

***BANKING AGENCY
OF REPUBLIKA SRPSKA
BANJA LUKA***

R E P O R T
on
June 30, 1998 - September 30, 1998
operation

Banja Luka, November 1998

INTRODUCTION

This is the first report produced on the basis of the Article 27 of the Law on Banking Agency of Republika Srpska and it represents a resume of data indicating status of banks composing the banking system of Republika Srpska and it gives a survey of activities this Agency performed in the course of the first three months of its operation.

The assessment has been done on the basis of banks data as of September 30, 1998 and pieces of information gathered in the course of regular operation.

The RS banking system used to be monitored and supervised by the National Bank of Republika Srpska which stopped operating in accordance with a new concept for creation of monetary-lending system in Bosnia and Herzegovina when the Banking Agency of Republika Srpska was established. In accordance with the tasks defined by the law, the newly-formed Agency, as an independent financial institution, performs the following activities:

- gathers applications and processes documentation required for issuing of licenses for bank founding and bank operation, implementation of organization and types of activities*
- performed by banks;*
- issues licenses for banks founding;*
- issues permissions for organizational changes within banks and changes in those types of activities usually performed by banks;*
- receives applications, makes evaluations and issues approvals for appointing banks management staff and high officials;*
- issues sub-legal acts regulating bank operation;*
- gathers, processes and records data that banks are obligated to submit to the Agency in accordance with the Agency Law and legal acts;*
- performs a control of banks operations by examining accounts and other documentation of banks;*
- prescribes the methodology of banks operations control;*
- supervises banks obligatory reserves;*
- issues legal acts to regulate deposits insurance in banks;*
- defines standards to be met by banks in deposit insurance;*
- collects insurance premiums, manages the fund and makes payments to depositors in case of bank failure;*
- plays the role of a receiver;*
- liquidates assets after banks bankruptcy;*
- evaluates compliance of requirements and approves issue of shares;*
- represents Republika Srpska at international conferences in the field of Agency's operation;*
- performs other activities in accordance with the Law and other regulations.*

After the Agency had been established, the Agency organization was developed on such basis as to perform its operation in a unified, complete, efficient and effective manner.

The managing body of the Agency is the Management Board consisting of five members. The Agency is run by a Director and a Deputy Director. In the course of this reporting period the Managing Board held five meetings discussing organizational, regulatory-legal and professional-analytical issues within the banking system.

Issuance of licenses for bank operation is performed by following a complete procedure of processing founders applications based on strictly defined requirements.

Control of bank operation is performed primarily by issuing sub-law acts, approvals and consents which stipulate strict standards of operation. Issuing such standards a basic intention is to be in compliance with international banking standards respecting, at the same time, the existing conditions of operation.

Bank supervision is performed by using reports, data and other information supplied by banks in a prescribed way and by direct control of overall or a part of bank operation.

Reports based control can be daily or periodical and each bank is subject to a direct control - examination within a period of 12-18 months. These provide for a continuous monitoring of each bank status, its liquidity, movements in operations, operation compliance with legal regulation as well as its forecasts of future activities. All that provides for an assessment of solvency of overall banking system.

Besides the reports prescribed by the Agency, other resources are used as well, such as auditing companies reports, reports submitted to other institutions as well as other types of information on banks.

The most reliable findings on banks and banking system, however, are those found in an on-site control - in the very bank, which have been very important in producing this report as well.

Of course, it should be kept in mind that in a relatively short period of time and in such circumstances where legal regulations are not completely defined for this field of operation, the Agency was not able to put into realization all of its authorities and tasks. In this sense significant steps are still to be made.

This report presents the banking system status and the Agency operation through the following chapters:

- Banking System - in general*
- Banks Income Statements*
- Banks Balance Sheets*
- Capital and Liquidity*
- Relative Indicators of Operation*
- Banking Agency Activities*
- Resume*
- Attachments*

1. BANKING SYSTEM - IN GENERAL

As of September 30, 1998, fourteen banks and one Post Office Savings were licensed to perform banking operation in Republika Srpska (hereinafter: RS).

Banking operation in the third quarter of 1998 was performed in very complex economical circumstances. Namely, on one hand the monetary and the foreign currency system of Republika Srpska was linked to the monetary and the foreign currency system of Federal Republic of Yugoslavia (hereinafter: FRY) and, on the other hand and at the same time it was incorporated into the monetary system of Bosnia and Herzegovina (hereinafter: BiH) with a new currency (KM) and linked to the Central Bank of Bosnia and Herzegovina (hereinafter: CBBH).

During 1998 overall economy activity in RS had an upward trend, while market exchange rate of dinar deviated from the official dinar exchange rate caused by a devaluation which took place in early April. The discount rate stayed unchanged and in the third quarter of the year it amounted to 2.5% on monthly basis. Active interest rate ranged from 2.5% to 7% on monthly basis.

It should be pointed out that introduction of convertible mark as an official tender in the payment system actually initiated the process of establishing obligatory reserves in KMs. Namely, in accordance with the Law on CBBH the Decision on Establishment of Minimum Obligatory Reserve in an amount of 10% of KM deposit base was issued and it was to be applied to all commercial banks in BiH. Such KM obligatory reserves started to be established in Republika Srpska on July 1, 1998.

In the third quarter of 1998 the banks operated in the above described circumstances and with a lot of inherited unresolved issues, such as: deposited old foreign currency savings, foreign currency loans, i.e. non-defined relationships with foreign countries. Such were conditions for operation of 14 banks, one Post office Savings and 3 branch offices located outside RS. Out of these, ten banks and the Post Office Savings had majority state owned capital while 4 banks had majority privately owned capital.

General data on banks

Based on the Article 29 of the Law on the Banking Agency of Republika Srpska ("Official Gazette of Republika Srpska" No.10/98), all institutions in possession of an approval to perform banking operation were obligated to apply for a temporary bank operation license.

In accordance with the above, said the Agency issued temporary licenses to 13 banks and one Post Office Savings as of September 30, 1998.

Based on the same Article of the Law, financial institutions having temporary licenses were obligated to submit an application with a complete documentation required by the Law on Banks in order to be granted permanent licenses to perform banking operations.

In accordance with that, the Agency is being working on issuing permanent licenses to those banks that had been in operation before the Agency was established and have been granted temporary licenses.

Beside the existing financial institutions, three applications for founding of new banks have been submitted. After a complete processing of all applications, four existing banks have been granted permanent licenses and two licenses for founding of new banks were issued. The rest of applications are being processed. Taking into consideration the strict requirements to be met, on one hand, and difficult situation in some banks, on the other hand, some additional problems are to be expected in this process.

2. BANKS' INCOME STATEMENTS

BANKS INCOME STATEMENTS AS OF SEPTEMBER 30, 1998

Currency amounts in thousands

I	I N C O M E	December 31, 1997		September 30, 1998	
		Amount	% of assets	Amount	% of assets
	1. Operating Income	46,568	10.54	183,461	23.63
	a) fees PR - (2)	42,225	9.56	160,926	20.72
	b) other PR - 2 (1)	4,343	0.98	22,535	2.90
	2. Financing based income	325,836	73.79	492,055	63.38
	- interest income PR - 1(1)	287,880	65.20	274,772	35.39
	- fx fluctuation income	27,921	6.32	190,120	24.48
	- other finan.based income PR-2(3)	9,819	2.22	26,898	3.46
	- revaluation income PR (3)	216	0.04	265	0.34
	3. Extraordinary income PR-2(4)	69,098	15.65	100,769	12.98
	4. Capital based income PR-2(5)	18	-	61	0.07
	TOTAL INCOME	441,520	100.00	776,346	100.00
II	E X P E N S E S				
	1.Mater.costs.gross salary RA-2(1)	45,742	10.76	117,032	16.96
	2. Intangible costs	44,116	10.38	168,172	24.38
	- bank service fees RA-1(2)	12,709	2.99	19,940	2.89
	- intangible costs RA-2(2)	20,453	4.81	122,782	17.80
	- taxes,contrib.non depending on operation results RA-5	10,954	2.57	25,450	3.69
	3. Financing costs	314,805	74.09	318,467	46.17
	- interest RA-1(1)	162,731	38.30	138,187	20.03
	- fx fluctuation costs RA-2(3)	2,384	0.56	-	-
	- write-offs, adjustments RA-3	114,358	26.91	99,218	14.38
	- revaluation costs RA-4	35,332	8.31	81,062	11.75
	4. Extraordinary costs RA-2(5)	20,137	4.73	86,056	12.47
	5. Capital losses RA-2(6)	74	0.01	12	0.01
	TOTAL EXPENSES	424,874	100.00	689,739	100.00
	SPEC. RESERVE ALLOCATION	12,090		57,251	

Total banks' income for nine months of 1998 amounted to 776.3 million dinars where basic portion of income was interest income in an amount of 274.7 million dinars or 35%. Foreign currency rate fluctuation income represents a significant portion of 24%, fees income of 21% and extraordinary income of 13%.

Total banks' expenses for nine months of 1998 amounted to 689.7 million dinars and were increased for 62.3% as compared to the statement as of December 31, 1997. Interests costs amounted to 138.1 million dinars or 20% of the total costs, while intangible costs amounted 168.1 million dinars or 24% and revaluation costs amounted to 81 million dinars or 12%. Write-offs and adjustments of non-collected receivables were very high amounting to 99.2 million dinars or 14% of the total costs.

In the nine-months period in 1998, ten banks generated a total profit of 40 million dinars, three banks had a total loss of 11.1 million dinars and one bank showed equal amounts in both costs and income.

Total net income of all 14 banks amounted to 192.8 million dinars. The balance after deduction of revaluation costs and taxes and contributions amounted to 86.6 million dinars, allocation for special reserves to cover risk loan losses amounted to 57.7 million dinars and profit to be distributed amounted 39.6 million dinars.

3. BALANCE SHEET AND ASSET QUALITY

RECLASSIFIED BANKS' BALANCE SHEET

- in thousand dinars -

R.b.	Balance sheet items	9/30/1997.		12/31/1997.		9/30/1998.		Index 98/97 7:3
		Amount	%	Amount	%	Amount	%	
1	2	3	4	5	6	7	8	9
I	ASSETS- balance + off- balance sheet items							
A-1	Cash	231,858	3.29	245,546	3.14	925,885	6.16	399
A-2	Funds at NB Yugoslavia	4,831,244	68.46	4,938,528	63.05	9,092,995	60.53	188
A-3	Due claims against ST loans & carried over LT due claims	256,076	3.63	276,960	3.54	712,458	4.74	278
A-4	ST securities and other ST receivables	35,958	0.50	25,605	0.31	23,112	0.15	64
A-5	Other assets	189,859	2.69	112,541	1.44	274,191	1.83	144
A-6	ST loans	1,279,135	18.12	1,959,806	25.03	3,433,648	22.86	268
A-7	LT securities and other LT receivables	362	0.01	5,714	0.07	5,045	0.04	1.394
A-8	Permanent deposits	2,611	0.04	2,338	0.03	4,855	0.04	186
A-9	Fixed assets	184,443	2.61	211,405	2.70	443,874	2.95	241
A-10	Funds not used in operation (apartments))	45,975	0.65	54,213	0.69	105,231	0.70	229
	TOTAL ASSETS (A-1 to A-10)	7,057,524	100.00	7,832,656	100.00	15,021,294	100.00	213
A-11	Off- balance assets	1,150,640		499,900		1,111,585		97
	TOTAL	8,208,164		8,332,556		16,132,879		196
II	LIABILITIES (balance+off-bal.sh.items)							
P-1	Deposits on demand	2,123,686	30.09	2,237,925	28.57	4,523,069	30.11	213
P-2	Payables to NB Yugoslavia	10,013	0.14	11,815	0.15	6,290	0.04	63
P-3	ST deposits	18,733	0.28	13,149	0.16	19,953	0.13	106
P-4	ST loans payables and due LT payables	22,107	0.31	22,942	0.29	165,868	1.11	750
P-5	ST securities payables	63,124	0.89	59,114	0.75	62,245	0.42	99
P-6	Other liabilities	292,958	4.15	159,048	2.04	503,786	3.35	172
P-7	LT deposits	2,679,129	37.96	2,769,021	35.35	5,119,476	34.08	191
P-8	Payables against LT loans	1,228,355	17.40	1,910,549	24.39	3,323,988	22.13	271
P-9	Payables against LT securities	-	-	-	-	-	-	
P-10	Capital and LT reserves	578,385	8.20	601,326	7.69	1,206,267	8.03	208
P-11	Not-in-oper.funds resources	41,028	0.58	47,767	0.61	90,350	0.60	220
	TOTAL B.SH. LIABILITIES (P-1 to P-11)	7,057,524	100.00	7,832,656	100.00	15,021,294	100.00	213
P-12	Not-in-operation funds	1,150,640		499,900		1,111,585		97
	TOTAL	8,208,164		8,332,556		16,132,879		196

The balance sheet breakdown shows that as of September 30, 1998 the total assets/liabilities amounted to 16.1 billion dinars, consisting of 15 billion dinars in balance sheet items and 1.1 billion dinars in off-balance sheet items.

Total balance sheet assets were almost doubled compared to the statement as of September 30, 1997, although there were no significant deviations in the structure itself. The increase was primarily caused by devaluation of dinar.

Total balance sheet liabilities were increased for 8 billion dinars or 96% compared to the statement as of September 30, 1997. The most significant items on liability side were long-term deposits - 34%, deposits on demand - 30% and long-term foreign currency loans - 22.1%. Three listed items represented 86.1% of the total liability, while capital and long-term reserves represented 8%.

Data shown in banks' reclassified balance sheet indicate that there were no significant changes in banks' balance sheet structure.

Analyzing the assets side of banks' balance sheet and its structure it should be pointed out that neither there any significant changes occurred. The most significant item was funds at the National Bank of Yugoslavia (60.5% - claims against deposited foreign currency old savings), then long-term foreign currency loans - 22.8%, representing together 83.3% of total assets. There was an increase in

the following items on the assets side: funds (currency), short-term loans and due receivables, other assets and permanent funds, indicating a more cautious operation of banks.

Total risk assets amounted to 5.8 billion dinars consisting of 5.0 billion dinars in balance sheet risk assets and 807 million dinars in off-balance sheet assets. The amount of total risk assets was higher for 3.0 billion dinars or 102% as compared to the same period of the previous year. Total risk assets represented 36% of total banks' balance and off-balance sheet assets, indicating potential risk in operation of banks.

Generally speaking, it can be stated that the quality of assets was poor in all examined banks. The main reason for this situation were problems faced by borrowers that emerged due to the war and unfavorable economy environment created by the imposed embargo. Banks had a lot of problem loans, borrowers very often generated losses making implementation of more aggressive forced repayment very difficult.

Examinations covered some 65% to 85% of the total loan portfolio out of which percentage over 50% were classified loans, and a high percentage was classified as doubtful or loss. A large number of loans was renewed or prolonged with capitalized interest since, very often, borrowers were not able to repay either principal or interest.

Banks' total loan portfolio could be divided in two parts. The first part consists of loans approved in the period from 1994 to the end of 1996 and majority of those loans has not been repaid. The second part consists of loans approved after 1996, smaller in amounts and for shorter repayment periods (60-90 days). Classification of these loans is better with a high percentage of repayments, but they represent only a smaller portion of the total loan portfolio (about 25%).

The most frequent loan security is "*akceptni nalog*" (acceptance order) but due to a poor financial situation of borrowers loan repayment cannot be performed and mortgage has not been activated in most cases due to a lack of an adequate documentation within loan files, as well as an adequate legal regulation on this issue.

Interest rates are not realistic ones, i.e. they are too high and in some cases they ranged even over 125% on annual basis.

It has been also noted that established reserves for potential loan losses are insufficient with all banks and some additional funds should be allocated to the reserves what will decrease banks' capital.

In order to enable banks to operate more efficiently in the economy oriented market it should be necessary to undertake the following steps:

- to establish comprehensive loan policy and standards for loan approving procedure;
- to train loan officers;
- to train loan managing high officials in the area of managing problem loans;
- to establish more aggressive collection repayment enforcement.

4. CAPITAL AND LIQUIDITY

Total permanent capital of banks as of September 30, 1998 amounted to 1.2 billion dinars, representing 8% of total banks' liabilities. The banks are obligated to provide for the capital not to participate less than 20% in the total liabilities. This requirement was met by five banks, i.e. 36% of total number of banks. If potential loss reserves are deducted from the permanent capital, net capital would amount to 40.3 million dinars. There are two banks whose net capital is net capital is negative, i.e. the potential loss reserves at these banks are higher than the amount of their respective capital.

In order to give a real evaluation of financial position of banks, banks liquidity over the third quarter of 1998 should be also observed. Starting from the fact that we are in a united payment system with FRY, the FRY monetary policy influence on liquidity of RS banks must be taken into account. Namely, the 1998 monetary policy was characterized by the same objectives as in the previous year, i.e. maintaining of stable exchange rate and prices; however, the realization of these goals has been only partial.

Banks' negative liquidity trends from the first half of the year continued in the third quarter of 1998 as well. Banks' liquidity trends are shown in the following table:

- in million of dinars -

Month	Average giro-accounts statements	Average negative statement		
		Amount	No. of days	No. of banks
December 1997	23.6	5.4	38	7
January 1998	35.0	3.4	22	4
February	5.1	5.8	42	8
March	18.2	4.1	48	6
April	16.8	3.0	37	6
May	17.3	4.5	42	5
June	18.1	4.5	35	5
July	11.0	7.0	31	5
August	39.7	7.6	51	9
September	48.2	4.5	41	6

Average negative statements on giro-accounts in August and September were higher than the total average statement on giro accounts while such a ratio was more favorable in September. Majority of banks have constant problems with liquidity. Essential reason for such illiquidity of banks is an adverse material situation, i.e. an adverse situation in the total RS economy. Beside that, banks have large amounts of outstanding due receivables against approved loans and capitalized interests. Such placements are generally increased by capitalized interest which is not payable and on the other hand are also increased due to write-off of such claims which cannot be collected in due terms.

In order to get a comprehensive picture on banks' liquidity it is necessary to take into consideration banks' foreign currency liquidity as well, i.e. banks' foreign currency statements.

As of September 30, 1998, banks' foreign currency deposits amounted to 49.3 million US dollars and compared to the amount as of June 30, 1998 they are higher for 15.5 million USD or for 147%. The amount of 49.3 million USD consists of 29.7 million USD in foreign currency cash and 19.6 million USD held in foreign currency accounts at banks abroad. These data show a certain increase compared to the statement at the end of the first six months period and are mostly reflecting legal persons' deposits.

Banks' illiquidity is mostly caused by a lack of flexibility, banks' not being able to react instantaneously to collect repayments of loans and unstable deposits (resources are mostly deposits on demand which can be easily moved).

5. RELATIVE INDICATORS OF BANKS' OPERATIONS

An analysis of banks' operation performed in accordance with criteria stipulated in Articles 26. and 27. of the Law on Banks resulted in a varying picture of the banking system.

An average ratio of capital adequacy is 17% while the stipulated minimum is 8%. Two banks have not been taken into this analysis, since they reported negative capitals. As for the analyzed banks, 4 of them have not met the requirement, and 10 banks have met the requirement.

An average ratio of capital participating in liability is 7.7%, while the stipulated minimum is 20%. The requirement has not been met by 9 banks, while 5 banks have met the requirement.

An average ratio of citizens' funds participating in liability is 58%, while the stipulated ratio is up to 50%. This requirement has been met by 7 banks, and other 7 banks have not met the requirement.

An average ratio of short term loans and resources is 209%, while a minimum stipulated ratio is 1:1. This requirement has been met by all banks.

Banks are obligated to maintain a balance between foreign currency assets and liabilities in the balance sheet (allowed deviation ranges from +/- 5%). An average ratio is 95%. This requirement has been met by 10 banks, and 4 banks have not met the requirement.

The biggest loans average ratio is 198%, while the stipulated one is 80%. The requirement has been met by 8 banks, and 6 banks have not met the requirement.

An average ratio of permanent investments into enterprises is 0.3%, and the requirement has been met by all banks; the fact being that only five banks have made such investments.

The stipulated ratio of permanent investments into banks is not to be higher than 51%. An average ratio is 0.12%. Such permanent investments have been made by only four banks, and the requirement has been met by all of them.

An average ratio of capital investment into fixed assets is 38%, while the stipulated ratio is 20%. Seven banks have met the requirement, and other seven have not.

6. ACTIVITIES OF THE BANKING AGENCY

After election of managing bodies of the Agency, early activities were directed on establishing an organization of a new financial institution. The Statute has been issued as well as other regulations pertaining to the operation.

The most essential part of operation consisted in banks' operation control performed either as off-site controls (based on reports) or on-site controls.

In order to have a more efficient and a more economical method of reporting, a program of a direct reporting using E-mail is being designed which final establishment requires some more time and resources. On-site controls consisted of diagnostic reviews and examinations of banks.

Diagnostic Reviews of Banks

A primarily goal to be reached by a diagnostic review of a bank is to provide for a comparable database on banks and banking system. Performed reviews focused on main financial issues, management structure, risks within management system, operation procedures and strategic planning. In the course of these reviews examiners' work was based at both written and oral information provided by bank staff as well as at control and checking of bank records and transactions.

Reviews covered banks' current financial statements, management system, quality of risk management process, staff expertise, ownership structure, clients' structure and viability under market economy conditions. Beside that, such reviews identified categories of relevant assets and liabilities.

Diagnostic reviews were performed in Razvojna banka a.d. Banja Luka (Development Bank) and Gold banka a.d. Banja Luka. These two were the last bank diagnostic reviews performed in all RS banks.

Examinations of Banks

A basic objective of banks' examinations is to collect data important for strengthening of financial sector, including assessment of banks' current financial statements and identification of their weak and strong points. Procedures followed in such banks' examinations are standard procedures used in USA and Western Europe which in our case were implemented through an active participation of USAID experts.

In addition to the above mentioned, identification and classification of all relevant assets and liabilities were also performed in order to facilitate development of potential proposals for restructuring and privatization programs. Banks' examinations were especially focused on the following:

- financial statement, reporting and planning;
- all relevant assets and liabilities, including balance sheet and off-balance sheet

items;

- accounting standards;
- assets quality including categorization according to risk classification;
- active, passive and neutral classification of assets and liabilities;
- capital adequacy, evaluation and adequacy of reserves for loan losses and

fixeassets;

- quality and stability of earnings;
- loan capacity, liquidity, financing resources and assets and liabilities management;
- bank ownership, organization and management;
- internal controls.

In the third quarter of 1998 examinations were performed in Prijedorska banka a.d. Prijedor, from June 19, to July 10; Privredna banka Sarajevo a.d. Srpsko Sarajevo, from July 28 to August 14; and Privredna banka a.d. Doboje, from August 19 to September 3, 1998.

In the first nine months of the year various types of controls were performed in seven banks. These controls findings confirmed conclusions on general status of the banking system given in this Report.

At the end it should be emphasized that all examined and reviewed banks actively cooperated with examiners and enabled compliance with examination and review schedules.

Banks' Privatization

Based on the Banks' Privatization Strategy adopted by the RS Government, the Agency has been involved to a maximum degree in the current banks privatization process. Its contribution in this period consisted in creating and issuing supporting regulation and enabling banks' auditing as stipulated by the law. The Decision on Obligatory Elements of Banks' Privatization Program has been issued and a Draft of Methodology for Preparation of Banks' Opening Balance Sheets has been submitted for adoption. Three internationally recognized auditing firms have been selected for banks' auditing, and preliminary audit reports have been completed for 4 banks. The auditing is being continued.

Considering that, under the Law on Privatization of State Capital in Banks, beside the Ministry of Finance, this institution has been given a special role in the privatization process, activities in this area are recognized as priorities.

Staff Training

Maintaining of a sound and stable banking system is a central task of the Banking Agency which cannot be reached without a capable staff. Because of that, special field of activities performed in this period by the Agency was training and education.

The Banking Agency employees have attended ten courses to improve their expertise in banking supervision organized and sponsored by USAID BARENTS GROUP - LLC. Seminars have covered a variety of banking operation fields in accordance with the international standards broadening attendees' knowledge which will be of an invaluable importance in their work.

The fields covered by the seminars were the following:

- Basic bank Supervision;
- Accounting for Examiners;
- Basic Credit;
- Internal Controls and Audits;
- Money Laundry and White Collar Crime;
- Funds Management and Liquidity;
- Intermediate Credit;

- Problem Bank Supervision;
- Ethics and Professional Conduct;
- Information Technology - Systems and Controls.

The listed seminars have defined more clearly bank supervision as a basis of a sound banking system, functions and the very process of a bank supervision as one of the key functions of the Agency, as well as, legal issues and regulations pertaining to supervision, types and analyses of risks within a bank, and assessment of a bank statement based on the CAMELS system, based on which a banks' rating list is prepared.

Seminars organized abroad covered the following areas:

- Bank Restructuring, Privatization and Liquidation - attended by three Agency employees;
- Bank Supervision - attended by four Agency employees.
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Seminars organized abroad extended an opportunity to analyze other countries' experiences which can be very useful in creating an improved RS banking system.

Other Activities

Activities of the Agency regarding deposit insurance, as a very important instrument in restoring confidence in banks, consisted mainly in preparation of regulation in this area. Taking into consideration the importance of this issue, a more serious and complete approach should be applied, first of all in establishing a legal regulation.

In order to create such conditions which would enable banks to incorporate gradually into international credit lines, a special part of the Agency's activities was directed to cooperate with international financial institutions. This cooperation mainly consisted in exchange of information on banks and establishing relationships between representatives of such institutions and banks. The most important relationships, established up to now, are those with the World Bank, European Bank for Reconstruction and Development, etc.

An extensive cooperation, which have lasted for some time, have been further developed with the International Monetary Fund regarding credit-monetary statistics.

Information system has been recognized to have an utmost importance when incorporating into international financial issues is considered. This is why a large portion of our activities is exercised in creating a new Charter of Accounts for Banks as well as a new and unified information system with a goal to make a part of international financial and banking standards.

A significant assistance in building up a new banking system has been extended by special banks' associations. Newly formed Association of Banks of Republika Srpska has a special role. In a firm cooperation with the Association, this Agency is creating, proposing or issuing regulations on banks' operation. This cooperation on behalf of the Agency is exercised through direct participation in Association's activities, during work of the Association's bodies or through informal contacts.

7. RESUME

Based on the available data it can be concluded that the main features of the banking system are the following:

– *majority bank capital is state-owned (about 85%) - this is related to 10 banks and one Post Office Savings;*

– *four banks have majority private ownership with modest potentials, technical equipment and staff;*

– *high level of non-active assets (not interest-bearing) - about 88%;*

– *low level of interest-bearing assets, about 12%;*

– *average rate of capital participation in liabilities is 7.7%, stipulated minimum is 20%;*

– *state-owned banks are managed by debtors, mainly state-owned companies at the same*

time the biggest shareholders of banks;

– *profitability of banks operation is at a low level, it can be almost said that they are non-profitable though interests rate are very high;*

– *banks employ 3.457 employees, out of which one bank has 1.276 employees working in payment system;*

– *majority of banks do not meet stipulated operational requirements;*

– *there are almost none new citizens savings;*

– *after an analysis in whole majority of banks management seems to be able to implement new forms of bank management.*

In order to perform all activities on establishing sound and stable banking system and in making banks qualified to operate in accordance with the international banking standards, the following is necessary:

– *to create macro-economical conditions, first of all in the sense of minimizing political risk, for foreign investments;*

– *to intensify started state-owned capital privatization process as a basic precondition for market based economy and further capitalization of banks;*

– *to develop further legal regulation for banking operation which would, by issuing new rules or changing existing ones, make adjustments in accordance with international financial standards. First of all this means issuing the Law on Banks, the Law on Old Foreign Savings, the Law on Payment System, the Law on Financial Operation, the Law on Bankruptcy, the Law on Money Laundry, the Law on Foreign Trade Operation as well as many other regulations which would regulate further capitalization of banks, deposit insurance, bank liquidity, preparation of opening balance sheet in the banks privatization process, etc.;*

– *to direct credit lines through banks and to include banks at a maximum level in monitoring of borrowers projects implementation;*

- *to restore confidence of depositors into banks by deposit insurance and adequate supervision of banks operation;*
- *to establish and develop money market as the only possible additional resource to regulate banks liquidity;*
- *to reform internal payment system with an ultimate goal to transfer it into banks;*
- *to train banks staff, first of all in loan approving and monitoring of financed programs, bank liquidity management, money laundry and risk management.*

Building up the Banking Agency as a sound, stable, independent and capable regulatory institution is a precondition for a success of all activities in the banking sector. In that sense, for further development of this institution the following is necessary:

- *to continue cooperation with international financial institutions;*
- *to intensify training of the Agency staff in further development of bank supervision policy and procedures and implement such expertise in a system of control in accordance with international banking standards;*
- *to participate in specialized seminars abroad;*
- *to provide for new computer equipment and adequate staff training with a provision of an adequate office space;*
- *to provide for donors resources in accordance with an earlier established schedule in order to finance regular Agency activities in the first two years of operation until banks are capable to pay supervision fees as a basic resource of financing this institution.*

At the end, it is necessary to point out that all positive results of all activities in banking sector are directly dependent on the success of privatization process, foreign banks investing into domestic banks and the strength of the Banking Agency as a supervisory authority.

A T T A C H M E N T S

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| Attachment No. 2. | Review of Permanent and Net Capital and Risk Assets |
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on Banks | Review of Relative Indicators of Operation in Accordance with
the Requirements Stipulated in Articles 26 and 27 of the Law |
| Attachment No. 5. | Banks' Reclassified Income Statement |

LIST OF BANKS

No.	BANK	LOCATION	ADDRESS	PHONE NO.	FAX NO.	9/30/1998.		
						ASSETS (in 000 din.)	CAPITAL (in 000 din.)	NO. OF EMPLOYEES
1.	Banjalucka banka ad B.Luka	Banja Luka	M.Bursac 7	078/12-140	12-830	3,513,732	301,307	623
2.	Agroprom banka ad B.Luka	Banja Luka	Knjaza Milosa 19	078/33-611	44-181	159,158	36,285	66
3.	Kristal banka ad B.Luka	Banja Luka	I.F.Jukica 9	078/12-930	12-878	3,030,238	179,750	281
4.	Privredna banka ad Gradiska	Gradiska	Vidovdanska bb	078/813-333	813-205	419,657	43,321	94
5.	Privredna banka ad Dobo	Dobo	Svetog Save 1	074/41-544	33-889	3,293,149	185,482	173
6.	Prijedorska banka ad Prijedor	Prijedor	Vozda Karad ord a 9	079/12-311	11-840	1,856,447	74,061	228
7.	Semberska banka ad Bijeljina	Bijeljina	Karad ord eva 3	076/471-588	472-247	392,655	24,371	137
8.	Privredna banka ad S.Sarajevo	Pale-temporary	Sp skih ratnika 14 Pale	071/786-587	786-587	2,252,587	96,948	455
9.	Export-import banka ad Bijeljina	Bijeljina	Svetog Save bb	076/471-094	471-098	50,010	4,784	15
10.	West banka ad Laktasi	Laktasi	Karad ord eva bb	078/832-174	832-115	23,458	15,596	4
11.	Privredna banka ad Brcko	Brcko	M.Aganovica 2	076/204-055	204-222	518,700	2,469	39
12.	Ekvator banka ad Banja Luka	Banja Luka	M.Bursac 2	078/17-920	11-757	70,069	21,659	8
13.	Razvojna banka ad Banja Luka	Banja Luka	Bana Milosavljevica 4	078/12-012	17-575	524,640	148,692	1,276
14.	Gold banka ad Banja Luka	Banja Luka	Kralja Alfonsa XIII/22	078/42-114	37-100	28,379	27,381	5
15.	Postanska stedionica ad B.Luka	Banja Luka	Karad ord jevica 61	078/11-433	11-555	61,386	28,143	53
T O T A L:						16,194,265	1,190,249	3,457

BANKS' PERMANENT AND NET CAPITAL

- in 000 dinars -

No.	ELEMENTS	12/31/1996.		9/30/1997.		12/31/1997.		9/30/1998.		Index 98/97 9:5	Index 98/97 9:7
		Amount	%	Amount	%	Amount	%	Amount	%		
1	2	3	4	5	6	7	8	9	10	11	12
I	<u>Permanent capital:</u>										
	1. Shareholders' principal	331,128	60.7	331,802	56.15	361,627	59.00	615,673	51.48	185	170
	2. Increased share values	-	-	-	-	1,336	0.22	1,336	0.11	-	100
	3. Reserves	115,205	21.1	115,652	19.57	130,637	21.32	158,466	13.25	137	121
	4. Special reserves	57,363	10.7	64,048	10.84	76,000	12.40	149,147	12.47	232	196
	5. Revaluation reserves	130	-	268	0.05	151	0.02	32,396	2.71	12.088	21.454
	6. Lump sum reserves	39,905	7.3	43,863	7.42	39,741	6.48	193,030	16.14	440	486
	7. Profit	1,252	0.2	35,246	5.97	3,458	0.56	45,984	3.84	130	1.330
	T O T A L:	544,983	100.00	590,79	100.00	612,950	100.00	1,196,032	100.00	202	195
II	<u>Deductions:</u>										
	1. Subscribed,not paid cap.	6,176	29.9	6,177	26.60	6,967	30.26	1,099	3.24	18	16
	2. Permanent investments	1,630	7.9	2,611	11.24	2,338	10.16	4,855	14.31	186	208
	3. Own participation	-	-	-	-	-	-	-	-	-	-
	4. Loss	12,846	62.2	14,437	62.16	13,715	59.58	27,972	82.45	194	204
	T O T A L:	20,652	100.00	23,225	100.00	23,020	100.00	33,926	100.00	146	147
III	Capital (I-II)	524,331		567,654		589,930		1,162,106		205	197
IV	Potential losses required reserves	554,557		641,798		639,949		1,121,809		175	175
V	Net capital (III-IV)	-30,226		-74,144		-50,019		40,297		-	-
BANK'S RISK ASSETS											
VI	<u>Ukupna rizi-na aktiva</u>										
	1.Total balance risk assets	1,806,514		1,988,539		2,645,929		4,990,251		251	189
	2.Total off-bal.risk assets	811,662		880,837		433,090		807,320		91	186
	T O T A L:	2,618,176		2,869,376		3,079,019		5,797,571		202	188
VII	<u>Odbitne stavke:</u>										
	1. Permanent deposits	1,630		2,611		2,38		4,855		186	208
	2. Potential losses required reserves	554,557		642,052		639,949		1,121,809		175	175
	T O T A L:	556,187		644,663		642,287		1,126,664		175	175
VIII	Net risk assets (VI-VII)	2,061,989		2,224,713		2,436,732		4,670,907		210	192

**BANKS' CLASSIFIED BALANCE AND OFF-BALANCE SHEET ASSETS
AS OF 9/30/1998**

- in thousand dinars -

Ord. no.	Form KA	TYPES OF CLAIMS	NON-CLASSIFIED	C L A S S I F I C A T I O N					TOTAL
				A	B	C	D	E	
1.	(A)	Loans	505,166	922,323	1,494,263	556,877	183,524	517,023	4,179,176
2.	(B)	Interests and fees	6,378	30,913	16,766	11,709	6,217	7,814	79,797
3.	(C)	Total placements(1+2)	511,544	953,236	1,511,029	568,586	189,741	524,837	4,258,973
4.	(D)	Risk off-balance sheet assets	244,922	209,929	215,107	13,335	4,274	126,373	813,940
5.	(E)	Total loan risk exposure (3+4)	756,466	1,163,165	1,726,136	581,921	194,015	651,210	5,072,913
6.	(III)	Other risk balance sheet assets	71,774	596,186	45,451	14,308	35	6,615	734,369
7.	(F)	Total risk bal.sheet & off-bal.sh.assets (5+6)	828,240	1,759,351	1,771,587	596,229	194,050	657,825	5,807,282
8.	(G)	Total non-clsified assets	10,279,245	-	-	-	-	-	10,279,245
9.	(H)	Total balance sh. & off-bal.sh.assets(7+8)	11,107,485	1,759,351	1,771,587	596,229	194,050	657,825	16,086,527
10.	(V)	Potential loan losses required reserves	-	-	-	298,115	145,536	657,825	1,101,476

NOTE: This classification has been performed in accordance with the Instruction on Unified Application of the Decision on Methods of Classification of Balance Sheet and Off-Balance Sheet Assets of Banks and Other Financial Institutions in accordance with degree of collectability.

ATTACHMENT NO. 4.

RELATIVE INDICATORS OF BANKS' OPERATION

RELATIVE INDICATORS OF BANKS' OPERATION	Banks meeting requirements		Banks not meeting requirements	
	No.	%	No.	%
1. Capital Adequacy (min. 8)	10	71	4	29
2. Capital participation in Liabilities (min. 20%)	5	36	9	64
3. Citizens' Funds participation in Liabilities (max. 50%)	7	50	7	50
4. Short-term placements/resources ratio (min. 100%)	13	93	1	7
5. Foreign currency assets/liabilities ratio (95%-105%)	9	57	5	43
6. Big loans ratio (max. 80%)	8	57	6	43
7. Permanent investments into enterprises ratio (max 15%)	14	100	-	-
8. Permanent investments into banks ratio (max. 51%)	14	100	-	-
9. Investments into fixed assets ratio (max. 20%)	7	50	7	50

RECLASSIFIED BANKS' INCOME STATEMENT

- in thousand dinars-

No.	INCOME STATEMENT ITEMS	<u>9/30/1997</u> Amount	<u>12/31/1997</u> Amount	<u>9/30/1998</u> Amount	Index 98/97 5:3
1	2	3	4	5	6
PR-1	Interest and fee income	223,357	330,106	435,698	195
RA-1	Interest and fee expenses	110,799	175,441	158,128	143
	NET interest and fee income	112,558	154,665	277,570	247
PR-2	Other income	56,634	111,199	340,383	601
	TOTAL INCOME	169,192	265,864	617,953	365
RA-2	Other expenses	44,858	88,790	325,881	726
RA-3	Write-offs and adjustments of non-paid in receivables	72,943	114,359	99,218	136
	NET INCOME	51,391	62,715	192,854	375
PR-3	Revaluation income	1	216	265	26.500
RA-4	Revaluation expenses	738	35,332	81,062	10.984
	Income and expense balance before legal obligations	50,654	27,599	112,057	221
RA-5	Legal obligations	6,730	10,950	25,450	378
	Income and expense balance after legal obligations	43,924	16,647	86,607	197
	Allocation from income into special reserve	10.189	12.096	57,722	566
	Generated income	35.424	4.551	40,029	113
	Taxes and contr. from income	228	1.105	393	172
	Income for distribution	35.196	3.446	39,636	113
	Loss	1.689	-	11,144	660