, while it is made easy precisely at the peak of the cycle. Mr. Freeland has admitted that it is a real problem.
- The Basel Committee is still working on several details, such as the details of the capital adequacy requirements, related to interest risks in the banking book. Furthermore, the capital adequacy requirements related to operating risks have not been fully developed yet. In respect of the latter it was brought up that next to the credit risk for various banks, the most substantial exposure comes from the operating risk. There is much thinking about employing some sort of probability based risk measurement technique, employed by insurance companies. Mr. Freeland strongly suggested studying the relevant practice and methodology of the insurance companies.
- According to the staff of the Basel Committee the acceptance of the rules cannot be expected before the end of 2001. even under the best-case scenario,

while their actual application can hardly be envisioned before the end of 2002. Nevertheless, the schedule that can be drawn up at the moment is the following:

- Comments from outside, gathered by the end of March 2000.
- These comments are processed and thorough professional discussions are prepared for the September 2000 Annual Conference of the Supervisors in Basel.
- Following that debate, at the end of 2000. a revised proposal is circulated for consultation, to be commented on within a smaller time frame. Today it is about three to five months.
- Based on the final decision of the approval, the new framework can be expected by the end of 2001. Which is approximately one year planned from the time of the decision making till the actual introduction in the G-10 countries.

BSCEE SEMINAR ON THE BASEL PRINCIPLES - BRATISLAVA, JUNE 7-9, 2000

The Seminar dealing with the implementation of the Basel Principles pertaining to bank supervision was organized by the **National Bank of Slovakia** in Bratislava, between June 7 and 9, 2000. The two invited speakers of the Seminar, Elizabeth Roberts (Financial Stability Institute), and Gabriella Ferencz (The World Bank) came from the US, while a third lady, Johanne C. Prévost (Secretariat, Basel Committee on Banking Supervision) arrived from Canada. The participants came from the banking supervisions of Eastern and Central European countries (Bulgaria, the Czech Republic, Hungary, Lithuania, Romania, Slovakia, and Slovenia).

The Seminar was opened by the keynote address of the deputy head of the National Bank of Slovakia. In his speech he briefly summarized the Slovakian situation in respect of compliance with international standards. He said that as a first step Slovakia strove to attain OECD membership, but this process might also speed up the fulfillment of the conditions required for EU accession. He highlighted the following as the key problems:

- the issue of measuring market and other risks;
- the need to modify the bank act (in light of the Basel Principles);
- stipulations pertaining to consolidated supervision, the shortcomings of accounting standards, and obscurities related to the establishment of new institutions;
- the issues of cross-border cooperation.

The deputy executive mentioned that he also found it a problem that the EU member states were not really interested in working together with the Slovakian banking supervision.

Thereafter the Seminar consisted of three main parts. First the US and the Canadian speakers talked in general about the Basel Principles and their corresponding experiences. It was then followed by a review of the Principles, the related problems, and comments through a discussion between the speakers and the participants. During the last two half-days the participants had to give a brief presentation on the implementation of the Principles (three or four by country), which were also distributed to participants at the end of the first day.

The presentation was given by Johanne C. Prévost, who spoke about the purpose of creating the Basel Banking Supervision Principles, which is first of all a general guideline for banking supervisions, at the same time it is also a reference document for national supervisions and international institutions. Its importance is emphasized by the fact that this is the first document that was the genuine outcome of the cooperation between G-10 and non-G-10 countries in this filed.

Subsequently, Ms. Prévost briefly outlined the Principles' essence, highlighting the importance of Principle 1 on the presence of the necessary preconditions (infrastructure, responsibilities, and regulation, etc.). She said that these Principles should under no circumstances be regarded as rigid standards, and it is important to meet them always in light of the particular characteristics of the individual countries. In order to promote the implementation of the Principles the Basel Committee issued additional, more detailed documents (e.g. on internal control, the management of credit risk and liquidity risk, or the accounting standards), conducted surveys, and developed in this respect its methodological guideline, **"The Core Principles Methodology"** to prevent interpretation problems.

Appropriate supervision strengthens the national banking systems, contributes to the stability of the entire financial sector, and reduces sensitivity to external shock. This, however, cannot guarantee a stable macroeconomic environment, and cannot make the country totally immune to external crises, furthermore, can offer no guarantee against banks' bankruptcy.

The US speakers added that they had always doubted claims like that a country 97 percent satisfies the Basel Principles, as there were still a lot of tasks to be solved in this field even in the most developed countries. Otherwise, rating is not an easy task, and they do not think that outside consulting firms, that do not have the required skill, should be contracted for the job. Furthermore, they told that some tried to set up some sort of an order of priority amongst the Principles, but since they are very much intertwined, this was not quite successful.

Concerning cross-border banking they mentioned that understanding the operation and risks of European bank branches that represented a different culture, created difficulties for the supervisors even in the States, but it was not easy for foreign banks either to understand the complicated American rules. Concerning the memorandum of understanding they were on the opinion, that those were really formal documents, what was important, is the experience behind them.