BSCEE

Review

2000

Group of Banking Supervisors from Central and Eastern Europe

Published by the Secretariat of BSCEE
Address: H-1027 Budapest, Csalogány u. 9–11.
Phone/Fax: (36-1) 214-6503

ISSN ???????????????

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Design by Tibor Rencsényi
Printed by Oláh Nyomda

Introduction

The Group of Banking Supervisors from Central and Eastern Europe (the BSCEE Group) was established in 1990, after 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. By 1996 the following seventeen countries signed the document: 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 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 co-operation and coordination in organizing common events. The primary role of the Secretariat is to provide technical support 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 1999. This publication gives an overview of the macroeconomic circumstances in the member states, and it describes banking sector developments and supervisory activities. This year a new chapter has been introduced into this publication, it contains the summary description of *bank liquidation procedures in Central and Eastern European counties.* It was prepared on the basis of the presentations given by the member countries and the replies given to the questionnaire put together by the Secretariat. The Group would like to continue this effort and each year select a particular topic with special interest to the member countries.

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 as an informative one and it lives up to your expectations. I am sure that this will help you to become acquainted with our supervisory job in the Central and Eastern European region and the cooperation among the supervisory authorities of the member countries and with the Basle Committee.

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* Secretariat has not received answer for its questionnaire in time that is why this information is not included.

1999 DEVELOPMENTS IN THE BANKING SYSTEM OF THE MEMBER COUNTRIES

1999 DEVELOPMENTS IN THE ALBANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

From a general point of view, economic developments during 1999 may be considered as a natural development of the consolidation of the last year achievements. The most remarkable element of the program was the maintaining of price stability.

Latest figures indicate that the economy grew by 8% while inflation decreased at an unprecedented rate. The economic growth contributed to a further increase of GDP per capita, which in dollar terms is estimated to be at USD 1100.

Beyond any expectation, the annual inflation rate at the end of December 1999 was negative, at –1.03%. However, the average annual inflation rate was positive, at the level of 0.4%. Both monetary and fiscal policies complied with the commitments of the authorities, and consequently their effect on inflation was positive. On the other hand, the large capital inflows registered during 1999 had a direct influence on the exchange rate, contributing further to the price stability. The challenge remains to ensure the price stability in the longer term.

Foreign exchange reserves of the Bank of Albania increased during 1999, covering 5.2 months of imports of goods and services. Current account increased by 2.6 percentage points as compared to the previous year, mounting to 4.1% of GDP. Foreign debt was further reduced to 25.4% of GDP. During the whole year, the domestic currency, lek, was stable, with some slight appreciation tendencies, mainly contributed to the larger inflows as compared with the previous year.

According to official sources on employment, it is observed that the labour market continued to decline. The unemployment rate registered by end of December was 18%. Incomes (reported by the average wages of the public sector) increased by 32% in real terms compared with the previous year.

Despite the difficulties due to the developments in the region, both monetary and fiscal policies proved to be effective. Pressures to deviate from the fiscal targets were largely smoothed by contributions of the international community, and therefore, the budget deficit remained within the projected targets. However, on the income side, with the starting of the conflict in Kosovo there was a decline in tax collections. On the expenditure side, the realization of the program of investments and the timely spending of public funding continued to be serious problems for financial authorities.

Favorable developments on prices, on performances of the local currency and bank deposits, provided an environment for a relaxing monetary policy, which continued during the whole year of 1999.

DEVELOPMENT OF THE BANKING SYSTEM (OFF-SITE SURVEILLANCE)

At the end of 1999, the Albanian banking system improved its financial situation. The profit resulted to be Lek 1.3 billion, while in the two previous years the banking system suffered considerable loses of Lek 7.9 billion and Lek 3.2 billion, respectively, for 1997 and 1998.

Considering the structure of the Albanian banking system, the main reason for this profit is thought to be the favorable climate for the banks, caused by the continuous decrease of the interests of deposits in leks. The reduction of this rate reduced the costs of funds (lek liabilities[1]) of the banks. On the other hand, the yield of the treasury bills and the lending rates have been reduced, although at a slower pace. This has lessened the pressure on banks and has increased the possibilities for profits. Therefore, the net income from interests for the banking system was a positive Lek 5.1 billion at the end of 1999, while at the end of 1998 it was negative for Lek 39.9 million. The profits of 1999 improved the capital position of the banking system. In general, the Albanian banking system is inadequately capitalized because of the lack of capital in the group of state-owned banks. The capital adequacy norm for the system is 8.2%, which is below the standard. The profit of Lek 973 million of the state-owned banks is one of the sources that will improve the capital basis. Actually, the capital's inadequacy in these banks has been reduced from 40% at the end of 1998 to 11% at the end of 1999. The capital adequacy level for the other two groups (joint-venture banks and private banks, 44.9% and 43.5%, respectively) is higher than the minimum approved standard (12%). This is an important fact that leaves space for these banks to extend their activity in the future without harming the capital position.

The capital position was strengthened also by the decision taken in March 31, 1998, by the Supervisory Council of the Bank of Albania to increase the minimum paid capital for the existing banks up to Lek 500 million by September 1999. Almost all banks increased their capital within the determined schedule. Only three banks did not respect the schedule. Considering the conditions and the reasons for not respecting the schedule, the Bank of Albania approved its postponing for one bank until February 2000 and for two other banks until the end of 2000[2].

Although it can be said that lending activities of the banking system is limited compared to the total of the balance sheet, covering only 4.2% of it, it is important to deal with the quality of loan portfolio.

The most notable problems in the quality of loan portfolios were encountered during the 1990s, forcing the Bank of Albania to suspend lending activities for the state-owned banks and one private bank. In 1999, because of the extension in this activity of many private banks, the situation of the credit portfolios improved somewhat. Standard loans represent 39.7% of the total outstanding loans for the entire banking system, while 87.9% of the loan portfolio of the state-owned banks are nonperforming loans.

Such a classification of the portfolio – being an inherited problem throughout the years – has not significantly increased financial expenses through the creation of reserve funds to cover the credit losses. These expenses represent only 4% of the total of financial expenses for the banking system.

During 1999, the structure of the banking system did not show any notable change. The Albanian banking system remains dominated by the Savings Bank and its segmented activities. State-owned banks are concentrated in Lek activity, while private banks in foreign exchange activity. In general, the banking system is not aggressive in the lending activity. Total loans during one year increased only 14% while the total of current accounts and deposits increased by 23%.

[1] Lek liabilities represent 69.5% of total balance of banking system. Their concentration is different for different groups of banks. More specifically, the share of lek liabilities in total liabilities is 81.9% for state-owned banks and 8.4 and 18.8% for joint-venture and private banks, respectively.

[2] This bank increased its capital within February 2000.

LICENSING AND PRUDENTIAL REGULATIONS

The passing of the law on "The banks in the Republic of Albania" in July 1988 forced the reviewing of the whole regulatory framework of the banking supervision to provide compliance with the clauses of the new law. The accomplishment of the 25 core principles of the Basle Committee on Matters of the Banking Supervision was the focus of attention of the reformulation of supervisory rules. The standard manual of accounting for all banks was implemented in January 1, 1999. This required agreement between the new chart of accounts and the banking supervision rules, especially those that include accounts of different indicators.

13 regulations were revised or formulated as during 1999. Currently, the regulatory framework in the area of banking supervision is considered almost complete and broadly in accordance with the respective international standards.

In 1999 the Bank of Albania licensed:

– three new banks, namely[3] :
  FEFAD Bank
  the First Investment Bank, Tirana branch and
  Intercommercial Bank
– a nonbanking financial institution[4] "Unioni Financiar" and
– ten foreign exchange bureaus[5] .

Based on the law "On Banks in the Republic of Albania", the Bank of Albania is allowed to extend its supervising authority even on nonbanking entities that exercise financial activity. For this reason, the framework of licensing regulations was further completed by the approval of the regulation "On licensing the financial activities of nonbanking subjects in the Republic of Albania". This increases the safety of the financial system in our country, especially after the disturbances caused by the 1997 crisis.

Regulations approved and revised by the Supervising Council of the Bank of Albania during 1999.

- The regulation "On the amount and completion of the minimal initial capital for permitted activities for banks and foreign banks branches" sets the conditions when the extension of the activity of a bank is allowed.
- The regulation "On requirements to be met by the administrators of banks and foreign banks branches" the new version determining the conditions that are to be met by the administrators of the banks that exercise banking activity in the Republic of Albania.
- The guideline "On the regulatory capital of the bank" determines the ways of calculating this indicator, in order to cover credit risk.
- The regulation "On the foreign exchange open position" and the guideline "On the risks of foreign exchange". Both documents aim at giving to the banks a set of rules to help reduce the risk in foreign exchange activity.
- The regulation "On the capital adequacy" that determines a more conservative standard for capital adequacy, increasing it from 8 to 12%.

[3] Licenses are given based on the bank licensing regulation.
[4] Licenses are given based on the nonbanking financial subjects regulation.
[5] Licenses are given based on the currency activity regulation.

- The regulation "On foreign exchange activity" clarifies the allowed and non-allowed activities in the capital account and current account. The criteria based on which money transfer operations from and to the Republic of Albania are settled by this regulation, and the amounts of foreign exchange allowed to enter and to leave its territory are determined. The regulation divides the payments into commercial and noncommercial categories and describes the required documentation to accomplish the payments.
- The regulation "On the market risks" is a new regulation, introduced for the first time, describes the criteria base on which the adequate level of the regulatory capital to cover the market risks is determined.
- The regulation "On the large risks" describes the criteria based on which the large risks undertaken by a bank as a result of loan portfolio concentrations to a single borrower or a connected group of borrowers will be controlled.
- The guideline "On the internal control of the banks" gives instructions for the commercial banks on how to organize more effective internal controls and how to report the results of these controls to the Bank of Albania.
- The regulation "On the participation of the commercial companies capital from the banks and foreign banks branches". In case the banks or the foreign bank branches require taking part in the capital of commercial companies, they should first provide themselves with the respective authorization from the Bank of Albania. Thus, this regulation categorizes the conditions under which such authorization can be given and which criteria that should be met by each entity.
- The regulation "On the banks liquidity ratio" determines the quantitative levels based on which the banks would restrict liquidity risks. During the application of this regulation, it was noticed that the determination of a quantitative level was not an efficient way to control and to manage the liquidity risk because it settled a unique norm for banks with different liquidity profiles. Therefore, the regulation was revised in January 2000 determining the principles based on which each bank manages itself the liquidity risk.

ON-SITE INSPECTION

On-site inspections are carried out by the On-site Inspection Unit, which is part of the Bank Supervision Department. During 1999, the inspections were carried out by 14 banking inspectors, who are responsible for inspecting 13 second-tier banks and 15 foreign exchange bureau. This is the number of inspections carried out:

– 22 general inspections, out of which
  7 in second-tier banks and
  15 in foreign exchange bureau.
– 18 special-target inspections in the second-tier banks.

Banking supervision and bank inspections, based on the laws and rules in effect, are exerted on all banks without making differences due to the origin of their capital (foreign, domestic, state-owned or private) or whether they are banks or foreign banks branches.

During 1999 examination of banking activities concentrated on evaluating the following:

- Strategic objectives developed by the individual banks and foreign branches;
- The reasonableness of individual business plans; and
- The adequacy of internal positions and procedures adopted by the banks and foreign branches.

Identifying, measuring, controlling and monitoring the risks the banks are faced with and especially the risks of the most important activities have been among the main directions of on-site inspection. Special care has been taken towards the strengthening of the role of internal control, acquaintance with the bank staff with internal acts and supervising authority, the completion, apart of increasing the banks' activity with the necessary structures.

The complete inspection period for each bank, as a rule, has been decided to occur every 18 months. On-site inspections are carried out starting from the risk scale and the financial situation of a particular bank in order to have enough time to take correcting measures.

An important development in the inspection process of the banks is considered a compilation and usage of the standard examination report. The examination report is a written communication that is used to present examination findings and recommendations to the directors of the Bank of Albania and to the directing council of the inspected bank. It contains the most important achievements, conclusions and recommendations for corrections that are a result of an inspection.

STATISTICAL TABLES

Number of Banks (at year-ends)

Type of Banks*	1997	1998	1999
State-owned banks (100%) (G1)	3	2	2
Joint-ventures (G2)	2	2	2
Banks with foreign capital (G3)	4	6	9
Banks, total	**9**	**10**	**13**

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

Ownership Structure of Banks in 1999 on the Basis of Registered Capital (%) (at year-ends)

Item	Type of banks			Total 1999
	G1	G2	G3	
State ownership	100.0	40.0	0.0	37.0
Other domestic ownership				
Domestic ownership total	100.0	40.0	0.0	37.0
Foreign ownership (private banks)	0.0		100.0	44.0
Other foreign ownership (joint-venture)		60.0		19.0
Foreign ownership total	0.0	60.0	100.0	63.0
Banks, total	**100.0**	**100.0**	**100.0**	**100.0**

Item	1997	1998	1999
State ownership	63.5	53.6	37.0
Other domestic ownership			
Domestic ownership total	63.5	53.6	37.0
Foreign ownership	13.0	20.3	44.0
Other foreign ownership (in j-v)	23.5	26.1	19.0
Foreign ownership total	36.5	46.4	63.0
Banks, total	**100.0**	**100.0**	**100.0**

Distribution of Market Shares in Balance Sheet Total (%)

Type of banks	1997	1998	1999
G1	89.9	85.1	81.4
G2	6.5	5.8	5.8
G3	3.6	9.1	12.8
Banks, total	**100.0**	**100.0**	**100.0**

* *based on assets*

Profitability of Banks

Type of Banks	1997		1998		1999	
	ROA	ROE	ROA	ROE	ROA	ROE
G1	-6.3		-1.9		0.5	
G2	0.4	0.8	1.2	2.9	1.6	6.1
G3	-5.0	-15.7	-0.9	-4.4	0.3	2.0
Banks, average	**-5.9**		**-1.7**		**0.6**	

The Structure of Assets and Liabilities of the Banking System in 1999 (%) (at year-ends)

ASSETS *(as percentage of total assets)*	1998	1999
1. TREASURY OPERATIONS AND INTERBANK	79.0	81.2
1. Cash in hand	1.4	1.7
2. Central Bank	10.0	10.5
a. Compulsory reserves	8.2	7.7
b. Other	1.7	2.8
3. Treasury bills and other bills for refinancing with the CB	43.9	46.8
a. Treasury bills	43.9	46.8
b. Other bills eligible for refinancing	0.0	0.0
provisions for other bills eligible for refinancing	0.0	0.0
4. Accounts with banks, credit inst. & other fin.inst.	23.7	22.2
a. Current accounts	1.6	1.8
b. Deposits with banks, credit inst. & other fin.inst.	21.9	20.0
c. Loans to banks, credit institutions and other fin.inst.	0.0	0.0
d. Other accounts	0.3	0.4
2. OPERATIONS WITH CUSTOMERS (net)	11.6	10.7
1. Loans and advances to private sector and individuals	4.1	3.9
a. Short term loans	1.7	1.5
b. Medium term loans	0.9	0.9
c. Long term loans	0.9	0.7
d. Real estate loans	0.6	0.9
e. Finance lease contracts	0.0	0.0
2. Loans and advances to public administrations	7.4	6.6
a. Current accounts	0.0	0.0
b. Loans	0.1	0.1
c. Other accounts	7.4	6.5
3. Other customer accounts	0.1	0.3
3. SECURITIES TRANSACTIONS (net)	3.5	0.8
a. Fixed income securities	3.5	0.8
b. Variable income securities	0.0	0.0
c. Securities purchased and sold under repurchase agreement	0.0	0.0
d. Collateral paid	0.0	0.0
e. Premiums received	0.0	0.0

PROVISIONS	-6.0	-5.8
Provisions for loan losses (principal + interest)	-6.0	-5.4
Provisions for investments	0.0	-0.4
4. OTHER ASSETS	2.7	4.3
a. Other assets	0.4	0.2
b. Agent transactions	0.0	0.0
c. Inter-office accounts	0.2	2.6
d. Suspense, difference and position accounts	2.1	1.5
Suspense accounts	1.4	1.4
Position accounts	0.7	0.0
e. Value added tax	0.0	0.0
5. FIXED ASSETS	3.1	3.0
a. Participating interests	0.6	0.7
b. Affiliates	0.0	0.0
c. Fixed assets (net)	2.5	2.2
Amortization	-0.3	-0.5
d. Difference of revaluation	0.0	0.0
TOTAL ACCRUED INTEREST	0.1	0.1
Total accrued interest (Class 1)	0.0	0.0
Total accrued interest (Class 2)	0.1	0.1
Total accrued interest (Class 3)	0.0	0.0
TOTAL	**100.0**	**100.0**

LIABILITIES AND SHAREHOLDERS' EQUITY *(as percentage of total assets)*	**1998**	**1999**
1. TREASURY OPERATIONS AND INTERBANK TRANSACTIONS	1.4	1.3
a. Central Bank	0.1	0.3
b. Treasury bills and other bills eligible for refinancing with the bank	0.0	0.0
c. Current accounts with banks, credit inst. & other fin.inst.	0.7	0.5
d. Deposits from banks, credit inst.& other fin.inst.	0.4	0.4
e. Borrowing from banks, credit inst.& other fin.inst.	0.2	0.1
f. Other accounts with banks, credit inst. & other fin.inst.	0.0	0.0
2. OPERATIONS WITH CUSTOMERS	83.0	82.9
1. Public administrations	1.1	1.1
a. Current accounts	0.9	0.9
b. Demand deposit accounts	0.1	0.0
c. Term deposit accounts	0.0	0.0
d. Borrowings	0.0	0.2
e. Other accounts	0.0	0.0
2. Private sector	81.9	81.9
a. Current accounts	13.0	13.0
b. Demand deposit accounts	1.4	2.2
c. Term deposit accounts	65.5	63.9
d. Other customer accounts	2.0	2.8
3. SECURITIES TRANSACTIONS	0.0	0.0
a. Debts represented by securities	0.0	0.0
b. Securities under REPOs	0.0	0.0
c. Collateral on securities transactions	0.0	0.0
d. Premiums on financial instruments	0.0	0.0
4. OTHER LIABILITIES	6.3	8.9
a. Other liabilities	0.4	0.9
b. Agent transactions	2.1	2.9
c. Inter-office accounts	0.9	3.5
d. Suspense, difference and position accounts	2.9	1.7

Suspense accounts	0.9	0.4
Position accounts	2.0	1.3
e. VAT	0.0	0.0
5. PERMANENT RESOURCES	5.7	4.8
a. Grants and public funding	0.0	0.0
b. Provisions	2.8	1.2
b1. Prov. for risks and expenses	0.1	0.3
b2. Other provisions	2.7	0.9
c. Subordinated debt	0.1	0.0
d. Shareholders' equity	2.8	3.6
Paid in capital	4.8	4.5
Share premiums	0.0	0.0
Reserves	4.6	3.6
Difference of revaluation	0.0	0.1
Retained earnings	-5.1	-5.1
Current year profit (loss)	-1.6	0.5
TOTAL ACCRUED INTEREST	3.5	2.0
Total accrued interest (Class 1)	0.0	0.0
Total accrued interest (Class 2)	3.5	2.0
Total accrued interest (Class 3)	0.0	0.0
Total accrued interest (Class 5)	0.0	0.0
TOTAL	**100.0**	**100.0**

Solvency Ratio of Banks

Type of Banks	1997	1998	1999
G1	-22.3	-57.7	-11.0
G2	83.6	76.8	44.8
G3	73.8	43.6	43.5
Banks, average	**5.5**	**-8.9**	**8.2**

Asset Portfolio Quality of the Banking System

Asset Classification	1997	1998	1999
Standard	34.8	40.9	48.0
Special mentioned	7.1	2.4	2.9
Substandard	9.3	7.4	6.6
Doubtful	6.2	6.2	2.4
Loss	33.9	40.5	36.6
Overdue loans/Total of loans	45.0	41.0	32.7
Classified Total	91.3	97.4	96.5
Provisions	**45.7**	**46.9**	**44**

The Structure of Deposits and Loans at year-end in 1999 (%)

	Deposits	Loans
Households	82.7	27.2
Public Sector	7.8	53.0
Private Sector	9.5	19.8
Total	**100.0**	**100.0**

The Structure of Deposits and Loans by time at year-end in 1999 (%)

Maturity of Deposits		Loans	
At sight	39.5	Long-term & Medium-term loans	64.0
Within one year	56.7	Short-term loans	36.0
Over one year	3.8		
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		
	1997	1998	1999	1997	1998	1999
G1	23.9	21.6	21.9	21.1	23.7	18.1
G2	97.9	97.3	93.3	97.6	98.1	91.6
G3	86.8	81.5	81.7	91.4	91.8	81.2
Banks, average	31.0	29.7	21.9	28.7	27.9	30.5

Structure of Incomes and Expenses for Banks

Incomes	1997	1998	1999
Gl	94.7	93.3	88.8
G2	3.0	2.1	2.8
G3	2.3	4.5	8.4
Banks, total	**100.0**	**100.0**	**100.0**

Expenses	1997	1998	1999
G1	95.6	93.9	89.2
G2	2.0	1.6	2.3
G3	2.4	4.5	8.5
Banks, total	**100.0**	**100.0**	**100.0**

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

Income	1998	1999
Interest income	67.8	66.0
Income from operations with securities & other fin.operations	0.3	0.1
Banking services commissions	3.7	4.1
Income from leasing operations	0.0	0.0
Other banking operations income	0.0	0.2
Profit on FX operations	25.5	25.5
Reversals of provisions for depreciation of fixed assets	0.0	0.0
Reversals of provisions for depreciation of receivables	2.1	3.0
Extraordinary income	0.6	1.0
Banks, total	100.0	100.0

Expenses	1998	1999
Interest expenses	62.3	54.6
Expenses and losses on securities transactions & other fin.operations	0.0	2.4
Commissions	0.2	0.4
Expenses for leasing operations	0.0	0.0
Other banking operating expenses	0.5	1.8

Losses on FX operations	22.1	23.2
Operating expenses	5.2	6.9
Amortization and provisions for depreciation of fixed assets	1.0	1.3
Losses on unrecoverable receivables and charges for provisions	8.3	7.2
Extraordinary expenses	0.2	0.6
Taxes other than income taxes	0.2	1.1
Income tax	0.0	0.4
Banks, total	100.0	100.0
Net profit after tax (in billion of Lek)	-3.2	1.3

Structure of Registered Capital and Own Funds of Banks in 1999

in mil of USD

Type of Banks	Registered Capital	/Total Assets	Own Funds	/Total Liabilities
	USD	%	USD	%
G1	22.7	1.5	4.4	0.3
G2	29.7	27.8	25.3	23.6
G3	41.2	17.5	36.7	15.6
Banks, average	93.6	5.1	66.4	3.6

Note: Rate of exchange USD/Lek =137.69

1999 DEVELOPMENTS IN THE BELARUSIAN BANKING SYSTEM

GENERAL ECONOMIC SITUATION OF THE REPUBLIC

After an economic decline brought about by the collapse in 1991 of the USSR and disruption of well-established economic links, the Belarusian economy achieved growth in 1996. An increase in GDP was from 2.8% (1996) to 11.4% (1998). The trend continued into 1999, when real GDP grew by another 3.4%. This gain was more than 70% due to increasing added value in industry, the trading and service industries being responsible for the rest.

The year 1999 saw a stable performance of industry. Industrial output in comparable prices increased by 9.7%. The highest growth rates were in mechanical engineering and metal processing (115.4%), in food industry (115.3%), in timber, woodworking and pulp and paper industries (114.2%).

In general, economic dynamics was stable, with the exception of agro-industrial production that was affected by extremely adverse weather conditions in 1999.

Foreign trade turnover of commodities and services in dollar terms dropped by 19.6% compared with 1998 (exports by 17.1%, imports by 21.8%). Export of commodities to CIS countries fell by 29.8% and increased to non-CIS countries by 18.6%. A decline in exports to CIS countries in value terms occurred in all commodity groups due to both declining dollar prices of export (by 23.6%) and physical volumes (by 7.7%), Russia being responsible for a 7.7% drop. The basic reason for this was the aftermath of the Russian financial and economic crisis.

A positive development was a 26.5% increase in physical volumes of export to non-CIS countries which was facilitated by an insignificant decline in dollar prices (by 5.3%) and by a relatively high share of exports on financial payment terms (72% versus 42% for CIS countries), as well as by the need to diversify exports because of lower CIS countries' requirements (for a number of reasons) for Belarusian goods. On the whole, physical volume of exports increased in 1999 by 3.6%.

One of the major problems in the economy and social sector is a continued price increase. In 1999, the consumer price index was 351.2%. In this connection, the Government and National Bank took measures that seek to improve financial and economic stability, with economic growth continuing at nearly 2-3% of real GDP growth, the main priority of their economic and social policy for 2000.

BANKING SYSTEM

GENERAL DESCRIPTION

In 1999, the Belarusian banking system was rather stable. As at January 1, 2000, it comprised 27 functioning banks, of which 15 were joint banks with foreign capital participation and one was a branch of a foreign bank. There are 545 affiliates. The banking system (including the National Bank) employs some 46,500 persons. Joint-stock company is the prevailing organizational and legal form.

Six banks constitute a group of backbone banks which specialize in servicing major complexes of the national economy and rendering credit support to the key state social and economic programs: Belarusbank, Belagroprombank, Belpromstroibank, Priorbank, Belvnesheconombank, and Belbusinessbank. Their share in the overall amount of active banks' operations accounts for 86.6% and keeps gradually growing. These banks have a steady functioning affiliate network throughout the country and can lend for rather large programs and facilities and develop relations with foreign partners by shifting their resources across the republic. Belarusbank, Priorbank, and Belvnesheconombank were given reliability ratings by Bank Watch international rating agency.

Banks, companies and private individuals from 13 countries are the shareholders of the Belarusian banks, namely: Russia, Great Britain, the USA, Switzerland, Germany, Austria, Latvia, Panama, Belize, Ukraine, the Bahamas, Ireland, and Finland. Foreign investments in the authorized funds of banks throughout the banking system account for nearly 4%.

Steps taken by the National Bank and banks' governing organs in 1999 helped to increase the authorized funds of 22 out of 27 Belarusian banks to the level exceeding EUR2 million, which is acceptable by the international standards.

In the system as a whole in 1999, the total amount of authorized funds increased by EUR289.6 million (a fivefold increase) – for comparison, the authorized funds amount in 1998 decreased by EUR13.3 million. In 1999, banks' authorized funds received investment worth BYB89.4 billion, USD16.4 million, and EUR3.5 million. Consequently, the banks' authorized funds totaled EUR362.2 million, as at January 1, 2000.

As of January 1, 2000, the share of legal entities in the authorized funds of the Belarusian banking system was of the order of 99%. Organs of state administration and economic entities with state ownership participate in authorized funds of 15 banks. In 1999, the aggregate own capital of the banks grew substantially (primarily, due to increasing authorized funds) – from EUR79.8 million to EUR413.5 million (a 5.2-fold increase).

Banking Supervision Development

Banking supervision methodology in Belarus is gradually approaching the international standards recommended by the Basle Committee and prudential norms applied by the Central Bank of the Russian Federation. Organization of supervision and economic norms of banks' save functioning are generally in line with the recommendations of the Basle Committee.

The following major economic standards have been established for commercial banks:

- the capital adequacy coefficient (the ratio of own capital to risk-weighted assets) may not be less than 14% during initial two years of a bank's functioning and must be at least 10% afterwards;
- the liquidity coefficient (the ratio of actual liquidity to that required during the year) must be at least 1;
- the amount of maximum risk per borrower, including related borrowers, may not exceed 20% of a bank's own funds during first two years of its functioning and 25% afterwards; and
- the maximum amount of credits extended by a bank to a natural person-insider may not exceed 2% (to all of them in the aggregate – 3%), and to a legal person-insider may not exceed 15% (to all of them in the aggregate – 30%) of the bank's own funds.

In 1999, agreements on cross-border supervision between the National Bank of the Republic of Belarus and central banks of Russia and Kazakhstan, elaborated in line with international recommendations, were signed and entered into force. Similar agreements with Ukraine and Cyprus have been worked out and are in the process of approval. Preliminary work on the preparation of cross-border supervision documents with the Baltic States and Poland is being carried out.

Conditions for Establishing Banks in Free Economic Zones

The National Bank has established a favorable treatment for setting up and regulating the activities of banks in free economic zones (FEZ) which function in four (out of six) regions of the republic: Brest, Grodno, Gomel and Minsk.

According to this treatment, the following applies to banks in free economic zones:

– the minimum authorized fund is set in the amount of EUR500,000 (for joint and foreign banks operating in the rest of the country – EUR5,000,000);
– there are no restrictions concerning the share of foreign founders (for other banks it may not, as a rule, exceed 51% and, though the limit is not "absolutely stringent", a special permission is required to exceed the share);
– banks-residents of free economic zones are exempt from the requirements concerning the maximum amount of natural persons' deposits, liabilities on bills of exchange, and some other liabilities; and
– procedures for their registration have been substantially simplified.

Besides, banks functioning in free economic zones may open their branches and representative offices within FEZs as well as outside Belarus.

STATISTICAL TABLES

Number of Financial Institutions
(at year-ends)

Type of financial institution	1995	1996	1997	1998	1999
Commercial banks	40	38	38	37	36

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

Assets	1996	1997	1998	1999
Credit to national economy	45.5	42.6	45.7	47.1
Credit to individuals	3.4	9.5	6.7	8.9
Credit to General Government, Local Government	6.4	8.5	7.0	7.7
Securities issued by legal entities (excluding banks)	0.1	0.1	0.2	0.7
Own debt securities	0.1	0.0	0.0	0.0
Required reserves	6.7	8.0	5.0	6.0
Cash assets, gold, precious metals	2.1	1.5	1.7	1.6
Assets in other banks	10.8	13.9	18.0	11.3
Participations	0.2	0.2	0.1	0.1
Permanent assets and intangibles	8.2	5.5	2.8	3.6
Correspondent accounts in other banks	10.0	6.5	8.4	7.9
Other assets	6.6	3.8	4.6	5.1
Total	**100.0**	**100.0**	**100.0**	**100.0**

Liabilities	1996	1997	1998	1999
Funds and undistributed profits	9.3	7.6	6.9	16.5
incl. statutory fund	3.6	3.1	1.4	12.2
Budget accounts	0.4	1.4	1.5	1.3
Accounts of individuals	17.3	12.9	13.3	11.3
Accounts of enterprises	29.3	33.6	36.4	37.4
Non budgetary resources and funds and resources of fiscal organizations	6.6	5.1	4.1	5.3
Debt securities	0.4	0.4	0.6	1.1
Correspondent accounts of other banks	4.0	3.3	3.4	2.0
Deposits of other banks	21.9	24.6	20.1	11.7
Credit from General Government	1.2	2.0	1.7	1.0
Other liabilities	9.5	9.2	12.1	12.4
Total	**100.0**	**100.0**	**100.0**	**100.0**

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

Type of financial institution	1995	1996	1997	1998	1999
Commercial banks	86.89	143.57	148.45	143.80	157.16

Solvency Ratio of Financial Institutions (%)

Type of financial institution	1995	1996	1997	1998	1999
Commercial banks	18.28	15.94	12.07	11.30	31.48

Asset Portfolio Quality of the Banking System

bln.roubles

Asset classification	1995	1996	1997	1998	1999
Loans, total	17,914.7	26,263.1	61,731.2	241,607.5	524,344.4
Extended loans	505.8	1,097.7	1,690.4	12,396.3	19,285.7
Past due loans	1,179.0	874.5	2,698.7	3,455.3	6,304.9
Doubtful loans	195.1	1,752.4	3,485.7	24,108.3	43,132.6
Past due interest:					
up to 30 days	286.1	306.3	457.0	1,951.2	3,756.1
more than 30 days	511.3	1,447.7	2,196.9	9,945.0	17,554.3
Special reserves	1,067.1	1,548.4	2,574.4	12,106.2	30,617.5

The Structure of Deposits and Loans (%)

	Deposits		Loans	
	1999/01/01	**2000/01/01**	**1999/01/01**	**2000/01/01**
Non financial state institutions	49.5	49.1	42.9	37.6
Private sector	20.3	22.3	44.0	45.7
Households	26.0	22.2	12.8	16.4
Nonbank financial institutions	1.3	2.2	0.3	0.3
Local Government	2.9	4.2	-	-
Total	**100.0**	**100.0**	**100.00**	**100.0**

Time Structure of Deposits and Loans

Types of Deposits	1999/01/01	2000/01/01
Demand Deposits	62.8	68.1
Time Deposits	37.2	31.9
Total	**100.0**	**100.0**

Types of Loans	1999/01/01	2000/01/01
Long-term Lending	51.2	55.7
Short-term Lending	48.8	44.3
Total	**100.0**	**100.0**

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

Type of financial institutions	Forex Assets/ Total Assets			
	1996	**1997**	**1998**	**1999**
Commercial banks	26.07	26.30	52.36	47.18

Type of financial institutions	Forex Liabilities / Total Liabilities			
	1996	**1997**	**1998**	**1999**
Commercial banks	25.75	25.82	50.21	44.74

Type of financial institutions	Off-Balance Liabilities Foreign exchange / Total			
	1996	**1997**	**1998**	**1999***
Commercial banks	26.68	29.63	9.77	2.26

Distribution of Market Shares in Balance Sheet Total

Type of financial institution	1998		1999	
	Quantity	**Market share**	**Quantity**	**Market share**
Commercial banks, total	27	100.0%	27	100.0%
incl.				
< 1 mln.EUR	9	33.3%	3	11.1%
from 1 to 2 mln.EUR	6	22.2%	3	11.1%
from 2 to 5 mln.EUR	7	25.9%	10	37.0%
more than 5 mln.EUR	5	18.5%	11	40.7%

Structure of Revenues and Expenditures of financial institutes

bln.roubles

Revenues	1996	1997	1998	1999
Interest revenues	9,936.9	15,297.6	29,952.6	165,857.0
Commission	1,763.6	3,083.9	5,854.4	25,258.3
Other revenues	2,567.0	3,470.1	12,604.7	41,588.6
Other operational revenues	140.6	236.9	987.9	2,067.4
Reserve settlement	452.5	417.2	680.6	2,071.5
Unanticipated revenues	1.0	2.5	4.0	14.2
Total revenues	**14,861.6**	**22,508.2**	**50,084.2**	**236,857.0**
Balance	*14,861.6*	*22,508.2*	*50,084.2*	*236,857.0*

Expenses	1996	1997	1998	1999
Interest expenses	6,878.2	10,107.6	19,637.7	102,971.7
Commission	459.8	370.1	963.6	3,442.0
Other expenses	1,454.9	2,373.6	7,955.3	31,063.9
Other operational expenses	4,101.9	7,563.2	14,988.1	73,970.2
Allocation to reserve	1,250.2	1,286.2	4,428.0	16,183.7
Unanticipated expenses	1.4	1.6	8.9	1.9
Total expenses	**14,146.5**	**21,702.3**	**47,981.6**	**227,633.4**

Economic revenue	1996	1997	1998	1999
	715.1	805.9	2,102.6	9,223.6
Balance	*14,861.6*	*22,508.2*	*50,084.2*	*236,857.0*

Excluding banks under liqiudation

Structure of Registered Capital and Own Funds of financial institutes

Commercial banks	Registered capital / Total assets		Own Funds / Total liab.	
	USD	**%**	**USD**	**%**
1999/01/01	22,0 mln.	1.23	93,3 mln.	5.20
2000/01/01	311,8 mln.	12.16	417,0 mln.	16.26

1999 DEVELOPMENTS IN THE BULGARIAN BANKING SYSTEM

THE BULGARIAN NATIONAL BANK MARKED ITS 120TH ANNIVERSARY ON 25 JANUARY 1999

One of Bulgaria's most prestigious institutions, the BNB noted the occasion with a special Anniversary Program of Events. This included publishing a detailed, annotated and illustrated History of the Bank; a collection of archival documents from 1879 to 1900 (jointly with the Council of Ministers' Central Office of Archives, and first stage in a project to publish major Bank documents from inception to 1989); a catalogue of all banknotes issued by the BNB; and a catalogue of the BNB Art Collection, whose best works went on a temporary show at the National Art Gallery as part of the Anniversary. The BNB headquarters hosted a public exhibition on money in the Bulgarian lands from antiquity to the present. A commemorative coin was minted for the occasion. The scientific conference on the Art of Eastern European Central Banking in the 1990s saw participation by central bank executives from the region and leading nations. The Anniversary Program contributed to BNB's institutional consciousness, which is an indispensable condition for raising the Bank authority and effectiveness.

MACROECONOMIC CIRCUMSTANCES

Regardless of the global economic uncertainty and the turmoil in the Balkan region, 1999 Bulgaria succeeded in defending its economy against a new collapse because the pace of its extended political, economic and social transformation finally accelerated. Over the first half of the year, unfavorable circumstances in the international markets, limited economic growth in the EU, and the Kosovo crisis, all exerted negative influence on the balance of payments. Exports slumped by 17.8% on an annual basis. After military operations ended, the economic situation considerably improved. In the second half of the year, the GDP grew by 4.5% on an annual basis and exports showed real growth of 7.3% in the third quarter and 8.6% in the last quarter. Consumption and income from industrial output also increased in the second half of the year. GDP grew by 2.4% in the whole 1999, versus 3.5% a year earlier and annual inflation was 6.2% versus 1% a year before. In December, the country received an official invitation to start negotiations for EU accession. This represented a positive appraisal of the reforms made and provided a guarantee for a consistent and controlled adoption of European rules, standards and models of governance.

Due to a continued recession in the industrial sector and radical restructuring of the economy, the volume of the industrial output decreased by another 12.5% following a decline by 13.7% in 1998. Exports shrank by 5.4% and imports increased by 10%, pushing the foreign trade deficit to USD 1,064 million compared to USD 381 million a year ago. In 1999, the current account deficit reached USD 659.1 million from USD 61 million in 1998. The balance of payments ended at a surplus of USD 86 million, due to the improved financial account, compared to a deficit of USD 95 million in 1998. Constrained by the tight fiscal policy imposed by the Currency Board, the BGL base interest rate was reduced several times during 1999 reaching 4.5% at the end of the year. Its annual average of 4.7% fell by 50 basis points compared to the previous year. In 1999, the state budget posted a 1% deficit against a 1.1% surplus in 1998. Gross external debt fell by 2.6% to USD 9,989 million and gross domestic debt swelled by 8.4% to BGL 5.2 billion.

Economic restructuring, although slower than planned, was faster than hitherto. The program for restructuring those state enterprises in the isolation list was completed. At year's end, 71% of fixed assets earmarked for privatization were sold. However, the management buy-out, extensively applied, had proved to be ineffective method for denationalization due to deficiencies in capital, long-term economic interest, know-how and management skills. Foreign direct investments reached USD 770.4 million, 43.4% more than in 1998, covering the current account deficit. Foreign investment from 1992 to 1999 reached USD 2.8 billion - much lower than the comparative figures for the other CEE countries.

The accelerated privatization, deep economic malaise and transformation of the state administration worsened the unemployment rate by 3.8 points to 16%. Irrespective of the moderate increase in real personal income, the standard of living and consumer demand remained remarkably low compared to European standards.

The domestic foreign exchange market emulated the developments in the international markets. The Bulgarian lev, pegged to the euro at the beginning of the year, depreciated against the US dollar by more than 16%. The demand for short-term government securities markedly exceeded their supply and the yield dropped from 5.1% to 4.5%, thus driving the BGL interest rate. The capital market remained marginal and illiquid.

DEVELOPMENT OF THE BANKING SYSTEM

For a third consecutive year banks continued to pursue a policy of conservative market behavior and maintenance of low-risk assets and high capital adequacy ratio: a clear sign that banks were extremely prudent in terms of risks related to economic processes in the country. Return on assets (ROA) of the banking sector in 1999 was 2.4% (against 1.7% in 1998), and return on equity (ROE) 20.9% (against 15.8% in 1998). Banking penetration rate, however, stays low with banking assets to GDP of 36% and loans to GDP of some 11%. The emergence of Bulgarian banks as major economic and financial agents, and their future position in international markets will depend on the pace of economic reform, and on restructuring of banks' activity and organization.

During 1999 the three biggest Bulgarian banks[1] (Bulbank, DSK Bank and the United Bulgarian Bank) sustained their sizeable shares in total sector assets: 52%, including 38% from lending, 74% from securities in investment portfolio, and 56% from securities in trading portfolio). This group concentrated 56% of all bank deposits of non-financial institutions and other customers. The group which ranks second by size and signifi-

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[1] To ensure precise monitoring of changes and their dynamics within the system, in 1999 commercial banks were reclassified into five groups from the previous three. This was intended to improve the precision of market share surveys, the nature of business profile, and comparability in terms of supervisory regulations. Based on these criteria, commercial banks were divided into four classification groups according to balance sheet size: Group I - over BGL 500 million; Group II - from BGL 300 million to BGL 500 million; Group III - between BGL 100 million and BGL 300 million; and Group IV - up to BGL 100 million; Group V comprises foreign banks' branches.

cance (Biochim, the Bulgarian Post Bank, Société Générale Express Bank, and Hebros Bank) experienced a decline of approximately 1%, the result of restructuring. However, this group had a significant market share comprising 19% of total banking sector assets (against 20% in 1998). No significant changes occurred in the market shares of banks included in the other three groups. In the group of foreign banks' branches, ING Bearings, which owns half of the assets in the group, participated most actively in the market.

The number of foreign investors in the banking sector continued growing and, they controlled at year's end nearly 47% of assets. The most significant changes reflect acquisition of equity stakes upon a permit from the BNB by foreign investors as Refco Capital Markets, AIG-New Europe Fund, Société Générale, and the Regent Pacific Group. After several years of delay, the local state-owned Nasarchitelna Banka AD was established to promote small- and medium-scale business. Both with the first private Turkish bank in Bulgaria, Demirbank (Bulgaria) A.S., obtained banking licenses and started operations. Citibank was also granted a license and is expected to start operations in mid-2000. Increased competition brought about something of a revival in the credit market and the launch of new customer friendly banking products.

The total assets' value of banks in liquidation as of December 31, 1999 (BGL 688 million, including cash balances) covered 49% of recognized and approved claims, which amount to BGL 1,390 million. Low collection rates on loans and other claims combined with difficulties in selling fixed tangible assets consistent with the lack of markets and demand did not contribute to replenishing the mass of bankruptcy as quickly as envisaged. Liquidation costs as of 31 December 1999 covered 40% of collected receivables. The sale of property and the sale of banks as going concerns, as set forth in Article 46, para. 4 of the Transitional and Final Provisions of the 1999 Law on Banks, is aimed to complete the process and concentrate remaining assets in one center created to that end – the Unified Revenue Agency.

A number of companies were interested in bankrupt banks and applied for a license to conduct bank transactions. The applications were rejected mostly due to the unacceptable amount offered to satisfy these banks' creditors, the lack of transparency in intentions and in the origin of funds.

Bank Assets and Liabilities

By the end of 1999 total banking system assets increased by BGL 797 million (10.7%) in nominal terms, reaching BGL 8,223 million. In fact, this growth reflected to a greater degree the increased lev equivalent of assets foreign exchange component, resulting from the 16%-rise of the US dollar from end 1998. Assets in levs increased by almost BGL 206 million (6.1%), while assets' size in foreign currency translated into USD[2] decreased by approximately USD 39 million in real terms. Given enhanced competition and the need to cover overheads, in 1999 commercial banks cautiously restructured easy liquid and low risky assets into assets earning higher yield. The share of claims on banks remained most significant: 32%. Lending, banks' major activity, saw a growth on 1998. Loans in foreign currency increased by approximately USD 123 million (in translated USD) and loans in levs by BGL 250 million. However, the share of loans to non-financial institutions and other customers in total bank assets remained low: less than 30%.

[2] Translated US dollars: positions denominated in various foreign currencies recomputed in USD. (Used only for monitoring and comparisons.)

By the end of 1999, banking system liabilities reported a nominal increase of BGL 577 million (9%) in borrowed funds, reaching BGL 6,945 million. As in assets, this reflected a higher lev equivalent of the liabilities' foreign exchange component. In real terms, no significant decrease in foreign currency deposits was reported: approximately USD 23 million (in translated USD). Interest obligations and other liabilities were substantially reduced, resulting in an overall decrease in foreign exchange liabilities by approximately USD 130 million (as expressed in USD equivalent). In addition, lev deposits of nonfinancial institutions and other customers rose by BGL 198 million (8.5%) from end-1998. These changes suggest a restructuring of banks' deposit base, which stood stable by its volume in 1999. The low level of saving and accumulation did not allow for banks' supplies of greater volumes of long-term savings and investment products to customers.

Profitability

The Bulgarian banking sector reported a net profit of approximately BGL 195 million (a 54% increase on 1998). The net interest income stood stable over the year, marking an increase of BGL 34 million (an increase of 10.5% on 1998). The ratio between net interest income and operating expenses (81%) was lower than in 1998 (90.1%). Comparing 1999 and 1998 revenues, it should be taken into account that banks did not earn income from reintegration of provisions allocated for covering credit losses. In 1998, reintegrated provisions covered almost all general operating expenses. The growth in net interest income in 1999 was cancelled up by an increase in operating expenses. Operating profit before taxation and other extraordinary operations indicated an increase of BGL 91 million or 44.6% on 1998. It is of note that the performance of particular banks significantly diverged from the general picture, reflecting the quality of their credit portfolios, trading portfolio indicators and policies pursued.

Compliance with Prudential Requirements

During 1999 the capital adequacy ratio of the banking system stood high. The total risk component of assets changed insignificantly: BGL 2,876 million against BGL 2,797 million in 1998. The capital base of the banking system reached BGL 1,188 million, an increase of BGL 145 million (13.9%) from 1998. As a result capital adequacy indicators improved: 41.31% against the minimum required capital adequacy ratio of 12%. The growth in the capital base reflected capitalized profits and increased shareholder capital through new monetary contributions. Own capital of Group I banks increased most substantially (by 15%) due to good financial results.

The higher own capital reported by most banks may be used as a prerequisite for expanding their activity. However, it is of note that unlike the potential for an increase in risk exposures shown by Group I and II banks, the capital base of some Group III and IV banks proved insufficient for business expansion.

High capital adequacy ratios primarily reflected commercial banks' conservative policy of placing funds in low-risk investments. The degree of assets risk stood constant primarily reflecting the improvement and stabilization of credit portfolio quality. The total moderate lending growth had a positive effect on the classification of claims. Consequently the ratio of overdue credits (the sum total of all overdue credits) to the capital base dropped to 39.3% by the end of 1999. Some deviations from the banking system average ratio occurred in particular bank groups. Some banks' own capital provided lower cover on risk assets. Insufficient profits reflecting low return on assets combined with the need for additional provisioning of exposures did not allow for a capital increase in many banks.

Until the end of 1999, compliance with the required limitation to large exposures had been applied only in respect to big loans. Since early 2000, concentration risk assessment will include all other exposures: balance sheet and off-balance sheet. During the review period banks continued to comply with the requirement for aggregate large exposure, with banks' total amount of large exposures in the banking system capital base falling to 60.3% (against the admissible level of 800%). Changes in the regulation intended to reduce big interbank exposures dependent on their residual maturity and the correspondent bank's licensing country on the one hand, and with the sizeable weight of these exposures in bank assets on the other, contributed most significantly to the drop of this indicator. Nevertheless, deviations of over 25% of own funds occurred in the individual exposures of a number of banks.

Placements of commercial banks in securities trading and investment portfolios during 1999 were comparatively less vulnerable to market risks as most banks invested in debt instruments of prime-rate central banks and governments. Sensitivity to market and foreign exchange risks was minimized due to smooth movements in the base interest rate, consistent with the government's fiscal policy intended to minimize government budget interest expenditure. A small number of banks traded in foreign exchange derivatives and used a portion of their resources to service foreign trade and insignificant capital flows. Some banks minded to invest in more risky securities aiming at increasing revenue from commercial operations.

The banking system total open foreign exchange position accounted for just 4.6% of banks' own funds (against 15% in 1998). The banking system's foreign exchange risk decreased more than threefold, reflecting the banks' improved management of foreign currency positions and security against foreign exchange risk through hedging operations, consistent with international forex market developments. By the end of 1998, the US dollar position accounted for half the weight of the net open foreign exchange position, while by the end of 1999 this weight was less than 1%. This change reflects the closure of a part of open US dollar positions in the last quarter of 1999 and their conversion into euro positions due to expected progressive exhausting of opportunities for gains at the existing levels of the US dollar.

Throughout 1999, commercial banks maintained high levels of primary and secondary liquidity. If there was any threat of liquidity risk so far, it was associated mostly with maturity mismatches between liabilities and liquid assets. Although average minimum balances on short-term deposits were left on account for a long time, they could not be characterized as long-term target savings, since they had to be at depositors' disposal. This impeded transformation of assets maturity into credit operations and investments with longer maturity. Therefore, commercial banks had to maintain high liquidity levels. Banking system cumulative cash flows in time horizons of up to three months were positive, as were six-month time horizons for 15 banks and branches. In addition, the country's settlement system operated normally, indicating a moderate increase in the volume of payments. Banks easily provided liquidity to meet increased non-cash payments in 1999. The ratio of high-liquid assets to borrowed funds reflected the changes that occurred during 1999: moderate lending growth and improved bank management.

BANK SUPERVISION ACTIVITIES

Supervision Policy

In the context of increased foreign participation in Bulgaria's banking system, supervisory activities and bank regulation should be sufficiently flexible and reflect financial sector developments and trends. In the pursuit of a policy of adapting international best practice, the Banking Supervision Department's priorities involved maximum harmonization of Bulgaria's banking laws and regulations with EU financial sector Directives. Therefore, the banks continued adjusting their activities in conformity with the Core Principles of the Basle Committee on Banking Supervision. It is of note that the harmonization and experience in applying these marked significant progress. To this end, the BNB accepted the IMF's proposal to make an expert assessment of the attained level of efficiency of applied procedures, as well as of the degree of transparency of banking supervision policies and activities. The assessment was published on the Internet.

Based on the amendments made to the Law on Banks in June, and in compliance with the Banking Supervision Department program, a new regulation on licenses and permits issued by the central bank was drafted, providing improved transparency in requirements and in procedures for issuing licenses.

The introduction of the euro, the single European currency, and indirect pegging of the lev exchange rate to the euro entailed changes in BNB Regulation No. 4 on foreign currency positions of banks. In practice, limitation on banks' foreign currency positions in euro and euro-included currencies were removed. Reporting forms were changed and improved.

Amendments made to Article 29 of the Law on the BNB and work on a new regulation on large exposures were intended to bring this regulator in line with the requirements of EU Directive 92/121 on monitoring and control over large exposures of credit institutions. The BNB Board adopted the Regulation coming into force in November. With its adoption, the scope of risk exposures has been widened. Exposures should be reported, that is this Regulation should apply both on an individual and consolidated basis.

BNB Regulation No. 9 on the evaluation of banks' risk exposures and the allocation of provisions to cover the risk from losses was amended significantly. Changes aimed to provide, *inter alia,* a more adequate regulation of netting exposures subject to provisioning with risk-free collateral; treatment of renegotiated and restructured credits; liberalizing requirements for the size of provision; and facilitating banks in writing off claims recognized as a loss within a shorter period.

Significant work was carried out on unifying and bringing banks' annual financial statements in compliance with international accounting standards. That has helped achieve transparency, data comparability and public accountability.

In addition to the requirements for consolidated financial statements, detailed instructions on consolidation methods were developed, providing a solid foundation for applying the principles of consolidated supervision over bank groups and financial holdings.

Off-site Supervision

During the review year, the system of off-site banking supervision (an early warning system) was improved, which helped monitoring and analysis of a database for each bank and for the entire banking system. Uniform monthly and quarterly forms of analytical reporting were introduced as an element of the system. This made for comparability and consistency of results for analysis and subsequent decision-making.

With a view to ensuring regular and timely presentation of analytical reports, banking supervision information technology were upgraded to gather and process incoming information from bank reports, maintain databases and archive them bank by bank, so as to address the needs of banking supervision staff, management and other users.

The methodology for assigning quarterly valuations under the CAEL system of indicators was improved. Estimating of ratings to banks and their systematizing was aimed at optimizing control within the supervisory strategy developed for each bank.

An important aspect of banking supervision activity was the periodic preparation of monthly statistical information on banks and aggregate information on selected indicators for the banking system, published in BNB bulletins. Work on compiling quarterly reports on performance and trends in the banking system continued.

Banking supervision plays an important role in assessing the risks of commercial banks servicing external lines of credit guaranteed by the Bulgarian Government. The Department is also in charge of preparing information related to the selection of primary dealers of government securities among the banks in order to guarantee government budget funding and liquidity.

On-site Supervision (Inspections)

In 1999 the Banking Supervision Department updated and enacted the new manual on banking supervision. The manual provides for standardized on-site supervision procedures based on a five-scale CAMELS/AIM system of assigning bank ratings and allows for higher efficiency and consistency in conducting inspections and examinations. Similarly to the early warning system, CAMELS/AIM is a risk-based approach to financial performance assessment and to the determination of appropriate and timely enforcement measures against problem banks depending on their weight and the gravity of violations found.

The rating scale ranges from one to five, rating one indicating the best financial performance and use of risk management procedures in accordance with a bank's size, complexity of operations and risk profile, and requiring minimum supervisory attention. Rating five means a critical level of financial performance and lacking or inadequate risk management procedures, as well as maximum attention from bank supervision. The number of institutions with higher ratings (one and two) increased in 1999 compared with 1998 mainly at the expense of the group rated satisfactory three.

After a series of examinations and supervisory enforcement measures, including license restrictions, at the end of 1999 the BNB appointed a conservator and, in early 2000, filed in court for the institution of bankruptcy proceedings against the only bank with the lowest rating: the Balkan Universal Bank. Banks with a rating of four reported better financial indicators at the end of the review year that gives grounds for assuming that a higher rating could be assigned to them in 2000. The positive change in the classification of banks under the CAMELS/AIM system compared with 1998 reflects their conservative risk policies.

In 1999 the Inspections Directorate carried out 19 thorough supervisory inspections, including three in banks with systemic significance from Group I and Group II, ten in banks (including a foreign bank's subsidiary) from the medium and small group, and six in branches of foreign banks. A great number of target examinations with different scopes and objectives were conducted.

In structuring bank assets, priority has been assigned to liquidity risk. Assessment and management of credit risk has been overlooked by a number of banks. In some banks, there is no risk management system, or else divisions charged with it do not operate effectively. Criteria for risk exposure classification adopted by some banks do not provide sufficient information on their actual quality and do not comply with supervisory regulations fully. Inspections found a number of mismatches in banks' lending activities despite the adoption of formal rules for effective lending (lending rules and credit committees). A number of banks do not have systems for current monitoring and analysis of financial performance, market behavior and borrower status. In some banks where equity is concentrated within a familiar circle, risk concentration was higher because of pressures to extend specific loans becoming nonperforming later. Some findings reveal improper interpretation and use of 'high-liquidity collateral' and of 'the net value' of credit exposures, which reflected negatively on the extent of allocated provisions.

In 1999, some banks failed to make consistent and decisive efforts to optimize their organizational structure and management. Some banks did not design procedures for risk assessment and management of particular types of risk (credit risk, country risk, market risk), while elsewhere breaches of these procedures were found. The future development of bank institutions is paid insufficient attention. Some banks have no strategic programs for capital provision and no financial revenue and expenditure plans itemized by potential source of revenue and item of expenditure. Restructuring of some banks' internal control is still underway and is inadequate. Staff number and qualification should be tailored to specific needs with a view to improving and increasing the volume and diversity of bank operations. The ongoing process of replacing majority shareholders impacted some banks' activities adversely.

All banks successfully resolved the "millennium bug" problem thanks to markedly upgraded and better information systems. At the same time, enhanced software potential and available databases were not used properly to improve management. Inspection findings reveal breaches of internal bank rules regulating different activities and non-compliance with legislative requirements on precision and thoroughness.

In view of the topicality of the money laundering problem, in 1999 commercial banks were given assistance in organizing their activities in compliance with the Law on the Measures against Money Laundering (LMML). The Banking Supervision Department prepared methodological instructions on designing internal rules for enactment of this Law by banks. Training on preventing the use of bank operations for the transfer of illegal capital was organized in collaboration with the Ministry of Finance's Financial Intelligence Service Office. Two glossaries were compiled: on financial crimes and on suspicious operations. These were distributed among specialized staff at commercial banks. A special manual was compiled based on improved methodology of inspections and examinations of banks on compliance with the LMML, systematizing and standardizing the procedures for these supervisory functions.

Commercial banks' operations as investment intermediaries are of crucial importance for building higher credibility in the capital market and its development. In 1999, inspections of 15 banks were carried out together with the Securities and Stock Exchanges Commission (SSEC). Serious breaches of the Regulation on requirements for trading as an investment intermediary and the Law on Securities, Stock Exchanges and Investment Companies were found: lacking requisites in contracts on individual securities portfolio management, including notification to customers on investment risks. Executive directors of banks were advised to remove breaches and infringements within foreseeable time limits while non-complying banks were sanctioned by the SSEC.

BNB Regulation No. 26 on transactions by finance brokerage houses in foreign instruments of payment was developed and amended to regulate non-bank financial institutions' activity. The Banking Supervision Department was set on exercising full control over compliance with the Law on Transactions in Foreign Currency Valuables and Currency Control (and after its repeal, the new Foreign Exchange Law) and statutory instruments thereof. The licenses of 222 finance brokerage houses and exchange bureaus were revoked. By the end of 1999 one-year per limits for conducting cash transactions in foreign instruments of payment were granted to 48 finance brokerage houses.

Legal Activity and Supervisory Measures

During the review year the Banking Supervision Department was charged with drafting amendments and supplements to the Law on Banks which came into force in June

1999. These helped improve the legal framework by clarifying terms, and expanding the scope of supervisory measures against operating banks and banks in bankruptcy with a view to accelerating bankruptcy proceedings. A number of draft amendments to supervisory regulations and new BNB regulations were reconsidered and made more precise. Newly adopted or amended Articles of Association of 12 banks were reviewed and statements of opinion on their compliance with the Law or breaches found in the entry of amendments in the Commercial Register were provided.

The Banking Supervision Department considered a number of complaints by persons who claimed their rights and interests had been infringed by commercial banks. Government offices, companies, or legal authorities brought many of these cases. Some cases were highly complex while others were groundless. This activity is of great importance for supervisory work because it provides a form of control over banks' relations with customers and is an indirect indicator of banking system status and credibility.

In compliance with established practice for the eradication of commercial banks' supervisory requirement breaches, 25 supervisory measures were imposed. Eight of these were formal and relevant orders were issued for their enforcement. Supervisory measures of an informal nature prevailed in the review period. These included meetings with banks' management to recommend various actions prepare plans and undertake commitments to remove banking regulation breaches. All formal measures were brought into effect and banks presented notifications of rectification undertaken in respect of informal measures. The record of supervisory measures imposed is permanently updated and is intended to monitor whether supervisory measures are applied properly, consistently and effectively.

Along with imposing supervisory measures, the Banking Supervision Department instituted several administrative penalty proceedings against managers, bank officials and banks. Most of these resulted in written warnings and four: with the imposition of penalties. Despite the improved effectiveness of supervisory measures, some banks failed to comply with recommendations and instructions in an adequate and timely manner. Clearly, measures under Article 65, para. 2 of the Law on Banks should be imposed more frequently.

Bulgaria is one of the first countries tested for compliance with Core Principles of Effective Banking Supervision and practical relevance of particular regulations. The modern methodology used is based on main and additional criteria graded as 'fully compliant', 'largely compliant', 'materially noncompliant', 'noncompliant' and 'not applicable'. Primary criteria show that Bulgaria applies 23 of the 25 principles. Fifteen of these are 'fully compliant', eight are 'largely compliant', and internal rules on one 'materially noncompliant' principle and a 'noncompliant' one will be harmonized with international standards in the transition period. Based on both main and additional criteria applied to the EU member countries, Bulgaria is 'fully compliant' to nine principles, 'largely compliant to 14, 'materially noncompliant' to one in the context of legislative changes on consolidated supervision and noncompliant to another one (country risk). Gradual convergence toward Core Principles of Effective Banking Supervision and their implementation by the BNB is also in correspondence with the Code of Good Transparency Practices for Monetary and Financial Policy, as approved by the IMF in general terms.

Looking at the progress in stabilizing the Bulgarian banking sector, the following main issues emerge in the context of the formal introduction of the framework of Core Principles of Banking Supervision in the local law, like: consolidated supervision and reporting; country risk; and market risks. A focus will also fall on requirements to bank management bodies to submit and implement integrated rules and procedures for, *inter alia*, corporate governance, risk management systems, and management information systems, etc.

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 Nonperforming Credits, effective since 1997;
- Law on Accounting, since 1991, last improved 1999;

Prudential Regulations of the BNB:

- Regulation No. 2 on the Licenses 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 the Internal Control 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. 20 on Issuance of Certificates under Article 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;
- Regulation No. 16 on the Requirements to the Activity of Exchange Bureaus, issued by the Ministry of Finance;
- Rules on Applying the Law on Measures against Money Laundering;

STATISTICAL TABLES

Number of Banks (operating at year -ends)

Type of bank	1996	1997	1998	1999
Top Banks	2	3	3	3
Large banks	8	4	4	4
Small and medium-sized banks	30	18	17	16
Foreign banks *	7	9	10	11
Banks, total	**47**	**34**	**34**	**34**

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

Ownership structure of banks in 1999 on the basis of registered capital (%) (at year-end)

Item	Type of banks			Total
	Top Banks	Large banks	Small and medium-sized banks	
State ownership	75.7	14.9	7.5	44.9
Other domestic ownership			31.7	8.5
Domestic ownership total	**75.7**	**14.9**	**39.2**	**53.4**
Foreign ownership	24.3	85.1	60.8	46.6
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	1999/1997
State ownership	15.0	42.6	44.9	+199.3*
Other domestic ownership	50.2	14.0	8.5	-83.1
Domestic ownership total	**65.2**	**56.6**	**53.4**	**-18.1**
Foreign ownership	34.8	43.4	46.6	+33.9
Banks total	**100.0**	**100.0**	**100.0**	-

* *The significant increase of the bank capital, that is state-owned is due to the rapid capitalizing of two top banks. Both banks have reported in the last two years huge profits, that have been transformed after taxation into share capital. This figure in 2000 is substantially smaller because of the purchase of the biggest Bulgarian bank Bulbank by Uni Credito Italiano*

Distribution of Market Shares in Balance Sheet Total (%)

Type of bank	1996	1997	1998	1999
Top Banks	48.1	56.2	51.5	51.7
Large banks	19.3	18.8	20.3	18.8
Small and medium-sized banks	7	17.1	17.4	15.4
Foreign banks *	2	7.9	10.8	14.1
Banks under conservatorship	23.6	-	-	-
Banks, total	**100**	**100**	**100**	**100**

* *Foreign banks' branches and subsidiaries established in Bulgaria. Existent and privatized 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
Cash in vault & funds in current account with BNB	8.2	12.8	10.6	11.2
Due From Banks & Other Financial Institutions	19.3	31.5	32.8	32.4
Securities in Trading Portfolio	20.0	20.6	16.7	12.7
Loans extended to non-financial institutions and other clients	45.8	15.3	24.6	29.2
Securities in Investment Portfolio	0.6	3.9	6.4	7.5
Fixed Assets	1.4	3.6	4.4	4.3
Other Assets	4.7	12.3	4.5	2.7
TOTAL ASSETS	**100.0**	**100.0**	**100.0**	**100.0**

Liabilities and Capital	1996	1997	1998	1999
Deposits by banks and other fin. institutions	31.9	9.5	7.6	7.7
Deposits by NFIs and other clients	39.1	67.7	69.2	69.9
TOTAL DEPOSITS	71.0	77.2	76.8	77.6
Other liabilities	6.0	10.8	8.7	6.8
Subordinated Debt				
Capital	10.1	4.3	8.9	10.8
Reserves	12.9	7.7	5.6	4.8
TOTAL LIABILITIES & OWN FUNDS	**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
Top Banks	120	6.5	7.2
Large banks	31.5	4.7	7.7
Small and medium-sized banks	88.8	14.8	14
Foreign banks *	82.5	24.8	40.6
Banks, total	**94.2**	**9.6**	**13**

** Foreign banks' branches and subsidiaries established in Bulgaria. Existent and privatized 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**	**1998**	**1999**
Top Banks	53.8	55.6	48.9	46.5
Large banks	46.8	46.2	51.2	51.1
Small and medium-sized banks	59.6	61.3	62	65
Foreign banks' branches	72.4	75.2	81.3	79.4
Banks, average	**54.6**	**56.4**	**54.2**	**54**

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

BGN in millions

Revenues	1997	1998	1999
Interest earned	689	457	493
Net income from fees and commissions	63	96	135
Securities income/loss (net)	7	-156	78
Forex operations income/loss (net)	1,389	-18	103
Other banking operations revenues	351	52	132
Extraordinary revenues/expenses (net)	117	12	-2
Total revenues	**2,616**	**443**	**939**

Expenses	1997	1998	1999
Interest paid	464	132	134
General operating costs	254	360	443
Reserve and provisions creation/reintegration (net)	1,272	-332	53
Other operating costs	62	58	14
Total expenses	**2,052**	**218**	**644**
Pre-tax profit	**564**	**225**	**295**
Taxes	196	77	100
Net profit	**368**	**148**	**195**

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

	1997		1998		1999	
	Deposits	**Claims**	**Deposits**	**Claims**	**Deposits**	**Claims**
Households	35.5	3.5	43.2	7.2	48.4	7.5
Government sector	9.8	9.6	7.1	23.7	4.5	17.6
Corporate	43.2	38.6	39.8	28.3	38.8	33.2
Foreign	10.5	46.3	8.7	40.5	7.2	41.3
Other	1.0	2.0	1.2	0.3	1.1	0.4
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Asset Portfolio Quality[1]

BANK	Loans (gross)	Dec.1997	Dec.1998	Dec.1999[2]
Top 3 banks	**Loans (in BGL Millions)**			**3,177,462**
	Standard %			95.1
	Watch %			2.3
	Substandard %			0.7
	Doubtful %			0.4
	Loss %			1.4
	Provisions %			4.9
Large banks	**Loans (in BGL Millions)**	**2,921,023**	**3,211,288**	**1,551,247**
	Standard %	78.7	83.6	74.9
	Watch %	2.2	3.6	4.3
	Substandard %	1.8	1.0	0.7
	Doubtful %	2.3	0.4	2.9
	Loss %	15.0	11.4	17.2
	Provisions %	25.8	13.7	19.3

BANK	Loans (gross)	Dec.1997	Dec.1998	Dec.1999 (2)
Small & medium-sized banks [3]	**Loans (in BGL Millions)**	**488,917**	**661,662**	**1,320,040**
	Standard %	76.2	76.8	87.0
	Watch %	13.8	12.1	4.9
	Substandard %	0.2	5.0	2.9
	Doubtful %	1.1	2.7	1.6
	Loss %	8.8	3.4	3.6
	Provisions %	14.6	11.9	8.1
Foreign banks	**Loans (in BGL Millions)**	**395,561**	**688,176**	**528,190**
	Standard %	83.0	89.6	89.7
	Watch %	2.0	2.9	9.1
	Substandard %	11.7	6.5	0.4
	Doubtful %	1.5	0.3	0.0
	Loss %	1.8	0.8	0.8
	Provisions %	10.1	6.0	4.1
Total of the banking system :	**Loans (in BGL Millions)**	**3,805,501**	**4,561,125**	**6,576,939**
	Standard %	**78.8**	**83.5**	**88.3**
	Watch %	**3.7**	**4.7**	**3.8**
	Substandard %	**2.7**	**2.4**	**1.1**
	Doubtful %	**2.0**	**0.7**	**1.2**
	Loss %	**12.9**	**8.6**	**5.5**
	Provisions %	**22.7**	**12.3**	**8.9**

(1) *Loans - includes loans to non-financial institutions plus deposits with banks.*
(2) *Since 1999 the group of the large banks was divided into two other groups "Top Banks" and "Large banks".*
(3) *1999 includes groups III & IV as of the new banks' classification.*

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

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

Solvency Ratio of Banks

Type of bank	1996 *	1997	1998	1999
Top banks	-	39.4	44.8	50
Large banks	19.3	18.7	29.7	28.8
Small and medium-sized banks	11.1	23.7	33.3	36.8
Foreign banks	36.2	17.2	27	n.a. **
Banks, average	17.7	26.9	36.7	41.3

* *Capital adequacy in % (excl. banks under conservatorship)*
** *The Group consists of foreign banks' branches only*

Structure of Registered Capital and Own Funds of Banks in 1999

Tipe of Banks	Registered Capital	/Total assets	Own Funds	/Total Liab.
	USD in thous.	%	USD in thous.	%
Top Banks	160,429	7.4	338,049	18.6
Large banks	57,600	7.3	90,588	13.3
Small and medium-sized banks	147,000	15.1	178,392	22.4
Foreign banks' branches	-	-	3,122	1.2
Banks, average	365,029	8.6	610,151	17.1

Consolidated Indicators of the Banking Sector (%) (at year-ends)

Item	1997	1998	1999
Equity capital leverage ratio	10.8	12.9	11.4
Share of risk weighted assets	29.2	34.7	35.3
Return on assets (ROA)	5.0	1.8	2.4
Return on equity (ROE)	71.2	14.4	18.0
Net interest margin	3.1	4.5	5.7
Net profit / earning assets ratio	6.0	8.9	5.5
Credits / deposts ratio	27.0	34.2	39.3

** 1997 the profit taxes of significant banks in privatisation procedure were reduced.*
*** 997 the high value of ROE was additionally effected by low capital base of the most of banks as well.*

1999 DEVELOPMENTS IN THE CROATIAN BANKING SYSTEM

MACROECONOMIC CIRCUMSTANCES

The main characteristics of the Croatian economy in 1999 was mild recession, with a 0.3% fall in GDP, accompanied by a further increase in unemployment, continuation of the consolidation of the banking system, and the second banking system crisis, in a situation when the new Banking Law, enacted towards the end of 1998, allowed the CNB to perform a considerably more active role. Other characteristics included stagnation in monetary and credit aggregates, further decrease in the balance of payments current account deficit and interest rates, as well as a substantial deterioration in the fiscal position.

In 1999, Croatia suffered from recession caused by the unresolved structural problems in economy, ranging from privatization and restructuring of companies to inadequate and increasingly deteriorating public expenditure structure, and by a second banking system crisis. The latter led to bankruptcy and exit from the market of several medium-sized and small deposit institutions. Add to that the Kosovo crisis and a relatively poor growth in the countries that are Croatia's major trading partners. Consequently, both components of the fiscal demand, foreign and domestic, fell for the first time since stabilization. Net exports of goods and services was the single component which positively effected growth, since the fall in imports, caused by recession, was greater than the fall in exports. Under such conditions, unemployment continued to grow as expected. In the first half of 1999, the internationally comparable rate of unemployment, measured by the Labor Force Survey (ILO), amounted to 12.6%.

Monetary policy completely reflected the economic activity stagnation, which was also evident from the stagnation in monetary and credit aggregates. Total liquid assets decreased by 0.6 billion kunas over 1999, amounting to 55.4 billion kunas. During 1999, money supply grew by a modest 0.3 billion kunas, amounting to 13.8 billion kunas at the end of the year. The increase was mainly caused by a 0.2 billion kunas growth in currency in circulation, and only to a smaller extent by the increase in demand deposits (0.1 million kunas). The increase in household demand deposits amounted to 0.2 billion kunas (8%), and decrease in corporate demand deposits was 0.1 billion kunas (2%). Such movements confirm a continuous aggravation of the corporate sector liquidity. The announced payment of government arrears in 2000 will favorably affect the recovery of demand deposits. As it is usually the case with small and open economies with considerable currency substitution, monetary policy was not capable of playing a more active role, instead, it had to focus on maintaining stability, which was seriously compromised by the pressures on the exchange rate, especially at the beginning of the year, partly due to problems in certain banks that were forced to exit the market. Another aggravating circumstance for pursuing a more active monetary policy was a failure of fiscal policy to restrain the expansion which characterized the Croatian economy for the last several years.

Inflation was maintained at a low, stable level of 4.4% on December basis, or 4.2% if a year-on-year average in 1999 is taken into account. The inflationary pressures due to kuna depreciation, increase in prices of petroleum products, telecommunication services and increase in excise duties on tobacco products and certain luxury goods did not significantly threaten the price stability in conditions of aggregate demand decline.

Balance of payments current account deficit continued to decline, which was realistic to expect in conditions of reduced economic activity. This decline would have been even greater, if there had been no Kosovo crisis, which considerably reduced exports of domestic services in comparison with the planned one. During 1999, both the export and import of goods decreased, but imports declined more, which reduced the merchandise trade deficit. Financing of current account deficit completely changed compared to the period before 1997. In 1999, foreign direct investment continued to increase almost fully covering current account deficit and becoming the most important source of financing. This role of foreign direct investment will continue in 2000, and will, at a later point, increasingly depend on the capability of Croatia to attract greenfield investments, i.e. investments in new companies or their recapitalization, in contrast to investments in the purchase of the existing companies. The latter has so far been predominant in the structure of foreign direct investments.

Interest rate movements were characterized by a fall in all interest rates, excluding those on the CNB bills and Ministry of Finance treasury bills (the CNB began to decrease interest rates on the CNB bills only in March 2000). At the beginning of 1999, the average daily interest rate on the money market exceeded 16%, under the influence of the banking system crisis, but it was progressively decreasing as the banking crisis was resolving, reaching 12.5% at the end of the year. The commercial banks' lending interest rates were reduced by more than 2 percentage points during 1999, and more than 3 percentage points compared to February 2000. This interest rate fall was positively influenced by the consolidation of the banking system, i.e. exit from the market of certain banks with high interest rates. On the other hand, the banking system crisis was a good lesson for clients and banks, warning that the level of deposit interest rates cannot be the only criterion when making a deposit. Banks reduced their deposit interest rates attempting to attract clients by high quality and a wide range of their services, which is positive, both for developing banking products and services and for reducing sources of funds' costs for banks, in view of the fact that deposits account for approximately 60% of banks' liabilities. As a result of the banking system crisis at the beginning of 1999, banks were reducing their deposit interest rates and mildly increasing their lending interest rates, so that the overall difference between the lending and deposit interest rates ranged from 9.5 to 12 percentage points, depending on whether the difference was measured by the banks' kuna (greater difference due to inclusion of currency risk) or foreign exchange activity. At the beginning of 2000, this difference was reduced to the level of 8 (without currency risk) to 9.5 percentage points. The CNB's decision to support the reduction of interest rates (reserve requirements reduction, reduction in its lending and deposit interest rates) by its measures and the government's intention to settle its arrears and prevent the generation of new ones, should be an additional incentive for the interest rate reduction. Naturally, structural problems should also be resolved, such as microeconomic inefficiency in banks, protection of creditors, i.e. expediting court procedures for collecting claims, etc.

In the period between 1998 and September 2000, within the process of banking market consolidation, the CNB proposed the initiation of bankruptcy proceedings in 13 banks and 5 savings banks. The rehabilitation process started in two banks. It is possible to say that most of the so-called "second banking system crisis" (as opposed to "the first crisis" in major state banks that were rehabilitated in mid nineties) is behind us. After exit from the market of several small and medium-sized bad banks and selling of the rehabilitated state banks to strategic investors, the Croatian banking system will be in the most favorable situation since gaining its independence.

More specifically, foreign investors will account for approximately 70% of the market in terms of assets, interest rates are falling, and banks' business results are considerably improved. The cost of "the second banking system crisis" can, at this point, be estimated at 800 million dollars (excluding income earned from the assumed privatization of rehabilitated banks).

The main characteristics of the fiscal 1999 included: a considerable mismatch between revenues and expenditures dynamics during the year, budget rebalance, central government and consolidated central government budget deficit, together with further increase in extrabudgetary funds' accounts deficit, and fiscal policy nearing the zone of unsustainability. Extrabudgetary funds have remained the main problem in implementing fiscal policy. In 1999, the negative trend continued from the previous years, which is confirmed by an increase in extrabudgetary funds' account deficit. In 1999, aggregate deficit of extrabudgetary funds amounted to 13.2 billion kunas on the consolidated basis, which is a 45.9% increase in negative balance compared to the previous year. In view of large transfers from central government budget to extrabudgetary funds, the consolidated central government account balance is only somewhat less favorable than the unconsolidated balance of the central government, amounting to -2.8 billion kunas. It should be noted that the above-mentioned deficit was mostly run up by the Pension Fund (8.2 billion kunas), Health Insurance Fund (3.2 billion kunas) and Child Benefit Fund (1.1 billion kunas). A redirection of an increasingly larger share of central budget revenues to extrabudgetary funds is the main obstacle to the tax burden relief. Therefore, it is important to point out the unsustainability of a further deficit growth in the pension and health care system in the existing conditions. In order to resolve this problem, it is necessary to immediately establish the expenditures control mechanisms and to carry out the required pension and health care system reform.

BANKING SYSTEM

The banking system of the Republic of Croatia consisted of 53 banks (including one branch of a foreign bank) and 34 savings banks (including four housing savings banks) in 1999. Total assets of the banking sector were 95.2 billion kunas at the end of 1999, with those of banks amounting to 98.5% and those of savings banks 1.5%.

The number of institutions operating in the banking system decreased for the first time in 1999: 7 banks and one savings bank went bankrupt, and only one housing savings bank was established.

The Croatian banks are of the universal type, which also was their main characteristic in previous years. 48 banks had the full authorization, meaning that they fulfilled the conditions for making foreign payments and entering into credit arrangements abroad, while only 5 banks had the limited authorization. Four major banks accounted for 57.71% of total bank assets, which means that their share in total assets increased compared to 1998 when it was 53%.

At the end of 1999, 8 banks were in majority state ownership (this number decreased to five as early as in January 2000), and 13 banks were in majority foreign ownership.

In 1999, drastic market exit measures had to be taken against several banks with risky operations (high interest rates, loans granted to connected persons, inadequate guarantees and lack of concern for recoverability of claims) that became incapable of fulfilling their obligations. The bankruptcy proceedings were initiated against seven banks and one savings bank. At the end of 1999, two banks were still undergoing the rehabilitation process.

The year 1999 was also characterized by the beginning of the implementation of the new Banking Law. Following that law, the Croatian National Bank was authorized to appoint temporary administrators and commissioners to banks with operating difficulties. During 1999, temporary administrators were appointed to several banks (one bank is still undergoing the rehabilitation and the other went bankrupt). At the end of 1999, temporary administrators were only in two banks. The temporary administrator is appointed to a bank when its potential losses exceed its risk-based capital and when it is incapable of making payments. The proposal for initiation of bankruptcy proceedings in both banks was submitted to the Commercial Court in 2000. The CNB commissioners were appointed to several banks with heavy operating losses.

After the elimination of certain unsound financial institutions from the Croatian banking system, the slight stabilization trends became again observable in the system in 1999. After losses incurred in 1998, the profit earned by banks in 1999 was 704.2 million kunas, and after the decrease in the first half of 1999 deposits started to increase slightly but steadily in the second half of the year. The decrease in interest rates was also a favorable trend. With regard to the relatively unfavorable trends in the Croatian economy and the depth of banking crisis it is not realistic to expect rapid and easy recovery of the banking system as a whole and its transformation into a modern banking system.

After resolving current crisis issues, the emphasis was laid on long-term solutions, such as the banking system restructuring and its recapitalization, primarily by attracting the strategic investors who shall bring the new technology and improve the operating quality.

Structure of Banks' Balance Sheets

At the end of 1999, total bank assets were 93.8 billion kunas and decreased by 9.1% compared to 103.2 billion kunas accumulated at the end of 1998. On the one hand, this decrease in assets resulted from reduced number of banks, and on the other from the implementation of the new banking regulations on reporting in 1999. The new banking regulations, which comply almost fully with reporting requirements, laid down by the International Accounting Standards, were implemented for the first time in 1999. This resulted in a change in policy for reporting single asset items (such as, for example, loans and interest). These are currently reported as adjusted for (decreased by) the specific reserves for potential losses. In addition, the specific reserves for potential losses are also the item, which is deducted from total assets. If we exclude the influence of this change, the fall in assets amounts to around 2.5%.

Structure of Banks' Assets

Loans to other clients (nonbanking sector) amounted to 45.4 billion kunas or 48.5% of banks' assets and decreased compared to the last year when they were 48.5 billion kunas or 51% of total assets. Expressed in maturity terms, 45% of these loans had a maturity term up to one year, while 55% are long-term loans. The portfolio of investment securities was ranked second, based on its 16.4% share in assets. It comprised money market instruments, bonds and shares. Bonds of the Republic of Croatia accounted for 14.1% of bank assets. Deposits with banking institutions amounted to 11.0% of bank assets, whereas the most important ones were deposits with foreign banks (8.85%). Deposits with the CNB accounted for 9.1% of total assets, while allocated reserves accounted for 8.8% of these deposits. According to the currency structure, foreign currency assets comprised 27.5% of bank assets. The share of assets bearing the interest amounted to 87.9%, while the remaining 12.1% were tangible, foreclosed and repossessed assets and other assets, as well as trading and investment portfolios of banks.

Aggregated Banks' Balance Sheet, December 31, 1999

	Amount million kunas	Share (%)		Amount million kunas	Share (%)
Assets			**Liabilities and Capital**		
Money assets	1,248.3	1.3	Borrowings from financial institutions	5,328.7	5.7
Deposits with the CNB	8,535.6	9.1	Giro and current a ccount deposits	9,173.7	9.8
Deposits with banking institutions	10,316.9	11.0	Savings deposits	13,845.2	14.8
Treasury bills and CNB bills	3,147.9	3.3	Time deposits	34,425.2	36.7
Trading portfolio of securities	1,102.4	1.2	Other borrowings	15,055.3	16.0
Loans to financial institutions	1,247.2	1.3	Debt securities issued	36.7	0.0
Loans to other clients	45,459.9	48.5	Subordinated instruments issued	102.3	0.1
Investment portfolio of securities	15,409.9	16.4	Hybrid instruments issued	79.4	0.1
Investments in subsidiaries and affiliated companies	1,771.9	1.9	Interests, fees and other liabilities	4,820.2	5.1
Foreclosed and repossessed assets	429.4	0.5	***Total liabilities***	**82,866.7**	**88.3**
Tangible assets and software	3,268.3	3.5	Equity capital	8,285.0	8.8
Interests, fees and other assets	2,666.2	2.8	Profit or loss for the current year	704.2	0.7
Specific reserves for unidentified	-783.5	-0.8	Profit (loss) brought forward	-250.6	-0.2
losses (general provisions)			Reserves	2,215.1	2.4
			Total capital	**10,953.7**	**11.7**
Total Assets	**93,820.4**	**100.0**	**Total Liabilities and Capital**	**93,820.4**	**100.0**

Structure of Banks' Liabilities

Bank liabilities represented 88.3% of liabilities, while capital accounted for 11.7%. Deposits (giro and current accounts, savings deposits and time deposits) accounted for 61% of bank liabilities. Time deposits comprised 60% of deposits, and 76% of all deposits were foreign currency deposits. Loans received (borrowings from financial institutions and other borrowings) accounted for 21.6% of banks' balance sheet. Out of total loans received, 26% was granted by domestic financial institutions, 12% by the Republic of Croatia and 62% by foreign entities (mostly by foreign financial institutions). 81.5% of received loans had a maturity term longer than 1 year.

Equity capital amounted to 8.3 billion kunas and fell by 11% compared 1998 due to a reduction in number of banks. In addition, its share in liabilities decreased from 9.9% in 1998 to 8.8% in 1999. At the end of 1999, total capital (equity capital, reserves and profit and loss) was 10.9 billion kunas and increased by 11% compared to 1998 due to the profit earned in 1999.

Risk-Based Capital and Capital Adequacy

At the end of 1999, risk-based capital in terms of the commercial banks stood at 10.4 billion kunas, whereas it amounted to 9.5 billion kunas at the end of 1998. Four banks reported negative risk-based capital at the end of 1999 (seven banks at end of 1998).

The capital adequacy ratio is a measure of a bank's stability and liquidity. Risk-based capital and assets classified and weighted by risk grades are taken into account. According to the Banking Law, a bank is required to adjust the volume of its operations so that the capital adequacy ratio amounts to not less than 10%.

In terms of the commercial banks, the capital adequacy ratio was 19.28% in 1999, whereas it was significantly lower (12.6%) at the end of 1998, due to a relatively large number of banks with negative risk-based capital reported. In addition, this increase in capital adequacy ratio, compared to the previous year, was influenced by the implementation of the new banking regulations in 1999 in accordance to which the assigning of weights resulted in less risky assets. Large and maximum loans are no longer assigned the weight of 200 and 300%, as it was required in 1998. In addition, the procedure for including off-balance sheet items in the risk-weighted assets comprises the conversion of these items into loan equivalents that are subsequently weighted. Apart from four banks that reported the negative risk-based capital and one that failed to comply with the capital adequacy requirement, all other banks had a relatively high capital adequacy at the end of 1999.

Asset Quality

Asset quality analysis is the most important segment in the evaluation of the operational stability of a bank and it has a significant impact on a bank's business output. The CNB decisions passed on a basis of the Banking Law regulate in details the classification of bank's placement by the degree of risk and the calculation of specific reserves for identified potential losses. Specific reserves for identified losses are bank's expenditures and asset items are decreased by these expenditures. The assessment of asset quality is carried out for bank's placements (loans and placements to banks and the central bank, off-balance sheet items, receivables based on interest income, investment portfolio of debt securities). Certain securities are not classified into risk category, but assessed in accordance with the Accounting Act and the International Accounting Standards. Items that according to their characteristic do not incur the risk are classified into non-risk categories (banknotes and coins, premises and equipment).

Assessed placements are classified into risk categories A, B, C, D, and E according to the degree of risk. Placements that do not include the risk of non-payment are classified into category A and specific reserves are not set aside for these placements. Specific reserves corresponding to the risk grade are calculated for all other categories. Placements classified into risk categories A and B are performing assets, while placements classified into risk categories C, D, and E are nonperforming assets, i.e., revenues generated on the basis of these placements are excluded from income. They may be included in the income only if they are collected.

At the end of 1999, risk assets classified into category A accounted for 86.06% of total risk assets, while all other categories together accounted for 13.94% of total risk assets. Performing assets' categories (A and B) comprised 89.88% and nonperforming assets' categories (C, D, E) 10.12% of total risk assets. At the end of 1998, risk assets classified into risk category A accounted for 85.09% and other categories 14.91% of total risk assets.

Specific reserves for identified potential losses were 8.8 billion kunas at the end of 1999 or 8.2% of total risk assets. In 1998, they were 6.9 billion kunas or 6.08% of total risk assets.

The increase in share of specific reserves for identified potential losses in total risk assets from 6.08% in 1998 to 8.2% in 1999 resulted from the application of more stringent assessment criteria (the new CNB decisions) and the cautious policies pursued by banks.

In addition to specific reserves for identified losses, banks are also required to set aside specific reserves for non-identified losses amounting to 1% of placements and off-balance sheet items classified into risk category A.

Limitations Decreasing Operational Risk

Banks are obliged to comply with maximum ratios and maximum levels of exposure regulated by the Banking Law.

Bank Exposure to One Person

Bank exposure to one person or the group of connected person may not exceed 25% of its risk-based capital. The calculation of this exposure does not include exposures covered by the first-class collateral instruments, such as money deposit, securities or guarantees of the Republic of Croatia. At the end of 1999, 21 banks, in 57 individual cases, reported the exposure to one person larger than the allowed maximum of 25% of risk-based capital. According to the Banking Law, a limited number of banks were allowed to gradually harmonize their operations and to adjust them to prescribed conditions. The legal procedures are currently opened against those banks that failed to fulfill the stated requirement. Four banks that have reported the negative risk-based capital also do not meet the requirements imposed by this regulation.

Bank Large Exposure

Bank large exposure is the exposure to one person or the group of connected persons, exceeding 10% of its risk-based capital. A legal action, which is to result in a large exposure, requires a unanimous decision of bank's supervisory board. The calculation of this exposure does not include exposures covered by the first-class collateral instruments. Total amount of all exposures of a bank may not exceed 400% of its risk-based capital. A total of six banks (including four banks with negative risk-based capital) violated this provision. In the overall banking system, large exposure totaled 20.6 billion kunas.

Exposure to Bank Shareholders

Bank exposure to one shareholder who holds more than 3% of bank's shares (and to persons connected to this shareholder) may not exceed 5% of its risk-based capital. Total exposure to shareholders that hold more than 5% of bank's equity capital must not exceed 25% of bank's risk-based capital. At the end of 1999, the exposure to a single shareholder with more than 3% of bank's shares, exceeding the allowed 5% of equity capital was reported by 22 banks in total of 55 individual cases. Therefore, the CNB and banks are jointly taking actions aimed at decreasing the exposure, and criminal proceedings are currently conducted. Total exposure to shareholders with more than 5% of bank's equity capital exceed the allowed amount of 25% of risk-based capital in 9 banks.

Exposure to Persons in Special Relation to Bank

Persons in special relation to bank are shareholder with more than 5% of shares, members of the management and supervisory board, bank's procurators, persons who have concluded temporary service contracts under special conditions with banks, spouses and children of all stated persons, legal entities in which the stated persons hold more than 20% of voting shares and legal entities in which the bank itself has more than 20% of voting shares. The legal action, which is to result in or increase the exposure to persons in special relation to bank, requires the approval of all members of bank's supervisory board.

In the overall banking system, the exposure to persons in special relation to bank amounted to 2.9 billion kunas on December 31, 1999.

Investment Restrictions

A bank's investment in tangible assets (land, buildings, equipment and business premises' remodeling) may not exceed 30% of risk-based capital, while its investment in tangible assets and equity participation in companies may not exceed 70% of risk-based capital. Banks may be allowed the temporary non-compliance with stated ratios. Tangible assets and participation acquired in bankruptcy and seizure proceedings as a compensation for unsettled claims are not included into this calculation in the period of one year following the date of their acquisition. Total investment in banks' tangible assets was 3.2 billion kunas, representing 30.6% of the risk-based capital of banks. Investments in tangible assets and equity participation, in the overall banking system, were 6.6 billion kunas or 62.6% of the risk-based capital of banking system.

At the end of 1999, 17 banks reported investment in tangible assets exceeding the allowed 30% of risk-based capital. These banks are currently implementing measures aimed at adjusting to prescribed amounts. 13 banks reported investment in tangible assets and equity participation exceeding the allowed 70% of risk-based capital. Out of these, nine banks were issued a decision on temporary non-compliance with stated provisions, while legal procedures were conducted against other entities.

Banks' Income Statement

In 1999, the overall banking system realized a profit of 704.2 million kunas. This shows that the banking system is stabilizing after a loss of 1.3 billion kunas generated in 1998. Out of 53 banks, 41 banks realized a profit totaling 1.2 billion kunas, while 12 banks reported a loss totaling 526.4 million kunas. Largest losses were reported by banks, which conducted risky operations in earlier years and had liquidity problems in the last year. Four banks reported loss that was larger than their capital.

Interest income, in the overall banking system, was 8 billion kunas and decreased by 11.5% compared to 1998 when it was 8.6 billion kunas. This decrease was influenced by a reduction in number of banks in 1999 and the fall in interest rate, i.e. by the investment in less risky operations. Interest expenses were 3.9 billion kunas and decreased by 7.1% compared to 1998 when they were 4.2 billion kunas. Net interest income was 3.8 billion kunas and decreased by 11.6% compared to 1998 when it was 4.3 billion kunas. Non-interest income was 2.8 billion kunas, while non-interest expenses were 0.9 billion kunas. Net non-interest income amounted to 1.9 billion kunas.

Banks' Income Statement for 1999

million kunas

Total interest income	7,865.3
Total interest expenses	3,975.8
Net interest income	3,889.5
Total non-interest income	2,858.2
Total non-interest expenses	912.2
Net non-interest income	1,946.0
General administrative expenses and depreciation	3,240.5
Net operating income before provisions	2,595.0
Loan loss provisions	1,868.5
Pretax income (loss)	726.5
Profit tax	22.3
Profit or loss for the current year	**704.2**

Loan loss provision expenses amounted to 1.8 billion kunas and decreased compared to 1998 when they were 4.6 billion kunas. The year 1998 saw large increase in provision expenses. In 1999, the exit of risky banks from the market was followed by decrease in provision expenses for loan losses, and showed a trend to less risky operating of banks.

As in previous years, the interest income accounted for the largest share of income, while general administrative expenses represented the largest item in expenses. This indicates to the relative underdevelopment of our banking system compared to global trends.

Measures Taken by the Croatian National Bank in 1999

The Banking Law sets forth the measures that the Croatian National Bank may take against a bank found to violating regulations or operating improperly or at risk. Measures for improving bank condition were taken against 31 banks and savings banks in 1999. When the Croatian National Bank establishes that a bank's capital adequacy is below 3/4 of minimum adequacy, it will appoint its commissioner in that bank. In 1999, the commissioner was appointed to three banks. When the potential losses of a bank, arising from risky placements, exceed the bank's risk-based capital and when the bank is incapable of making payments, the Croatian National Bank may, in accordance with the provisions of the Law, appoint a temporary administrator in such a bank. In 1999, the Council of the Croatian National Bank appointed the temporary administrator to eight banks.

If the said measures fail to give expected results, the Croatian National Bank is obliged by the provisions of the Law, to submit to the competent court a proposal for initiating bankruptcy proceedings in a bank. The Croatian National Bank submitted to the Commercial Court proposals for initiating bankruptcy proceedings against seven banks and three savings banks, while bankruptcy proceeding were opened in seven banks and one savings bank.

According to the Law on Bank Rehabilitation and Restructuring, the Croatian National Bank may also propose bank rehabilitation to the Government of the Republic of Croatia. The decision on the rehabilitation is passed by the Government if it evaluates that the rehabilitation is of the special state interest and if it determines that all other possibilities for preventing further impairment of the total banking system stability have been explored. The decision on the rehabilitation of one bank was passed in 1999.

Seventy-five examinations were conducted in 1999. Out of these, 47 were examinations of banks' operations, 10 were examinations of the implementation of issued measures, 10 were examinations of foreign representative offices, and 8 examinations were conducted together with temporary administrators. Fifty-seven decisions were issued. Twenty-six dealt with liquidity problems and 31 were aimed at improving bank condition and correcting irregularities and illegal actions.

In 1999, 43 charges were brought against banks (16 citations for business violations, 16 citations for violations of foreign exchange regulations and 11 requests for the opening of legal procedures). The intervention of crime investigators and financial police was required in six banks.

SUPERVISION OF BANKS AND SAVINGS BANKS

The Bank Supervision Area was established as the organizational unit and staffed in 1993.

The Bank Supervision Area[1] of the Croatian National Bank comprises the following organizational units:

1. *On-Site Supervision Department* - The basic function of this Department is to conduct on-site examinations of banks and savings banks, aimed at checking the accuracy and reliability of data recorded in the bank's/savings banks' business records, in order to insure bank's compliance with the CNB regulations, as well as to evaluate the bank's/savings bank's business management with the purpose of minimizing all risks which could derive from business operations. The basic objective of this Department is to conduct an on-site examination of each bank/savings bank at least once in two years or more often if possible.

2. *Off-Site Supervision Department* - The basic function of this Department is to analyze the financial condition of each bank/savings bank on an ongoing basis, as well as the system as a whole, by use of data submitted by banks and savings banks. Results obtained on the basis of these analyses are be used for making decisions on conducting on-site examinations and implementing preventive (corrective) measures against a certain bank/savings bank.

3. *Department for Improving Bank Supervision* - The basic function of this Department is to monitor the implementation of, and recommend new supervisory regulations, to make and improve internal work methodologies, to follow international developments and cooperate with other domestic and foreign institutions.

At the end of 1999, the Bank Supervision Area had 76 employees.[2] During 1999, 24 new employees were hired. Some of them are experienced bankers and auditors. The training of employees is conducted on an ongoing basis by external advisors and lecturers. It also includes the attendance of seminars, training courses, postgraduate studies and various training programs carried out by international financial organizations (IMF, World Bank and other).

The legal framework is one of the most important pillars of the banking supervision. The enactment of regulations falls within the authority of the Bank Supervision Area. The most important prudential regulations came into force in April 1999. They regulate the methodology for calculating capital and its adequacy, the methodology for evaluating the quality of assets and for forming specific reserves to insure against identified losses incurred by risky assets. It is important to note that these regulations were designed in accordance with guidelines and principles of the Basle Committee for Effective Banking Supervision and Directives of the European Union, and we believe that the existing Croatian regulations in this area largely comply with international community requirements. The work on improvement and development of new regulations has been continued.

Numerous regulations were enacted in 1999 (ten decisions, seven instructions for the implementation of these decisions and two rule books). They are based on the new Banking Law that became effective in 1998.

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[1] The integral part of the Bank Supervision Area is also the Department of Foreign Exchange Transactions Control, which due to the nature of its operations has not been taken into consideration.

[2] Employees of the Department of Foreign Trade Transactions Control are not included into this figure.

The following regulations and rule books were issued:

Decision on the Methodology for Calculating Bank's Capital, Decision on the Methodology for Calculating Capital Adequacy and Risk-Weighted Assets of Banks, Decision on the Classification of Placements and Risky Off-Balance Sheet Items and Assessment of Bank Exposure, Decision on the Amount and Method of Forming Specific Reserves to Ensure Against Potential Losses of Banks, Decision on the Chart of Accounts for Banks, Decision on Restriction of Investment into Tangible Assets and Equity Participation, Decision on Reporting to the Croatian National Bank on Single Borrower Indebtedness with Banks to an Amount Exceeding Five (5) Million Kunas, Decision on Detailed Conditions for the Establishment and Operation of Representative Offices of Foreign Banks in the Republic of Croatia, Rule Book on the Banking Exam, Rule Book on the Procedure and Criteria for Granting Prior Approval for the Appointment of the Chairman and Members of a Bank's Management Board, Decision on the Statistical Report for Banks and Instructions for Completing the Statistical Report, Decision on the Form and Minimum Scope and Content of Bank Audit and Audit Report, Decision on the Form and Content of the Application for Granting a Bank Operating License.

The new prudential regulations and the new reporting system used by banks and savings banks to submit data to the CNB on the various aspects of their operations were introduced at the same time. It should be noted that data are received on diskettes, a media more suitable for further analysis of data sent by banks. Software for receiving and checking submitted data is already in use. Moreover, it may also be used for the preparation of few (additional) output reports. It is an integral part of the complex information system that is currently being designed. This information system will be used for a high-quality analysis and off-site supervision of financial operations conducted by banks, as well as timely detection of problems in banks' performance. This system will have a positive effect on the efficiency and effectiveness of the banking supervision.

The strategic goal of the Croatian National Bank is further strengthening and development of the banking supervision. The supervision of banks and saving banks has been continuously improved. The special efforts are being made to strengthen the application of currently used CAMEL method (the more sophisticated CAMELS method has not yet been applied). Further adjustment to the BIS Core Principles that lay down the minimum requirements for the effective banking is also in progress.

Twenty-five Core Principles for Effective Banking Supervision issued by the Bank for International Settlements are used in performing banking supervision.

The development of the early warning system is considered to be of the utmost importance for the banking supervision efficiency. A certain form of the early warning system has already been constructed by the Research and Statistics Area of Croatian National Bank. It is our intention to further develop this system and use it within the Bank Supervision Area.

In addition, the enhancement of transparency of banking operations is one of our objectives. In respect to this, we have started designing the Bulletin on Banks, which would present an overview of the most important data on banks' condition. The first set of data shall include data on peer groups, while the second set of data shall include data on individual banks. This means that potential creditors and investors shall have direct access to quarterly and semi-annual data. We believe that this publication will positively influence banks' behavior and the system stability.

STATISTICAL TABLES

Number of Financial Institutions (at year-ends)

Type of financial institution	1998	1999
Banks	60	53
Savings banks	36	34
Financial institutions, total	**96**	**87**

Ownership Structure of Financial Institutions in 1999 on the Basis of Registered Capital (%) (at year-end)

Item	Type of financial institution		Total
	Banks	Savings banks	
State ownership	39,6	0	37,5
Other domestic ownership	28,8	82,6	31,6
Domestic ownership total	68,4	82,6	69,1
Foreign ownership	31,6	17,4	30,9
Financial Institutions, total	**100.0**	**100.0**	**100.0**

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

Item	1998	1999	1999/1998 (indeks)
State ownership	33,1	37,5	106,5
Other domestic ownership	53,6	31,6	55,4
Domestic ownership total	86,7	69,1	74,9
Foreign ownership	13,3	30,9	218,7
Financial Institutions, total	**100.0**	**100.0**	94,0

Distribution of market shares in balance sheet total (%)*

Type of financial institution	1998	1999
Banks	98,8	98,5
Savings banks	1,2	1,5
Financial Institutions, total	100.0	100.0

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

Type of financial institution	1998	1999
Banks	56,32	45,08
Savings banks	33,47	1,46
Financial Institutions, total	56,04	44,51

* Please indicate on what basis you differentiate between financial institutions

Solvency Ratio of Financial Institutions

Type of the financial institution	1998	1999
Banks	12,66	19,28
Savings banks	33,59	49,74
Financial Institutions, average	**12,93**	**19,78**

** Capital adequacy ratio*

The Structure of Assets and Liabilities of the banking system in 1999 (%) (at year-end)

Assets	1998	1999
Money assets	0,84	1,33
Deposits with CNB	5,78	9,10
Deposits with banking institutions	11,84	11,00
Treasury bills and CNB bills	1,11	3,36
Trading portfolio of securities	0,30	1,18
Loans to financial institutions	0,88	1,33
Loans to other clients	51,24	48,45
Investment portfolio of securities	18,34	16,42
Investment in subsidiries and affiliated companies	2,88	1,89
Foreclosed and repossessed assets	0,35	0,46
Tangible assets and software	3,27	3,48
Interests, fees and other assets	3,87	2,84
General provisions	0,70	0,84

Liabilities	1998	1999
Borrowings from financial institutions	4,92	5,68
Giro and current account deposits	9,42	9,78
Savings deposits	14,02	14,76
Time deposits	37,10	36,69
Other borrowings	17,60	16,05
Debt securities issued	0,00	0,04
Additional capital	0,51	-
Subordinated debt instruments	-	0,11
Hybrid instruments	-	0,08
Interests, fees and other liabilities	6,77	5,14
Equity capital	9,24	8,8
Current year profit or loss	-1,73	0,75
Profit (loss) brought forward	0,02	-0,27
Reserves	2,13	2,36

Asset Portfolio Quality of the Banking System

in 1000 HRK

Asset Classification	1998	1999
– A	97.227.857	92.524.686
– B	6.377.832	4.108.188
– C	5.574.783	3.335.775
– D	2.718.117	3.386.777
– E	2.359.643	4.150.493
Classified Total	114.258.232	107.505.917
Specific Reserves	6.951.570	8.843.804

The Structure of Deposits and Loans in 1999 (%)
(at year-end)

	Deposits	Loans
Households	69,30	37,10
Government sector	2,85	10,13
Corporate	15,66	48,86
Foreign	7,13	1,05
Other*	5,06	2,86
Total	100.0	100.0

** Financial sector is included*

The Structure of Deposits and Loans by time in 1999 (%)
(at year-end)

Maturity of Deposits		Loans	
At sight	40,05	Long term loans	31,92
Within one year	43,08	Medium-term loans (1 to 3 years)	22,19
Over one year	16,87	Short-term loans	45,89
Total	**100.0**	**Total**	**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.		Off-balance Foreign Exchange sheet items/ Total Liab.	
	1998	**1999**	**1998**	**1999**	**1998**	**1999**
Banks	32,18	27,58	61,33	64,62	38,24	28,86
Savings banks	12,39	9,54	42,27	40,42	18,67	0,00
Financial Institutions, average	**31,94**	**27,30**	**61,10**	**64,25**	**37,94**	**28,42**

Structure of Revenues and Expenditures of Financial Institutions in 1999**
(at year-end)

in 1000 HRK

Revenues	1998	1999
Interest Income	8.713.616	7.865.343
Non-Interest Income	4.507.072	2.858.205

Expenditures	1998	1999
Interest Expense	4.339.212	3.975.842
Non-Interest Expense	2.877.410	912.185
General and Administrative Expenses	3.515.061	3.240.534
Provisions for Identified and Unidentified Losses	5.212.025	1.868.452
Income Taxes	179.841	22.335

* Please indicate off-balance Foreign Exchange sheet items/ total liabilities if possible
** Indicating profitability, provisioning of financial institutions included in the table or separately

Structure of Registered Capital and Own Funds of Financial Institutions in 1999

Type of the financial institutions	Registered Capital	/Total assets	Own Funds	/Total Liab.
	1000 USD	**%**	**1000 USD**	**%**
Banks	1.083.339	8,79	1.431.660	11,67
Savings banks	61.601	32,34	58.495	30,71
Financial Institutions, average	1.144.940	9,14	1.490.156	11,96

1999 DEVELOPMENTS IN THE CZECH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The recession that started in 1997 ended in the second half of 1999. A recovery emerged within a low-inflation environment. In the first half of 2000, y-o-y GDP growth reached 3.1%. The recovery was driven by growing domestic demand. The rise in consumer demand was followed in the first half of 2000 by renewed growth in investment demand. The previous three-year decline in investment in fixed capital rapidly switched into steady growth thanks to growing business activity by foreign investors, growth in industrial production and increasing consumer demand. Contrary to these trends, the previous rapid growth in net exports has stagnated since May 2000. Demand-pull inflationary pressures have remained subdued. Conversely, growth in import prices, brought about chiefly by the rising prices of energy raw materials on world markets and accompanied by the koruna's weakening exchange rate against the US dollar, has exerted upward pressure on inflation.

DEVELOPMENTS IN THE BANKING SECTOR

As of 31 December 1999, the Czech banking sector consisted of 42 active banks and foreign bank branches. The number of banks peaked in 1995 and has decreased in every subsequent year.

In 1999, fundamental changes occurred in the structure of the banking sector. The privatization of the state's stakes in large banks continued. The state's involvement in the banking sector further decreased substantially thanks to the privatization of the state's majority in Československá obchodní banka. This increased the share of foreign private capital in the bank's equity to 48.4%. In the 1999 Q1, the privatization of Česká spořitelna led to an increase in this share to almost 66%. The state's majority in Komerční banka will probably be sold in 2001. This will definitively confirm the dominant role of foreign private capital in the banking sector. The entry of highly rated foreign investors is an important contribution to the stability of the banking sector.

Three small banks controlled by domestic private capital went bankrupt and their licenses were revoked. The already marginal role of small banks controlled by domestic private capital decreased further.

The development of banks' business activities was closely tied to that of the domestic economy. Nominal and real household income grew only very modestly in first half of 2000 and in the previous year. This modest growth may have adversely influenced the growth of banking sector, as households' deposits account for around 65% of client deposits. In addition, nominal deposit rates declined and alternative forms of savings (pension funds etc.) yielded double digit growth rates. In spite of these factors, client deposits (in nominal terms) grew and banks did have sufficient funds.

On the asset side, the recovery remained too weak to change the main trends in the structure of banking sector assets that emerged during the recession.

The first trend – which emerged in 1997 – has been a "flight to quality", represented by a decline in the share of credits to below 50% and a rising share of liquid assets.

However, underlying this overall trend are differences between the large banks on the one hand (whose volume of credits has decreased) and foreign banks and branches of foreign banks on the other (which have achieved y-o-y growth in credits). This difference is reflected in changes in their shares of the credit market.

The second trend appeared in 1999: as from that year the banking sector has been a net foreign creditor, with its balance-sheet assets vis-ŕ-vis non-residents exceeding liabilities.

These trends were the banks' response not only to the decline in economic activity itself, but also to the structural and institutional weaknesses that the recession fully revealed on the microeconomic level. The first factor has disappeared thanks to the recovery. The second factor persists. The restructuring of the corporate sector has advanced and labour productivity is steadily rising. Nevertheless, much more needs to be done. The biggest risk in banking remains credit risk. The financial situation of a significant section of businesses remains bad. Together with the difficulty in recovering credits and seizing collateral, this continues to place credit risk at a level which banks cannot accept. Banks have increased their prudence in granting credits and have tightened their criteria for client evaluation. On the other hand, the same factors that have been curtailing the supply of credit have restricted the room for an increase in the efficiency and creditworthiness of troubled enterprises. Thus, the demand for credits has remained strong, but only partly effective with regard to creditworthiness i.e. to the capacity and willingness to repay credits in line with the market criteria set by banks.

The Czech banking sector's main problem is its high burden of classified credits and its low ability to deal effectively with them. In 1999, the share of classified credits in overall credits granted rose. The overall nominal volume of classified loans also increased. However, the weighted classification, which represents potential losses, decreased. Underlying this relatively favorable development was a high volume of write-offs against loan loss provisions and a transfer of bad loans to Konsolidační banka. Nevertheless, the poor quality of loan portfolios remains a challenge to the stability of the banking sector.

The high burden of classified credits has been the main factor behind the poor profitability of the banking sector over the past three years. Banks have been able to generate a solid operating income, and their cost/income ratio (operating costs/operating income before write-offs and LLP creation) has been satisfactory. Provisioning and write-offs, however, are pushing net profits into the red.

The development of the legal and institutional framework for the operation and supervision of banks

Since 1999 there have been no major changes in the legal framework (Act on Banks etc.) or in the institutional framework (mergers/re-organizations of supervisory authorities). However, essential progress has been made in the development of the regulatory framework toward full implementation of international standards with the introduction of regulations on capital adequacy incorporating market risk and on consolidated banking supervision.

The CNB Provision on Capital Adequacy Incorporating Market Risk

Approved in June 1999, this regulation entered into force on 1 April 2000. It replaces the former Provision on Capital Adequacy of Banks and two others (regulating banks' open foreign exchange positions and their large exposures). It substantially enlarges the scope of the risks covered by the bank's capital. The purpose of this Provision is to set requirements ensuring that banks have adequate capital to cover both credit risk and market risk (i.e. interest rate risk, foreign exchange risk and commodities risk).

The Provision contains all the key elements included in international standards i.e. it:

- splits bank business between the banking book and trading book;
- sets capital requirements both for credit risk (including counterparty risk in derivatives dealing) and for market risks – interest rate risk, equity risk, foreign exchange risk and commodities risk;
- defines a standardized measurement method for market risk and conditions for the use of banks' internal models.

The Provision on Banking Supervision on a Consolidated Basis

The first consolidated banking supervision will take place in the first half 2000 based on the 1999 consolidated reports. Based on EU Directive 92/30/EEC, this Provision ensures comprehensive evaluation of the financial strength of banking groups as well as comprehensive evaluation of the risks to which banks belonging to such financial groups are exposed. Inter alia it:

- determines the scope of consolidation, including exemptions from consolidation;
- defines the consolidation techniques;
- defines capital elements and the breakdown of assets and off-balance sheet items by individual risk weights;
- sets a minimum binding limit on the capital adequacy of the group in the amount of 8%;
- stipulates the range of assets and off-balance sheet items included in the credit exposure of a bank;
- sets limits on net credit exposure which the group is obliged to observe vis-ŕ-vis its debtors;
- defines the qualifying holdings of the group; and
- stipulates limits for the group's qualifying holdings in legal entities other than banks (15% of the group's capital in a single legal entity and a total of 60% of the group's capital in the sum of all legal entities).

THE CNB BANKING SUPERVISORY ACTIVITIES IN 1999 AND 2000 H1

The bulk of the activities of the CNB as a banking regulatory and supervisory authority are performed regularly on the basis of an annual plan. No new banking license was granted. The everyday supervisory activities entailed development of the regulatory framework, analysis of banks and the banking sector, regulation of investment in banks, off-site surveillance, on-site examinations and cooperation with other Czech regulatory authorities. Worthy of mention are some major achievements, events and programs in the area of international cooperation. In 1999, a Memorandum of Understanding was concluded with Slovakia. The CNB also organized a BSCEE workshop on capital adequacy and market risk. In May 2000, the 13th Conference of the Group BSCEE was held in Prague. The CNB's banking supervisors are actively taking part in an EU "twinning program" whose goal is to enhance the ability of national supervisory authorities to implement EU banking regulatory standards.

Legal competence of CNB in the area of banking regulation and supervision

The Czech National Bank is responsible for licensing and for prudential supervision of all banks. In this respect, it fulfils the criteria of independence laid down by the Basle Core Principles for Effective Banking Supervision (especially the first principle). In order to perform banking supervision effectively the Czech National Bank is authorized by law:

- to issue prudential regulations and other operational requirements as well as regulations governing the form of applications for banking licenses and for acquiring qualifying holdings in existing banks;
- to issue banking licenses;
- to issue prior consent for the sale of a bank or part thereof, for any decision of a general meeting to wind up the bank, for a merger of the bank with a bank being wound up, for reductions in the capital of the bank unless this entails a reduction to cover a loss, for a general meeting decision not to perform any activity for which a banking license is required, and for acquiring a qualifying holding exceeding 20%, 33% or 50% of the voting rights;
- to ask for any information and documents about a bank's ownership structure or business;
- to supervise adherence to the conditions set forth in banking licenses, adherence to the legal regulations and measures decreed by the Czech National Bank and observance of acts by banks whenever it is empowered to do so by law (Act on the CNB, Act on Banks);
- to perform on-site examinations;
- to apply remedial measures and sanctions up to imposition of conservatorship or revocation of a banking license if shortcomings are detected in the activities of a bank;
- to check the professional skills and integrity of the top managers of banks;
- to suspend some principal shareholder rights, especially the right to participate and vote in the general meeting if the activities of the owner of shares with voting rights operate to the detriment of the prudent and sound management of a bank;
- to approve a bank's external auditor;
- to enjoy the exclusive right to submit to the court a nomination of the liquidator of a bank if the bank is being wound up and liquidated.

Some of these measures and areas of competence of the CNB are also applied to authorized branches of foreign banks.

STATISTICAL TABLES

Number of Financial Institutions *
(at year -ends)

Type of financial institution	1997	1998	1999
Large banks	5	5	5
Small banks	9	8	5
Foreign banks	14	13	13
Foreign bank branches	9	10	10
Specialised banks	9	9	9
Banks under conservatorship	4	0	0
Financial Institutions, total	50	45	42

* *Operating institutions without central bank*

Ownership Structure of Financial Institutions in 1999
on the Basis of Registered Capital (%)
(at year-end)

Item	Type of financial institution					Total banking sector
	large banks	small banks	foreign banks	spec. banks	banks under conservator.	
State ownership	40.1	10.7	-	19.1	-	27.0
Other domestic ownership	23.3	73.9	2.5	46.2	-	24.6
Domestis ownership total	63.4	84.7	2.5	65.3	-	51.6
Foreign ownership	36.6	15.3	97.5	34.7	-	48.4
Financial Institutions, total	**100.0**	**100.0**	**100.0**	**100.0**	**-**	**100.0**

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

Item	1997	1998	1999	1999/1997
State ownership	20.3	25.1	27.0	1.3
Other domestic ownership	50.2	36.2	24.6	0.5
Domestis ownership total	70.5	61.3	51.6	0.7
Foreign ownership	29.5	38.7	48.4	1.6
Financial Institutions, total	**100.0**	**100.0**	**100.0**	**1.0**

Distribution of Market Shares in Balance Sheet Total (%)

Type of financial institution	1997	1998	1999
Large banks	69.0	66.3	65.1
Small banks	2.9	3.0	1.6
Foreign banks incl. foreign bank branches	23.6	25.2	27.1
Specialised banks	4.5	5.5	6.3
Financial Institutions, total	**100.0**	**100.0**	**100.0**

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

Assets	1997	1998	1999
Liquid assets	16.3	21.6	24.3
Deposits in other banks	21.7	20.5	22.6
Credits (gross)	49.3	46.3	42.8
Securities in trading and investment portfolios (gross)	9.2	8.6	8.6
Other assets	3.5	3.0	1.7

Liabilities	1997	1998	1999
Clients´deposits	50.2	50.3	51.9
Banks´ deposits	22.9	20.8	19.4
Sources from central bank	3.3	2.2	1.3
Equity	2.9	3.1	3.5
Reserves, reserve and capital funds	5.9	6.2	4.9
Other liabilities	**14.8**	**17.5**	**19.0**

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

Type of financial institution	1997	1998	1999
Large banks	36.6	50.1	52.4
Small banks	9.7	15.6	11.3
Foreign banks	118.0	180.6	170.8
Foreign bank branches	113.0	203.6	185.4
Specialised banks	21.1	16.8	25.5
Financial Institutions, total	**53.8**	**78.2**	**81.3**

Solvency ratio of financial institutions*

Type of financial institution	1997	1998	1999
Large banks**	8.4	10.5	12.1
Small banks	7.0	11.8	19.2
Foreign banks	14.0	17.2	17.4
Specialised banks	20.2	18.2	17.2
Financial Institutions, average ***	9.5	12.0	13.6

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

Asset Portfolio Quality of the banking system

CZK in mil.

Asset Classification *	1997	1998	1999
Standard	722,069	709,198	787,451
Watch	60,595	59,093	92,847
Substandard	26,811	33,684	38,447
Doubtful	29,386	35,862	38,170
Loss	149,597	133,002	121,045
Classified Total	266,390	261,641	290,511
Specific reserves and provisions	105,287	110,126	103,758

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

The Structure of Deposits and Loans at year-end in 1999 (%)

	Deposits	Loans
Households	65.3	7.2
Government sector	3.5	3.1
Corporate	22.6	69.0
Small business	3.2	3.2
Public sector	3.5	9.4
Other	1.9	8.1
Total	**100.0**	**100.0**

The Structure of Deposits and Loans in 1999 (%) (at year-end)

Maturity of Deposits		Loans	
At sight	33.4	Long term loans	39.5
Within one year	48.9	Medium term loans	22.0
Over one year	17.7	Short term loans	38.6
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		
	1997	**1998**	**1999**	**1997**	**1998**	**1999**
Large banks	16.76	15.59	17.33	16.08	14.77	14.29
Small banks	10.42	2.80	2.45	8.60	2.47	2.09
Foreign banks	44.21	36.87	34.80	38.66	32.62	31.48
Foreign banks branches	43.74	40.83	37.89	47.38	34.38	31.95
Specialised banks	9.43	7.34	9.05	9.39	7.29	9.04
Financial institutions, aver.	22.67	20.39	21.70	21.72	18.56	18.51

Structure of Registered Capital and Own Funds of financial institutes in 1999

Type of the financial institutions	Registered Capital	/Total assets	Own Funds	/Total Liab.
	USD in mil.*	**%**	**USD in mil.***	**%**
Large banks	1,563	3.4	4,115	10.0
Small banks	162	15.5	140	15.5
Foreign banks	497	4.5	950	9.5
Foreign bank branches	0	-	166	2.1
Specialised banks	222	5.1	474	12.1
Financial Institutions, aver.	2,444	3.5	5,844	9.1

** Rate of exchange CZK/USD= 35,98*

ČNB ČESKÁ NÁRODNÍ BANKA

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

CZK in mil.

Revenues	1997	1998	1999
Interest earned	172,515	256,661	198,787
Fees and commissions earned	13,331	17,157	19,959
Receivables sold revenues	1,962	3,691	11,353
Other banking operations revenues	70	692,834	550,791
Extraordinary revenues	710	2,956	2,700

Expenses	1997	1998	1999
Interest paid	132,578	188,968	140,270
Fees and commissions paid	1,606	4,169	5,320
Receivables sold costs	8,467	15,372	37,949
Other banking operations costs	51	674,570	531,850
Reserve and provisions creations (net)	29,823	14,734	-3,384
Receivables written off costs	10,968	29,472	25,324
General operating costs	42,886	48,543	51,149
Taxes	1,080	3,073	1,084
Net loss	- 3,510	- 8,428	- 5,572

** Banks with valid licence as to 31. 12. 1999 excl. Konsolidační banka*

1999 DEVELOPMENTS IN THE HUNGARIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

On the whole, the macroeconomic environment in 1999 was favorable. The development of the main macroeconomic indicators took a sharp turn in June of 1999. The first six months of the year can be characterized by a slow recovery following the Russian crisis of 1998, which was accompanied by substantial domestic and international uncertainty. The gross domestic product grew by 4.5% in 1999, and the increase of savings exceeded the rise in consumption. The current account deficit of USD 2076 million was lower than expected, and it was more than offset by the USD 2631 million of non-debt-generated capital inflow.

The gross financial wealth of households increased by 6.8% in real terms, less than the 11.1% growth in 1998. In 1999, a part of the deceleration could be explained by the decrease in the level of real interest rates. Looking back from this year, that development proved to be a start of a new tendency of the income processes. The households tend to reduce their savings and increase their consumption partly by accelerating indebtedness. As a consequence, the former expansion of gross financial wealth stopped, moreover, in the second quarter of 2000, net financial wealth decreased. A clear restructuring of the financial wealth has been going on for a while. Proportion of the wealth held in banking savings has declined further to 66%, while the relative weight of households savings held in pension funds and life insurance savings have gone up to 4.5% and 5.3%, respectively.

One of the main issues of the macroeconomic development is inflation. In May, having declined to their lowest rate since the beginning of the transition, both the CPI and the PPI started to grow moderately. The exchange rate of the Hungarian forint has been at the stronger edge of the intervention band since the middle of 1995. The Russian crisis caused only a temporary weakening of the Hungarian currency, still within the band.

Concerning the yield curve in the first half of 1999, it remained almost at the same level as it was at the beginning of 1999, but its slope decreased significantly. Short-term yields started to decline in June, followed by longer-term yields in September. In the middle of the year, interest premium reached 500 basis points, which resulted in a continuously growing capital inflow. The spread between bank deposits and government securities fluctuated between 150 – 300 basis points for most of 1999, but declined rapidly by the end of the year. The official index of the Budapest Stock Exchange, the BUX, moved along an upward tendency, while its volatility decreased significantly compared to the previous year.

DEVELOPMENT OF THE BANKING SYSTEM

The development of the banking system was encouraged by the macroeconomic prosperity. Growth of credit activity (+26.1% in nominal terms) exceeded that of the GDP, while the growth in deposits (+16.9%) was remarkable as well. As a result, a declining bankable assets/GDP ratio is not accompanied by a declining role of the banking sector in the financial intermediation. Moreover, it is growing.

Despite favorable developments, some risk factors have evolved recently.

- Credit expansion is linked to the prosperity period of the economy and may hold high default risk in the case of a downturn. Independently from the economic cycle, relative deterioration of the presently very high quality banking portfolios is expected to a certain extent due to the increasing role of riskier assets in them. The credit/deposit ratio is over 70% - with further growth expected -, which makes provisions higher.
- Concerning the structure of the portfolios, the most significant acceleration can be observed in the stock of its riskiest part, the loans granted to households.
- Profitability of the banking sector was low and declined as compared to the previous year. In order to maintain an acceptable level of solvency ratio while portfolios become somewhat riskier, banks need a higher capital accumulation than that is available on the basis of profitability. Polarization grew further even among profitable banks.
- The number of banks is higher than optimal. Some banks have moved out from certain market segments, others have merged. The process is expected to continue.

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

The operation of the credit institutions is regulated by Act CXII of 1996 On Credit Institutions and Financial Enterprises. Supervision of credit institutions was the responsibility of the former Hungarian Banking and Capital Market Supervision. (As of April 1, 2000, the three former supervisory agencies were merged and a new Hungarian Financial Supervisory Authority was established. That authority is responsible for the supervision of the whole financial sector.)

The most important change in the rules of operation was that banks have been allowed to provide investment services as from January 1, 1999. By the end of 1999, eight banks had the authorization from the Supervision to operate as 'universal' banks. While that tendency has developed further since then (and market developments have encouraged the cleaning of the market), the overall number of investment service providers has declined significantly.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY LAST YEAR

In Hungary, the supervision of the credit and financial institutions, investment services providers and mutual funds was the responsibility of the Hungarian Banking and Capital Market Supervision in 1999. Operation of the HBCMS included on-site and off-site inspection of the institutions, authorization activities, consumer protection and participation in preparing financial legislation and in the job of international financial institutions. Focusing on the banking sector, 19 general on-site inspections were concluded in 1999. 17 out of them resulted in a resolution, obliging banks to improve their (non-)prudential operation. In the case of three banks, extremely rigorous changes were ordered. The strategic planning and risk management systems of the banks were greatly emphasized. The capital base of the institutions proved to be stable.

Concerning authorization, the number of banks remained stable while the number of savings cooperatives declined due to mergers. Compared to the previous year, the number of authorization applications grew significantly in the area of providing credit institution activities by agents. Those agents usually participate in granting consumption credits. More than 6000 customers turned to the Supervision with complaints in 1999. Most of the complaints referred to investment service providers. Concerning the banking sector, typical problems were related to interest calculation, banking cards, inappropriate information in the cases of granting credits, etc.

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY

Legislation (regulation) is the responsibility of the Ministry of Finance. Therefore, the supervisory agency cannot autonomously issue prudential and solvency regulations (e.g. on capital adequacy). The HBCMS (and the National Bank of Hungary) are expected to participate in the preparation of law amendments and the elaboration of new regulations. Moreover, the Supervision has the right, as defined by Act XCIV of 1996 on the HBCS, to put forward recommendations concerning financial markets.

The HBCMS is responsible for licensing banks, other credit institutions and branches of them, and for revoking licenses. The Supervision shall regularly check whether the institutions fulfill the conditions prescribed for their operation. In the case of a violation, the law grants a wide range of possible actions to the Supervision from imposing a penalty to appointing supervisory commissioner(s). The banking law precisely defines the conditions of bank problems and gives only a limited power to the Supervision for preventive action.

STATISTICAL TABLES

Number of Credit Institutions (at year-ends)

Type of credit institution	1997	1998	1999
Joint stock companies (banks)	43	44	43
Credit co-operatives	251	245	217
– Savings co-operatives	243	237	209
– Credit co-operatives	8	8	8
Credit institutions, total	294	289	260

Ownership structure of banks in 1999 on the basis of registered capital (%) (at year-end)

Item	Type of bank				Total
	Large banks	Medium-sized banks	Small banks	Specialized credit institutions	
State ownership	20,5	0,0	0,4	62,2	19,3
Other domestic ownership	9,6	11,6	26,3	19,7	12,9
Domestic ownership total	30,1	11,6	26,7	81,9	32,2
Foreign ownership	65,2	88,4	71,0	18,1	65,3
Other*	4,6	0,0	2,4	0,0	2,5
Banks, total	100,0	100,0	100,0	100,0	100,0

** Preference and re-purchased shares*

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

Item	1997	1998	1999	1999/1997
State ownership	21,7	20,7	19,3	96,1
Other domestic ownership	15,4	16,0	12,9	75,1
Domestic ownership total	37,1	36,7	32,2	86,6
Foreign ownership	60,5	60,6	65,3	107,8
Other*	2,4	2,7	2,5	113,6
Banks, total	**100,0**	**100,0**	**100,0**	

** Preference and re-purchased shares*

Distribution of market shares in balance sheet total (%)

Type of credit institution	1997	1998	1999
Joint stock companies (banks)	95,0	94,6	94,2
Credit co-operatives	5,0	5,4	5,8
– Savings co-operatives	5,0	5,3	5,7
– Credit co-operatives	0,0	0,0	0,1
Credit institutions, total	100,0	100,0	100,0

The structure of assets and liabilities of banks (%) (at year-end)

Assets	1998	1999
Cash and settlement accounts	6,5	7,1
Securities for trading purposes	10,6	7,8
Securities for investment purposes	10,7	7,9
Deposits with the central bank and interbank deposits	24,4	25,3
Loans	39,6	44,3
Proprietary interests	2,6	2,5
Active interest accruals	1,7	1,5
Other active settlements and other assets	1,2	1,1
Own assets	2,6	2,4
Total assets	**100,0**	**100,0**
Liabilities	**1998**	**1999**
Deposits	60,8	63,2
Interbank deposits from credit institutions	11,3	9,2
Borrowing	10,6	9,2
Debt securities	1,4	1,5
Passive interest accruals	1,3	1,1
Other passive settlement	3,0	3,7
Subordinated liabilities	1,9	2,0
Specific provision	1,1	1,2
Shareholders' equity	8,7	8,9
Total liabilities	**100,0**	**100,0**

**There aren't comparable data for 1997.*

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

Type of credit institution	1997	1998	1999
Joint stock companies (banks)	44,7	43,1	43,1
Credit co-operatives	0,6	1,0	1,4
– Savings co-operatives	0,6	1,0	1,4
– Credit co-operatives	0,0	0,0	0,0
Credit institutions, total	**42,5**	**40,8**	**40,7**

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

	Deposits	Loans
Households	51,6	8,7
Government sector	2,8	3,6
Corporate	29,4	78,0
Foreign	12,7	8,5
Other	3,6	1,3
Total	**100,0**	**100,0**

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

Maturity of deposits		Loans	
Within one year	92,9	Long term loans	58,5
Over one year	7,1	Short-term loans	41,5
Total	**100,0**	**Total**	**100,0**

Proportion of Foreign Exchange Assets and Liabilities on Balance Sheet Item (at year-end)

Type of the financial institution	FOREX Assets/Total Assets			FOREX Liabilities/Total Liabilities		
Type of the credit institutions	**1997**	**1998**	**1999**	**1997**	**1998**	**1999**
Joint stock companies (banks)	32,9	35,9	36,1	37,1	36,7	35,8
Credit co-operatives	0,0	0,1	0,0	0,0	0,1	0,0
– Savings co-operatives	0,0	0,0	0,0	0,0	0,0	0,0
– Credit co-operatives	0,0	0,1	0,0	0,0	0,0	0,0
Credit institutions, total	**31,3**	**34,0**	**34,1**	**35,3**	**34,8**	**33,7**

Structure of registered capital and own funds of credit institutions in 1999

	Registered Capital	/Total liab.	Own assets	/Total assets
Type of credit institution	**Bn HUF**	**%**	**Bn HUF**	**%**
Joint stock companies (banks)	354,5	4,8	179,6	2,4
Credit co-operatives	10,2	2,3	17,0	3,8
– Savings co-operatives	9,7	2,2	16,9	3,8
– Credit co-operatives	0,4	8,6	0,2	3,6
Credit institutions	364,6	4,7	196,6	2,5

Solvency ratio of financial institutions (%)

Type of the financial institution	1997*	1998	1999
Large banks		13.7	11.5
Medium-sized banks		20.5	20.4
Small banks		19.2	26
Specialized credit institutions		37.3	34
Banks total		16.5	15

* *There aren't comparable data for 1997.*

Asset Portfolio Quality of the Banking System (%)

Asset classification	1997	1998	1999
Classified total	**100.0**	**100.0**	**100.0**
Problen free	92.1	89.5	91.1
Special mention	5.0	5.6	5.2
Non-performing loans	2.9	4.9	3.7
Substandard	1.0	1.4	0.9
Doubtful	0.7	1.8	1.5
Bad	1.2	1.7	1.2

Structure of Revenues and Expenditures of credit institutions (at year-end)

HUF billion

Revenues	1997*	1998	1999
Interest income		934.3	873.3
of which: Loan to customers		378.7	383.4
Deposit with centralbank		190.8	172.6
and on interbank market			
Securities		319.3	281.5
Other		45.4	35.9
Dividends		4.7	12.4
Release of provisions		230	145.5
Revenues of other financial services		116	137.4
Other and extraordinary revenues		84.8	83.4
Revenues total		**1369.8**	**1252**

Expenditures	1997*	1998	1999
Interest expenses		663.9	596.6
of which: Deposits of customers		329.3	328.6
Loans from centralbank		54.8	47.4
and interbank market			
Securities		33.1	48
Other		178.1	107.9
Expenses of other financial services		101.6	69.4
Provisions		328.2	148.9
Overheads		243.2	271
Other and extraordinary expenses		164.6	129.1
Expenditures, total		**1501.5**	**1215**

**The Profit and Loss Statement was changed in 1998 therefore there aren't comparable data for 1997.*

1999 DEVELOPMENTS IN THE LATVIAN BANKING SYSTEM

LATVIJAS BANK

MACROECONOMIC ENVIRONMENT

In 1999, the recovery of the Latvian economy from the downturn caused by the Russian crisis gave rise to a positive development outlook for Latvia.

In the first two quarters of 1999, the decrease in GDP slowed down gradually, while in the third and fourth quarters, GDP grew year-on-year by 0.2% and 2.8%, respectively (a 0.1% growth for the year as a whole).

Price stability was one of the preconditions for the country's macroeconomic stability and foreign investors' interest. Likewise, it enhanced enterprise competitiveness. On average, the consumer price index (CPI) rose by 2.4% in 1999 compared with the previous year (by 4.7% in 1998).

The share of the European Union (EU) member states in Latvia's exports reached 57.5%. With imports outweighing exports less markedly, the foreign trade deficit decreased by 11.9%. The balance-of-payments current account deficit was mainly covered with direct investment and the Government's long-term borrowing by issuing eurobonds. In 1999, Latvia witnessed a larger foreign currency inflow than was needed to finance the current account deficit; therefore, the Bank of Latvia's international reserves grew and the balance of payments was in surplus.

In 1999 the number of unemployed persons registered at the State Employment Service declined by 1.7%, and the unemployment rate dropped to 9.1%.

Although the country's fiscal position deteriorated and the government posted a consolidated budget fiscal deficit, the deficit (4.0% of GDP) was below the level provided for by the Law "On the State budget for 1999"(4.5% of GDP).

The planned accession to the EU continued to be the main priority of Latvian foreign and economic policies. In December 1999, Latvia was invited to begin accession negotiations. This provides additional stimulus for the development of Latvia; however, it also obliges the country to undertake a set of measures in order to meet convergence criteria set forth in the Maastricht Treaty, to harmonize and improve the Latvian legislation and to provide for observance of laws.

The rating agencies Moody's, Fitch IBCA and Standard & Poor's retained the previously assigned ratings, which rank Latvia among countries with a safe investment environment. This reflects the country's good future growth prospects and acknowledges that Latvia has an opportunity of achieving compliance with EU requirements and setting up a vigorous and growing economy.

DEVELOPMENT OF THE BANKING SYSTEM

At the end of the reporting year, there were 33 licensed credit institutions in the Republic of Latvia, comprising 23 banks, 9 credit unions, the Riga Branch of Société Generale (France), and the representative office of Dresdner Bank AG (Germany). The paid-up share capital of credit institutions increased by 4.3% in 1999 and amounted to 208.6 million lats. The share of foreign investment in banks' share capital was 66.2% at the end of 1999. Several internationally well-known banks acquired qualifying holdings in Latvian banks thus reinforcing the capital base of banks and promoting the development of banking services and growth in the Latvian banking sector. Foreign investment was made in twenty banks; in twelve of these, foreign shareholders owned over 50% of the share capital, and six banks were the subsidiaries of foreign banks.

Privatization of the banking sector is well advanced. The Latvian Government was the sole owner of the JSC Latvijas Hipoteku un zemes banka (Mortgage and Land Bank). The state's share in JSC Latvijas Krâjbanka (Savings Bank), which is in the process of further privatization, was 41.8%.

Capital concentration in the banking sector continued. On December 31, 1999, the assets of five largest banks accounted for 61.7% of banks' assets (10 largest –78.1%).

In 1999, the ongoing positive development of Latvian banks was reflected in strong performance indicators: assets increased by 16.4%, reaching 1,962.9 million lats, the largest amount since the restoration of Latvia's independence. According to the audited financial statements for 1999, the profit earned during the 1999 amounted to 12.5 million lats compared to previous year losses.

The structure of assets as at the end of 1999 did not show any substantial year-on-year changes. Although the share of loans in banks' assets remained at the 1998 level, 43.4%, banks' loan portfolio in 1999 increased by 16.1%. 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 46.9% to 49.5%, as did that of long-term loans (over 5 years), from 12.7% to 15.3%. At the same time the share of short-term loans declined from 40.4% to 35.2%. These changes are indicative of a gradual transition from short-term lending to trade to lending to the goods-producing sector and the service sector. Of total loans, 77.1% was issued to domestic enterprises and private persons. An increase registered for loans granted to residents (by 17.1%) shows that Latvian banks increasingly seek to be active in the domestic market. Loans were mainly granted to manufacturing, trade, and transport, storage and communication.

And at the end of 1999, the quality of loans granted by banks was as follows: 89.4% of total loan portfolio were classified as standard, 4.4% as close-watch and 6.2% as nonperforming loans, i.e. loans that are classified as substandard, doubtful and lost. The relatively large share of nonperforming loans does not pose a treat to the stability of the banking sector, as nonperforming loans are adequately covered by provisions (specific loan loss provisions constituted 4.1% of gross loans).

At the end of 1999, total non-bank deposits received by banks amounted to 1 290.8 million lats, increasing by 23.8% compared with the level at end-1998. The 1999 level is the all-time highest level recorded for Latvian banks. With purchasing power on the rise and public confidence in the banking sector remaining strong, deposits of domestic enterprises and private persons increased in 1999. The maturity profile of deposits tends to show positive changes. The share of demand deposits declined to 68.3% (74.9% at the end of 1998), and short-term deposits increased by 65.2%, reaching 28.1% of total deposits.

Positive trends marked the liabilities of Latvian banks to non-resident credit institutions, which increased by 9.1% in 1999. Liabilities to OECD credit institutions constituted 63.2% of the total liabilities to credit institutions. At the end of 1999, 73.1% of liabilities to OECD credit institutions where with maturity more than one year, reflecting growing confidence in Latvian banks.

The capital adequacy ratio of the banking sector, which in accordance with the Law "On Credit Institutions" may not fall below 10% minimum required, was at 16% at the end of the year. The liquidity ratio increased from 52% at the end of 1998 to 64% at the end of 1999 that is above the 30% minimum requirement.

THE LEGAL AND INSTITUTIONAL FRAMEWORK FOR THE OPERATION AND SUPERVISION OF CREDIT INSTITUTIONS

In 1999, the Credit Institutions Supervision Department continued to harmonize banking regulations with the requirements of EC directives and the Basle Core Principles for Effective Banking Supervision.

The "Regulation for Receiving Bank of Latvia Permits Governing Credit Institution Operations" came into effect on May 1, 1999, replacing the "Regulation for Amending the Charter, Changing the Shareholders, the Initial Capital, the Management, the Chief Accountant, the Legal Address, the Name of Credit Institutions, and Undertaking Merger or Split-up of Credit Institutions", which was approved by the Bank of Latvia Board of Governors on March 15, 1996. In the new regulation, the requirements concerning the identification of credit institutions' shareholders, their financial standing and qualifying holdings in other undertakings or business ventures are set out more explicitly and are expanded, in particular distinguishing whether said undertakings or business ventures include credit institutions, financial institutions or financial holding companies. The regulation lists the relevant documents to be submitted. Another new requirement establishes that should a credit institution intend to render new financial services, it must inform the Bank of Latvia 30 days in advance and concurrently submit to the Bank of Latvia a description of policies and procedures for managing inherent risks.

The introduction consolidated supervision as of January 1, 1999 marked a qualitatively new stage in supervision of credit institutions. In view of this, the Bank of Latvia developed the "Regulation for Consolidated Supervision of Banks" (in effect as of May 1, 1999). The regulation establishes procedures for the preparation of consolidated financial statements and other information for the purposes of consolidated supervision, determines enterprises to be included in the consolidated financial statements, and describes the procedure for calculating performance indicators on a consolidated basis.

In order to ensure full implementation of the EC directive (86/635/EEC) "On the Annual Account and Consolidated Accounts of Banks and Other Financial Institutions" the "Regulation for Consolidated Annual Accounts of Banks" was passed that established detailed requirements for 1999 consolidated accounts and subsequent years. Consolidated annual accounts must disclose information about the financial standing and activity results of the group consisting of a bank (a parent undertaking) and its subsidiaries to any person or investor wishing to obtain such information.

As Of October 1, 1999, new "Report on Country Risk" was introduced with the aim to ensure regular monitoring and evaluation of country risk inherent in banks' operations.

The drafting of new "Regulation for Assessing Assets and Off-Balance-Sheet Liabilities" (in effect as of January 1, 2000) was prompted by considerable qualitative changes in lending and credit risk management practices of Latvian banks. The regulation replaced "Provisions for Evaluating Credits and Off-Balance-Sheet Items" approved by the Board of Governors on January 17, 1996. The regulation was worked out in accordance with the consultative paper of the Basle Committee on Banking Supervision "Sound Practices for Loan Accounting and Disclosure", and provides guidelines for evaluating the quality of assets and off-balance-sheet liabilities, their classification in accordance with the determined degree of credit risk, as well as for disclosing changes in their quality in financial statements.

In the reporting year, work on a number of regulatory documents was begun to complete the harmonization of the Latvian banking legislation with the EU legislation and to introduce the EC directives establishing the capital adequacy requirement with respect to market risks.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

During 1999, the Bank of Latvia licensed four credit unions, no new licenses were issued to banks, 14 banks received permission to increase their share capital.

The Bank of Latvia revoked the credit institution operating license of four banks. The license of the JSC bank Land was revoked for the failure to meet the minimum requirements for own funds as stipulated in the Law "On Credit Institutions" and a regular non-compliance with the requirements governing the activity of credit institutions as stipulated in the said law. The Bank issued permits to reorganize a number of banks: the JSC Latvijas Industriala banka, which was insolvent, was merged with the JSC Baltijas Starptautiska banka, the JSC Rigas Naftas un kimijas banka was merged with the joint-stock commercial bank Baltijas Tranzitu banka; the JSC Latvijas Kreditbanka was reorganized into an undertaking other than a credit institution. The licenses of the banks that ceased to exist as a result of a reorganization were revoked.

In 1999, two banks, whose insolvency had been recognized, were rehabilitated in accordance with the rehabilitation plans approved by the Bank of Latvia. Once the JSC Rigas Komercbanka (the new name, the JSC Pirma Latvijas Komercbanka), which suffered from the Russian crisis, was reopened in October, confidence in the banking sector and the financial system became stronger. Moreover, this was evidence of an efficient collaboration among interested parties to find ways for rehabilitating an insolvent bank.

In 1999, the Bank of Latvia's staff conducted 56 on-site inspections, of which 49 were in banks. As in previous years, attention was mainly directed at the evaluation of risk assets, analysis of internal control systems and internal audit functions. The growing lending activity of banks throughout 1999 led to an increase in loans granted and the introduction of new types of credit. Hence, in bank examinations attention was increasingly paid to the assessment of borrowers' financial standing, so as to timely detect problems in repaying loans. As credit institutions expanded their activity and introduced new financial services, the focus was on the improvement of the internal control systems at banks to provide for a prudent management of traditional and new risks.

Cognizant of the possible effect of the Year 2000 problem on financial institutions, the Credit Institutions Supervision Department monitored whether banks took adequate measures to avoid the Year 2000 problem and, in collaboration with the Information Systems Audit Division of the Internal Audit Department of the Bank of Latvia, conducted the relevant audits.

The auditing companies Arthur Andersen, Deloitte & Touche and Pricewaterhouse Coopers performed interim reviews on behalf of the Bank of Latvia, assessing selected banks' financial statements for the first half of 1999, as well as banks' internal control systems and the Year 2000 compliance.

In 1999, the Bank of Latvia concluded its first agreement on cross-border cooperation with Financial Supervision Authority of Finland. Negotiations on MoU's with other foreign supervisory authorities were started.

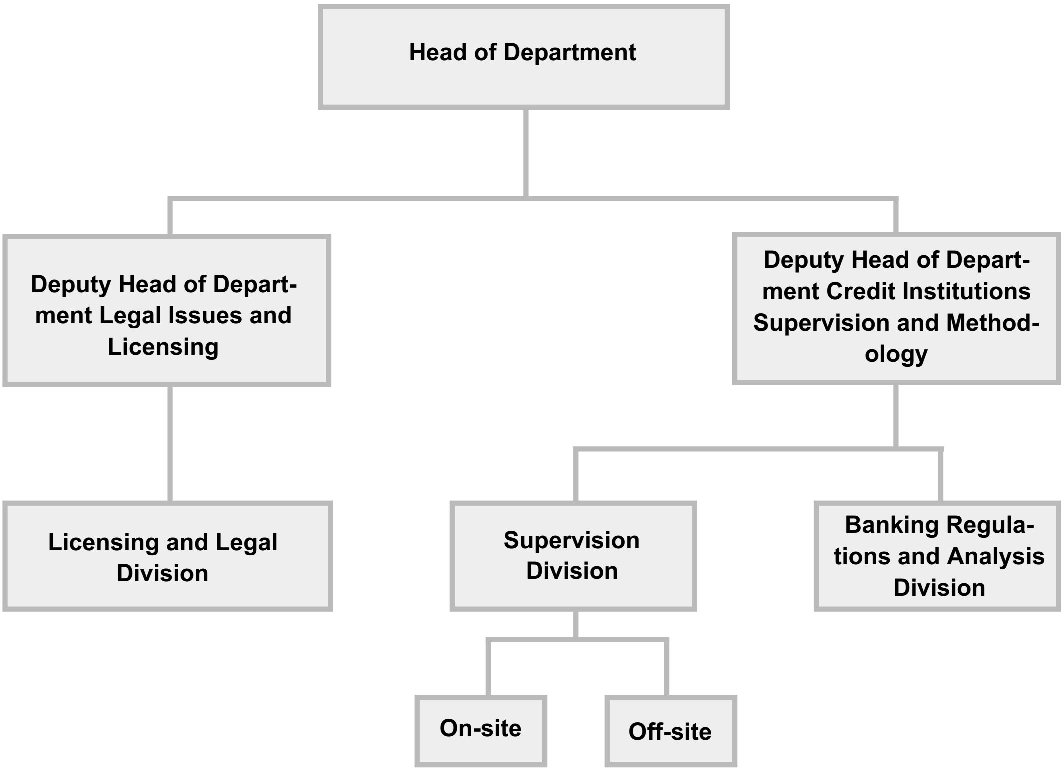
Extensive training programs in the form of seminars, courses and conferences both in Latvia and abroad allowed the supervisory staff to improve their professional knowledge and upgrade computer, foreign language, personal management and other skills.

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY

As based on Article 10 of the Law "On the Bank of Latvia", the Bank of Latvia performs supervision of credit institutions. This function has been entrusted to the Credit Institutions Supervision Department formed at the Bank of Latvia.

In Latvia, credit institutions, their branches and representative offices may begin their activities only after they have received a license (or permit) from the Bank of Latvia. As based on the Law "On Credit Institutions", the Credit Institutions Supervision Department has to perform on-site inspections in each credit institutions at least once a year. The aim of supervision is to pinpoint problems that are likely to arise and to assist credit institutions in avoiding them, as well as to curb negative economic consequences. In order to attain this goal, the Bank of Latvia issues regulations for banking activities, which are aimed at reduction of risks, and is empowered to use a wide rage of enforcement measures to ensure compliance.

Structure of Banking Supervision



STATISTICAL TABLES

Number of Financial Institutions (at year-ends)

Type of financial institution	1997	1998	1999
Banks	31	27	23
Credit unions	5	7	9
Foreign bank branches	1	1	1
Financial institutions, total	**37**	**35**	**33**

LATVIJAS BANK

Ownership Structure of the Financial Institutions in 1999 on the Basis of Registered Capital (%) (at year-end)

	Type of financial institution		Total
	Banks	Credit unions	
State ownership	3.71	0.00	3.71
Other domestic ownership	30.05	100.00	30.10
Domestic ownership total	33.76	100.00	33.81
Foreign ownership	66.24	0.00	66.19
Total	**100.00**	**100.00**	**100.00**

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

	1997	1998	1999	1999/1997
State ownership	6.8	4.9	3.7	74.0
Other domestic ownership	28.9	27.4	30.1	140.6
Domestic ownership total	**35.7**	**32.3**	**33.8**	**128.0**
Foreign ownership	64.3	67.7	66.2	139.1
Total	**100.0**	**100.0**	**100.0**	**135.1**

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

Type of financial institution	1997	1998	1999
Banks	98.59%	98.28%	98.31%
Credit unions	0.02%	0.03%	0.03%
Foreign bank branches	1.39%	1.69%	1.66%
Financial institutions, total	**100.00%**	**100.00%**	**100.00%**

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

Assets	1997	1998	1999
Cash and balances with the Bank of Latvia	8.4	9.4	9.4
Claims on credit institutions	28.9	18.8	22.4
Loans	29.7	43.5	43.4
Bonds and other fixed interest securities	20.1	14.1	15.7
Shares and other variable yield securities	5.1	4.0	1.1
Participating interest and other financial investments	0.5	0.5	0.5
Other assets	7.3	9.7	7.5

Liabilities	1997	1998	1999
Amounts owed to the Bank of Latvia	0.4	3.3	3.2
Amounts owed to credit institutions	10.6	13.4	12.2
Deposits	63.9	61.8	65.8
Other liabilities	9.9	6.4	5.4
Provisions	2.3	3.5	3.6
Total capital	**12.9**	**11.6**	**9.8**

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

Type of financial institutions	1997	1998	1999
Banks	28.2	20.2	18.6
Credit unions	0.0	0.0	0.0
Foreign bank branches	59.9	53.6	30.9
Financial institutions, total	**29.1**	**20.8**	**19.7**

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

Loan Classification	1997	1998	1999
Standard	86.6	88.3	89.4
Watch	3.6	5.4	4.4
Substandard	3.0	2.6	2.7
Doubtful	1.8	2.0	2.0
Lost	5.0	1.8	1.5
Specific Reserves	7.4	4.3	4.2

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

	1997	1998	1999
Solvency ratio of banks	21.0	17.4	16.0

The Structure of Deposits and Loans in 1999 (%)
(at year-end)

	Deposits	Loans
Households	24.6	12.0
Central and Local Governments	4.3	2.1
State Enterprises and Financial Institutions	4.5	3.7
Private Companies and Financial Institutions	65.6	79.7
Other	0.9	2.4
Total	**100.0**	**100.0**
Out of which non-residents	47.8	21.0

The Structure of Deposits and Loans by Original Maturity in 1999 (%)
(at year-end)

Maturity of Deposits		Maturity of Loans	
At sight	68.3	Short-term loans (up to 1 year)	35.2
Within one year	28.1	Medium-term loans (1-5 years)	49.5
Over one year	3.6	Long term loans (over 5 years)	15.3
Total	**100.0**	**Total**	**100.0**

LATVIJAS BANK

Proportion of Foreign Exchange Assets and Liabilities in the Banking System (%) (at year-ends)

Type of the financial institution	FOREX Assets/Total Assets			FOREX Liabilities/Total Liabilities		
	1997	**1998**	**1999**	**1997**	**1998**	**1999**
Banks	65.7	59.7	65.9	61.1	56.8	65.2
Credit unions	3.2	5.5	4.7	4.4	6.2	5.7
Foreign bank branches	73.0	63.3	56.4	73.0	63.3	67.7
Financial institutions, average	68.3	61.7	65.8	64.2	59.0	65.3

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

Revenues	1997	1998	1999
Interest income, incl.:	49.7	58.0	55.5
interest on loans	19.7	31.2	37.2
interest on deposits with credit institutions	9.9	9.4	6.4
interest on bonds and other fixed income securities	19.8	17.2	11.7
Dividends	0.2	0.2	0.1
Commission received	23.9	22.8	23.5
Profit loss from securities and currencies trading	15.9	10.8	10.2
Other	10.3	8.2	10.7
Expenditures	**1997**	**1998**	**1999**
Interest expense	18.7	17.5	22.2
Commission paid	7.1	4.3	3.9
Operating expenses (incl. salaries)	45.7	30.1	40.9
Depreciation	8.5	5.8	7.7
Loan loss provision expense	11.5	19.1	17.9
Other	8.5	23.2	7.4

Structure of Registered Capital and Own Funds of Financial Institutions in 1999

Type of the financial institution	Registered Capital	/Total Assets	Own Funds	/Total Liab.
	USD	**%**	**USD**	**%**
Banks	357,556,945	10.6	300,000,000	8.9
Credit unions	261,197	22.5	349,750	30.1
Foreign bank branches	-	-	-	-
Financial institutions, average	357,818,142	10.6	300,349,750	8.9

1999 DEVELOPMENTS IN THE LITHUANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The year 1999 was not favorable for Lithuania's economic development. The 1999 GDP at current prices stood at LTL 42.6 billion[1] or LTL 393.2 million less than in 1998. The decline of the GDP in 1999 (by 4.1%) was mostly determined by the decline of industry, agriculture, construction, trade and public administration where the decrease in exports of industrial and agricultural output to Russia and other CIS countries and the volume of work performed by the Lithuanian construction companies in those countries was the driving factor.

In 1999 inflation, as reflected by the consumer goods and services price index (CPI), was only 0.3%. One of the key factors that contributed to the low rate of inflation was the fall in food prices (-1.4%) and the prices on alcoholic beverages and tobacco (-9.3%) that declined due to lowered excise taxes. While the general price level declined in 1999, the prices in many groups of goods and services grew. The highest increase in prices was observed in communication (16.9%) and transport (15.8%) services.

The year 1999 was complicated for public finances due to a strong influence of the Russian crisis. The state budget, non-budgetary and social insurance fund expenditures had to be cut. Deteriorating financial results in most economic activities had a huge impact on the collection of budget revenues.

Economic decline in 1999 caused a decrease of employment. Unemployment at the end of 1999 stood at 10% and reached the highest level since the restoration of independence.

Wages and salaries accounted for 53% of disposable household income. In 1999, gross average monthly earnings made up LTL 1,013 and net monthly earnings were LTL 739. Average monthly wages and salaries in the public sector exceeded those in the private sector; the latter, however, grew more rapidly.

On 1 January 2000, the total public debt was LTL 12.1 billion (28.5% of 1999 GDP). Over the year, it increased by LTL 2.5 billion, or by 25.5%.

Two international rating agencies ("Fitch IBCA" and "Standard and Poor's") approved the previous credit ratings (BB+) for Lithuania in March-April 2000 having taken into consideration the country's progress in the sphere of privatization and strengthening of the banking system.

DEVELOPMENT OF THE BANKING SYSTEM

As of 1 January 2000, the Lithuanian banking system consisted of 10 commercial banks, 3 foreign bank branches, 4 foreign bank representative offices and 2 banks regulated by special laws.

[1] LTL 1.00 = USD 0.25

The domestic commercial banks had 171 branches and 1 representative office in Lithuania. In addition, there were 33 credit unions including 4,314 members, or one third more than a year ago. In 1999, the banking system continued to strengthen. One foreign bank subsidiary and one foreign bank branch appeared in the national market. The merger of the two largest private banks JSC Vilniaus Bank and JSC Bank Hermis began at the end of 1999.

The asset share of two state-owned banks, the Savings Bank of Lithuania and the Agricultural Bank of Lithuania, holding the largest part of all deposits (48.9%), went down from 44.4% to 41.9%.

The domestic commercial banks did not increase their share capital in 1999. As of 1 January 2000, foreign investors owned more than a half of the share capital in four out of ten commercial banks, in two banks the largest portion of the capital was state-owned and in the remaining banks the share capital was held by foreign and local investors. An increasing share of foreign ownership indicates growing confidence in the Lithuanian banking system.

In 1999 net assets of banks increased by 6.5% and comprised more than LTL 11.2 billion, the amount of issued loans (excluding loans to credit and financial institutions) grew by 17.6% and equaled LTL 5.6 billion. The largest share of new loans was issued for long term (maturity of more than one year) projects. During the year the share of long term loans increased from 51.1% to 57.2%.

Loans made up the main part of bank assets (during the year the share of net loans grew from 42 to 47%). Therefore, credit risk management remained an essential premise for successful development of banks. The largest share of loans (73.2%) was issued to private enterprises.

The general loan portfolio indicators of the banking system slightly improved in 1999 compared with 1998: the ratio of specific provisions to loans went down from 5.9% to 4.5%, the share of nonperforming loans in total loans contracted from 12.5 to 11.9%.

The key activities of banks were based on resources attracted from the domestic market, primarily deposits and letters of credit. Total amount of deposits and letters of credit grew by 10.0% to exceed LTL 6.9 billion at the end of year 1999. The share of deposits in foreign currencies during the year grew from 40.1% to 47.3%. A significant increase, from 32.4% to 40.2%, was observed in individuals' deposits as part of bank liabilities. The share of individuals' deposits increased quite noticeably in two state-owned banks (from 44.1% to 56.6%).

The net profit of the banking system in 1999 stood at LTL 112.2 million. In 1998 the profit earned by banks amounted to LTL 88.6 million.

The 1999 bank income structure showed an increase of interest income accounting for nearly 71%. Commissions and fees for related services generated around 20% of income earned by banks. Operational expenses, though going down, still accounted for a significant share of expenses (around 40% of total expenses). Interest expenses went up from 27% up to 33% in 1999.

In 1999 banks operated in a sufficiently prudent manner. As of January 1, 2000 capital adequacy ratio of commercial banks amounted to 17.4%, while the minimum requirement was 10%, the liquidity ratio stood at 45.4%, whereas the minimum requirement was 30%.

The Bank of Lithuania also performs the supervision of credit unions. Credit unions played an insignificant role and their assets at the end of 1999 accounted for 0.09% of the banking system assets and stood at LTL 10.2 million.

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

The Law of the Republic of Lithuania on the Bank of Lithuania and the Law of the Republic of Lithuania on Commercial Banks are the two main laws that establish the central bank's responsibilities and regulate the establishment, licensing, operations and supervision of credit institutions. The supervision of banks, including granting licenses to local banks and foreign bank branches and subsidiaries, is assigned to the Credit Institutions Supervision Department (hereinafter CISD), which is a structural unit of the central bank. Additionally CISD is responsible for the supervision of credit unions.

While following a concept of prudential supervision, the CISD begins supervision of a bank before it receives a banking license. Prospective banks are required to submit a number of documents, which are comprehensively reviewed. The issue of a bank license has become more noticeable with the interest of foreign investors in the Lithuanian banking market. The licensing area is also responsible for reviewing and approving any increase of bank share capital or any acquisition from an individual or company of block of shares (over 10%). Due to this licensing is one of the main functions in banking supervision.

The off-site monitoring division is responsible for the analysis of bank's reports, compilation of data and trends, and providing data to the on-site inspectors. The off-site monitoring also monitors and controls banks' compliance with the prudential requirements established by the BoL. An Early Warning System designed and implemented within the off-site monitoring division provides a number of financial indicators to assist the division in determining if a bank is beginning to have financial difficulties. Based on the ratios calculated and other cumulative data obtained a rating system was developed. It highlights the banks' capital adequacy, asset quality, earning and liquidity (CAEL) and is utilized to follow the trends of the industry. The ratings of banks are not publicly disclosed. On-site inspectors perform bank inspections on a regular basis and each commercial bank must be examined at least once a year. If any deficiencies are found during the course of a year, a specialized (limited scope) inspection can take place. On-site examinations are carried out using an international CAMELS methodology where composition of capital, asset quality, management performance, earnings, liquidity management and sensitivity to market risk is taken into account.

Supervision of credit institutions is based on internationally accepted practices and procedures and is aimed at ensuring safety and soundness of the banking system.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 1999

In supervising credit institutions, the Bank of Lithuania follows the Basle Committee Core Principles for Effective Banking Supervision (the implementation of which was approved by the Government of the Republic of Lithuania) and other requirements and recommendations of the Committee.

A lot of attention was paid to the tightening of prudential requirements or their calculation methodology. In April 1999, the Board of the Bank of Lithuania approved the new Rules for Calculation of Bank Liquidity Ratio. According to the said rules, tighter requirements are applied when evaluating liquid assets. In December last year, the Board of the Bank of Lithuania approved tighter ratios of maximum open position in foreign currency and precious metals that have been applied since the middle of this year. The tightening of said requirement is related to the fact that not only the ratios have been changed, but the banks have been also obligated to evaluate the risk of their operations in foreign currency and precious metals on the daily basis and ensure compliance with the said requirement. In recent years, banks have expanded their currency trading activities; therefore, tighter management of currency exchange risk has to be implemented.

The amended Law on Commercial Banks was adopted. The said law provides including the ratio of large exposure into the list of prudential requirements and, if necessary, the right to the Bank of Lithuania to set additional prudential requirements taken into consideration the Basle Committee for Banking Supervision requirements. It is related to the development of financial markets when bank services expand and the number of financial instruments used increases. Due to the said, banks face new types of risks that have to be properly managed and controlled.

Additional attention was paid to bank risk management. The aim is to make more accurate evaluation of bank risks and calculate the capital required to amortize this risk. Due to that in cooperation with an international audit firm a project on market risk management and requirements for internal Value at Risk models in commercial banks was started.

In order to create conditions for banks to better evaluate credit risk, Loan Risk DataBase was restructured and services for commercial banks were expanded. Information on loans granted and borrowers was expanded. It is important that data base will contain information on loans granted not only by banks and foreign bank branches themselves, but their controlled enterprises and financial leasing as well.

One of the most important conditions necessary for effective supervision is proper regulation of accounting in credit institutions. In 1999, taken into consideration recommendations of credit institutions and international audit companies as well as the new amendments made in IAS, forms of bank financial statements for publication and requirements for explanatory letters were amended. These amendments were made so that the public could receive comprehensive information on bank activities.

As bank activities expand, it is necessary to plan these activities by formulating the main bank goals, their implementation measures, and the priorities of bank activities. For that purpose last year, new requirements for bank business plans were prepared. Banks took into consideration these requirements and at the beginning of 1999, submitted their business plans for 1999 and strategic activity plans for the period of three years.

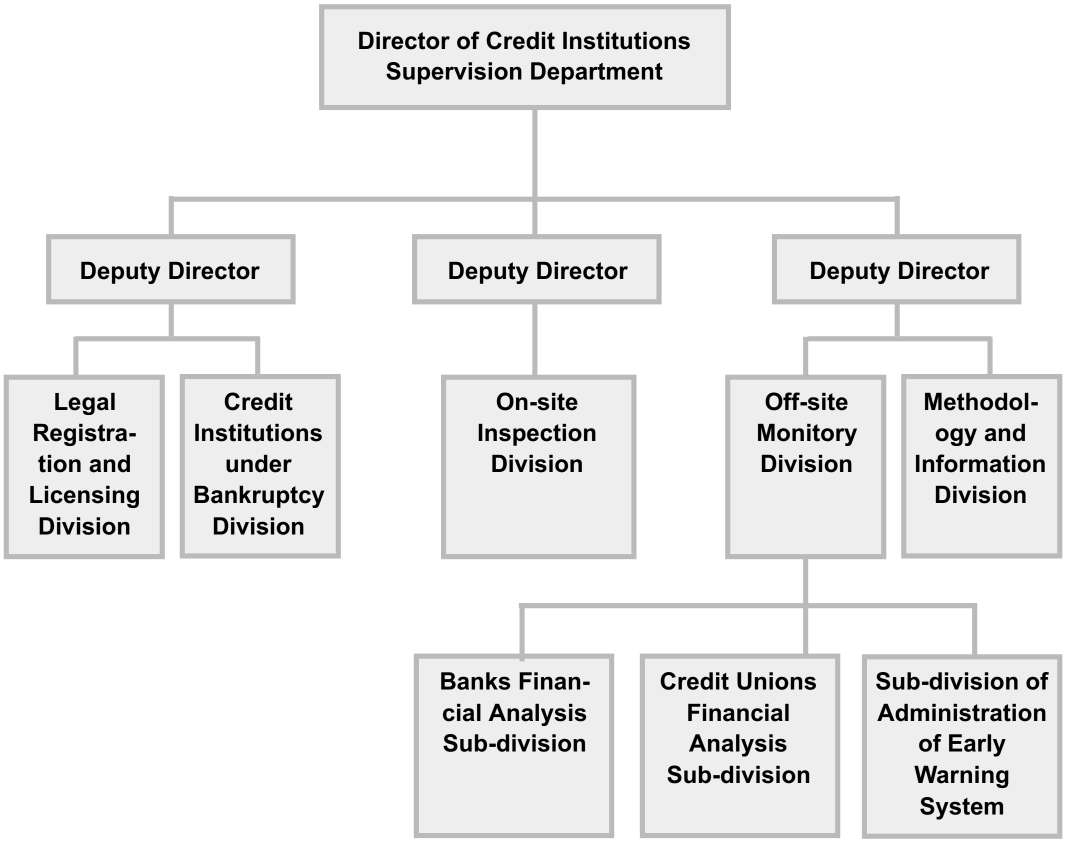
In order to expand the number of bank operations, in July 1999, the Board of the Bank of Lithuania approved additional bank operations, which can be performed by commercial banks, i.e. factoring, financial mediation, and cash management.

Last year, amendments of the Rules for Financial Statements Consolidation and Consolidated Supervision were prepared. These amendments will allow avoiding the risk of double accounting of the same investment by different institutions (in case several banks have invested into the same credit institution or enterprise) and to more accurately evaluate the performance of the group. Besides, the amended Rules provide for including insurance companies into the consolidated financial statements.

In 1999, the Bank of Lithuania continued cooperation with international audit firms, and was organizing bilateral and tripartite meetings among the Bank of Lithuania, commercial banks, and auditors. During these meetings, opinions on accounting and reporting issues were exchanged.

We also continued cooperation with foreign countries' supervisory institutions. Draft agreements on cooperation in the area of credit institutions' supervision with German, Estonian, Swedish, Polish, and Belarusian supervision authorities are under preparation. Cooperation agreements with the central bank of the Russian Federation, Finnish supervisory authority, and the central bank of Latvia have already been signed.

The Structure of Credit Institutions Supervision Department of the Bank of Lithuania at the end of 1999



STATISTICAL TABLES

Number of Financial Institutions (at year-end)

Type of financial institution	1997	1998	1999
Commercial banks	11	10	10
Foreign bank branches	1	2	3
Banks operating under special laws	2	2	2
Credit unions	23	28	33

Ownership Structure of Financial Institutions in 1999 on the Basis of Registered Capital (%) (at year-end)

	Commercial banks	Foreign bank branches*	Banks operating under special laws	Credit unions	Total
State ownership	33.6	-	75.9	-	36.9
Other domestic ownership	28.2	-	-	100.0	17.8
Domestic ownership total	61.8	-	75.9	100.0	54.7
Foreign ownership	38.2	100.0	24.1	-	45.3
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-end)

Item	1997	1998	1999	1999/1997
State ownership	48.9	39.6	36,9	-26.5
Other domestic ownership	19.0	19.1	17.8	-8.4
Domestic ownership total	68.0	58.7	54,7	-21.5
Foreign ownership	32.0	41.3	45,3	38.0
Financial institutions, total	**100.0**	**100.0**	**100.0**	**-2.4**

Distribution of Market Shares in Balance Sheet Total (%)

Type of financial institution	1997	1998	1999
Commercial banks	79.0	80.2	80.5
Foreign bank branches	0.2	1.8	2.6
Banks operating under special laws	1.7	2.4	2.1
Credit unions	0.03	0.07	0.09
Financial institutions, total	100.0	100.0	100.0

The structure of Assets and Liabilities of the banking system in 1999 (%) (at year-end)

Assets	1997	1998	1999
Cash in hand	4.1	3.3	3.4
Claims on banks and other financial institutions	15.7	12.5	23.6
Securities	23.0	19.2	14.7
Loans granted*	47.8	44.9	49.5
Other assets	9.4	20.1	8.8
Liabilities	**1997**	**1998**	**1999**
Liabilities to banks and other financial institutions	9.2	14.5	16.4
Deposits and L/C	70.9	59.8	61.7
Other liabilities	10.0	13.5	10.2
Bank capital	9.9	12.2	11.7

* *Carrying amount*

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

Type of financial institution	1997	1998	1999
Commercial banks	20.1	20.9	12.9
Foreign bank branches	16.8	33.2	1.6
Banks operating under special laws	4.1	13.2	6.1
Credit unions	-	-	-
Financial institutions, total	**20.1**	**20.8**	**12.4**

Solvency ratio of financial institutions (%)

Type of financial institution	1997	1998	1999
Commercial banks	10.8	23.8	17.4
Foreign bank branches*	-	-	-
Banks operating under special laws	35.1	14.4	9.1
Financial institutions, average	11.4	23.4	17.1

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

Asset portfolio Quality of the banking system (%)

Asset Classification	1997	1998	1999
Standard loans	64.4	67.8	64.3
Watch loans	13.4	19.7	23.8
Substandard loans	5.6	4.4	4.4
Doubtful loans	4.7	2.1	3.7
Bad loans	11.9	6.0	3.8
Classified total (LTL million)	**3968.4**	**4735.7**	**5569.2**
Specific Reserves (LTL million)	**734.8**	**280.5**	**249.1**

The Structure of Deposits and Loans in 1999 (%) (at year-end)

	Deposits	Loans
Households	56.4	11,9
Government sector	11.8	14,5
Corporate	25.3	69,2
Foreign	4.6	4,1
Other	1.9	0.3
Total	**100.0**	**100.0**

The Structure of Deposits and Loans in 1999 (%) (at year-end)

Maturity of Deposits		Loans	
At sight	54.2	Long-term loans*	15.0
Within one year	42.5	Medium-term loans**	23.2
Over one year	3.3	Short-term loans***	61.7
Total	**100.0**	**Total**	**100.0**

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

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

Type of the financial institution	FOREX Assets/Total Assets			FOREX Liabilities/Total Liabilities		
Type of financial institution	**1997**	**1998**	**1999**	**1997**	**1998**	**1999**
Commercial banks	36.1	40.6	48.1	39.6	45.3	52.9
Foreign bank branches	22.7	90.6	88.3	4.2	89.9	87.3
Banks operating under special laws	69.5	61.0	60.0	79.6	53.1	63.8
Financial institutions, average	**36.7**	**42.2**	**49.6**	**40.2**	**46.4**	**54.2**

Structure of Revenues and Expenditures of Financial Institutions in 1999 (%) (at year-end)

Revenues	1997	1998	1999
Interest income	61.6	59.9	70.8
Profit from operations in foreign exchange	11.2	12.2	4.5
Other bank income	25.6	1.3	1.4
Other income	1.6		23.3
TOTAL REVENUES	**100.0**	**100.0**	**100.0**

Expenditures	1997	1998	1999
Interest expenses	24.7	27.2	32.7
Operational expenses	47.4	43.2	42.4
Expenses for specific provisions	12.8	5.5	3.9
Other expenses	15.1	24.1	21.0
TOTAL EXPENSES	100.0	100.0	100.0
Net profit (loss), LTL million	**-68.6**	**88.6**	**112.2**

Structure of Registered Capital and Own Funds of Financial Institutions in 1999

Type of the financial institution	Registered Capital	/Total assets	Own Funds	/Total Liab.
	USD million	**%**	**USD million**	**%**
Commercial banks	184.8	6.8	312.9	13.0
Foreign bank branches	10.7	12.3	15.7	21.8
Banks operating under special laws	31.7	44.5	5.4	8.1
Credit unions	0.5	17.6	0.5	24.4
Financial institutions, average	**217.0**	**7.9**	**334.4**	**13.1**

1999 DEVELOPMENTS IN THE MACEDONIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Economically speaking 1999 was very specific year for the Republic of Macedonia. The external shock, caused by the war in the neighboring FR Yugoslavia, had a major impact on the Macedonian economy, creating negative effects on the demand side as well as the supply side. Under such circumstances, the Macedonian economy showed surprisingly high level of vitality, i.e. capability of facing the extremely unfavorable external influences. The upward trend in the economy registered in the last couple of years continued in 1999. Despite the fact that it is relatively slower, it is exceptionally important that it was achieved at times of extremely unfavorable external influences.

Despite all the turbulent movements, the previously established stability of the domestic currency was preserved on both internal and external plan. Namely, the rate of inflation remained low and stable, while the exchange rate of the denar against the Deutsche Mark was preserved at the targeted level. However, this was not followed-up by more significant improvement on the issues that have been causing problems in the previous years. The rate of unemployment, the foreign trade deficit and the lack of financial discipline remained high. In addition, the need of further improvement in the corporate management remained, as a way to bring the corporate sector closer to the logic of free market. The unsolved problems in 1999 call for prompt continuation and acceleration of the structural reforms in the Macedonian economy, in order to bridge the gap to the most developed countries in transition.

According to the preliminary estimates, the real gross domestic product (GDP) increased by 2.7%. Despite the fact that the rate of growth is by 0.2 percentage points lower compared to 1998, it is far better than the pessimistic estimates of reduction in real GDP by 4.0% to 15.0%. It is important to note that this is the fourth year in a row in which positive rate of economic growth is being registered. What is typical for 1999 is that the growth in GDP is not a result of the implementation of structural reforms, but of the responsiveness of the supply side factors to the changes in demand following the war in FR Yugoslavia.

The modest reduction in the rate of unemployment during 1999 does not alter the conclusion that the unemployment is the single macroeconomic variable that corrupts the positive developments in the Macedonian economy to the largest extent.

Exceptionally important macroeconomic achievement in the Republic of Macedonia in 1999 is the preservation of the established macroeconomic stability. Hence, on December basis (December 1999 / December 1998), the rate of inflation, measured through the increase in retail prices, equaled 2.3%, which is within the framework of the projected maximum increase of 3.0%.

The favorable movements on the foreign exchange market, especially in the period following the end of the military action in FR Yugoslavia, as well as the continuing successful coordination of the monetary and fiscal policies, contributed significantly to the successful realization of the projected monetary policy for 1999. Namely, the greater supply than demand on the foreign exchange market resulted in significant net-purchase of foreign currency by NBRM, which was the main factor acting towards an increase in the foreign exchange reserves of NBRM. At the end of 1999, they reached USD 458 million, which represents the highest level since the monetary independence of the Republic of Macedonia, and it covers 3.1 months of imports. At the same time high growth rates were registered in the monetary aggregates.

Despite the considerable increase in the money supply, NBRM did not endanger the established price stability, and at the same time supplied amount of money sufficient for the normal execution of economic transactions in the economy. Simultaneously, the banking sector of the Republic of Macedonia passed a major test, showing great responsiveness while facing a danger of "a run on the banks". Namely, the banks successfully responded to the sudden and intensive withdrawal of deposits by the economic agents in the moments prior to the beginning of the war in FR Yugoslavia, when the risk and uncertainty were greatest. This led to a relaxation in the overall environment, which acted towards further increase in the confidence in the banking system and continuation of the tendency of growth in the savings of both households and enterprises.

The favorable movements on the foreign exchange market in 1999 are primarily due to the influence of external factors (foreign donations and increased presence of nonresidents), and not to the qualitative improvement in the foreign trade and inflow of foreign exchange on these grounds. The external shock caused a contraction in the foreign trade by 7.4%, resulting from a reduction in exports and imports by 9.1% and 6.2%, respectively. The lower pace of decline of imports relative to exports resulted in a continuation of the trend of registering high foreign trade deficits, which equaled USD 604 million in 1999. It is especially important to note that the deficit in the current account of the balance of payments in 1999 was brought to half of the level in 1998 and equals 3.9% of GDP.

The banks' interest rates in 1999 remained high, thus continuing their adverse effect on potential investors. Characteristics of the interest rates is that they remained unchanged even during more intensive economic fluctuations, generated by the influences of external factors, which reflects the rigidity of the banks designing of their interest rate policy. In 1999, the banks' nominal average weighted lending interest rates equaled 20.5%, which represents only 0.5 percentage points decline compared to 1998. In conditions of established price stability, this resulted in substantially high real interest rates of banks, which equaled 21.6%.

The positive trend of development of the financial sector in the Republic of Macedonia and the steps towards its consolidation and strengthening continued in 1999. Macedonian banks managed to overcome the challenges they faced during the escalation of the crisis in FR Yugoslavia relatively successfully. At the same time, there was a further affirmation of the role of the money and short-term securities market and the Macedonian Stock Exchange. In 1999, the activities related towards the reform of the payments system continued, as well as the successful functioning of the Deposit Insurance Fund. With this, environment is being set for an increased financial intermediation in the Republic of Macedonia, as a precondition for a more efficient allocation of financial resources and promotion of economic growth.

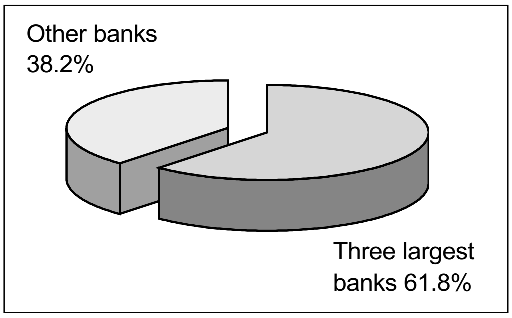
Looking ahead to the future, to assure a more dynamic economic activity and to reduce the effect of the problem of unemployment in the Republic of Macedonia, two major issues should be addressed and resolved. Firstly, a prompt continuation and expansion of the structural reforms. Secondly, a reduction in the price of capital borrowed from banks is of utmost importance for the future development of the Macedonian economy.

STRUCTURE OF THE BANKING SYSTEM

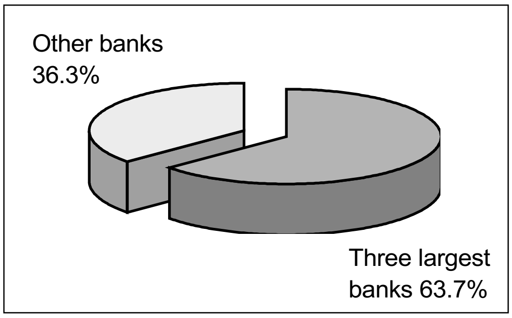
At the end of 1999, the banking system of the Republic of Macedonia was comprised of 22 banks, 1 foreign bank branch and 16 savings houses. Last year there were no major changes in the structural shares of the two main segments of the banking system of the Republic of Macedonia - the banks and the savings houses. Hence, relative to the end of 1998, the share of banks in the total financial potential increased for 0.3 percentage points, and at the end of 1999 was at the level of 99%. This confirms their structural domination in the banking system of the Republic of Macedonia, i.e. the marginal role of the savings houses which is also clearly visible through their share in the collection of savings deposits from households, as one of their basic functions. As of December 31, 1999, savings houses accounted for only 3% of the total savings deposits of households.

The analysis of the structure of the banking system according to the size of the financial potential, the volume of business and banks' own assets, shows the asymmetrical structure of the banking sector. Namely, the three largest banks in the Republic of Macedonia accounted for 63.7% of the total volume of banking operations, as well as 61.8% of the collected financial potential. According to capital strength, the three largest banks had a 38.4% share, which relative to December 1998 was a 1.1 percentage points decline.

Concentration by volume of assets



Concentration by volume of business



Through the process of privatizing the shareholders in the Macedonian banks, as well as through the sale of new shares, the banks in the Republic of Macedonia are gradually being privatized. These processes proceeded during 1999 as well. Thus, as of December 31, 1999, the average rate of privatization of banks was 76.8%.

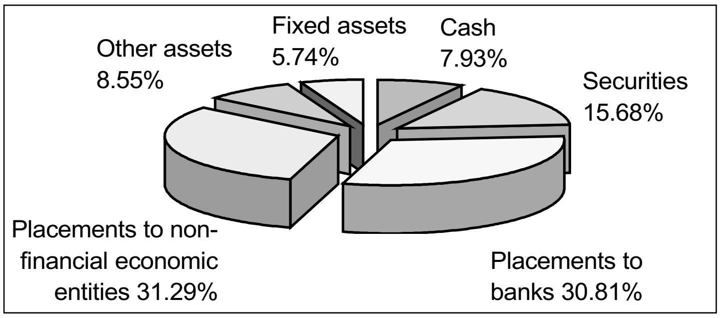
The average share of foreign capital in the total equity capital of Macedonian banks as of December 31, 1999 was 19.3%. Out of the total number of banks, there is foreign capital in 15 of them, while the remaining banks have only domestic capital.

The unfavorable structure of the banking system in the Republic of Macedonia is confirmed from a regional aspect, too. Namely, only 6 banks and 4 savings houses are located out of Skopje. The potential of financial institutions located out of the capital Skopje, account for only 11.5% of the total financial potential. The relatively extended network of branches, subsidiaries, windows, operational units and representative offices is partly alleviating this disproportion in the supply of financial services. At the end of 1999, banks in the Republic of Macedonia had 20 branches, 185 windows, 8 operational units and 4 representative offices. "Postenska stedilnica" (postal savings house) should also be mentioned, which has a wide network of windows (600 windows are located throughout the whole territory of the Republic of Macedonia).

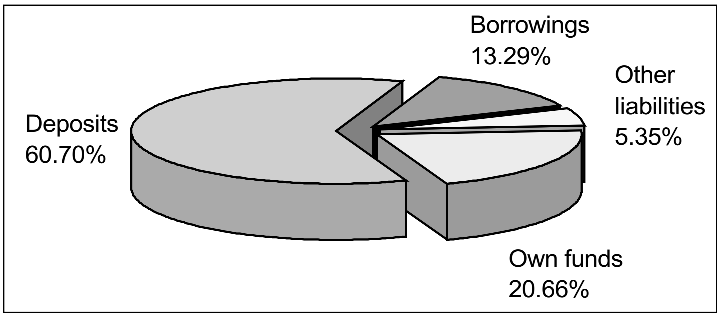
Structure of the Balance Sheet of the Macedonian Banking System

At the end of 1999, the total financial potential of the Macedonian banks was denar 72.3 billion. The main structural composition of the balance sheet of the Macedonian banks is presented in the following figures:

Structure of Assets



Structure of financial potential



Performances of the banking system

Asset Quality

Quality of the assets remains one of the major problems of the banking system of the Republic of Macedonia The high percentage of participation of bad debts in total credit exposure, low percentage of collection of claims, high interest margins, difficulties in realization of overtaken mortgages which serve as a collateral of claims are basic problems in this area which directly reflect the other performances of banking activities such as level of capitalization, liquidity position, profitable potential etc.

Unlike in previous years, when as a result of the vitalization of the economic activities of the Republic of Macedonia, supervisory examinations strengthened, as well as improved methods and procedures for measuring and accepting the inherited risks, a certain improvement of the quality of the banks' assets happened, in 1999 all ratios for quality of assets deteriorated. The basic reason for such situation are mostly of an external nature, especially as a result of the war in our neighborhood. Consequences of the large external shock experienced by the real sector of Macedonian economy were transferred into banking system with negative implications on the quality of claims, as well as the ratios for profitability and efficiency of the banks, mostly as a consequence of the decreased ability of economic subjects for serving their debts towards the banks and increment of their risks, which forced the banks to allocate larger amounts of provisions for bad debts.

The analyses of performances of the banks' credit portfolio include quantification of several ratios in order to estimate the quality of credit portfolio.

As of December 31, 1999, all claims classified in the risk categories C, D and E participated with 41.3% in total credit exposure. However, it should be considered that this indicator in 1999 experienced increment relative to the declining trend in the previous years (44.4% in 1995, 42.8% in 1996, 35.6% in 1997 and 32.9% in 1998). If the claims ranked in the risk category E, which are 100% provisioned, are taken out of the analysis, the share of the claims classified in the C and D categories in the total credit portfolio would amount to 34.3%. On the other hand, the claims classified in the D and E categories alone, which according to our regulation are nonperforming claims, accounted for 25.1% of the total credit exposure**.** As of December 31, 1999, the average rate of risk on the credit portfolio of banks, expressed as a ratio between the amount of potential losses and the total credit exposure, was 22.6%, which is closely to the risk category C (25%). Compared to December 31, 1998, this indicator was 5.1 percentage points higher.

Capital Adequacy

As of December 31, 1999, banks' and savings houses' own funds were denar 15.1 billion or DEM 487.6 million in denar value (calculated by the exchange rate of NBRM on December 31, 1999). All banks fulfilled the capital requirement for performing domestic banking operations, while 17 banks were licensed to conduct payment operations and credit operations abroad.

If banks' and savings houses' own funds are compared to the total amount of assets of the banking sector, the average level of capitalization of the banking sector on December 31, 1999, was 20.7%. If the off-balance-sheet activities are also considered, the rate of coverage of the total operations with banks' own funds was 17.4%.

As of December 31, 1999, the capital adequacy ratio of the banking sector was 28.7% (including the savings houses, this ratio was 28.8%), which is 3.5 times higher than the minimum of 8% proposed by the Basle committee for banks supervision and accepted in the legislative framework in the Republic of Macedonia.

Profitability

With the final financial statement for 1999, the banking system in the Republic of Macedonia reflected a net profit of denar 503 million, which is almost twice lower than the financial result the year before. However, if we adjust the value of net income for unallocated provisions, then the banking system of the Republic of Macedonia will reflect a negative financial result.

The profitability ratios of banks in the Republic of Macedonia are calculated on the basis of the presented net profit for 1999, as well as the average assets and average equity during 1999. Thus, the rate of Return on Assets (ROA) was 0.8%. Compared to December 1998, this ratio declined by 1.2 percentage points. The rate of Return on Equity (ROE) was 3.5%, compared to 8.2% in 1998, and 9.3% in 1997.

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

The supervisory function is defined by two basic laws: the National Bank of the Republic of Macedonia Act (Official Gazette of the Republic of Macedonia No. 29/96 – revised text, 37/98) and the Law on Banks and Savings Hoses[1] (Official Gazette of the Republic of Macedonia No. 29/96 – revised text, 37/98), as well as numerous decisions, instructions and supervision circulars. The regulatory framework of the banking supervision in the Republic of Macedonia is based on international supervisory standards and Core Principles for Effective Banking Supervision issued by the Basle Committee for Banking Supervision.

According to the regulation, the National Bank of the Republic of Macedonia is authorized supervisory agency.

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN THE REPUBLIC OF MACEDONIA

The Banking Supervisory Authority carries out its supervisory function at three levels:

- Licensing function, i.e. processing of applications for granting licenses and approvals, in compliance with the Law on Banks and Savings Houses;
- Supervision control of banks and savings houses operations;
- Undertaking corrective actions against banking institutions in which certain irregularities have been identified.

Licensing function

The National Bank of the Republic of Macedonia Act, the Law on Banks and Savings Houses, the corresponding bylaws, as well as the Licensing Manual with Instructions underlie the basic framework, which regulates the licensing process. This legal framework stipulates the basic conditions and criteria that should be fulfilled for granting a founding and operating license (for founding and operation of a bank, foreign bank branch, savings house, money and short-term securities market, operation and statutory changes within the bank and savings houses).

Also, the existing regulation stipulates the procedure for issuing all kinds of approvals (appointment of executive body; establishment of branches of the bank in the country and abroad; purchase of shares of another bank; establishment of a representative office of a foreign bank; change of the ownership structure of voting shares; change of the name and head-offices of the bank; etc)

Supervision control

The National Bank of the Republic of Macedonia simultaneously implements two levels of supervision control:

1. Permanent monitoring of the data and reports which the bank is obliged to submit to the National Bank of the Republic of Macedonia in compliance with the existing regulations, as well as at special request by the National Bank of the Republic of Macedonia

[1] A new Banking Law was adopted at the end of July 2000.

2. Direct (on-site) supervision control, which might be full-scope or targeted examinations.

The full-scope examinations are conducted according to Annual plan for examinations. The National Bank of the Republic of Macedonia is obliged to conduct full-scope examination over each bank and savings house at least once a year.

There was no formal distinction between these two functions until the second half of 1999. The change in the organizational structure of the Supervision Department made in this period resulted in formal segregation of these two functions, by establishing two separate organizational units for conducting on-site examination and permanent off-site monitoring of the banks' operations.

Enforcement Actions

The National Bank of the Republic of Macedonia disposes of wide range of corrective actions which shall be undertaken depending on the size and the type of the irregularities and problems, as well as the willingness of the banks and savings houses to overcome these irregularities. Thus, banks' mechanism for corrective action undertaken by the National Bank of the Republic of Macedonia may be summarized through the following:

- the supervisors provide recommendations and suggestions during the examinations in order to eliminate the minor irregularities, or recommendations described in the report of the examination;
- in case of major irregularities, the banks develop a program for elimination of the identified irregularities in cooperation with the National Bank of the Republic of Macedonia. If the content of the program is approved, protocols for elimination of the identified irregularities based on mutual agreement are developed.
- in case of serious irregularities, as well as in case of permanent deterioration of the conditions in the bank, or if the offered solutions failed to meet the expectations, the National Bank of the Republic of Macedonia undertakes corrective actions in form of decisions with measures, brought by the Governor of the National Bank of the Republic of Macedonia, which clearly define the obligations of the institution and the time framework of their fulfillment.
- the ultimate level of actions undertaken by the National Bank of the Republic of Macedonia is revocation of the banking institution operating license. This action may be undertaken against institution where serious financial and operational difficulties have been identified, without perspectives for further existence and where the aforementioned enforcement of actions failed to meet the expectations.

LAST YEAR'S ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

The activities of the National Bank of the Republic of Macedonia related to the aspects of the supervisory function in the course of 1999 are further explained.

Licensing

During 1999, license for founding a savings house was issued, as well as an approval for opening a representative office in the Republic of Slovenia. During the same period, because of certain irregularities identified during the operation, decisions have been passed for revocation of the operating licenses of 1 bank and two savings houses.

Also, processing of applications for granting different kinds of approvals has been carried out, i.e. for opening of windows or branches of domestic banks, for appointing an executive body, for changing the ownership structure of the voting shares, for changing the statute, changing the name, headquarters, as well as for insight in the examination report.

Supervision control

In the course of 1999, the National Bank of the Republic of Macedonia conducted 47 on-site examinations, 26 out of which full-scope examinations and 21 targeted examinations. Full-scope supervisory examinations were conducted in 16 banks, 9 savings houses, as well as the operation of the Deposit Insurance Fund. Targeted examinations were conducted in 17 banks and 4 savings houses. By conducting these examinations, the 1999 annual plan regarding full-scope supervisory examinations was entirely implemented.

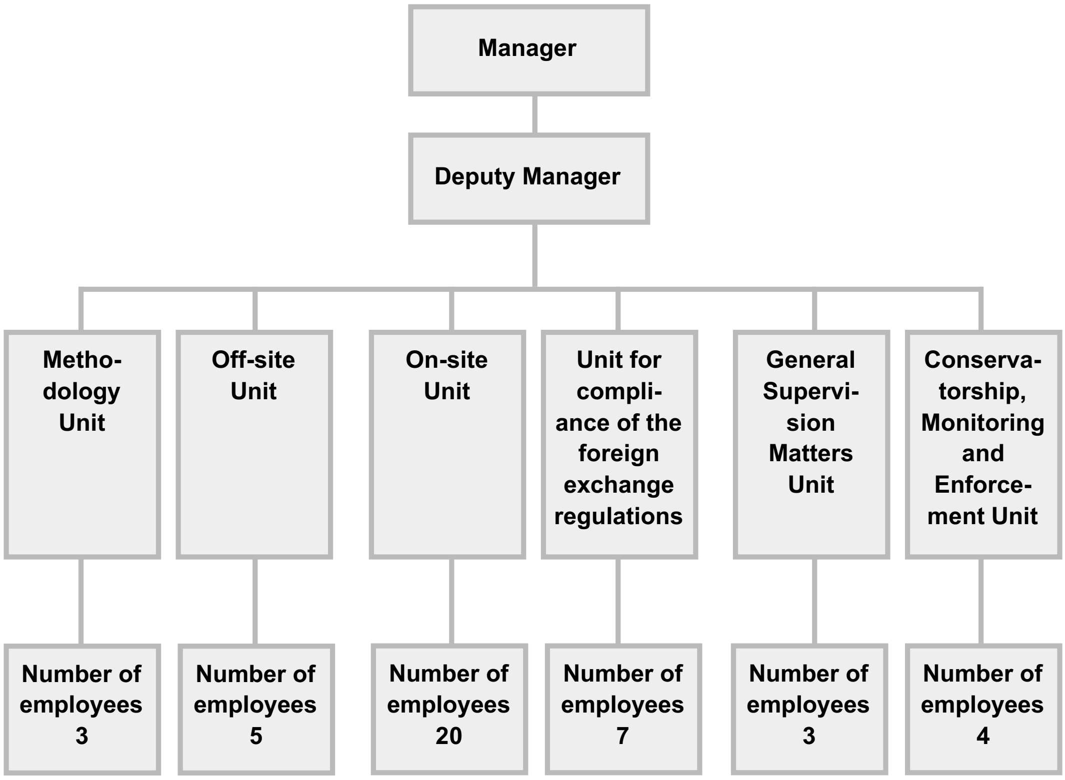
Also, in January – December 1999 period, due to the identified liquidity problems, monitoring of the process of implementation of corrective actions, institution of pre-rehabilitation or bankruptcy proceedings, withdrawn approval for executive body, the authorized supervisors of the National Bank of the Republic of Macedonia were organizing the operations on temporal or permanent basis, verifying the payment orders and conducting permanent supervisory control in 4 banks and 4 savings houses.

Corrective action

Based on the supervisory findings, the National Bank of the Republic of Macedonia during the implementation of its third aspect of supervisory function imposed 62 decisions with corrective measures. The following corrective measures have been undertaken against banks and savings houses:

- reclassification and allocation of additionally determined reserves for potential losses;
- revocation of an approval for an executive body, and suspension of authorized signatories for operations abroad;
- compliance of the banks' ownership structure, with the Law on Banks and Savings Houses (Article 9);
- prohibition of collection of savings deposits;
- prohibition of conducting all the banking operations;
- organization of the operations through verification of payment orders;
- allocation of compulsory reserves funds;
- instituting pre-rehabilitation procedure;
- prohibition of operations with denar placements;
- establishing internal audit function.

Organizational chart of the Supervision Department



STATISTICAL TABLES

Number of Financial Institutions (at year-ends)

Type of financial institution	1997	1998	1999
Banks	21	22	22
Foreign bank branches	1	2	1
Savings houses	20	18	16
Deposit insurance funds	1	1	1
Insurance companies	5	5	5
Stock Exchange	1	1	1
Money Market Broker	1	1	1
Financial Institutions, total	**50**	**50**	**47**

Ownership Structure of Financial Institutions in 1999 on the Basis of Registered Capital (%) (at year-end)

Item	Type of financial institution*		Total
	Banks	**Savings Houses**	
State ownership	6.47		6.40
Other domestic ownership	82.07	100.00	82.29
Domestic ownership total	88.54	100.00	88.69
Foreign ownership	11.46		11.31
Financial institutions, total	**100.00**	**100.00**	**100.00**

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

Item	1997	1998	1999	1999/1997
State ownership	0	6.14	6.47	0.00
Other domestic ownership	89.08	81.51	82.07	1.06
Domestic ownership total	89.08	87.65	88.54	1.14
Foreign ownership	10.92	12.35	11.46	1.21
Financial institutions, total	**100.00**	**100.00**	**100.00**	

* *Data for the other financial institutions are N/A*

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

Type of financial institution	1997	1998	1999
Banks	98.70	98.70	99.00
Savings houses	1.30	1.30	1.00
Financial institutions, total	100.00	100.00	100.00

** as a market share is determined the share in the financial potential.*

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

Assets	1997	1998	1999
Cash and claims on nbrm	5.80	8.00	7.93
Securities rediscounted by nbrm	0.80	0.70	2.38
Debt securities	3.70	2.40	11.47
Placements to banks	30.60	26.70	30.81
Placements to customers	44.50	43.20	32.81
Accrued interest and other assets	6.20	11.20	8.55
Capital investments	1.20	1.20	1.83
Fixed assets	7.20	6.60	5.74
Non-allocated reserves for potential loan losses			(1.52)
Total assets	**100.00**	**100.00**	**100.00**
Liabilities	**1997**	**1998**	**1999**
Deposits of banks	3.50	4.70	4.27
Sight deposits	30.80	32.90	38.36
Short-term deposits up to one year	9.50	11.40	11.94
Short-term borrowings up to one year	12.00	7.20	6.21
Other liabilities	6.10	2.80	3.81
Long-term deposits over one year	6.00	5.60	6.13
Long-term borrowings over one year	6.10	8.60	7.08
Provisions for off-balance sheet liabilities	2.20	1.70	1.54
Own funds	23.80	25.10	20.66
Total liabilities	**100.00**	**100.00**	**100.00**

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

Type of financial institution	1997	1998	1999
Banks	23.78	24.94	17.85
Financial Institutions, total	**23.78**	**24.94**	**17.85**

Solvency Ratio of Financial Institutions

Type of financial institution	1997	1998	1999
Banks	28.30	25.89	28.67
Savings Houses	56.50	55.82	45.81
Financial institutions, average	**28.50**	**26.15**	**28.79**

Asset Portfolio Quality of the Banking System

in 1000 denars

Asset Classification	1997	%	1998	%	1999	%
A	17,534,242	38.75	20,358,281	40.76	21,617,057	42.69
B	11,602,287	25.64	13,173,761	26.38	8,083,135	15.96
C	5,270,171	11.65	7,787,624	15.59	8,217,902	16.23
D	5,834,359	12.89	7,074,593	14.17	9,174,895	18.12
E	5,010,335	11.07	1,549,809	3.10	3,541,401	6.99
Classified Total	**45,251,394**	**100.00**	**49,944,068**	**100.00**	**50,634,390**	**100.00**
Provisions	**10,755,971**		**8,119,429**		**11,359,719**	

The Structure of Deposits and Loans in 1999 (%) (at year-end)

	Deposits	Loans
Households	21.82	7.34
Public sector	5.58	1.63
Corporate	61.48	81.05
Domestic Banks	4.64	4.89
Foreign	2.39	0.84
Other	4.09	4.25
Total	**100.00**	**100.00**

The Structure of Deposits and Loans in 1999 (%) (at year-end)

Maturity of Deposits		Maturity of Loans	
At sight	68.76	Long term loans*	47.83
Within one year	21.04	Medium term loans	
Over one year	10.20	Short term loans**	52.17
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 Liabilities/Total Liabilities		
	1997	**1998**	**1999**	**1997**	**1998**	**1999**
Banks	44.77	45.70	55.46	21.53	40.16	39.63
Fin. institution, average	**44.77**	**45.70**	**55.46**	**21.53**	**40.16**	**39.63**

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

in 1000 denars

	1997	1998	1999
Interest income	4,046,808	5,410,493	4,809,470
Interest expenses	1,978,562	2,134,513	2,664,626
Net interest income	2,068,246	3,275,980	2,144,844
Net interest income after provisions	183,826	451,647	(1,267,786)
Other incomes	4,520,923	4,415,021	5,914,526
Other expenses	3,230,514	3,572,056	3,979,742
Income before taxes	1,474,235	1,294,612	666,998
Income tax	349,412	194,532	164,085
Net income	**1,124,823**	**1,100,080**	**502,913**

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

in 1000 denars

Revenues	1997	1998	1999
Interest income	4,046,808	5,410,493	4,809,470
Other incomes	4,520,923	4,415,021	5,914,526
Expenditures	**1997**	**1998**	**1999**
Interest expenses	1,978,562	2,134,513	2,664,626
Provisions for potential loan losses	1,884,420	2,824,333	3,412,630
Other expenses	3,230,514	3,572,056	3,979,742
Income tax	349,412	194,532	164,085

Structure of Registered Capital and Own Funds of Financial Institutions in 1999

Type of the financial institutions	Registered Capital	/Total assets	Own Funds	/Total Liab.
	USD*	**%**	**USD**	**%**
Banks	224,626	18.75	247,520	20.66
Savings houses	5,346	52.82	2,950	29.15
Fin. Institutions, average	114,986	19.04	125,235	20.73

** Calculated by the exchange rate of NBRM on December 31, 1999*

1999 DEVELOPMENTS IN THE MOLDAVIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 1999, the Republic of Moldova followed the economic processes characteristic for previous years. Both external factors and some internal imbalances influenced economic activity. The traditional export markets remained to a largely extent inaccessible for domestic products; the value and quantitative volume of the export considerably decreased.

Financial difficulties related to commercialization, provisioning, and the increase of prices for electricity and imported fuel were the major factors that stood the basis of the economic evolution in 1999.

The Gross Internal Product amounted in 1999 to 12204 million MDL which in comparative prices is by 4.4% less than in the previous year.

The value of the industrial output in 1999 amounted to 8055 million MDL and decrease din comparable prices by 0.9% as compared to the previous year.

The value of the agricultural output gained in 1999 for all categories of agricultural enterprises amounted in current prices to 5370 million MDL or 92.0% in comparable prices as against in 1998.

Investment in fix capital to the national economy in 1999 amounted to 1026 million MDL and decreased by 25.0% as compared to 1998.

The value of goods' retail sailing through all commercialization channels in 1999 totaled 3581 million MDL, which is by 28.0% less than the value realized during the previous year (comparable prices).

In 1999, the value of public services rendered against payment reduced in comparable prices by 13.0% and amounted to 1828 million MDL.

The average monthly salary of an employee in the economic sector of the country in 1998 stood at 303.4 MDL, which in real terms is by 12.6% less than the average monthly salary in 1998.

The indebtedness of labour remuneration as on 31 December 1999 amounted to 552.1 million MDL or by 13.5% less than as on 31 December 1998.

The indebtedness of pension and indemnities payment as on 31 December 1999 amounted to 300.4 million MDL which is by 1.2% more than as on 31 December 1998.

Prices increase during 1999 by 43.7% (in 1998 – 18.3%).

The nominal depreciation of the leu exchange rate in 1999 was 39,2% as compared to 78.6% in 1998 that followed the introduction of the freely floating exchange regime.

Introduction of the freely floating exchange regime in November 1998 allowed for the stabilization of the domestic foreign exchange market and building up foreign exchange reserves, which increased by 32% from USD 144 million by the end of 1998 to USD 190 million by the end of 1999.

In 1999, both export and import volumes declined, exports by 27% and imports by 42.6% as compared with 1998. In 1999, the trade deficit had reached USD 123 million, showing a decrease from 26,4% of GDP in 1998 to 14,82% in 1999.

The cumulative foreign direct investments have grown from USD 275 million in 1998 to USD 335 million in 1999.

External debt of the Republic of Moldova accounted for USD 1,039.0 million by the end of 1999 showing a decrease by 2% compared with the external debt stock by the end of 1998.

DEVELOPMENT OF THE BANKING SYSTEM

There were 20 commercial banks as on 31 December 1999 on the territory of the republic of Moldova, including three branches of foreign banks that had the license of the National Bank of Moldova to perform financial activities. The total number of commercial banks' institutions in the republic constitutes 388 units, including 156 branches, 140 representatives offices and 92 agencies.

During the reported year the banking system assets increased by 540.42 million MDL or by 20.31% and amounted as on 31 December 1999 to 3201.29 million MDL. The largest weight in total assets as on 31 December 1999 is held by credits and net financial leasing – 40.60%; securities held 9.53%, money means owed by banks – 17.22%, money means owed by the NBM – 9.8%, cash – 2.95%, other assets – 19.9%.

The total value of credits and net leasing as on 31 December 1999 amounted to 1597.64 million MDL and reduced during 1999 by 173.89 million MDL or by 9.81%. The value of overdue and overdue interest non-accumulating credits reduced as compared to the year beginning by 103.38 million MDL or by 22.79% and amounted as on 31 December 1999 to 350.31 million MDL or 21.93% of total credit portfolio. The quality of the credit portfolio during the reported period relatively improved and registered a reduction by 2.66 percentage of the weight of unfavorable credits (substandard, bad and doubtful) and an increase with the same value of the weight of standard and supervised credits; these credits amounted as on 31 December 1999 to 70.67% of the total credit portfolio.

The total normative capital on the banking system amounted as on 31 December 1999 to 918.9 million MDL and increased as compared to as on 31.12.1998 by 183.9 million MDL or by 24.9%. The average of risk weighted capital sufficiency (the ration of total normative capital on the banking system to total risk weighted assets) on the banking system as on 31.12.1999 constituted 46.04%; the minimum level is 12%.

The foreign investment share in the capital of the banking sector increased during the reported period by 9.47 percentage and amounted as on 31.12.1999 to 452.26 million lei or 48.88%.

The liabilities of commercial banks amounted as on December 31, 1999, to 2276.04 million MDL, which is by 352.51 million MDL or by 18.33% more than at the beginning of the year.

In the structure of banks' liabilities the largest weight is held by deposits – 69.76%, out of which: deposits by legal persons held 40.9%, deposits by natural persons held 27.13% and banks' deposits held only 1.73%. Other loans and other liabilities held 24.34% and 5.9% respectively.

The net income gained by the commercial banks of the Republic of Moldova during the reported year amounted to 141.45 million MDL, which is by 40.24 million MDL or by 39.76% more than in the previous year.

LEGAL AND INSTITUTIONAL FRAMEWORK OF FINANCIAL INSTITUTIONS' OPERATION AND SUPERVISION

Presently 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 promote 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 and 3 branches of foreign 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 on efficient banking supervision elaborated by the Basle Committee.

THE ACTIVITY OF THE BANKING SUPERVISION AUTHORITY IN 1999

With the view to consolidating the banking system, the National Bank of Moldova undertook during the reported year a number of measures directed to reduce the risk of foreign exchange operations, to increase the banks' solvability and liquidity and to safeguard the depositors' interests.

The National Bank of Moldova followed up its effort to strengthen the stability of the country's banks by increasing the minimum required capital. In 1999, the minimum quantum of the total normative capital as on June 30, 1999, totaled 12 million MDL and on 31.12.1999 – 16 million MDL. Requirements on the total minimum capital were modified with the view to consolidating banks. Thus, starting with June 30, 2000 banks are required to have a minimal normative capital with the value of 24 million MDL; starting with December 31, 2000, – 32 million MDL. New licensed banks and operational banks seeking for a higher level license are to maintain starting with 16 July 1999 a minimum required capital in a value of 32 million MDL. Starting with 31 December 1999, all the banks are obliged to have and maintain the ratio between the total normative capital and the risk weight assets of capital sufficiency) of at least 12%.

With the view to increasing the banking management quality and to ensuring the possibility of capital investment in the commercial banks of the country by only solid investors, the NBM toughened the requirements for getting the license to perform financial activities, for allowing the maintenance of substantial shares and for holding the position of bank administrator.

The investment by banks into long term material assets (buildings, areas, etc.) results in the immobilization of bank's resources and further investment of excessive amounts may cause financial problems. That is why the NBM introduced new limits on such investments – up to 50% of the bank's total normative capital; the total value of bank's investment in long term material assets and of participation quotas in the capital of economic agents should not exceed 100% of the total normative capital. In addition, in the case of acquisition of long term material assets in exchange of payment of provided loans, the bank has the right to maintain such assets for a period of up to 18 months since acquisition.

An efficient management of assets and liabilities is essential for the management of the bank's risks. The target of assets and liabilities management is to keep control on the interest rate risk, maturity risk and liquidity risk. To achieve this target the NBM worked out formal requirements based on which commercial banks have to build and implement the function of assets and liabilities management. These requirements provide the creation of a system that shall efficiently set out, evaluate and supervise the bank's interest rate risk and that shall include the elaboration of this risk management by adjusting it the bank individual condition. The system shall also provide the formation of a special committee to manage the bank's assets and liabilities. This committee shall be responsible for the elaboration and supervision of the above mentioned policy, for the combined management of the interest rate risk, of the liquidity risk, of the maturity risk and for the ensurance of fulfillment by the bank of stipulations provided in the normative acts.

To increase the efficiency of banking supervision and monitoring the NBM improved the evaluation and analysis methods of licensing, on-site controls and analysis of financial reports submitted by commercial banks.

During 1999, each bank was subject to a complex or focused check at least once per year. Banks that concerned problems were subject to more frequent focused checks. Following those checks, a number of banks received remedy notes and undertook modifications and completions to the existent remedy documents. The fulfillment of these stipulations essentially contributed to the restructuring of the banking system assets by reducing the weight of excessively risk weighted assets, sufficiently covering current risks with own capital and ensuring the necessary level of liquid means. The implementation of remedial measures contributed to the creation of new mechanisms of internal control in many banks, the activity of which are based on internal procedures directed to the control of the bank's insufficiently prudent activities. In some cases the remedy documents issued by the National Bank directly forecast the excessively risky activities of a number of banks, like operations with foreign exchange, provision of credits, investment in corporate securities, etc. These measures allowed stopping the increase of excessive risks until the liquidation of drawbacks in internal mechanisms of preparation and implementation of relevant operations. In cases when banks' problems could become a real danger for depositors and clients, the National Bank of Moldova called on the respective banks to attract deposits until the improvement of their financial situation.

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY

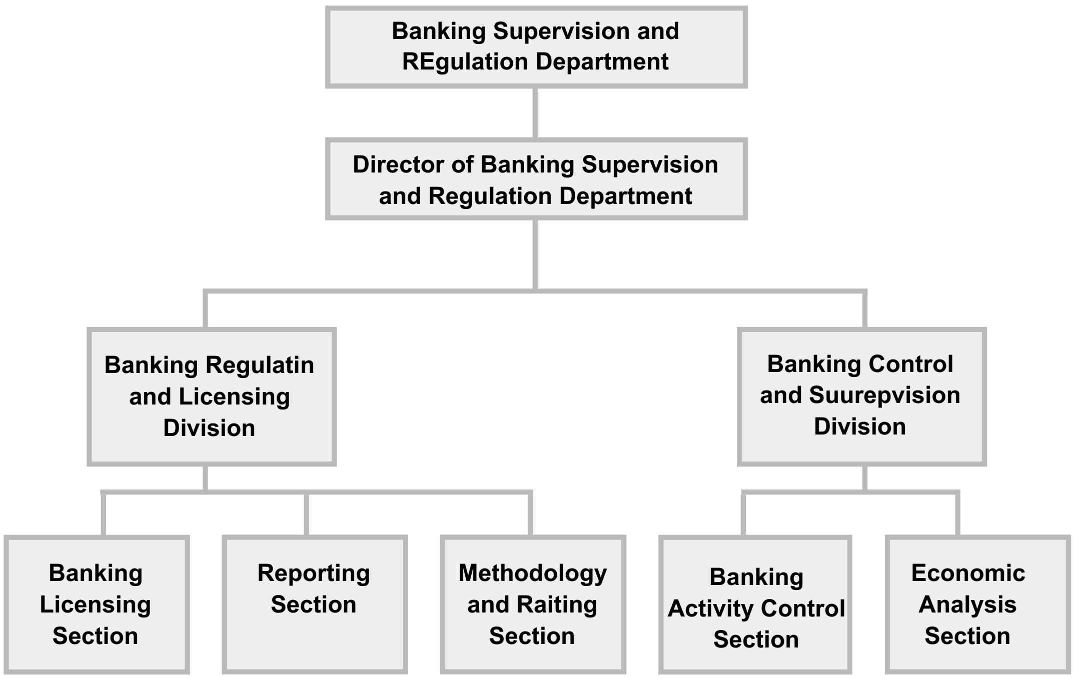
The basic stipulations of the Law on Financial Institutions and of the Law on the National Bank of Moldova which include the rights of banking supervisory authorities are s follows:

- 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 mentioned measures;
- To control all the banks and to examine their registers, documents and accounts, conditions under which banks perform their activity and the fulfillment by banks of legislative stipulations;
- To require from every employee of the bank to submit to the National Bank the necessary information with the view to supervising and regulating the activity of financial institutions;
- To take remedial measures if the bank, its owners or its administrators have violated 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 remedial 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 Structure of Banking Supervision



STATISTICAL TABLES

Number of Financial Institutions (at year–end)

Type of financial institution	1997	1998	1999
Banks, total	22	23	20

Ownership structure of capital of financial institutions in 1999 on the basis of registered capital (at year–end)

Item	(%)
State ownership	4.16
Other domestic ownership	46.96
Domestic ownership total	51.12
Foreign ownership	48.88
Financial Institutions, total	**100.0**

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

Item	1997	1998	1999	1999/1997
State ownership	N/A	0.98	4.16	
Other domestic ownership	N/A	59.61	46.96	
Domestic ownership total	N/A	60.59	51.12	
Foreign ownership	N/A	39.41	48.88	
Financial Institutions, total	**100.0**	**100.0**	**100.0**	**100.0**

Distribution of Market Shares in Balance Sheet Total(%)

Type of financial institution	1997	1998	1999
Commercial banks	96.96	93.48	95.67
Foreign branches	3.04	6.52	4.33
Banks, total	**100.0**	**100.0**	**100.0**

Solvency Ratio of Financial Institutions

Type of financial institution	31.03.1998	1998	1999
Commercial banks:	average	average	average
Short-term liquidity	20% (N≥10%)	26% (N≥20%)	39% (N≥20%)
Long-term liquidity	0.34 (N≤1)	0.40 (N≤1)	0.44 (N≤1)

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

Assets	1997	1998	1999
Total credits and leasing	70.7	66.57	49.91
Total securities	11.1	6.90	9.53
Others	18.2	26.53	40.56
Total assets	**100**	**100**	**100**
Liabilities	**1997**	**1998**	**1999**
Deposits by natural persons	21.8	17.85	19.29
Deposits by legal persons	27.0	21.53	30.31
Others	24.3	32.91	21.50
Shareholder capital	26.9	27.71	28.90
Total liabilities and shareholder capital	**100**	**100**	**100**

Asset Portfolio Quality of the banking system

thou MDL

Asset Classification	31.03.1998	1998	1999
Standard	649132.67	525173.39	621281.08
Supervised	635346.96	679553.67	507695.84
Substandard	266886.42	309615.16	221441.41
Doubtful	98589.99	174736.36	213821.72
Bad	86921.16	82345.13	33395.40
Total Credits	1736877.21	1771423.71	1597635.45
Specific Reserves	285328.92	350808.75	298004.13

The Structure of Deposits and Loans in 1999(%)
(at year–end)

Deposits		Loans	
Natural persons	38.9	Credits to agriculture, food industry	27.8
State budget and local budgets	4.0	Credits to immovable, construction	10.6
Legal persons	54.6	Consumer credits	4.1
Banks' deposits	2.5	Credits to the state	2.8
		Energy resources and fuel loans credits	4.4
		Industrial and commercial credits	45.5
		Other credits	4.8
Total	**100.0**	**Total**	**100**

The Structure of Deposits and Loans in 1999
(at year–end)

Maturity of Deposits	thousand lei	%
Sight	989594.67	62.3
time and long-term	598124.64	37.7
Total	**1587719.31**	**100**
inclusive in foreign currency	**818609.75**	**51.6**

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

Type of the financial institution	FOREX Assets/Total Assets			FOREX Liabilities/Total Liabilities		
	1997	**1998**	**1999**	**1997**	**1998**	**1999**
Banks	23	54	55.7	22	71	74.2

Structure of Revenues and Expenditures
of Financial Institutes in 1999
(at year–end)

thousand lei

Revenues	1998	1999
Total Income related to interestinclusive:	522044.12	486054.22
income related to interest on credits and financial leasing	426725.07	383376.08
income related to interest from securities	69506.33	64206.21
income related to interest from other assets	25812.72	38471.93
Total Income non-related to interest	176768.97	304760.28

Expenses	1998	1999
Total expenditure related to interest	202700.62	183223.16
Total expenditure non-related to interest	224834.85	322821.06
Less: Provision for Loan Losses	157236.78	117097.47
Total net income	101204.66	141466.67

In 1997 banks were operating on the basis of the old Chart of Accounts, that did not correspond to International Accounting Standards and data cannot be presented because of their inaccuracy.

Structure of Registered Capital and Own Funds of Financial Institutions in 1999

Type of the financial institutions	Registered Capital	/Total assets	Own Funds	/Total Liab.
	thousand USD	**%**	**thousand USD**	**%**
Banks	44282.19	16.03	35.55	18.10

1999 DEVELOPMENTS IN THE POLISH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 1999, economic growth in Poland was lower than projected in the annual Budget, and lower than a year before. Poland's Gross Domestic Product (GDP) rose 4.1%, to stand at some 612 billion zlotys.

First quarter GDP growth (1.6% year-on-year) was weaker than that reported in the fourth quarter of 1998 (2.8%), and the economy did not pick up markedly until the second half of the year (Q2 growth came to 3.0%, Q3 growth to 5.0%, and preliminary estimates put Q4 growth at around 6.2%).

The slowdown in business activity is attributable to both external and internal factors, prime among them being the further growth of the current account deficit, an increase in inflation, the higher cost than expected of implementing structural reforms (local government, health care, education and social insurance), an increase in the public sector financial deficit, and also rising unemployment and a declining propensity to save.

The impact of the Russian crisis on the Polish economy proved much greater than initially forecast. In addition, slacker growth in the countries of the European Union, particularly Germany, meant that the erosion of external demand was sharper than that caused solely by the collapse of Polish exports to Russia and the other CIS countries.

Exports shrank not only to Central and Eastern Europe (down nearly 20%), but also to Germany, Poland's principal trading partner for the last eight years (down 3.3%). The end result was that the drop in export receipts (down 3.1% to USD 27.4 billion) proved steeper than the decrease in import payments (down 2.5% to USD 45.9 billion), thus increasing the current deficit by a further USD 4.8 billion, taking it to over 7.6% of GDP.

Given the fall in exports, Polish economic growth was driven by domestic demand, primarily consumer demand, which grew faster than GDP. The relatively swift rise in consumer demand is traceable to a weaker propensity to save among households (personal zloty deposits at the banks edged up just 3.2% in real terms) and strong growth in personal lending (up 53.4%, or 39.7% in real terms). Households thus attempted to maintain their levels of consumption despite low growth in personal incomes.

The year 1999 saw a surge in liquid fuel prices (up 52.7%). There was also an increase in other fuel prices (12.9% for electricity, 14.4% for gas) and in rents (up 21.5%). Service prices went up by an average of 12.4%, with transport services 22.8% more expensive. Food price growth proved more rapid than anticipated (up 6%), with the fastest growth being recorded for fruit (up 16.8%) and vegetables (up 18.7%). Consequently, inflation proved much higher than projected in the annual Budget, and higher than in 1998. Consumer price growth, December-on-December, came to 9.8%[1]. Producer price growth was also twice as fast as the year before (8.0%, compared to 4.8%).

[1] Annualized average price growth, measured January-December 1998 to January-December 1999, was lower, at 7.3%. Cf. *Biuletyn Statystyczny GUS* [Statistical Bulletin of the Central Office of Statistics] No. 12 (1999), p. 106, Table 34.

Slower economic growth, coupled with higher industrial productivity, reduced the demand for labour. In December 1999, average employment in the corporate sector came to 5,679,000, down 90,000 on December 1998, with industrial employment down 152,000 (to 2,940,000), and employment in construction down 15,000 (to 568,000).

At the end of the year 1999, there were 2,349,800 job seekers registered at employment offices, while unemployment had risen to 13.0% (up 2.6 points on December 1998), i.e., to a level last seen in 1996[2]. Unemployment was highest in the voivodships of Warmia and Mazury (22.8%), Lubusz (17.5%) and Western Pomerania (17.5%), and lowest in those of Mazovia (9.6%), Silesia (9.9%) and Malopolska (10.3%).

Higher inflation, together with slower growth in income from employment and business activity and in social benefits, resulted in weak growth in real household incomes. Average monthly employee earnings in the corporate sector (1,834.8 zlotys) rose 3.1% over the year in real terms, while average old-age pensions (931.7 zlotys for employees, 562.4 zlotys for farmers) were up 3.3%.

Corporate finances deteriorated sharply in 1999. Pre-tax profits were 23.6% lower than in 1998, while net profits were down 90.4%. The cost/sales ratio moved up from 98.1% to 98.8%, and pre-tax margins slumped from 2% to 1.4%.

The banking sector constitutes an integral part of any economy, with the condition of the banks contingent on the state of the economy and the economic strategy and policies being pursued. In 1999, the weakening in corporate finances, rise in unemployment and attendant worsening of household finances led to a lowering of loan portfolio quality (with an increased proportion of irregular loans). Another painful development for the banks was the acute slowdown in deposit growth. This led to heightening competition for funds, not only among the banks, but also on the part of other financial institutions.

Mounting competition compelled the banks, on the one hand, constantly to extend the range of services being offered and improve their quality, and on the other – to conduct a systematic search for opportunities to cut costs.

DEVELOPMENT OF THE BANKING SYSTEM

The banking industry is the largest and most developed segment of Poland's financial markets. At the end of the year 1999, the total assets of the banking system accounted for almost 90% of the overall assets of the regulated financial services sector (banks, brokerage houses, pension funds, insurance companies, mutual funds and investment funds)[3]. The total footing of the banks was some 13 times greater than that of the second largest segment of the financial markets, the insurance industry.

While the relative share of the banks in the market capitalization of the Warsaw Stock Exchange has gradually been declining, it remains very high. At the end of 1999, it stood at 28.1% (as against 32.1% at the end of the year 1998). In addition, the 20 companies with the largest individual market capitalization included 10 banks[4].

The year 1999 saw an acceleration of bank privatization and a major intensification of bank consolidations. Let us recall that the Ministry of the Treasury finalized the privatization of 4 banks:

[2] By the end of January 2000, unemployment had climbed to 13.6%.

[3] Throughout the present study, the term "total assets" refers to a net amount, i.e., total assets less accumulated depreciation, specific provisions and valuation allowances.

[4] A schedule of banks listed on the Warsaw Stock Exchange is given in Appendix 2.

- in January, Bayerische Hypo- und Vereinsbank AG acquired a 36.7% interest in Bank Przemyslowo-Handlowy SA from the Treasury (under an agreement concluded in October 1998), and subsequently purchased equity from the other shareholders to obtain control of that bank[5];
- in August, a consortium of UniCredito Italiano SA and Allianz AG took up a majority holding (52.09%) in Bank Polska Kasa Opieki SA (pursuant to an agreement with the Treasury signed in June);
- in September, AIB European Investments Limited took up 80% of the share capital in Bank Zachodni SA (under an agreement with the Treasury concluded in June);
- in August, foreign investors associated with Denmark's Unibank acquired a controlling interest in Bank Wlasnosci Pracowniczej SA (previously this bank had been indirectly controlled by the Treasury)[6].

As in other countries, banks in Poland have been displaying an increasing interest in consolidation[7]. The year 1999 brought the following mergers and acquisitions:

- the largest ever merger within the Polish banking industry, creating the second biggest bank in Poland, occurred on January 1, involving the 4 banks constituting the Pekao SA Group (Bank Polska Kasa Opieki SA merged with Powszechny Bank Gospodarczy SA, Pomorski Bank Kredytowy SA and Bank Depozytowo-Kredytowy SA);
- Powszechny Bank Kredytowy SA acquired the banking business of Pierwszy Komercyjny Bank SA, incorporating the offices of the latter into its own network as of July 1[8];
- Bank Energetyki SA merged with Bank Inicjatyw Spoleczno-Ekonomicznych SA on November 22[9];
- the consolidation was carried out of 3 banks belonging to Bayerische Hypo- und Vereinsbank AG, which took up a new issue of shares in Bank Przemyslowo-Handlowy SA by means of a non-cash consideration for equity, this comprising title to 100% of the share capital of Hypo-Bank Polska SA and HypoVereinsbank Polska SA. The latter bank was subsequently merged with Bank Przemyslowo-Handlowy SA (on November 11)[10], while Hypo-Bank Polska SA was converted into a mortgage bank (as of December 1)[11].

The directing bodies of Bank Handlowy w Warszawie SA and BRE Bank SA also took steps towards a merger of their respective banks. The idea of this merger had the approval of the Commission for Banking Supervision, as it would have led to the cre-

[5] Although Bank Przemyslowo-Handlowy SA was privatized in 1995, the Treasury retained a significant shareholding, as a result of which the bank continued to have majority Polish equity until the end of 1998.

[6] As of October 22, 1999, this bank changed its name to "Bank Wlasnosci Pracowniczej – Unibank SA".

[7] The largest banks worldwide owe their position to mergers performed in recent years. Leaving aside the takeover of distressed banks, there had been few significant mergers in Poland prior to 1999; those that did take place included the merger of BRE Bank SA with Polski Bank Rozwoju SA, that of Bank Inicjatyw Gospodarczych SA with Bank Gdanski SA, and that of Kredyt Bank SA with Polski Bank Inwestycyjny SA.

[8] On March 1, 2000, the Commission for Banking Supervision adopted a resolution (Resolution No. 24/2000) revoking Ruling No. 4 of the President of the NBP, November 24, 1990, authorizing the establishment of Pierwszy Komercyjny Bank SA.

[9] Bank Energetyki SA thereby relinquished its separate personality at law.

[10] HypoVereinsbank Polska SA was duly deleted from the commercial register.

[11] On January 24, 2000, this bank changed its name to HypoVereinsbank Bank Hipoteczny SA.

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ation of one of the largest banks in this part of Europe and ensured Bank Handlowy, as the oldest bank in Poland (in operation since 1870), not only dynamic growth, but also maintenance of its corporate identity and continued Polish management. However, owing to the emphatic objections of two shareholders in Bank Handlowy (the PZU insurance company and the Treasury), the merger was not consummated[12].

The process of consolidation within the Polish banking industry is not yet over. The merger of Bank Austria Creditanstalt Poland SA and Powszechny Bank Kredytowy SA can be expected in the not too distant future[13], as can that of Gliwicki Bank Handlowy SA and Wielkopolski Bank Kredytowy SA. Looking further ahead, it is highly probable that Allied Irish Bank European Investments Ltd. will carry out the merger of the banks it controls (i.e., Bank Zachodni SA and Wielkopolski Bank Kredytowy SA). The rising tide of bank mergers in Europe will also speed up corresponding developments in Poland, e.g., Bank Wlasnosci Pracowniczej – Unibank SA might be merged with Bank Komunalny SA, which would be a natural consequence of the purchase of Denmark's Unidanmark by the Finnish-Swedish group MeritaNordbanken[14]. Further, Deutsche Bank AG, which has steadily been increasing its equity involvement in Big Bank Gdanski SA, has announced that over time it will join the banks that it controls[15]. Mergers can also be anticipated among the regional banks and other institutions affiliating local cooperative banks.

Because of consolidations, the **total number of commercial banks** declined from 83 at the end of the year 1998 to **77** at the end of the year 1999. While one new bank was also established (Rheinhyp-BRE Bank Hipoteczny SA[16]), this did not affect the overall number, as one bank was declared bankrupt – Savim Bank Depozytowo-Kredytowy SA[17].

The year 1999 witnessed major changes in the ownership structure of the commercial banks; in addition to privatization and consolidations, these changes also stemmed from the following developments:

- the Treasury increased the registered equity of Bank Gospodarstwa Krajowego by contributing to it shares held in Bank Rozwoju Budownictwa Mieszkaniowego SA, which thus became indirectly controlled by the Treasury (whereas previously it had been controlled directly);
- Bank Wspolpracy Regionalnej SA took over 5 offices of BWR Bank Secesyjny SA (thereby increasing its own assets and office network), while selling its majority holding in the latter bank, on May 31, to the German company of DaimlerChrysler Services (debis) AG[18];

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[12] Citigroup has expressed interest in purchasing a controlling stake in Bank Handlowy w Warszawie SA.

[13] Powszechny Bank Kredytowy SA is virtually controlled by Bank Austria Creditanstalt International AG, which at the end of December held 43.0% of the bank's equity (36.19% belonged to small investors) and is interested in acquiring further shares being offered for sale by the Treasury.

[14] Unibank (which is part of Unidanmark) and Nordbanken hold controlling interests in Bank Wlasnosci Pracowniczej – Unibank SA and Bank Komunalny SA, respectively.

[15] This would involve a merger of its subsidiary, Deutsche Bank Polska SA, with BIG Bank Gdanski SA, and in time also with Bank Wspolpracy Regionalnej SA and BWR Real Bank SA, which are in the process of rehabilitation by Deutsche Bank.

[16] Authorization was granted by the Commission for Banking Supervision on March 12, 1999, the bank was entered in the commercial register on April 16. It commenced operation on December 1.

[17] The operations of this bank were suspended on March 25, 1997, and it was declared bankrupt by the Court of Appeals on January 13, 1999. A petition to reverse this ruling filed by the bank's management board was rejected by the Supreme Court on December 7.

[18] On January 28, 2000, the bank changed its name to DaimlerChrysler Services (debis) Bank Polska SA.

- in May, foreign investors assumed a controlling equity interest in Kredyt Bank SA[19], and indirectly also in Prosper-Bank SA;
- a shift took place in the ownership structure of BIG Bank Gdanski SA, with foreign equity involvement rising to 47.8%[20]. The large amount of shares in dispersed holdings (45.1%) meant that the bank's ownership structure had not been stable, making it a relatively easy takeover target[21];
- Kredyt Bank SA acquired a 18.6% interest in Bank Ochrony Srodowiska SA;
- Belgium's Fortis Bank NV obtained 98.4% of the share capital of Pierwszy Polsko-Amerykanski Bank SA, thus acquiring full control over that bank;
- Germany's DG Bank AG raised its share in the equity capital of Bank Amerykanski w Polsce SA "AmerBank" (taking this to 71.1%);
- Telewizja Polsat SA became the strategic investor in Invest-Bank SA, and together with a subsidiary held 51.7% of the bank's equity at the end of the year;
- Bank Pocztowy SA became the strategic investor in Wielkopolski Bank Rolniczy SA, recapitalizing the latter to the level required by regulations;
- a controlling stake in Bank Komunalny SA was assumed in December by Nordbanken, part of the Finnish-Swedish group MeritaNordbanken.

As a result of privatization[22], the number of **banks with majority public-sector equity** fell from 13 at the end of 1998 to 7 at the end of 1999 (with the number of banks directly controlled by the Treasury dropping from 6 to 3). The total assets of those banks with a majority public-sector interest represented less than one quarter of the total assets within the banking sector at the end of the year 1999 (23.9%, to be precise)[23], while those banks under majority private ownership accounted for 71.8%. The remaining assets (4.2%) were held by the cooperative banks.

Although the number of banks with a majority private-sector interest remained unchanged, the number of **banks with majority foreign equity** rose from 31 to 39[24]. At the end of December, this group of banks comprised 3 branches of foreign banks, 16 joint-stock banks under 100% foreign ownership, 17 with a majority foreign interest, and 3 banks indirectly controlled by foreign investors.

The total capital base[25] of banks with majority foreign equity, which attests to their potential share of the market for banking services, and the total assets of those banks,

19 The bank received a capital infusion. The new investor, Portugal's Banco Espirito Santo e Comercial de Lisboa holds 9.7% of share capital, while the equity interest of Belgium's Kredietbank NV has risen to 29.9%.

20 At the end of 1999, 14.8% of equity was held by Banco Comercial Portugues, 10.0% by the Eureko insurance group, 13.0% by Deutsche Bank AG, and 10.0% by RZB Central European Development.

21 Let us recall that banks listed on the Stock Exchange are generally unaware of the identity of investors with less than 5% of shares, since the latter are under no obligation to disclose their shareholdings outside shareholders general meetings. At the shareholders general meeting of BIG Bank Gdanski SA convened in January 2000, it transpired that Deutsche Bank AG, acting with the support of certain minority shareholders (including PZU, PZU Zycie and the Treasury), was in a position to take control of the bank. The ensuing conflict between the principal shareholders proved so fierce that it was referred to the courts and the Securities and Exchange Commission, which will have to determine whether any violations of the relevant Polish regulations were committed.

22 And also of the consolidation of the banks making up the Pekao SA Group, a process which preceded the privatization of Bank Polska Kasa Opieki SA.

23 By comparison, at the end of the year 1993 the total assets of the 29 banks with a majority public-sector interest accounted for 80.4% of total assets within the banking system, while those of the 16 banks directly controlled by the Treasury made up 76.1%.

24 1 new bank was established, foreign investors took control of 8 banks previously under majority Polish ownership, and 1 bank forfeited its separate personality at law (due to a merger).

25 Total core and supplementary capital, prior to any regulatory deductions.

which reflect their current share of that market, represented 50.2% and 47.2%, respectively, of total capital and total assets within the Polish banking system. These banks had also taken 45.7% of non-financial sector deposits and originated 50.9% of loans outstanding[26].

Given that, in view of the high proportion of their share capital in dispersed holdings, Powszechny Bank Kredytowy SA (together with its subsidiary, Gornoslaski Bank Gospodarczy SA), Bank Handlowy w Warszawie SA (together with Cuprum-Bank SA), BRE Bank SA and BIG Bank Gdanski SA (together with BIG Bank SA) are all already in reality controlled by foreign investors, and that Deutsche Bank Polska SA will be assuming a controlling interest in Bank Wspolpracy Regionalnej SA (together with BWR Real Bank SA), it should be recognized that the banks controlled by foreign capital in fact have a market share in excess of 70%

At the end of the year 1999, the equity held by foreign investors amounted to the equivalent of 4,089.1m zlotys, representing 56.0% of the total share capital of the commercial banks. The largest investments in the Polish banking system had been made by German and American institutions, with these investments standing at 1,075.8m zlotys and 945.9m zlotys, respectively. Sums above 200m zlotys had also been invested by institutions from Holland, France, Ireland and Austria – 538.7m, 343.1m, 290.4m and 273.5m zlotys, respectively

In 1999, the commercial banks brought 743 new offices into operation (including 371 branch offices). Despite this, total staffing at the commercial banks grew by just 571, or 0.4%. The offices newly brought on stream are usually small, offer a standard range of services and generally have at least one ATM installed, allowing them to employ a modest staff[27]. Thanks to the application of new IT technologies, the increase in the number of offices (up 7.8%) does not entail a proportional growth in employment. Indeed, some banks have even seen a trend in the opposite direction, recording an expansion of their office network, yet a contraction in staffing. This tendency was particularly in evidence at the group of eight banks previously under majority Polish ownership where control was assumed in 1999 by foreign investors. Within this group, staffing decreased by 511[28], although the number of branches increased (up 80), as did the number of other offices (up 86).

The streamlining of employment at the banks is undoubtedly being assisted by the growing number of ATMs and of retail and service outlets accepting payment by bank card, and also by the accompanying increase in the number of customers using these cards (both ATM and payment cards)[29]. An increasing number of banks are also making available telephone banking services, and a few are offering Internet banking.

The Polish banking industry is witnessing a constant increase in its concentration ratio. At the end of the year 1999, the 5 largest banks held 47.7% of total banking system

[26] Over the years 1993-99, banks with majority foreign equity increased their share of the total assets of the banking system by 44.6 points, of the total capital base by 48.0 points, of non-financial sector deposits by 43.6 points, and of outstanding loans by 48.2 points.

[27] Examples of modern, highly computerized banking operations are the retail customer networks developed on a green-field basis, such as Millennium and Handlobank.

[28] This is largely traceable to the consolidation of the banks in the Pekao SA Group (prior to privatization).

[29] The banks and the Euronet company together operate some 4,700 ATMs, of which almost 1,500 were purchased in 1999. The two largest settlement institutions in Poland, PolCard and the Pekao SA Card and Check Center processed twice as many transactions in 1999 (almost 26m) as they had in 1998, to a total value of over 5 billion zlotys. The settlement institutions now service over 73,000 retail and service outlets. By the end of December, the banks had issued around 7.7m cards, 4.5m of these in 1999 alone. This means that the number of cards grew 140% during the year (up from 3.2m at the end of the year 1998).

assets (compared to 42.9% at the end of the year 1998), while the 15 largest institutions commanded 79.0% of assets (compared to 75.1% a year earlier). These banks had taken 55.4% and 83.5% of non-financial sector deposits, respectively, and originated 46.0% and 77.4% of loans to that sector.

The number of cooperative banks fell from 1,189 to 781 in 1999, a decline of 408, which is attributable to the record number of mergers within the cooperative sector. During the year, 406 cooperative banks merged with other cooperative banks (256 in Q1, 29 in Q2, 83 in Q3 and 38 in Q4), 1 bank was put into liquidation in performance of a resolution of an extraordinary members meeting, and 1 other, having first had its operations suspended, was taken over by a commercial bank as based on a ruling of the Commission for Banking Supervision.

The cooperative banks accounted for 5.0% of non-financial sector deposits within the whole banking system and 5.1% of loans (less provisions) to that sector, and generated 5.7% of pre-tax earnings. Almost four fifths of the operating activity of the cooperative banking sector was concentrated at 379 institutions. It should be added that the cooperative banks employed over 25,000 people, i.e., 14.4% of the total staff employed within the banking industry. The volume of assets per employee at the cooperative banks was little more than 25% of that at the commercial banks (614,000 zlotys vs. 2,332,400 zlotys).

At the end of 1999, 780 local cooperative banks were affiliated to 11 higher-tier institutions, with 629 of them (affiliated to nine institutions) belonging to the National Cooperative Banking Group[30] . A total of 152 banks remained outside the National Group, with one of these operating independently[31] .

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

The legal and institutional framework of the operations and supervision of the banks are laid down in two basic acts: The Banking Act of August 29, 1997 as published in Dziennik Ustaw (the Journal of Laws) of 1997 No. 140, item 939 with subsequent amendments and The Act on the National Bank of Poland of August 29, 1997 as published in Dziennik Ustaw (the Journal of Laws) of 1997 No. 140, item 938 with subsequent amendments.

According to The Act on the National Bank of Poland the activities of banks are supervised by the Commission for Banking Supervision. The decisions of the Commission together with responsibilities it assigns are carried out and coordinated by the General Inspectorate of Banking Supervision, a separate organizational unit within the structure of the NBP.

The responsibilities of the Commission include, in particular:

[30] Of these 629 banks, 57 were affiliated to Warminsko-Mazurski Bank Regionalny SA; 117 were affiliated to Lubelski Bank Regionalny SA; 57 were affiliated to Pomorsko-Kujawski Bank Regionalny SA, 114 were affiliated to Malopolski Bank Regionalny SA; 82 were affiliated to Mazowiecki Bank Regionalny SA; 88 were affiliated to Gospodarczy Bank Wielkopolski SA; 39 were affiliated to Baltycki Bank Regionalny SA; 31 were affiliated to Dolnoslaski Bank Regionalny SA; and 44 were affiliated to Rzeszowski Bank Regionalny SA.

[31] These 152 institutions comprised 65 banks affiliated to Bank Unii Gospodarczej SA and 86 affiliated to Gospodarczy Bank Poludniowo-Zachodni SA, and also Spoldzielczy Bank Rozwoju "Samopomoc Chlopska", which was unaffiliated.

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1) setting out principles for the conduct of banking activity that ensure the safety of the funds held by customers at banks,
2) supervising compliance by banks with statute, their articles of association and other legal regulations, and also with mandatory financial standards,
3) performing periodic assessments of the financial condition of banks and presenting these to The Monetary Policy Council, and evaluating the impact of monetary, tax and supervisory policies on the development of banks,
4) giving its opinion on the organizational structure of banking supervision and establishing procedures for the performance of such supervision.

The Commission grants authorization for establishment of the bank.

The Commission is composed of the following persons:

1) the Chairperson of the Commission, this being the President of the NBP,
2) the Deputy Chairperson of the Commission, this being the Minister of Finance,
3) a representative of the President of the Polish Republic,
4) the President of the Management Board of the Bank Guarantee Fund,
5) the Chairperson of the Securities and Exchange Commission,
6) a representative of the Minister of Finance,
7) the General Inspector of Banking Supervision.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

All of the measures instituted by the Commission for Banking Supervision and General Inspectorate of Banking Supervision in 1999 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 authorization to establish those banks.

The basic function of banking supervision within a market economy, regardless of the level of socioeconomic development achieved, is to influence the banking system through prudential regulations, analytical surveillance and examinations, thereby laying the correct foundations for the proper operations of the banks.

In consideration of the process of integration with the European Union and the globalisation of financial services, in 1999 the Commission for Banking Supervision and General Inspectorate of Banking Supervision continued work with a view to implementing new prudential regulations, and also ensuring the proper performance of recommendations to individual banks and prudential recommendations specifying the desired level of safety and compliance at the banks, doing so with due regard to the interests of both the banks and their customers.

As part of the adjustment process prior to EU membership, the Polish Republic has declared its intent to adopt the entire legal framework developed by the EU and carry out integration in all fields of political and economic activity. This undertaking directly entails specific responsibilities for the Commission for Banking Supervision and General Inspectorate of Banking Supervision, Focussing on performance of these responsibilities, and in fulfillment of the statutory authorization given to it, the Commission adopted implementing regulations that take into account both the requirements of the Polish banking system and Polish legislation, and also the legal solutions generally applicable within the EU countries. At the same time, the regulations adopted by the Commission take into consideration the specific nature of Poland's financial markets, and also the need to provide for a transition period that would allow Polish banks to effect a smooth entry into the structures of European financial markets.

The resolutions adopted in this area by the Commission for Banking Supervision in 1999 - and in particular the resolution on procedures for the performance of banking supervision, as twice amended, and the three amendments to the Commission's resolution on procedures for provisioning against the risk of banking operations - constitute examples of the constant process of adjusting regulations to correspond to the changing conditions on the market for banking services and furnish evidence of a resolve to ensure that the quality of those regulations is continually improved.

The many resolutions adopted by the Commission include one specifying the procedures for holding examinations for candidates for the post of bank examiner and for on-the-job training for such candidates. The adoption of this resolution not only represents the performance of a responsibility stipulated by statute, but also signifies the introduction of transparent selection principles with respect to persons wishing to apply for the post of bank examiner. Implementation of this resolution is designed to ensure, over time, that those recruited to this post represent the highest professional skills and are the best predisposed for the job.

The prudential recommendations developed by GINB and adopted by the Commission for Banking Supervision, in particular those on internal controls and audit and on foreign exchange risk, shed new light on these areas of banking activity and the risks inherent in them. Risk is an inseparable component of banking operations, and the supervisory view and assessment of risk has come to provide valuable guidance to the banks. While the recommendations in question are non-obligatory, the practice of recent years has demonstrated their usefulness in indicating to the banks the boundaries of safe operations.

In addition to measures to achieve a constant increase in the effectiveness and quality of banking supervision - with consideration given to the risks associated with new banking products and instruments - in 1999 banking supervision conducted a broad campaign of activity related to the problem of the Year 2000, the negative consequences of which, had they made themselves felt, could have had an adverse impact on the whole banking sector.

In 1999, the General Inspectorate of Banking Supervision also continued work to conclude cooperation agreements with other financial regulators in Poland and with supervisory agencies from other countries. On June 29, 1999, an agreement was signed between the Commission for Banking Supervision and the Securities and Exchange Commission.

At the same time, in view of the rapidly escalating involvement of foreign capital on the Polish banking market, work was stepped up on concluding the relevant agreements with supervisory authorities from abroad. The Commission approved a draft framework agreement that was forwarded to the countries with which Poland's supervisory agency would like to conclude appropriate cooperation agreements. This draft not only details the form of bilateral relations between the supervisory agencies concerned, but also takes into account the need for appropriate information flows and exchange of experiences.

One conclusion drawn from the communications on the possibility of establishing agreements with foreign supervisory agencies is that amendments are necessary to the provisions of the present Banking Act to bring these into line with the regulations in place within the European Union.

Furthermore, in 1999, GINB continued intensive efforts to enhance the efficiency of supervision, in particular by undertaking measures that seek to allow a comprehensive approach to financial institutions within the framework of consolidated supervision. The introduction of consolidated supervision will on the one hand make it possible to avoid any disputes over regulatory jurisdiction, while on the other hand allowing an integrated assessment of the processes and problems that may emerge in relation to the establishment and operation of financial conglomerates on the Polish market.

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY.

According to the Banking Act, the objective of supervision is to ensure:

1) the safety of funds held on bank accounts,
2) 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 authorization to establish those banks.

The measures taken in performance of banking supervision shall involve, in particular:

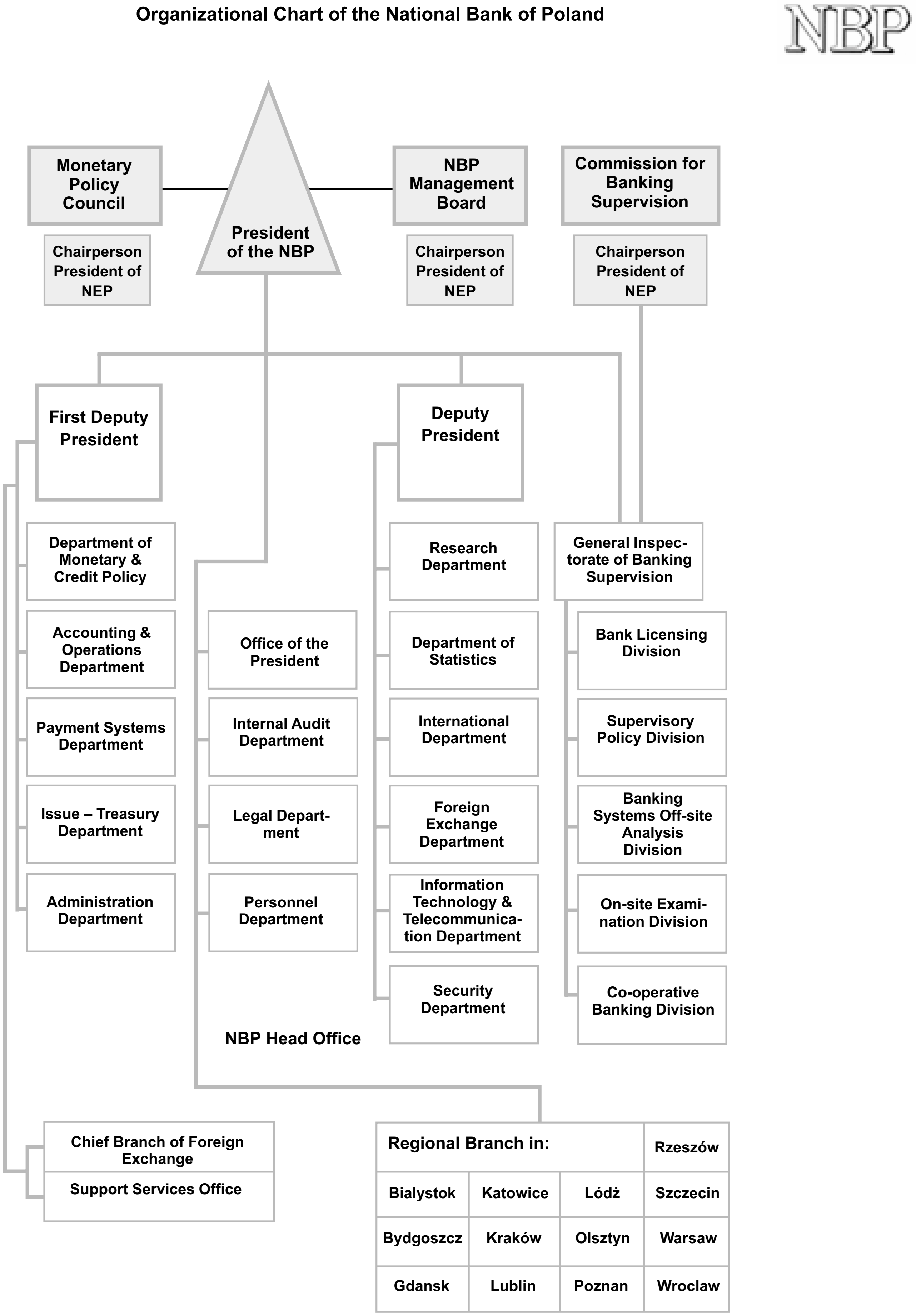
1) reviewing the solvency, liquidity and financial performance of banks,
2) reviewing loans, advances, guarantees and endorsements for compliance with the regulations in force in these respects,
3) reviewing the security taken against loans and advances, and timeliness of repayment,
4) reviewing the interest rates applied on the loans, advances and bank accounts,
5) assessing the financial situation of banks.

The Commission for Banking Supervision establishes also mandatory standards of bank liquidity and other standards regulating the permissible level of banking risk.

In performance of its supervisory responsibilities, the Commission among others may in specific circumstances:

1) issue recommendations to banks,
2) order a bank to cease payouts from net profit,
3) apply to the appropriate directing body of the bank for recall of the president, vice president or other member of the management board,
4) suspend from office the members of the management board,
5) restrict the scope of the bank activity,
6) revoke the authorisation

Organizational Chart of the National Bank of Poland



STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	1997	1998	1999
Commercial banks	83	83	77
Cooperative banks	1295	1189	781
Banking system	1378	1272	858

Ownership Structure, Commercial Banks (at year ends)

	Value of equity (million zloty)			Structure (%)		
	1997	1998	1999	1997	1998	1999
Total equity capital,	5,930.1	7,172.8	7,305.9	100.00	100.00	100.00
Of which held by:						
– the Treasury directly	1,303.8	1,351.0	1,036.8	21.99	18.84	14.19
– the National Bank of Poland	174.6	8.0	8.0	2.94	0.11	0.11
– other state institutions *	331.6	319.1	249.9	5.59	4.45	3.42
– other domestic investors **	589.0	690.2	866.3	9.94	9.62	11.86
– foreign investors	2,462.4	3,561.4	4,089.1	41.52	49.65	55.97
– dispersed holdings ***	1,068.7	1,243.1	1,055.8	18.02	17.33	14.45

* *State enterprises and banks, companies wholly owned by the Treasury, registered companies with a majority Treasury interest, government agencies, etc.*

** *Including equity held by local government.*

*** *In their reports, the banks disclose only those shareholders entitled to exercise no less than 5% of votes at shareholders general meetings, with the remaining shareholders, entitled to less votes, being grouped together under the heading “other shareholders”. Equity held by the latter is customarily referred to as “dispersed holdings”. Let us note that listed banks usually do not have information on all their shareholders.*

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

Type of financial institution	1997	1998	1999
– Commercial banks	95.5	95.7	95.8
– Cooperative banks	4.5	4.3	4.2
– Banking system	100.0	100.0	100.0

** Please indicate on what basis you differentiate between financial institutions*

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

Assets	1997	1998	1999
Cash and balance with Central bank	7.3	7.8	4.6
Interbank deposits	13.6	13.2	14.2
Due from non-financial and government entities	42.5	42.7	47.8
Securities	26.6	26.9	23.8
Other assets	10.0	9.4	9.6
Liabilities	**1997**	**1998**	**1999**
Borrowing from Central bank	3.2	2.0	1.6
Interbank deposits	6.6	11.1	9.3
Deposits from non-financial and government entities	61.7	62.1	64.0
Bonds	1.1	0.5	0.4
Other liabilities	19.3	15.9	16.4
Capital and reserves	8.1	8.4	8.3

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

Type of financial institution	1997	1998	1999
Commercial banks	45.3	62.1	85.2
Cooperative banks	3.1	4.0	5.5
Banking system	43.3	59.6	81.8

Solvency Ratio of Financial Institutions*

Type of the financial institution	1997	1998	1999
Commercial banks	12.5	11.7	13.1
Cooperative banks	11.1	11.8	12.8
Banking system	12.5	11.7	13.1

* *Arithmetic mean %.*

Asset Portfolio Quality of the banking system (%)

Asset Classification	1997	1998	1999
Consumer loans classified satisfactory*	x	x	17.3
Special mention claims**	x	x	6.3
Irregular claims, of which:			
substandard	3.8	3.9	5.1
doubtful	1.2	1.9	3.4
loss	5.2	4.7	4.7
Classified Total	**10.2**	**10.5**	**13.2**
Specific Reserves (mln zl)	**6,459.9**	**7,287.8**	**9,222.5**

* *Cathegory introduced sinee 30 June 1999 r.*
** *Cathegory introduced sinee 30 June 1999 r.*

The Structure of Deposits and Loans in 1999 (%) (at year-end)

	Deposits	Loans
Households	66.2	19.7
Government sector	5.1	7.2
Corporate	23.8	65.7
Foreign	1.9	0.7
Other	3.0	6.7
Total	**100.0**	**100.0**

The Structure of Deposits and Loans by time in 1999 (%) (at year-end)

Maturity of Deposits (from non-financial sector)		Loans (for non-financial sector)	
At sight	28.1	Long term loans (over 3 years)	35.3
Within one year	70.4	Medium-term loans (from 1 to 3 years)	16.0
Over one year	1.5	Short-term loans (to 1 year)	48.7
Total	**100.0**	**Total**	**100.0**

NBP

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

Type of the financial institutions	FOREX Assets/Total Assets			FOREX Liabilities/Total Liabilities		
	1997	**1998**	**1999**	**1997**	**1998**	**1999**
Commercial banks	22.1	18.8	21.4	21.3	18.5	19.9
Cooperative banks	0.0	0.0	0.0	0.0	0.0	0.0
Banking system	21.1	18.0	20.5	20.3	17.7	19.0

* *Please indicate off-balance Foreign Exchange sheet items/ total liabilities if possible*

Structure of Revenues and Expenditures of Financial Institutions in 1999* (at year-end)

million zloty

Revenues	1997	1998	1999
Commercial banks	42,853.1	61,783.2	76,324.1
Cooperative banks	2,372.5	2,632.4	2,608.2
Banking system	45,225.6	64,415.6	78,932.3
Expenditures	**1997**	**1998**	**1999**
Commercial banks	36,547.1	57,413.0	71,375.9
Cooperative banks	2,021.8	2,347.3	2,285.4
Banking system	38,568.9	59,760.3	73,661.3

** *Indicating profitability, provisioning of financial institutions included in the table or separately*

Structure of Registered Capital and Own Funds of Financial Institutions in 1999 (at year-end)

Type of the financial institutions	Registered Capital	/Total assets	Own Funds	/Total Liab.
	Million USD	**%**	**million USD**	**%**
Commercial banks	1,758.2	2.1	7,127.2	8.5
Cooperative banks	71.3	1.9	329.7	8.9
Banking system	1,829.5	2.1	7,456.9	8.5

1999 DEVELOPMENTS IN THE RUSSIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The macroeconomic indicators of 1999, i.e., the moderate increase in consumer prices, an increase in the production volume indices for many products and services, the relatively stable financial position of the enterprises and the boom of Russian export items on external markets, indicate that in 1999 the Russian economy showed positive trends. Compared to the previous year, the Gross Domestic Product (GDP) increased by 3.2% in real terms in 1999, while industrial output grew by 8.1% and capital investments increased by 1%. On the basis of the 1999 annual results, the trade balance had USD 33.3 billion surplus (in 1998 the surplus was USD 15.1 billion).

The inflationary processes may be characterized with a relatively stable dynamism of the RBL/USD exchange rates (31% increase in the exchange rate), reduced inflation expectations and low consumer demand from the households. In 1999 consumer prices went up by 36.5% (in 1998 the increase was 84.4%).

DEVELOPMENT OF THE BANKING SYSTEM

In 1999 there was an increase in the volume of banking activities. The value of the assets of the banking sector grew by 52% at current prices (within that total the increase in RBL assets was higher than 76%) and was almost 59% higher than the figure before the crisis. Regarding the structure of the assets of the banking sector, the%age of foreign currency receivables was falling gradually: on January 1, 1999, those receivables still represented 56% and on January 1, 2000, they represented only 49%.

In March 1999 the capital amount of the banks began to grow: between March 1, 1999, and January 1, 2000, the total capital of the operating banks (without Sberbank) increased by RBL 97.4 billion, i.e. 3.4 times, and reached RBL 138.6 billion (135.7% of the figure before the crisis).

The liabilities of the credit institutions also increased: the total of deposits collected from companies and organizations increased by 66.7% in 1999, while the consumer price index grew by 36.5%. In accordance with the data of 1 January 2000, the funds placed in the accounts of companies and organizations increased to 29% among the total liabilities of the banking sector (on August 1, 1998, that ratio was 18.9%).

The household deposits also returned to their former level: in 1999 the RBL deposits of private individuals increased by 43.1% (by 46% in Sberbank, and by 22.8% in other commercial banks), and the foreign currency deposits (in USD value) went up by 23.7% (by 41.1% in Sberbank, and by 10.4% in other commercial banks). Among the liabilities of the banking sector the%age of deposits of private individuals was close to 19% on January 1, 2000. Based on the data of the entire year, the deposit portfolio of Sberbank represented more than 76% of the total household deposit portfolio of the banking system.

It should also be considered a favorable trend that the number of banks closing the business year with a profit has increased from 1113 to 1216 (representing 75 and 90% of all the operating banks). However, taking into account the results of the previous periods, the financial result of the banking sector showed a loss of RBL 34.5 billion on January 1, 2000.

LEGAL AND INSTITUTIONAL FRAMEWORK OF THE REGULATION AND SUPERVISION OF THE ACTIVITIES OF CREDIT INSTITUTIONS AND THE LEGAL STATUS OF THE BANKING SUPERVISION IN RUSSIA

The institutions of the Russian banking sector consist of the Central Bank of the Russian Federation (Bank of Russia), the credit institutions and representation and branch offices of foreign banks. The legal regulations governing the banking activities include the Constitution of the Russian Federation, the federal Acts on "The Central Bank of the Russian Federation (Bank of Russia)", "On the Banks and Banking Activities", "On the Restructuring of Credit Institutions", and "On the Insolvency [bankruptcy] of Credit Institutions", other federal laws and the decrees of the Bank of Russia.

In the Russian Federation the Bank of Russia is the institution responsible for the regulation of banking activities and the supervision of the activities of credit institutions.

In order to maintain the stability of the banking system, and protect the interests of depositors and creditors, the bank of Russia continuously safeguards the credit institutions making sure that they comply with the provisions of the statutory regulations related to banks and the requirements of the Bank of Russia, including the mandatory requirements of the supervisory agency. However, apart from cases specified in the federal acts, the Bank of Russia does not interfere in the daily activities of the credit institutions.

ACTIVITIES OF THE BANKING SUPERVISORY AGENCY IN 1999

The main strategic goal of the supervisory activities of the Bank of Russia is to implement the Basle Principles of effective banking supervision. The Bank of Russia has done a lot to that end in the area of the legal environment applicable to banking activities, including the modernization of the system containing the prudent regulations compiled on the basis of the recommendations of the Basle Banking Supervisory Committee, and the establishment of a system of banking financial reports which comply with the international accounting standards.

For the purpose of approximation of the conditions specifying the generation of provisions for potential loan losses and the provision generating practices to the conditions of the stable operation of the credit institutions, on March 5, 1999, the Bank of Russia announced its Decree No. 62 "on the modification and complementation of the rules of generation and use of provisions for potential loan losses", which was originally created on June 30, 1997. The requirements of classification of rescheduled loans in the referred decree focus on the banking evaluation of the real lending risks as opposed to the former formal criteria.

In the area of modernization of the regulation of risks assumed by the banks the Decree of the Bank of Russia No. 89-P "On the Calculation of Market Risks of Credit Institutions" established on September 29, 1999, has entered into force. Among other things, that decree relates to the calculation of sufficient capital on the basis of market risks (as from April 1, 2000).

The Russian banks have introduced measures for stronger actions against the laundering of incomes from crime. Similarly, measures have been introduced to update the regulations governing transactions between Russian banks and offshore credit institutions. For example, the Bank of Russia has introduced new regulations that include some restrictions for deposit collection and also provide on the generation of provisions related to transactions with residents of offshore regions. In addition, restrictions were also imposed on the requirements related to provisions on loans extended to so-called "one day" companies.

In order to exercise stricter control over the own risks of banks and the combination of risks of subsidiaries and other organizations in which the bank has an interest, i.e. risks related to complete banking groups, the methodology base of supervision has been developed. For example, another Decree of the Bank of Russia No. 85-P "On the use of data of non-credit institutions belonging to a group during the preparation of the consolidated financial statements of credit institutions" has also been announced.

In 1999 the Bank of Russia considered that the acceptance of the conditions for the recapitalization of the Russian banks, which were in a difficult situation as a result of the financial crisis in 1998, was one of its major tasks. In order to create favorable conditions for the recapitalization the owners of the banks (that is, the shareholders) were allowed to cover the capital increase with assets, such as a bank building. In addition, the rules of conversion between the liabilities of the credit institution and the equity participation acquired in the institution were also accepted. Rules were adopted for the payment of the capital of credit institutions in the form of government securities (OFZ-PD). The decisions had a favorable influence on the increase of the capital stock of the banking sector.

Until August 1, 1999, a special (easing) system remained in effect regulating the operation of credit institutions. The Bank of Russia originally introduced this system for the period of the financial crisis. It made it possible for banks that suffered from the crisis but retained a favorable chance of the recovery of their operation to continue their activities in the ordinary fashion. Consequently, the Bank of Russia managed to prevent the extension of the crisis that paralyzed the banking system to the real economy.

The events of the subsequent period proved that the decision of the Bank of Russia, according to which it introduced temporary regulations for the operation of banks suffering from the negative consequences of the suspension of payments arising from the internal national debt, was absolutely well founded for the aspects of prudent requirements. In the settlement periods starting from August 1, 1999, the ordinary procedures of the control of financial reports were restored.

The new operating conditions of the credit institutions and the conditions of their own assets justified the elimination of the minimum requirements for the absolute amount of total assets of credit institutions. In its decision, the Bank of Russia did not primarily rely on the specific conditions of the operation of the bank but the fact that the most important factor was not the total assets amount but the extent to which the equity of a bank is suitable for the magnitude of the activities of the bank and the risks assumed by the bank.

ORGANIZATION OF THE SUPERVISORY AGENCY

As was already indicated, pursuant to the provisions of the federal act "on the Central Bank of the Russian Federation (Bank of Russia)", in the Russian Federation the Bank of Russia is the institution responsible for the regulation of banking activities and supervision of the credit institutions operating in the territory of the Russian Federation.

In order to regulate the activities of credit institutions and implement the policy related to their supervision and enforce actions, an institution has been created to act as a permanent partner of the Bank of Russia. It is the Banking Supervisory Committee, the rights of which have been determined by the Board of Directors of the Bank of

Russia. Pursuant to the provisions of the federal act "On the Central Bank of the Russian Federation (Bank of Russia)", the Board of Directors is the supreme organ in Russia which defines the main directions of the activities of the Bank and also controls the activities of the Bank of Russia.

The activities of the credit institutions in the various aspects are supervised by the following organization units of the Bank: Licensing Department of Credit Institutions and Audit Companies, Prudent Banking Supervisory Department, Audit Department of Credit Institutions, and Refloatation Department of Banks.

The practical performance of the banking supervisory tasks takes place through the regional organizations of the Bank of Russia. The Regional Directorates of the Bank of Russia and the local national banks operate in the territory of almost all subjects of law of the Russian Federation (altogether 79 regional institutions).

STATISTICAL TABLES[1]

Number of Financial Institutions (at year end)

Type of the financial institution	1997	1998	1999
Total	**1697**	**1476**	**1349**
Of which			
Banks	1675	1447	1315
Non banking institutions	22	29	34

Total Assets, Liabilities and Capital

Description	01.01.1999		01.01.2000	
	RBL billion	**%**	**RBL billion**	**%**
ASSETS	1027.6	100.0	1522.0	100.0
Central bank deposits	4.7	0.5	3.7	0.2
Other inter-bank loans and deposits	95.5	0.5	168.5	11.1
Total loan portfolio	392.5	38.2	168.5	38.7
Government securities portfolio	179.7	17.5	213.7	14.0
Total securities portfolio	211.7	20.6	262.3	17.2
Other assets	323.2	31.5	499.1	32.8
LIABILITIES	900.6	100.0	1319.7	100.0
Liabilities to the central bank	8.2	0.9	14.2	1.1
Inter-bank liabilities	195.7	21.7	173.8	13.2
Deposits of private individuals (including also funds in the accounts of enterprises without legal entity)	201.3	22.4	300.4	22.8
Deposits of companies and other organisations	305.5	33.9	496.2	37.6
Other liabilities	189.9	21.1	335.1	25.4
CAPITAL	106.9	100.0	180.4	100.0
Share capital	70.3	65.8	142.7	79.1
Reserves and funds	67.1	62.8	142.7	40.0
Profit (loss) taking into account the results of former years	-30.5	-28.5	-34.5	-19.1

* *The total assets do not contain the reserves.*

[1] The 1997 data are not included in the tables because the new chart of accounts was introduced for the credit institutions on 1 January 1998.

Composition of the Loan Portfolio (%)

Quality of the loans	01.01. 1999.	01.01. 2000.
Performing	75.4	78.8
Substandard	7.2	7.8
Doubtful	6.0	2.7
Bad	11.3	10.7

Loan Portfolio (%)

Description	01.01. 1999.	01.01. 2000.
To the public sector	4.6	4.8
To banks	13.2	14.3
To private individuals	4.4	4.2
To legal entities	76.4	74.8
Other	1.5	1.8

Profit and Loss Account (%)

Description	01.01.1998.	01.01.1999.	01.01.2000.
Revenues	**100.0**	**100.0**	**100.0**
Revenues from loans and credits	33.2	11.7	9.1
Securities transactions	35.5	11.1	6.7
Foreign currency transactions	11.7	64.6	63.8
Commission income	7.7	2.3	2.4
Extraordinary revenues (fines. default interest. penalty interest)	0.6	0.4	0.3
Other	11.3	9.9	17.7
Expenditure	**100.0**	**100.0**	**100.0**
Debt service related to loans and credits taken	11.8	2.2	1.2
Payments to deposit holders.	35.2	10.0	8.3
Payments related to issued securities	23.5	10.4	2.9
Payments related to foreign currency transactions	12.6	54.1	59.9
Provisions	0.0	12.2	17.9
Extraordinary expenses (fines. default interest. penalty interest)	0.9	0.2	0.1
Other	15.9	10.9	9.6

Banking Assets with Various Risk Weight

RBL billion

Risk weighted assets	01.01.1998.	01.01.1999.	01.01.2000
Group 1. (Ar 1)	0.2	0.4	0.9
Group 2. (Ar 2)	0.8	17.2	23.1
Group 3. (Ar 3)	9.4	29.4	59.5
Group 4. (Ar 4)	21.4	21.6	48.0
Group 5. (Ar 5)	381.3	547.9	724.5
Total risk weighted assets of credit institutions	371.4	710.0	856.0

Percentage of Foreign Currency Assets and Liabilities in the Assets and Liabilities of the Banks

	01.01.1999.	01.01.2000
Foreign currency assets among the total assets of the banks, %	56.1	48.9
Foreign currency liabilities among the total liabilities of the banks , %	47.0	37.6
Difference in the foreign currency percentage of the assets and liabilities of the banks	9.1	11.3

1999 DEVELOPMENTS IN THE SLOVAKIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Macroeconomic and monetary development recorded a change in 1999 towards mitigation of macroeconomic imbalances from previous years, particularly the fiscal deficit and the shortfall in the current account of the balance of payments. To solve the problem of economic instability, the Government of the SR adopted a strategy for the acceleration of economic reforms in May 1999. Based on a complex of measures, the strategy was designed to improve budgetary performance in public finances and to reduce the dynamics of domestic demand by freezing the level of wages in public administration, adjusting the lower rate of value-added tax, and raising excise duties. At the same time, price anomalies gradually began to be straightened out through increases in regulated prices. In addition to measures taken in the area of domestic demand, the solution of the problem of the increased current account deficit was supported by an increase in the import surcharge. The aforementioned measures began to produce results in the second half of 1999.

The National Bank of Slovakia and the economy as a whole gradually learnt to live with the conditions of a floating exchange rate, which was stabilized successfully with the support of the economy policy of the Government. Over the course of the year, further steps were taken towards liberalization, with a positive effect on monetary development. As a result of the measures taken by the Government, particularly in the area of domestic demand, the trend of development began to change in both deficits -the fiscal deficit and that of the current account -in the second half of the year.

In 1999, the balance of payments on current account resulted in a deficit of Sk 44.8 billion (USD1.1 billion), representing an improvement of 40% compared with the previous year. The share of the deficit in gross domestic product decreased from 10.1% in 1998 to 5.8% in 1999.The improvement in the balance on current account was due mainly to a reduction in the trade deficit (Sk 37.2 billion, to Sk 45.7 billion) and improvement in the balance of services, while the shortfall in the income balance increased and the surplus in current transfers diminished. During 1999, the foreign exchange reserves of the NBS increased by USD 720.5 million (Sk 30.1 billion) to USD 3.4 billion, and sufficed to cover 3.1 times the volume of average monthly imports of goods and services into Slovakia in 1999.

The absolute annual change in net credit to the Government and the Fund of National Property, which roughly corresponds to the size of the fiscal deficit in general government, reached Sk 28.9 billion (i.e. 3.7% of GDP) in 1999. In comparison with 1998, the share of net credit to the Government in gross domestic product decreased by 2.8 percentage points and contributed to stabilization of the Slovak economy.

The measures adopted by the Government in 1999 were designed to mitigate the effects of macroeconomic imbalances and therefore focused on domestic demand, which fell in real terms, by 4.0%. In 1999, gross domestic product grew in real terms by 1.9%, compared with 4.4% in 1998.

In addition to a slowdown in the rate of growth in GDP, the stabilization measures of macroeconomic policy led to a rise in domestic price levels in the short term. Due to increases in regulated prices, Slovakia's inflation rate, expressed in terms of the consumer price index, reached a two-digit figure. At the end of 1999, the annual rate of inflation stood at 14.2%. However, the rise in inflation was of a short-term nature and the effects of the administrative measures are to disappear after 12 months. The effect of the increase in regulated prices on inflation was partly offset by a fall in domestic demand; by monetary policy, which did not compensate the rise in price levels by supplying excess liquidity; and by government measures taken in the area of wages, i.e. the freezing of the volume of wages resources in public administration at the level of the previous year. This prevented the start of an inflationary spiral in the Slovak economy, which had a positive influence on the deficit of trade, and started the process of convergence in price levels in Slovakia and EU countries.

The conduct of monetary policy focused on quantitative liquidity control in the banking sector and placed emphasis on trading through REPO tenders in particular. From the beginning of the year, monetary policy aimed at lowering the relatively high rates of interest on the interbank market, which had persisted since the period of turbulence on the financial market in September 1998. The steady development in the exchange-rate area had a favorable effect on the level and volatility of interbank deposit rates: the rates for one-month deposits fell in December by an average of 3 percentage points in comparison with January 1999.

A positive result of the restoration of macroeconomic balance in the Slovak economy was the invitation of the Slovak Republic to start negotiations on accession to the European Union, which was approved at the Helsinki summit of the EU in December 1999. In this connection, the exchange rate of the Slovak currency started to appreciate. During 1999, the Crown strengthened against the euro by 1.5%, mainly during the second half of the year.

In response to the actual development of the Slovak economy during the first months of the year, Moody's Investors Service reassessed the country's credit rating and changed its outlook from stable to negative, which had an unfavorable effect on the bank's attempt to lower the level of interest rates at that time and contributed to the destabilization of exchange rate development. At the beginning of the last quarter of 1999, the major rating agencies reacted favorably to the measures adopted by the Government for the stabilization of the country's economy. In October, Moody's Investors Service changed its rating of Slovakia back to stable from negative. Standard & Poor's took a similar step in November.

In 1999, bank restructuring commenced at selected commercial banks (VÚB, Slovenská sporiteľňa, Investičná a rozvojová banka), with an increase in their registered capital and the transfer of classified assets to Konsolidačná banka, š.p.ú. (Consolidation Bank, state financial institution) and Slovenská konsolidačná, a.s. (state agency), in the total amount of Sk 82.2 billion. Thus, the loan portfolio of the banking sector changed in structure: the share of classified loans decreased and that of standard loans increased.

With respect to the favorable trend of development in fiscal matters, foreign trade, and exchange rates, we may be satisfied with the year 1999, which was a turning point in the development of the Slovak economy with prospects for a qualitative change in macroeconomic development. The slowdown in economic growth and the rise in inflation are to be viewed, on the one hand, as a price to pay for improvement in some of the macroeconomic indicators and, on the other hand, as a temporary phenomenon that will disappear over the next few years.

THE LEGAL FRAMEWORK

Important amendments to three banking laws came into force in 1999:

An amendment to the Act on Banks 21/1992, Coll. in the wording of subsequent regulations, with effect from 11 October 1999:

- made it possible for more citizens to obtain mortgage loans,
- established legal conditions to provide mutual legal assistance in criminal matters,
- increased protection of clients of banks and branch offices of foreign banks,
- contributed to improved payment discipline of debtors of banks and branch offices of foreign banks,
- improved the effectiveness and reinforced the operations of bank supervision.

An amendment to Act 310/1992, Coll. of the National Council of the Slovak Republic on home savings in the wording of Act 386/1996, Coll. with effect from October 1, 1999, was passed in order to:

- eliminate existing barriers to comprehensive implementation of the system of home savings,
- constitute legal conditions for the entry of corporate bodies into the system,
- encourage the return of so-called solidarity depositors,
- widen the possibility to use available resources from the home savings fund.

The most significant changes enacted in the amendment to Act 118/1996, Coll. on the protection of deposits and on changes and amendments to some other laws with effect from 1 July 1999 can be summarized as follows:

- acceleration of the payout of compensation for inaccessible deposits,
- improving the effectiveness of the Deposit Protection Fund,
- preventing instability in the banking system at a time when compensation is being paid for inaccessible deposits.

DEVELOPMENT OF THE BANKING SECTOR

On 31 December 1999, twenty-five banking entities were active in the banking sector of the Slovak Republic - twenty-three banks and two branch offices of foreign banks. On 1 January 1999, a merger of two banks, Bank Austria (SR), a.s. Bratislava and Creditanstalt, a.s. Bratislava, took place. A representative office of Bank Przemyslowo-Handlowy SA from Poland started its activities on 1 January 1999. At the end of 1999, ten representative offices of foreign banks were active in the Slovak Republic. The total subscribed capital in the banking sector of the Slovak Republic, including funds permanently provided to branch offices of foreign banks (excluding the NBS) increased from 31 December 1998 to 31 December 1999 by Sk 18.2 billion, i.e. from 34.6 to Sk 52.8 billion. An increase in registered capital took place in Tatra banka, a.s. Bratislava of Sk 522 million in assets; of Sk 5.7 billion in Investičná a rozvojová banka, a.s. Bratislava via a subscription of new shares; in Priemyselná banka, a.s. Košice of Sk 598.9 million via a subscription of new shares; in Slovenská záručná a rozvojová banka, š.p.ú. Bratislava of Sk 120 million in assets; in Slovenská sporiteľňa, a.s. of Sk 4.3 billion via a subscription of new shares, and in Všeobecná úverová banka, a.s. Bratislava of Sk 8.9 billion via a subscription of new shares. On the other hand, a reduction of Sk 2.0 billion resulted from the merger of Priemyselná banka, a.s. Košice with Slovenská sporiteľňa, a.s. Bratislava. The share of foreign investors in the total subscribed registered capital and funds permanently provided to branch offices of foreign banks was substantially reduced by the increased capital of the Ministry of Finance of the Slovak Republic in restructured banks, i.e. Všeobecná úverová banka, Slovenská sporiteľňa, and Investičná a rozvojová banka. From a maximum share of 38.3% in the second quarter of 1999, it fell to 24.6% in the fourth quarter of 1999. This development was not associated with an absolute reduction of foreign investment in the banking sector of the Slovak Republic, but was caused by the process of restructuring, which included the aforementioned capital input of the Ministry of Finance of the Slovak Republic.

The year 1999 may be considered a breakthrough in the development of the banking sector, above all, because after years of effort on the part of the National Bank of Slovakia, the first tangible steps were made in restructuring the loan portfolio of the largest banks. In accordance with a decision of the government and the set timetable, the first two steps were taken in pre-privatization restructuring. The capital in these banks was reinforced towards the end of 1999. In this operation, the Ministry of Finance of the Slovak Republic and the National Property Fund of the Slovak Republic acquired 84.5% in VÚB, 97.2% in Slovenská sporiteľňa, and 69.6% in Investičná a rozvojová banka. In the second phase, approximately Sk 82.2 billion of bad loans of these banks was transferred, thereof Sk 62.7 billion from outside the banking sector, into a specialized state agency, Slovenská konsolidačná, a.s., and the rest to Konsolidačná banka, š.p.ú. In December 1999, based on results of an international tender announced by the government of the Slovak Republic, the long-term advisors for the privatization of VÚB, Slovenská sporiteľňa, and Banka Slovakia, were selected. They are J.P.Morgan as financial consultants and White&Case as legal advisor. At the same time, audit began in the banks with the aim to prepare them for strategic foreign investors before the end of the year 2000.

Total assets of banks in the Slovak financial market on 31 December 1999 totaled Sk 769.8 billion with a year-on-year decline of 3.3% (SK 26.5 billion). The decrease in total assets is to some extent ascribable to cancellation of the regulation on the foreign exchange position of banks for monetary purposes and the aforementioned transfer of nonperforming loans. The share of banks undergoing transformation in the total volume of total assets has not significantly changed and at 31 December 1999 was 45.8%.

In the course of the period under review, banks concentrated on less risky transactions. Continuing deterioration of the financial situation of entrepreneurial entities had its effect on the growth of nonperforming loans with a negative impact on the quality of the loan portfolio of banks. Lending activity is only slowly recovering, and mostly only for existing clients. This is due to concern over the high level of risk and a shortage of available resources in the first half of the year in particular. Deterioration in the structure of assets of the banking sector started in 1998, continued throughout 1999. The volume of classified assets increased in several banks, above all in the second half of the year 1999, and the creation of reserves and provisions lagged behind the needs ensuing from growth of nonperforming loans. This development stemmed mainly from more precise classification of claims in banks undergoing restructuring. This was clearly reflected in the results for September, when the volume of classified claims reached Sk 174.5 billion. At the end of the year the volume decreased to Sk 129.7 billion, primarily because of the transfer of a portion of the claims to Slovenská konsolidačná. In the fourth quarter, the share of classified claims in total claims decreased from 32.3% to 23.0%. The share of primary and secondary resources placed in current performing assets had been on the decrease, but this slowed down after the transfer of the bad loans and its development has since improved. From 91.8% of resources allocated to performing assets in December 1998 this share dropped to 88.1% on 30 September 1999 and at the end 1999 had climbed to 95.7%. The banking sector reported a loss at 31 December 1999 of Sk 29.5 billion year-on-year. This development was essentially influenced by the transforming banks that have created the full volume of required provisions and they reported no uncovered estimated loss from loan classification. However, the creation of provisions led to an operating loss. The problem of high operating costs persisted in some banks.

EVALUATION OF PRUDENTIAL BANKING BEHAVIOR

In 1999, as previously, the prudential conduct of banks was governed by five decrees of the National Bank of Slovakia, based on international standards and recommendations of the Basle Committee for Banking Supervision. Evaluation is based on the processing of bank accounting data as well as on bank reports on capital adequacy, credit exposure, management of liquidity, open FX positions, and classification of claims and off-balance sheet commitments of banks according to risks involved, and the creation of provisions to cover risks (classification of claims and off-balance sheet commitments), submitted to the Banking Supervision Division of the NBS. The information system of Banking Supervision Division serves to evaluate and monitor tendencies in individual banks, groups of banks, and the banking sector of the Slovak Republic as a whole, using a set of indicator-ratios. With regard to compliance with prudential standards, improvement was recorded in 1999 in the banking sector of the Slovak Republic as a whole, in observing liquidity limits and open foreign exchange positions. Assessment of prudential behavior in the banking sector is the responsibility of the Banking Supervision Division of the NBS and is carried out by systematic on-site inspections.

Capital Adequacy

NBS Decree No. 5/1997 on capital adequacy requires banks to maintain a minimum level of capital adequacy of 8%. At 31 December 1999, four banks had failed to meet the capital adequacy level. These included one state financial institution and two commercial banks where the deductible items exceeded the value of capital. Compared with December 1998, the funds needed to achieve capital adequacy of 8% in these banks decreased to Sk 27.5 billion. Capital adequacy in banks operating in the banking sector of the Slovak Republic (without Konsolidačná banka, š.p.ú.) increased, compared with 1998, by 5.9 points and reached 12.6%. This positive trend results from an increase in the capital base for the calculation of capital adequacy and a decrease in the volume of risk weighted assets, which was plainly due to restructuring of the largest Slovak banks. The increase in capital for calculation of capital adequacy of the banking sector resulted primarily from the increase in registered capital in restructured banks and a decrease in deductible items, above all uncovered estimated loss.

Credit Exposure

Under NBS Decree No. 3/1994, banks are required to monitor their credit risk in terms of potential loss caused by high credit exposure to one or several debtors constituting an economically linked group of borrowers. Net credit exposure in respect of non-bank clients must not exceed 25% of a bank's capital, and 80% in respect of bank clients, and the total amount of net loan exposure over and above 15% of the bank's capital must not exceed 800% of the bank 's capital. During 1999, nineteen banks were found to have overstepped the net credit exposure limit for non-bank borrowers and fourteen banks had broken the limit for lending to other banks. The limit on aggregate amount of reported loans was broken by eleven banks. Failure to comply with limits was due mainly to insufficient capital strength and high loan exposure inherited from the past. However, development was on the whole positive and the number of banks overstepping limits was less then in the previous year.

Liquidity

The Banking Supervision Division of the NBS by the amendment of Decree No. 7/1997 introduced stricter rules for bank liquidity, whereby banks and branch offices of foreign banks are required to achieve the ratio of assets and liabilities payable within one month to be equal to or exceeding 100%. The development of the set liquidity limit in 1999 was positive compared with the preceding year. The number of banks that failed to meet this requirement during the year fell to thirteen, whereof five failed to meet the limit only once.

Apart from application of monetary instruments by the National Bank of Slovakia, liquidity was also influenced by the current situation and market developments. This amounted to the persisting shortage of mainly long-term and to a lesser extent medium-term funds, chronic problems of the capital market and insufficient number of large investors. These factors resulted in a shortage of liquid funds and subsequent failure of certain banks to comply with the minimum reserves requirement and a mismatch in maturity of resources and their allocation.

Open Foreign Exchange Positions

The NBS Decree No.11/1997 on limitations pertaining to open foreign exchange positions of banks governs rules for prudential banking operations in foreign currencies. The Decree sets a limitation on the difference between assets and liabilities in individual currencies converted to Slovak crowns to 10% of the individual currency positions, and for aggregate open foreign exchange positions, 25% of the bank's capital. From 1 January 1999, the common European currency, the euro, has been included in the reports on open foreign exchange positions.

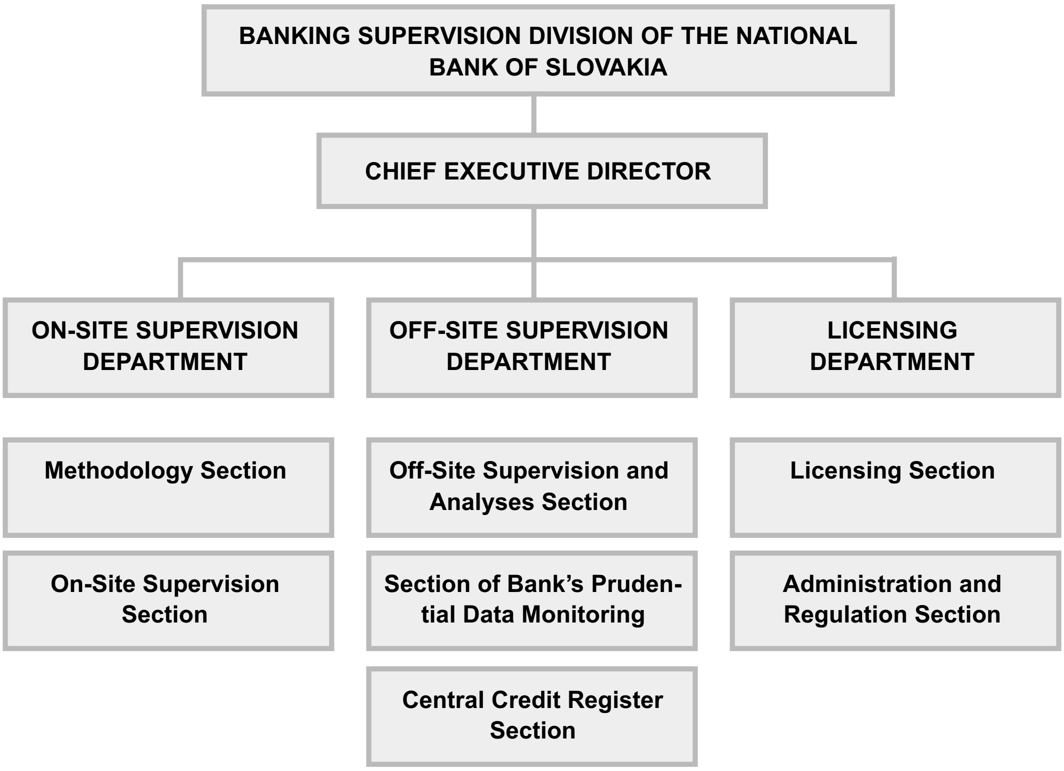
With the exception of banks undergoing transformation, as based on the procedure adopted by the Banking Supervision Division for banks exceeding the set limits, risks ensuing from open foreign exchange positions were mostly of short-term character and the number of banks violating the provisions of the Decree has declined.

Classification of Claims

Decree No. 3/1995 sets out uniform rules for reporting and evaluating the claims and off-balance sheet commitments of banks and branch offices of foreign banks with respect to risks involved, specifying the need to set aside funds to cover such risks. An important breakthrough took place in the development of classified claims in 1999, when, after years of effort on the part of the National Bank of Slovakia, the first tangible steps were taken towards restructuring the loan portfolios of the largest banks. Towards the end of 1999, the capital of these banks was increased and bad loans were transferred to a state-owned financial institution and to a specialized agency outside the banking sector. As a result of these steps, the uncovered estimated loss from claims and off-balance sheet commitments of banks for the banking sector as a whole fell year-on-year by Sk 18.7 billion, i.e. by 96.9% to Sk 603.2 million. The priorities which the NBS will have to concentrate on in the near future include addressing the problems of certain small banks in Slovakia; it will be necessary to cooperate on the preparations to complete the restructuring of banks with majority state ownership and prepare preconditions for their privatization in line with Government plans; and also to actively contribute to negotiations on Slovakia's accession to European structures. Achieving this goal will require full implementation of 25 Core principles for effective banking supervision, and necessitate further adaptation of the rules for prudential banking behavior and changes to the Act on Banks, the NBS Act, and other statutes.

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 Core principles for banking supervision known as the Basle Core Principles.



STATISTICAL TABLES

Distribution of Market Shares in Balance Sheet Total (%)

Type of the financial institutions	1995	1996	1997	1998	1999
Joint stock companies	81.43	81.02	82.08	82.45	79.96
State financial institutions	5.87	4.76	3.07	2.99	4.84
Building savings banks	2.45	3.48	4.50	5.46	6.65
Branches	10.25	10.74	10.35	9.10	8.55
Financial institutions, total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

The Structure of Assets and Liabilities of the Banking System in 1999 (at year-end)

in mil. SKK

Assets	1996	1997	1998	1999
Cash	12116	12828	12447	15024
Deposits and credits with NBS	31213	40541	34349	43629
of which minimum reserves requirements	28798	37564	32406	41428
Deposits and credits with banks	149060	172099	182932	149234
of which: current account	7301	6927	8218	7830
term deposits	135657	160019	161771	124741
granted credits	5048	5077	12555	15437
T - bills	29255	41938	19764	15448
NBS - bills	15	0	0	0
Granted credits	321688	353793	361884	360695
of which: to clients	314419	346147	353633	352341
to state and municipal autorities	7269	7646	8251	8354
Securities	84149	98711	86261	80059
of which: bonds	78031	94347	80323	77922
shares	5335	3921	3645	1527
Bank participations (investments)	3511	3926	2998	2444
Tangible and intangible assets	27930	30214	30527	30999
Other assets	57659	22802	68831	72232
Total assets	**716596**	**776852**	**799993**	**769764**

Liabilities	1996	1997	1998	1999
Resources from NBS	40224	51607	61527	40741
Deposits and credits from banks	139798	160991	159932	113337
of which: current account	5756	5701	3063	3281
term deposits	101550	117104	110885	89999
received credits	32491	38185	45984	20057
Received deposits	407498	437567	453257	497096
of which: from clients	367185	400435	421271	466797
from state and municipal autorities	34407	31916	28018	23247
deposit certificates	5906	5216	3968	7052
Bond issue	11950	13141	11817	8516
Reserves	27046	34914	39241	47171
Reserve funds	13004	12399	13017	12878
Capital funds	8707	7391	8679	8744
Initial capital	23469	26963	30113	48242
Retained profit	1711	2315	3351	5308
Current year profit	2588	-1340	-3678	-29522
Other liabilities	40601	30904	19009	17253
Total liabilities	716596	776852	796265	769764

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

Type of the financial institutions	1995	1996	1997	1998	1999
Joint stock companies	12.64	46.49	51.49	58.32	65.01
State financial institutions	2.75	1.36	0.37	1.67	4.16
Building savings banks	0.00	0.00	0.67	2.23	4.16
Branches	4.14	5.68	5.97	8.45	8.59
Financial institutions, total	**19.53**	**53.53**	**58.50**	**70.66**	**81.92**

Risk Based Capital to Risk-Weight Assets (%)

Type of the financial institutions	1995	1996	1997	1998	1999
Joint stock companies	7,97	7,25	9,10	7.15	11.05
State financial institutions	25,99	23,55	22,43	25.39	-71.25
Building savings banks	34,55	36,54	44,85	40.71	26.46
Branches	0	0	0	0.00	0.00
Financial institutions, average	**8,37**	**7,73**	**10,03**	**8.70**	**5.34**

Asset Portfolio Quality of the Banking System

in mil. SKK

Asset Classification	1995	1996	1997	1998	1999
Substandard	25 071.47	7 759.90	7 909.66	14 318.60	13,664.50
Doubtfull	12 411.40	10 371.32	9 780.05	11 842.50	13,820.21
Loss	86 192.66	92 128.10	101 514.26	118 961.90	102,194.40
Classified Total	123 675.53	110 259.32	119 203.97	145 123.00	129,679.12
Specific Reserves	**49 036.89**	**56 902.50**	**66 342.31**	**73 392.18**	**89 309.62**

The Structure of Deposits and Loans in 1999 (%)
(at year-end)

	Deposits	Loans
Households	64.7	10.3
Government sector	7.9	2.3
Business sphere	26.2	87.1
Foreign	0.3	0.2
Other	0.9	0.1
Total	**100.0**	**100.0**

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

	Foreign Exchange Assets / Total Assets			
Type of the financial institutions	1996	1997	1998	1999
Joint stock companies	31.50	41.40	46.03	34.96
State financial institutions	0.50	0.70	0.77	0.50
Building savings banks	0.70	0.40	0.41	0.35
Branches	40.60	47.70	44.63	27.02
Financial institutions, average	**15.70**	**20.30**	**22.11**	**15.96**

	Foreign Exchange Liabilities / Total Liabilities			
Type of the financial institutions	1996	1997	1998	1999
Joint stock companies	31.70	38.60	43.96	32.54
State financial institutions	0.30	0.50	1.00	1.81
Building savings banks	0.00	0.00	0.02	0.00
Branches	44.80	50.00	49.57	31.64
Financial institutions, average	**16.50**	**19.60**	**21.80**	**15.38**

Income statement - revenues and expenses

in th. SKK

Ratios	1996	1997	1998	1999
Net interest income from interbank operations	-1 292 283	551 184	36 233	1 101 515
Net interest income from client operations	14 068 322	13 879 445	7 394 139	-1 366 606
Net interest spread	**12 776 039**	**14 430 629**	**7 430 372**	**- 265 091**
Income from FX operations	3 710 099	5 542 139	5 500 738	5 394 107
Income from securities operations	6 666 074	7 320 978	12 997 398	15 490 047
Income from banking operations (core activities)	**23 152 212**	**27 293 746**	**25 928 508**	**20 619 063**
Other operational income	2 769 390	3 032 599	5 503 243	1 556 322
Operational expenses	15 148 319	17 816 376	19 510 886	19 928 013
Income from current operations	**10 773 283**	**12 509 969**	**11 920 865**	**2 247 372**
Net expenses from provisions and reserves	9 938 781	10 730 585	12 076 481	26 166 948
Net losses from irrecoverable debt	2 172 060	1 871 323	1 962 648	4 323 559
Extraordinary income	1 857 830	1 029 834	1 157 643	623 957
Extraordinary expenses	2 720 008	853 386	879 394	1 112 765
Net icome from extraordinary operations	**- 862 178**	**176 448**	**278 249**	**- 488 808**
Applicable income taxes	597 279	1 425 023	1 838 300	789 773
Net icome/loss	**-2 797 015**	**-1 340 514**	**-3 678 315**	**-29 521 716**

The Structure of Deposits and Loans in 1999 (%) (at year-end)

Maturity of deposits		Loans	
At sight	23	Long term loans	30
Within one year	52	Medium-term loans	37
Over one year	19	Short-term loans	33
Total	100	Total	100

Structure of Registered Capital and Own Funds of Financial Institutions in 1999 (%) (at year-end)

in mil. USD

	Registered Capital	/Total Assets	Own Funds	/Total Liabilities
Type of the financial institutions	**USD**	**%**	**USD**	**%**
Joint stock companies	1,031.20	7.08	2,298.49	15.78
State financial institutions	74.69	8.47	461.65	52.34
Building savings banks	35.49	2.93	234.83	19.38
Branches	0.00	0.00	262.47	16.86
Financial institutions, average	1,141.38	6.27	3,257.43	17.89

SKK/USD = 42,266

1999 DEVELOPMENTS IN THE SLOVENIAN BANKING SYSTEM

BANKA SLOVENIJE

MACROECONOMIC ENVIRONMENT

The two hallmark events in 1999 with far-reaching consequences for Slovenia's banking industry were the entry into force of the EU-Slovenia Europe Agreement on 1 February 1999 and the new Banking Act which became effective on 20 February 1999.

Further steps were taken to increase the competitiveness of the domestic banking sector. The intrabank agreement on capping deposit interest rates expired on 1 March 1999, new foreign exchange legislation was passed in April 1999, and value added tax replaced sales tax on 1 July 1999. In addition, the computer bug scare prompted efforts to ensure that banks are fully Year 2000 compliant.

The introduction of the value added tax had a strong impact on economic developments in 1999. Inflation expectations feeding on the new tax system have boosted domestic spending, and therefore intensified the lending activities of banks. In the second phase, the value added tax pushed up the consumer price index (CPI), which in turn triggered a change in the base interest rate and consequently influenced interest margin and the composition of bank earnings. However, the influence of the introduction of the value added tax on the rise recorded at the general price level was not as significant as expected.

In addition to institutional changes, in the first half of 1999 there were changes in the method of issuing base money. Tolar transactions generated a rise in base money, while over the past years it used to be foreign exchange transactions between the Bank of Slovenia and commercial banks. The said change in the method of issuing base money had an impact on somewhat impaired liquidity of the banking system during the first months of the year 1999. Nevertheless, all banks complied with requirements to set aside mandatory reserves and to maintain minimum foreign exchange assets. Impaired liquidity of banks did not contaminate the real sector.

Economic environment proved to be rather favorable for banking operations during 1999 – its principle feature was vigorous economic prosperity at home and the countries, which are Slovenia's most important trading partners, picked up the brisk pace of economic growth. In the wake of economic crisis in Russia and in Asia in 1998, and a crisis in the immediate vicinity of Slovenia, economic conditions at the beginning of 1999 could be described as volatile in many countries around the world. Despite difficulties experienced by a number of countries, Slovenia escaped unscathed and its hefty and sustainable GDP growth continued. All these developments were reflected on banking operations of banks' customers and banks' lending activities. The growth in banks' total assets in 1999 notched 14.3% – a rather modest performance if 8% inflation (December-December) and 4.9% GDP growth are taken into account. The share of aggregate total assets of banks and savings banks accounted for just over 74% of GDP at the end of 1999 and it ranks us at the very top of transition countries, but it still lags behind countries of the European Union.

After a more pronounced fall of inflation from the beginning of 1998, the process of lowering inflation culminated in the first half of 1999 and hit the bottom at just above

4%. Due to the introduction of the value added tax, consumer price grew faster and by the end of the year soared to 8% (December-December). Since the inflation rate is used as a basis for the calculation of the base interest rate, the correlation between price fluctuations and movements in interest rates has been rather notable. Consequently, interest rates paid on deposit and charged for loans in 1999 continued to go down and converged with interest rates prevailing in the European Union. Although the inter-bank agreement on maximum deposit interest rates expired on 1 March 1999, banks opted to follow recommendations on top interest rates paid on deposits within the framework of the Bank Association of Slovenia - a step towards further stability of interest rates.

DEVELOPMENT OF THE BANKING SYSTEM

Turning to the structure of the banking system and the number of credit institutions at the end of 1999, there were no major changes.

As at 31 December 1999, there were 25 operating banks in the Slovenian banking environment. Four of them are subsidiaries of foreign banks and one is a branch of a foreign bank. Alongside banks, there were also six savings banks and 68 savings and loan undertakings. Compared to 31 December 1998, the number of banks increased by one, the number of savings banks remained unchanged and the number of savings and loan undertakings reduced by two.

Although 1999 Banking Act allows foreign banks to establish branches in Slovenia, the structure of the banking system has not changed as only one foreign bank decided to open a branch in Slovenia during 1999.

As during the past few years, the market share of savings banks and savings and loan undertakings (measured by total assets) at the end December 1999 was extremely low in comparison with banks. Namely, it amounted to mere 2.1% (in savings banks it was 0.4%, in savings and loan undertakings 1.7%).

Out of 25 operating banks at the end of 1999 there were 10 banks owned by domestic shareholders and 5 wholly owned or controlled by foreign shareholders. The remaining 10 banks were controlled by domestic shareholders; however, the share of foreign owners in 6 banks did not exceed 1%. All savings banks are owned by domestic shareholders and are mostly in private hands.

The market shares (measured by unconsolidated total assets) of the largest seven banks has been constant at just above 73% or in the range of 85% if the banking group of the largest Slovenian bank Nova Ljubljanska banka is taken into account.

As for the ownership structure, the two largest Slovenian banks still remain in state hands. The Republic of Slovenia also has equity stake in one smaller bank and indirectly owns Poštna banka Slovenije d.d. (Slovenian Post Office Bank).

After the first steps to gradually privatize Nova Ljubljanska banka d.d. and Nova Kreditna banka Maribor d.d. in the middle of 1999, there has been an impasse in the process.

Financial results of banking operations for the year 1999 were below the figures for 1998. The explanation for this lackluster performance is that one of the largest banks had to make higher provisions for credit risk (net provisions rose by 7.6 billion tolars in 1999). In addition, interest margins thinned as banks stepped up efforts to attract clients. Profit before taxes was 20.1 billion tolars for the financial year and resulted in return on average assets (ROAA) of 0.8% – a significant drop on a year-on-year basis when ROAA was 1.2%. Squeezed by sliding interest rates across the industry and thinner revaluation profit, interest margin fell to 4.0% in 1999 (1997: 4.9%; 1998: 4.5%). On the other hand, interest margin remained too high in comparison with margins earned by the banks from the European Union. The figures posted in the profit and loss account reflect a favorable trend in movements of expenses, although there is ample room for further improvement (operating expenses incurred by the banking sector accounted for 3.6% of average assets in 1998, while in 1999 they were 3.4%. Nevertheless, expenses of Slovenian banks compare unfavorably with banks from the European Union.

Aggregate total assets of Slovenian banks as at 31 December 1999 amounted to 2,687.6 billion tolars (audited figures). With regard to the end of 1998, there was a 14.3% nominal rise, i.e. 5.8% growth in real terms. It means that the trend of moderate growth from the past year continued in 1999.

In 1999, total assets of almost all banks (20 banks to be exact) increased in nominal and in real terms, while their nominal grow rates ranged from 9.4 to 27.5%. More vigorous growth in total assets, which outpaced growth rates achieved by most banks, was posted by the newly established banks and the branch of the foreign bank. On the other hand, total assets of three banks decreased in real terms.

The downward trend of capital adequacy ratio across the banking system has been noticeable since 1995, and it continued during the period under review. Thus at the end of 1999, capital adequacy ratio was 14.0% (1998: 16.0%). However, capital adequacy ratio achieved by banks was above regulatory capital requirement of 8%.

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

The Bank of Slovenia conducts supervision of banks and savings banks in accordance with the 1991 Law on the Bank of Slovenia and 1999 Banking Act.

The Banking Act highlights banking supervision and surveillance, underpins internal controls and internal audit function, the role of supervisory board, independent external audit, etc. Banks focused efforts on the implementation of provisions laid down in the Banking Act. In particular, the stress was on the field of risk management and a lot of attention was paid to responsibilities conferred upon bank management and senior officers for safe and sound banking operations.

The 1999 Banking Act stipulates terms and conditions to be met when applying for an authorization to perform banking and other financial services. The Bank of Slovenia is vested with power to prescribe requirements applicable to human resources, organizational structure and technical issues. These requirements shall be complied with in order to be authorized to carry out banking and other financial services.

The amount of initial capital for banks has been set at 1 billion tolars irrespective of the scope of banking services. Consequently, the "old", multi-tier licensing system has been replaced and as from the effective date of the Banking Act, credit institutions are authorized in line with generally accepted practice in the EU. As for savings banks, the minimum amount of initial capital has been set at 186 million tolars. The same threshold will apply to savings and loan undertakings after a five-year transitional period.

Foreign banks may provide services listed in the Banking Act through a branch in the Republic of Slovenia. Foreign banks may establish a branch on the territory of the Republic of Slovenia, subject to the authorization granted by the Bank of Slovenia. The Bank of Slovenia may require that a foreign bank, which has requested to open branch on the territory of the Republic of Slovenia, shall deposit endowment capital, pledge another type of financial assets or other adequate collateral as a security that liabilities arising from business transactions concluded on the territory of the Republic of Slovenia will be duly settled. The provisions laid down in the Banking Act apply meaningfully to branches of foreign banks in the field of risk management, confidentiality of information/data, books of account and annual reports, internal and external audit, etc. Provisions that stipulate criteria applicable to bank management (to be fit and proper), shall apply also to Slovenian branch managers.

In line with the Banking Act, the Bank of Slovenia promulgated a number of bylaws in 1999 and in the first half of 2000. In addition, the Banking Act conferred upon the Banking Supervision Department a wide array of new tasks and responsibilities in connection with supervision and surveillance of legal entities connected with the bank. The Banking Act also provides for supervisory intervention in cases where other legal entities are suspected of providing banking services without being duly authorized by the Bank of Slovenia. After the adaptation period expires, the Bank of Slovenia will also be responsible for the supervision of savings and loan undertakings.

ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 1999, examiners of the Bank of Slovenia conducted 39 examinations at banks and savings banks, out of which nine were full-scope examinations of banking operations and 30 targeted only particular segments. The breakdown further shows that 8 full-scope and 22 targeted examinations were conducted in banks, while one full-scope and 8 target examinations were carried out in savings banks.

In the light of the widely expected Y2K date-processing problem, throughout 1999 examiners focused on preparations carried out in banks and savings banks.

In line with the strategic plan adopted by the Bank, the number of full-scope examinations is to be decreased to 7 to 9 annually, while targeted examinations focused on individual segments of banking operations is increase to at least 30 target examinations of banks and savings banks scheduled per year. As it has been common so far, a certain bank or a savings bank could be examined several times in a year. A targeted examination should be conducted in each bank or a savings bank at least once a year.

Regular annual meetings take place with members of management board of bank and savings banks, either within the framework of full-scope examination or with the aim to discuss relevant issues.

There is also ongoing exchange of views and information between supervisors of the Bank of Slovenia and other supervisory authorities at home and abroad. In addition to sharing information and expert opinion on supervising financial market participants connected with banks, 8 targeted examinations were conducted in 1999 together with the representatives of the Securities Market Agency (control of securities depots in Slovenia).

Since exposure of Slovenian banks and savings banks to credit risk is regarded as the most significant risk, the examinations carried out during 1999 highlighted adequate classification of on-balance sheet assets and off-balance sheet items. Special attention was paid to supervision on a consolidated basis – examination of a bank and persons connected to it. The examiners of the Bank of Slovenia analyzed financial statements prepared by connected persons, the bank's current and future policy in relation to connected persons, quality of assets - investments, management and the relationship with the bank, as well as operational risks. Information compiled served to examiners to decide whether provisions established and value adjustments for the bank's exposure (credits, equity/capital investments) to connected persons were adequate.

The Banking Supervision Department within the Bank of Slovenia has achieved a satisfactory level of compliance with the Core Principles for Effective Banking Supervision. In the middle of 1999, the Banking Supervision Department carried out an in-house assessment of the compliance with the Core Principles and the result showed that 17 principles can be considered as fully compliant, 6 principles are substantially compliant, and two principles are complied with up to a limited extent. By the promulgation of new bylaws – the Decree on the Supervision of Banks and Savings Banks on a Consolidated Basis and the Decree on Deposit-Guarantee Scheme – and enhanced liaison with supervisory authorities of other countries finalized through memoranda of understanding with banking supervisors - the compliance level has been raised further. The most recent self-assessment carried out indicates that as at the first half of 2000, Slovenia fully complies with 20 principles, 4 principles have been implemented up to a large extent, while only one principle has been partly implemented. Full compliance with all Core Principles for Effective Banking Supervision is to be achieved by the end of the year 2001.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

See enclosure.

The Banking Supervision Department was established at the beginning of April 1992 within the framework of the Bank of Slovenia. The Department comprises three separate units:

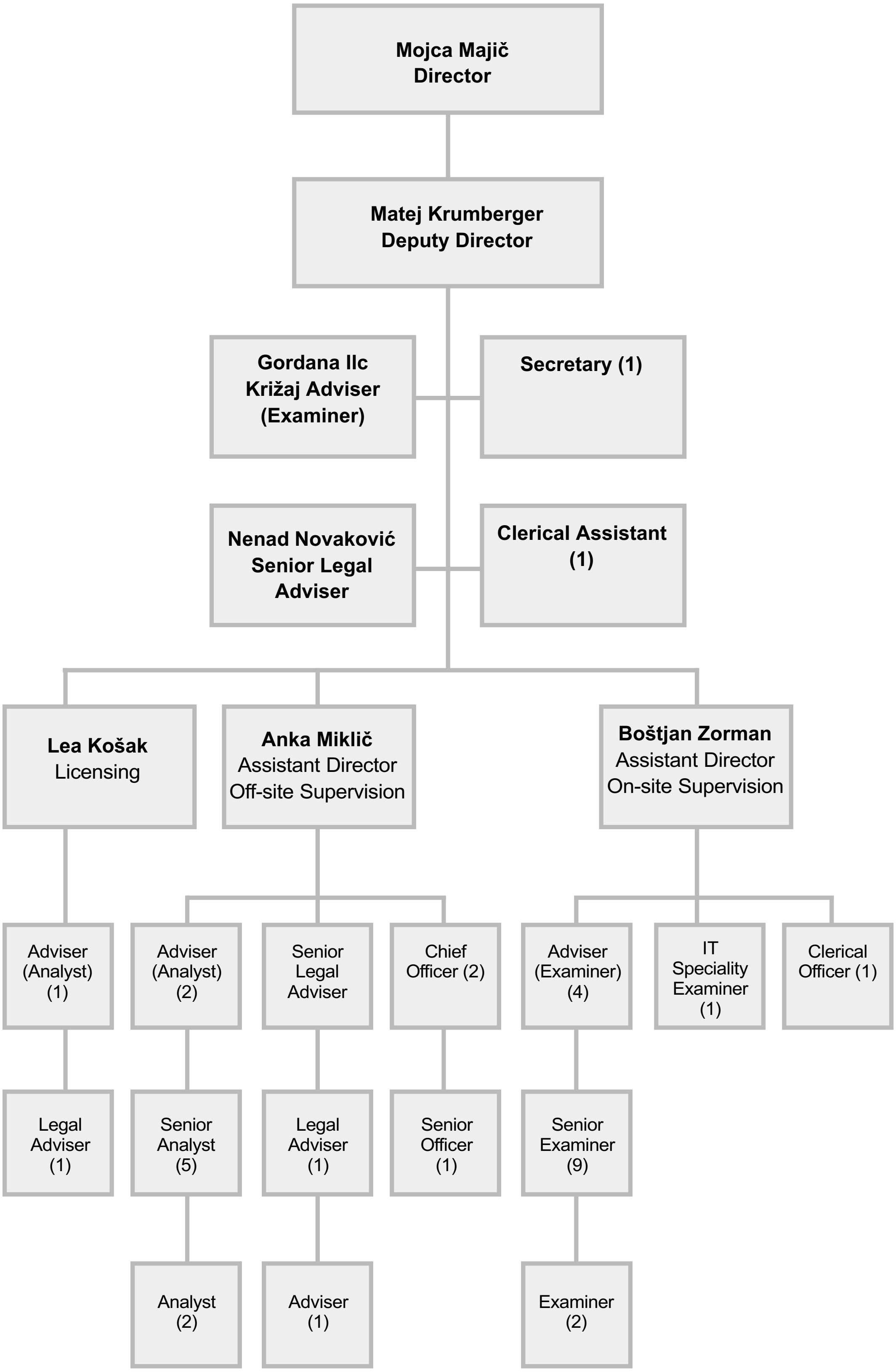
- Licensing
- Off-site supervision of banking operations
- On-site supervision of banking operations

The nucleus of the Banking Supervision Department was a 15-strong staff that increased by the end of June 2000 to 42 people. The breakdown of the headcount at end-June 2000 shows that there were 8 people in the executive and administrative section, 14 employees were working in the off-site supervision section, 17 people were engaged in on-site examinations, and 3 employees handled licensing issues. It is scheduled the number of employees will increase to 45 by the end of 2000.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN THE COURSE OF 1999

Within the framework of negotiations with the European Union with regard to free flow of services, Slovenian negotiation team has proposed two transitional periods for the banking industry. Namely, the position that savings and loan undertakings established prior to the effectiveness of the Banking Act should be granted additional time to comply with capital requirements and to abide by other requirements pertinent to safe and sound banking operations, has been approved. As for the proposal to grant a transitional period for the protection of domestic deposit-guarantee scheme, it is still in the pipeline. There are also two more issues addressed in the Europe Agreement that still have to be fully aligned with European directives: the principle of single banking license and the home country control principle. It has been agreed to implement these two principles as of the date of Slovenia's full-fledged membership.

Organisational Structure Of The Bank Supervision Department
As At 30 June 2000



BANKA SLOVENIJE

STATISTICAL TABLES

Number of Credit Institutions[1] (at year-ends)

Type of financial institution	1997	1998	1999
Banks (operating banks)	28	24	25
Savings banks	6	6	6
Savings and loan undertakings	70	70	68
Credit institutions, supervised by the Bank of Slovenia	**34**	**30**	**31**

Ownership Structure of Banks in 1999 on the Basis of Shareholders' Equity (%) (at year-end)

	Banks
State ownership	41.4[2]
Other domestic ownership	47.3
Domestic ownership total	88.7
Foreign ownership	11.3
Banks, total	**100.0**

Ownership Structure of Banks on the Basis of Shareholders' Equity (%) (at year-ends)

Item	1997	1998	1999
State ownership[1]	34.1	39.2	41.4
Other domestic ownership	54.1	49.6	47.3
Domestic ownership total	88.2	88.8	88.7
Foreign ownership	11.8	11.2	11.3
Banks, total	**100.0**	**100.0**	**100.0**

Distribution of Market Shares in Balance Sheet Total (%)

Type of financial institution	1997	1998	1999
Banks	98.0	97.8	97.9
Savings banks	0.4	0.4	0.4
Savings and loan undertakings	1.6	1.8	1.7
Credit institutions, total	**100.0**	**100.0**	**100.0**

[1] The amount of initial capital for banks is set at SIT 1 billion (approximately EUR 5 million), the amount of initial capital for savings banks and savings and loan undertakings is set at SIT 186 million (approximately EUR 1 million).

[2] State-owned bank property include indirect state holdings. State-owned bank property include indirect state holdings

BANKA SLOVENIJE

The Structure of Assets and Liabilities of the banking system in 1999 (%) (at year-end)

Assets	1997	1998	1999
Cash and balances with CB	3.7	3.6	3.3
Loans to banks	10.6	9.7	9.4
Loans to customers	42.7	47.2	51.7
Securities	34.1	30.4	26.4
Other assets	9.0	9.2	9.3

Liabilities	1997	1998	1999
Deposits from banks	10.1	9.5	11.5
Deposits from customers	69.8	71.0	69.2
Liabilities from securities	2.6	2.5	1.7
Capital and subordinated liabilities	11.3	10.9	11.4
Other liabilities	6.2	6.2	6.3

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

Type of credit institution	1997	1998	1999
Banks	18.9	21.4	21.2
Savings banks	0.5	1.0	0.8

Solvency Ratio of Credit Institutions

Type of credit institution	1997	1998	1999
Banks, average	19.0	16.0	14.0
Savings banks, average	14.5	13.4	14.4

Asset Portfolio Quality of the Banking System

in millions of Tolars

Asset Classification	1997	1998	1999
– A	2,067,463	2,442,371	2,751,937
– B	100,241	137,094	196,315
– C	53,040	56,335	63,123
– D	40,352	50,155	46,511
– E	32,885	41,023	51,794
Classified Total	**2,293,981**	**2,726,978**	**3,109,680**
Specific Reserves	**91,285**	**104,885**	**136,835**

The Structure of Deposits and Loans in 1999 (%)

(at year-end)

	Deposits	Loans
Households	55.6	31.0
Government sector	11.2	9.0
Corporate	21.3	56.0
Foreign	2.6	1.5
Other	9.4	2.6
Total	**100.0**	**100.0**

BANKA SLOVENIJE

The Structure of Deposits and Loans by time at year-end in 1999 (%)

Maturity of Deposits		Loans	
At sight	34.9	Long term loans	42.8
Within one year	56.8	Medium-term loans	
Over one year	8.4	Short-term loans	57.2
Total	**100.0**	**Total**	**100.0**

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

Type of credit institution	FOREX Assets/Total Assets			FOREX Liabilities/Total Liabilities		
	1997	**1998**	**1999**	**1997**	**1998**	**1999**
Banks	32.2	29.7	30.2	34.1	30.6	31.2
Savings banks	0.8	0.2	0.1	0.0	0.0	0.0

Structure of Revenues and Expenditures of Banks in 1999

	Amount (in millions of Tolars)			Nominal growth (%)		
	1997	**1998**	**1999**	**97/96**	**98/97**	**99/98**
Net interest income	84,512	90,153	94,770	2.2	6.7	5.1
Net fees and commissions	26,923	30,206	33,726	14.0	12.2	11.7
Net financial operations	7,462	6,691	9,541	-942.0	-10.3	42.6
Net other	-7,650	-5,162	-4,183	40.3	-32.5	-19.0
Gross income	**111,248**	**121,888**	**133,854**	**11.3**	**9.6**	**9.8**
Operating expenses	67,921	77,106	87,318	16.8	13.5	13.2
- labour costs	35,361	38,343	43,701	11.0	8.4	14.0
Net income	**43,327**	**44,782**	**46,536**	**3.6**	**3.4**	**3.9**
Net provisions and write-offs	-22,240	-18,806	-26,401	-5.3	-15.4	40.4
Profit before taxation	**21,087**	**25,976**	**20,134**	**15.0**	**23.2**	**-22.5**

Structure of Registered Capital and Own Funds of Credit Institutions in 1999

Type of the financial institutions	Registered Capital	/Total assets	Own Funds	/Total Liab.
	USD	**%**	**USD**	**%**
Banks	298,6	2.2	1,092,2	8.0
Savings banks	2,9	5.2	6,4	11.4

Main BSCEE Group events of the year 1999

12th Conference of the Group

The annual Conference of BSCEE was hosted by Slovenia and held in Ljubljana on September 20-21, 1999. Representatives from almost all member states attended and many lectures were presented as a part of the agenda of the Conference by speakers, from the Basle Committee, the FSI, the European Commission, The Contact Group of EU Supervisory Authorities, member countries, and banking supervisory authorities outside the Group. The Conference was held in autumn – differently from the usual timing– because a Leaders' Meeting was held in February. (Since these events were similar to each other and the participants were about the same, the Conference was postponed, but in the future it will be held on the basis of the earlier practice in spring. (The 13th BSCEE Conference will be held in may, 2000, in Prague.)

Subsequent to the presentations and their discussions in the framework of the tour the table the representatives of the member countries reported on the developments in the domestic implementation of Core Principles, and on their experience of BSCEE member countries in cooperation with other countries on bilateral basis, furthermore on the New Capital Adequacy Framework.

Chairman of the Conference: Samo Nucic
Deputy Governor, Bank of Slovenia

Topics discussed:

- Recent developments in the Slovenian banking system
- New secondary legislation arising from the Law on Banking in Slovenia
- Implementation of the Core Principles for Effective Banking Supervision
- Linking On-site and Off-site Supervision Activities in Poland
- Bilateral co-operation among EU banking supervisory authorities
- Bilateral co-operation with countries outside the Community
- Memorandum of Understanding between home and host countries supervisors
- Experience of BSCEE member countries in co-operation with countries on bilateral basis
- Supervision of US banks in UK
- New Capital Adequacy Framework
- Y2K workshop for BSCEE countries
- Activities of the BSCEE Secretariat

Speakers:

- Charles Freeland (Deputy Secretary General, Basle Committee)
- Frederik C. Musch (Associate Director, Financial Stability Institute)

- James Gianetto (National Bank Examiner, Comptroller of the Currency, London Office)
- Dr. Giuseppe Godano (Director, Bank of Italy)
- Luis Garcia Collados (Principal Administrator, European Commission, Brussels)
- Mojca Majic (Director of Banking Supervision Department, Bank of Slovenia)
- Matej Krumberger, Deputy Director of Banking Supervision Department, Bank of Slovenia)
- Pavel Racocha (Chief Executive Director, Czech National Bank)
- Piotr Bednarski (Chief Specialist in on site Examination Division, General Inspectorate of Banking Supervision, National Bank of Poland)
- László Seregdi (Deputy Head of Department, Hungarian Banking an Capital Market Supervision)
- Éva Vincze (Senior Coordinator of the Secretariat of BSCEE)

Conclusions:

- Free movement of capital, goods and services as well as the process of globalization are affecting the financial stability in all the countries of the world. Banking supervisors should contribute to the development of the culture of stability in their countries.
- The Core Principles as a global standard for effective banking supervision (a »bible« for supervisors) are a support for all supervisors to do a better job and also an important political statement. Development of a sound legal structure is a prerequisite to implementation of the principles, but has to be supported by development of a credit culture and supervisory powers to bring about timely corrective actions.
- Self-assessment of the level of compliance with the principles is the first step on the path to their implementation and a way to identify weaknesses in existing supervisory methods and regulatory framework.
- Results of the questionnaire on the compliance with the Core Principles in the CEE countries have shown the most problematic areas for the region's supervisors: consolidated supervision, regulation and supervision of market risks, cross border supervision, exchange of information, harmonization of accounting standards and practices.
- Supervision is cooperation. This is becoming more and more important in the world of globalization and internationalization. Cooperation between supervisors from different countries may take different forms; from the formal collaboration based on bilateral agreements (such as MOUs) to informal personal contacts, which are in the majority opinion of vital importance.
- In establishing relationships with our supervisory colleagues from countries with a longer supervisory tradition, the CEE's supervisors should take the initiative and convince their counterparties to be equal, serious and reliable partners.
- CEE countries are invited to send the comments regarding the consultative paper on the New Capital Adequacy Framework to the Basle Committee. The Committee will take into account all the comments before issuing a more definitive paper covering the complete framework.
- The member countries shall by the means of questionnaire, which will be submitted, to them by the Secretariat of the BSCEE decide on the issue of providing the Russian interpretation of the workshops and seminars, which are conducted in English. Interpretations into Russian language, if decided to be necessary, could be sponsored from the yearly contributions of the member states. Alternatively the costs should be covered by the host country.

Represented member countries: Republic of Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Poland, Romania, Russia, Slovenia, Slovakia and Ukraine

Leaders' Meeting

According to the decision made on the Leaders' Meeting during the 10th International Banking Supervisor Conference the following Leaders meeting was organized in Warsaw on 17-20, February 1999. Unlike from BSCEE Conferences which are prestige events summarizing activity of member countries in the area of supervision, the idea of the Leaders meeting was to establish basis for working exchange of views, sharing information, and discussion about issues of mutual interest. The following topics were discussed, but no concrete decisions were made. The meeting was chaired by Ewa Sleszynska-Charewicz, General Inspector of Banking Supervision, National Bank of Poland.

Topics discussed:

- Consolidated Supervision
  - Supervision of subsidiaries and affiliates of banks (non-banking firms: leasing, insurance, brokerage houses, non-financial companies)
  - Supervision of domestic banks branches abroad (cross border supervision)
  - Off-site supervision (consolidation of financial statements), supervision of the consolidated risk profile (on-site examination within the banking group),
  - Legal protection of banking supervisors,
- Strategic Issues for Banking Supervision
  - Merger or cooperation between banking supervision and other financial market supervisory agencies (capital, insurance, pension funds, leasing companies and brokerage houses markets): pros and cons; the Group member countries experiences,
  - Partnership negotiations with the European Union, challenges and progress in banking and banking supervision, the Group member countries experiences,
  - Year 2000 problem in the banking system
  - Foreign investors share in the domestic banking sector: discussion on the experiences of countries in our region and the solutions in the European Union.
  - Globalization of the financial market
- Framework of cooperation between BSCEE countries
  - Exchange of banking legislation (regulations, banking law, drafts of regulations).
  - Discussion on possibility of concluding Memorandum of Understanding with home country and host country supervisors.

Represented member countries: Albania, Bulgaria, Croatia, Czech Republic, Estonia, Latvia, Lithuania, Macedonia, Poland, Russia, Romania, Slovakia, Slovenia, Ukraine.

Workshop on Y2K – May 11-12, 1999, Basle

The Basle Committee has established a task force to coordinate supervisory efforts with a view to ensuring that banks prepare to meet the challenges posed by the Year 2000 date change. This task force has created a small team to lead workshops on this issue for bank supervisors within different regions of the world. These workshops are targeted at bank supervisors who are responsible for the Year 2000 compliance program.

They contain elements focussing on examination, assessment, testing and contingency planning. Thus the organizer of this workshop was the Basle Committee in cooperation with the Secretariat and delegates participated only from seven member countries of the Group. The discussion leaders were Charles A. Freeland, Deputy Secretary General at the Basle Committee and Pietro Franchini from the Bank of Italy.

Topics discussed:

- Brief review of Year 2000 issues in their own countries within the Group
- The Year 2000 IT Project at the BIS
- Ongoing Supervisory Initiatives in dealing with Y2K
- Beyond Compliance Monitoring – Supervisory Approaches in Dealing with Non-Compliant banks and Financial Institutions
- The Testing Phase
- Contingency Planning and the Challenges Ahead (discussions)

Speakers:

- Charles A. Freeland (Deputy Secretary General, Basle Committee)
- Christian Rime, Y2K IT Project Manager for the BIS
- Andi Klöfer (Deutsche Bundesbank, Member of the Y2K Task Force of the Basle Committee
- Johanne C. Prevost (Secretariat for the Y2K Task Force)
- Yves Carlier

Represented member countries: Albania, Croatia, Czech Republic, Lithuania, Poland, Russia, and Slovakia

Capital Adequacy Implementation Workshop – September 27-28, 1999, Prague

The Czech National Bank organized a workshop for banking supervisors of Central and Eastern European countries focusing on the new capital adequacy incorporating market risk. The objective of the workshop was to gain an understanding of the level of implementation of European Union directives and Basle Committee suggestions in transforming countries. The discussions were lead by Pavel Vacek.

Speakers:

Petr Stanek (Czech National Bank)
Josef Milek (Czech National Bank)
Jaroslava Bauerova (Czech National Bank)
Roland Raskopf (Financial Stability Institute)
Petr Kriz, (Chamber of Auditors)
Ota Hora (Chamber of Auditors)
Karel Kafka (Komercni Banka, Banking Association)

Topics discussed:

- The level of CAD implementation in Central and Eastern Europe
- Presentation of Czech National Bank CAD provision
- Provision Implementation Monitoring

- Presentations of the member countries on the New Capital Adequacy Framework
- The New Capital Accord
- The Standard Method for Market Risk and Modeling Techniques
- New Capital Adequacy Rules, Challenges and Benefit for auditor
- Application of the New CNB Capital Adequacy Methodology in Komercni Banka

Conclusions:

- The majority of the participating member countries have already begun work on amending their capital adequacy provision or on a totally new provision.
- None of the participating countries has implemented the new regulation so far. Just two countries from the region have declared implementation of this regulation. Those countries are Estonia and Moldavia, which unfortunately were not present at the workshop.
- In six countries, the new regulation will enter into force during the year 2000. The relevant provision has already been prepared and approved in the Czech Republic and is in approval proceedings in Hungary. A draft for discussion has been prepared in Latvia.
- Supervisory authorities permit the use of internal models for assessment of market risk in five countries (Czech Republic, Estonia, Hungary, Latvia and Lithuania).
- The methods for market risk measurement are quite complicated. The lack of specialists is crucial problem in member countries.
- During the second half of the 1990s, the supervisory authorities in member countries have been occupied primarily with the crises in financial systems. Their main target has been to stabilize the banking sector and to build up basic rules. Capital adequacy incorporating market risk has not been a priority.
- The regulations for banking book credit risk in member countries are broadly compliant with EU directives.
- The member countries associated to the EU that were present at the workshop declare that they will be totally compliant with EU directives before their entry into the EU.
- Workshop participants were informed about the new capital adequacy framework recently prepared by BIS. They appreciated the effort to clarify the area of credit risk, but with regard to the situation in transforming economies they would like to participate in further discussions concerning the new approach to credit risk assessment so that the position of emerging markets in financial markets is not adversely affected.

Represented member countries: Bulgaria, Croatia, Czech Republic, Hungary, Latvia, Lithuania, Macedonia, Russia, Slovakia and Slovenia

„Interest Rate Risk. Regulation and Supervision" - December 2-3, 1999, Warsaw, Poland.

The General Inspectorate of Banking Supervision National Bank of Poland organised a workshop for Banking Supervisors from Central and Easter Europe on "Interest rate risk Regulation and Supervision. The workshop was design for bank supervisors specializing in examining and monitoring of market risk (including interest rate risk) in commercial banks, experienced in the area of market risk assessment, supervisory policy unit staff in charge of market risk regulations (CAD implementation).

The objective of the workshop was to get aquatinted participants with the issue of risk management and supervision of interest rate risk. The workshop address following key issues:

- Interest rate risk in banking and trading book.
  - How far can regulators set up general binding regulatory requirements in the form of quantitative norms for banks? Basle Committee and US approach.
  - Capital Adequacy rules - interest rate risk of trading book (CAD 1993).
  - Capital requirements for interest rate risk in banking book - new capital adequacy framework?
  - Standard measures versus own banks models in measurement of interest rate risk - for calculation of capital expense
- Off-site monitoring and examination of Interest Risk in complex (large) banks.
  - minimum requirement regarding systems and controls, measurement and monitoring systems
  - call report and UBPR - is it possible to use them to monitor off-site interest rate risk
  - VAR models examination
  - assessment of IRR hedging strategy
  - rating of IRR - „S"
- Supervision of interest rate risk in non-complex banks
  - On-site examination of interest rate risk in small and medium banks in Poland.

Represented member countries: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Slovakia and Slovenia

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During the year the Secretariat carried on its regular tasks according to the Agreement of the Group and the Operational Bylaws of the BSCEE Secretariat.

ANNEX

REGULATION AND EXPERIENCES OF BANK LIQUIDATION PROCEDURES IN CENTRAL EASTERN EUROPEAN COUNTRIES

The 13th Conference of the Group of Banking Supervisor from Central and Eastern Europe was held on 22-24 May 2000 in Prague. 16 member countries participated on the event. One of the main topics of the Conference was the regulation and experiences of bank liquidation procedures in central eastern European countries. Mr. Warren Coats, (IMF), Mr. Marc Vereecen (European Commission) and Mr. Karel Gabrhel (Czech National Bank) took a lecture on this issue. All the participant countries gave a report on its own legal, institutional framework and the practical implication and a debate took place on the subject.

After the conference the Secretariat prepared a questionnaire, which was distributed among the member countries. The present Summary was made on the basis of the replies of the member countries of the Group.

* * *

In 2000 a questionnaire was distributed among the institutions engaged in banking supervision in Central Eastern European countries in order to assess the individual countries' experiences in respect of bank liquidations, and to see what rules are in place in the different countries for the efficient implementation of liquidation procedures. The aim of this summary is not to rank the various countries, rather, to offer a useful guide for the further development of regulation and practice by pointing out the similarities and differences, for making decisions about specific issues. For that reason the names of the individual countries are not mentioned in the summary.

The questionnaire was filled out by sixteen countries. It is clear from the answers that liquidation procedures against credit institutions have already been initiated in all of the countries with one exception. Liquidation procedures were launched primarily against commercial banks and credit cooperatives and, essentially, only countries where this sector was inexistent, or did not fall within the competence of the organization responsible for banking supervision, did not report liquidation of cooperatives. Liquidation procedures against specialized credit institutions and branches of foreign banks are relatively rare, yet in certain countries the number of these is also significant. There was a country both in case of commercial banks and credit cooperatives, where the number of liquidation procedures started exceeded one hundred. Altogether it may be concluded that the number of liquidation procedures initiated against credit institutions in Central Eastern European countries in the nineties was large, especially, when compared to developed countries. The large number of liquidation procedures are possibly explainable by the individual countries economic problems, the initial difficulties of launching banking operations, and, on many occasions, the crisis phenomena effecting all countries within the region.

Of the sixteen countries that delivered the report four has been unable to conclude any liquidation procedure yet, in case of three only one or two liquidation procedures have been completed, which is a very small number compared to the number of liquidation procedures launched, and there are additional four countries where the ratio of started and finished liquidation procedures is below fifty percent. This also shows that the regions' countries face serious difficulties conducting liquidation procedures, they take a long time, and are completed late.

Several countries could not respond to the question about the average length of liquidation procedures, as either they have not completed one yet, or they have completed too few to be able to make a general statement. Of the twelve analyzable answers the average length of completing liquidation procedures was between two to five years in case of twelve counties, while in case of an other three counties more than five years were required. This length of time is to be deemed too long under any circumstances, especially, if considered the high rate of inflation in these countries, as deposit holders suffer substantial losses as a result of the lengthy liquidation procedures. Therefore, regulatory and practical changes that would help accelerating the completion of liquidation procedures appear to be essential.

Figures of the shortest and longest liquidation procedures suggest a contradictory picture. The shortest liquidation procedure was completed within one year in case of seven of the twelve respondents. Thus demonstrates the in a good part of these countries there have already been cases of quickly implemented liquidation procedures, which could definitely be viewed as positive development. However, the lengthiest liquidation procedure took more than five years similarly in case of seven countries, while it exceeded two years for another four countries.

The collected answers reveal that the majority (10) of the countries has adopted special rules for the liquidation of credit institutions, while the minority of the countries (6) applies the general rules of liquidation procedures. Looking at the relationship between the application of special liquidation rules and actual practices, two connections can be established:

- Primarily those countries employ special rules, where the occurrence of liquidation procedures is frequent, and those countries do not employ special rules, where the occurrence of liquidation procedures is less frequent.
- The countries that do employ special rules for the liquidation procedures of credit institutions are generally in a better position with respect to the proportion of completed liquidation procedures, and their average length, than the countries, that do not employ liquidation rules different from the general scheme.

In almost half of the responding countries there are no restrictions on who may initiate a liquidation procedure against a credit institution. In case of the rest of the respondents only the supervisory authority may initiate stating a liquidation procedure, however, in some cases the rules also allow the credit institutions to submit an application for liquidation.

The situation is similarly complex with respect to who may decide about launching a liquidation procedure. In most countries the courts are in charge, yet in several countries the supervisory authority also has that authority. There are three countries where explicitly the supervisory authority is responsible for deciding about liquidation procedures. It is typical of most countries' practices that several types of liquidation schemes exist, and the type of procedure employed also depends on who decides about launching the liquidation procedure. About half of the countries offers the opportunity to the management or the owners of credit institutions to decide by themselves about the launch of the liquidation (final settlement of accounts).

An appeal may be submitted against the decision to start the liquidation procedure in all but two countries, however, normally in these countries the appeal does not have a delaying force.

In the majority of the countries the supervisory authority does have an influence on who should be appointed by the court as liquidator, with the exception of three countries. Nevertheless, there is only one country, where the supervision appoints the liquidator itself, in all the other countries the supervision may either make a proposal, or comment on the court's decision.

It is a general practice that liquidation procedures may only be conducted by a person recommended or accepted by the supervision. In two of the countries separate institutions have been set up for the liquidation of credit institutions.

In all but two countries there are control mechanisms in place for oversee the liquidator's work. The means are rather varied, there is no standard practice. The respondents identified the following methods:

- regular, normally monthly reports sent by the liquidator to the supervising authority or the court;
- the liquidator prepares a report on the entire duration of the liquidation procedure for the supervising authority or the court;
- the liquidator must prepare a preliminary plan concerning the liquidation procedure, which is approved by the court and later compared to the final report;
- the supervisory board's function is maintained during the time of the liquidation and it supervises either the liquidator of the bankruptcy trustee instead of the bank's management;
- in certain countries the credit committee is given additional control functions in case of deposit insurance or bankruptcy procedures.

Deposit insurance institutions play a role either in liquidation or in bankruptcy procedures in very few countries. For the most part deposit insurers participate in the liquidation procedure only as one of the lenders, and are not given any special opportunity for preliminary intervention. In about half of the responding countries deposit insurers are included in the seniority, and when they are, they are normally in the beginning of the list.

It is not typical of the region's countries to employ some sort of netting or imputation system, such a procedure is feasible in very few countries and only under rather restricted circumstances.

In two-thirds of the countries the liquidator has the power to annul deals made before the launch of the liquidation procedure or contracts that put one of the contracting parties in a significantly more favorable position than the other clients. In several countries this is not done by the liquidator alone, rather he has the right to ask the court to cancel the given deal. The investigable period is rather varied in the countries, it is between six months and ten years, but generally around one year.

In the majority of the countries neither the deposit holders, nor the creditors have an interest organization that would expressly represent the deposit holders, or the creditors. In the course of bankruptcy procedures this normally becomes possible only when creditors may elect their own representatives, and act jointly and more efficiently in order to defend their interests. However, this option is only available in a few countries during liquidation procedures.

There are only four countries, where there is some degree of limitation on the costs of the liquidation procedure. For the most part this limit is manifested in that a preliminary plan must be prepared for the implementation of the liquidation procedure, and the expected costs of the liquidation must be indicated in that plan. The plan may only be approved by the court or the party who initiated the liquidation procedure, and discrepancies from the planned expenditures are allowed only when specially justified. There are countries, where the cost of liquidation is determined in terms of the percentage of collected debts, or in terms of the incomes of senior officers.

During the liquidation procedure normally credit institutions cannot engage in any sort of financial services any longer, or if they can, permitted activities are only those that serve closing its businesses and completing the liquidation procedure itself.

The supervisory authorities have to right to stop credit institutions making any sort of payments in all but four countries.

Evaluating the collected responses in general we may conclude that there are relatively few common features in the regulation and practice of liquidation procedures among the countries in the region. Individual countries have reached different levels of development in regulation, and, for the time being, too many general conclusions cannot be drawn.