BSCEE Review 2021

Albania
Croatia
Latvia
Romania
Armenia
Czech Republic
Lithuania
Serbia
Austria
Estonia
North Macedonia
Slovakia
Belarus
Georgia
Moldova
Slovenia
Bosnia and Herzegovina
Hungary
Montenegro
Turkey
Bulgaria
Kazakhstan
Poland
Ukraine

Introduction

The Group of Banking Supervisors from Central and Eastern Europe (the BSCEE Group) was established in 1991. The Agreement of the BSCEE Group was signed during the Stockholm International Conference of Banking Supervisors (ICBS) in 1996. The BSCEE Group operates according to its Agreement and the Operational bylaws that determine its organizational structure and the rules governing its operations. At the time of publishing the report, the BSCEE Group comprised twenty five Member Institutions from twenty four member countries: Albania, Armenia, Austria, Republic of Belarus, Bosnia and Herzegovina (Federation of Bosnia and Herzegovina, Republika Srpska), Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Latvia, Lithuania, North Macedonia, Moldova, Montenegro, Poland, Romania, Serbia, Slovakia, Slovenia, Turkey and the Ukraine.

The Chairmanship of the BSCEE Group rotates on an annual basis. In 2021 Mr Mukhtar Bubeyev, Chief Executive Officer of the Astana Financial Services Authority (AFSA) chaired the Group. Since January 2006 the Secretariat of the Group has been located in Poland, with the Polish Financial Supervision Authority (UKNF).

Given the COVID-19 pandemic, the 2021 BSCEE Members' Conference was held fully virtual in May. Also in May 2021, the BSCEE co-organised the virtual 'BCBS-BSCEE-FSI Europe high-level meeting on banking supervision' which was a valuable platform on exchange of views on some key supervisory and regulatory issues. At the initiative of the BSCEE Chairman, two virtual thematic workshop were held in 2021, dedicated to the COVID-19 impact on the banking sector (September 2021) and climate-related financial risks (November 2021).

This Annual Report intends to provide in-depth information reflecting the mission of the BSCEE Group in a detailed and accurate manner regarding the banking sectors of the Member Institutions. We hope that you will find this publication informative and useful. We are certain that this will help you become acquainted with the supervisory an regulatory activities of the Group's members in the Central and Eastern European region.

BSCEE Secretariat

Contents

Macroeconomic environment

The Albanian economy has recovered strongly from the COVID-19-induced recession in 2020. Following a contraction of 3.5% in 2020, real GDP strongly rebounded by 8.5% in 2021 recovering to well above pre-pandemic levels by the second quarter of 2021. The recovery was broad based across sectors and demand components. The recovery of domestic demand was driven by both household consumption and investments. The latter embodied a continued monetary and fiscal policy support, including public investment thrown to the reconstruction process post 2019 earthquake, as well as reduced restrictions to movement and improved consumer and business confidence. A strong demand from countries in the region boosted tourism and increased the export of services, while the better foreign demand and high commodity prices have contributed to higher commodity exports

Labor market has improved, with unemployment rate dropping to 11.4% from 11.8% in 2020, and employment expanding. A tighter labor market has exerted upward pressures on wages especially in the private sector, which have been increasing throughout 2021.

The external position of the economy has improved, though rising import prices have led to an increase in the current account deficit in last quarter of the year. The current account deficit shrunk to 7.7% of GDP from 8.7% in 2020, as export flows, particularly tourism, rebounding strongly, and with commodity exports and remittances contributing to the narrowing of the deficit. The current account deficit continues to be financed mostly through FDIs, which averaged around 6.7% of GDP in 2021. International reserves have remained broadly stable and at optimal levels.

Inflation has been increasing starting from the second half of 2021, reaching 3.7% in December. The pick-up of headline inflation was largely due the rapid increase of commodity and food prices in the international market. On the other hand, the underlying pressures were increasing more gradually, amidst strong demand and a tightening labor market.

The strong fiscal response, accommodative monetary policy and prudential policies have been key to fostering the recovery.

Overall financial conditions have been favorable and credit flows have continued to support the domestic demand. Financial markets have been calm, interest rates have remained at low levels, and the exchange rate was relatively stable. The demand for loans was high, while the balance sheets of the banking sector have remained solid. Banks have continued to allocate funds towards financing the needs of both business and households.

Financial stability has been preserved. The Albanian banking sector has remained solid, solvent and liquid. Based on stress testing exercises, the exposure of banks towards risks was contained. Credit risk has declined further, with non-performing loans ratio standing at 5.65% at the end of 2021.

Overall, growth drivers are sound creating as such the appropriate preconditions for continued growth going forward. The expansion of economic activity will continue to be underpinned by sound balance sheets of the households and businesses, positive labor market outcomes and solid credit growth.

Development in the banking system (including the assets total / GDP)

As at the end of 2021, the structure of the banking and financial system in Albania consisted of 12 banks, 35 non-bank financial institutions (NBFIs), 556 foreign exchange bureaus, 16 Savings and Loan Associations (SLAs) and 1 Union of SLAs.

During 2021, banking system assets grew by around ALL 192.97 billion or 12.21%, compared to the ALL 105.27 billion or 7.13% growth a year earlier. The loan portfolio increased by ALL 62.12 billion, or 10.28% during this year.

The banking system's share in the economy, measured by the ratio of total assets to the Gross Domestic Product (GDP), continued to remain at high levels, even though, in 2021, the indicator has been decreasing by 4.51 p.p. to of 93.84%. Meanwhile, the loan to Gross Domestic Product ratio fell due to the growth of GDP against the increase in the loan portfolio.

The most important indicator of supervision, the capital adequacy ratio (CAR), at the end of 2021, stood at 18.02%[1]. This ratio shows a fall of 0.30 percentage point, compared with the same period in the previous year.

As at end of 2021, the non-performing loans ratio (NPLR) dropped by 2.46 percentage points, in annual terms, to 5.65%. At the end of 2021, the non- performing loans reached at ALL 37.9 billion. Meanwhile, the loan portfolio increased by ALL 62.12 billion, or 10.28% during this year.

Profitability indicators, Return on Average Assets (RoAA) and Return on Average Equity (RoAE), respectively, increased compared with 2020. At the end of 2021, RoAA stood at 1.31% while RoAE stood at 12.89% from 1.10% and 10.41%, respectively at the end of 2020.

The following are banking system highlights for 2021

1. Net outstanding non-performing loans to total credit portfolio ratio stood at 1.8%, down by 1.05 percentage points compared with December 2020;
2. The non-performing loans ratio (NPLR) dropped by 2.46 percentage points in annual terms, to 5.65 % at the end of 2021.
3. Provisioning of NPLs was 68.6%, from 65.2% a year earlier.
4. The liquidity continuously appeared significantly above the regulatory requirement laid down in the Bank of Albania's regulatory acts. In December 2021, liquid assets ratio to short-term liabilities in the banking system was 45.4%[2], down by 2 percentage point from the previous year.
5. Liquidity coverage ratio stood at 391% form the regulatory limit of 100%. This ratio started to be reported in March 2020.
6. In December 2021, total value of deposits in the system amounted ALL 1.433 billion, recording 10.25% annual growth from the previous year. The share of the domestic currency in total deposits decreased to 41.1%, from 49.5% in ember 2020;
7. At the end of 2021 the capital adequacy ratio – the main supervision indicator – was reported at 18.02%, slightly down by 0.30 percentage point, compared with the same period in the previous year.
8. The banking system's profit was positive in 2021, at ALL 21.63 billion or ALL 5.13 billion higher than in 2020.

[1] Data for 2021 in this this Report may be different from those reported in the Annual Supervision Report 2021, due to the corrections of the data reported from banks and other licensed entities, as a result of the auditing processes which drive to the correctness of calculations

[2] The minimum required level for this indicator, as laid down by the regulatory requirements, is 20%.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in Albania

The drafting of new bylaws and the review of the regulatory framework in force, through the approximation with the EU directive, or in compliance with legal requirements, aims at completing and improving this framework, with the focus in accomplishing a more effective supervision on banks and other financial entities being licensed and supervised by the Bank of Albania.

In 2021, special attention was paid to the drafting of the regulatory framework pursuant to the Law 55/2020 "On Payment Services". This regulatory framework aims at meeting and detailing the requirements of the Law 55/2020, while its drafting is based on the EU Acquis and the European Banking Authority (EBA) guidelines. In this light, the revision of the implemented regulatory acts was carried for the implementation of the commitment of the Bank of Albania for the alignment of the regulatory framework with the Basel III requirements.

Also, part of the regulatory amendments approved during 2021 took into consideration the situation created during the year by the COVID-19 pandemic and its effects on the economy of Albania.

The new regulatory acts approved, as well as those revised during 2021, are listed in details below.

I. Pursuant to the Law 55/2020 "On payment services:

- Approval of the new Regulation "On licensing payment institutions and electronic money institutions, as well as registering payment services providers" (adopted with Decision No. 59, dated 24.11.2021 of the Supervisory Council of the Bank of Albania)
- Approval of amendments to the Regulation "On licensing and activity of non-bank financial institutions" (adopted with Decision No 60, dated 24.11.2021 of the Supervisory Council of the Bank of Albania)
- Approval of amendments to the Regulation "On licensing and carrying out the activity of banks and branches of foreign banks in the Republic of Albania" (adopted with Decision No. 61, dated 24.11.2021 of the Supervisory Council of the Bank of Albania)
- Approval of amendments to the Regulation "On licensing and activity of savings and loan associations (SLAs) and their Unions" (adopted with Decision No. 62, dated 24.11.2021 of the Supervisory Council of the Bank of Albania)
- Approval of amendments to the Regulation "On minimum security requirements regarding premises where banking and financial activities are conducted and transportation of monetary values" (adopted with Decision No. 63, dated 24.11.2021 of the Supervisory Council of the Bank of Albania)

II. In the framework of further alignment with the EU Acquis and the best European practices.

- Approval of amendments to the Regulation "On the net stable funding ratio of banks", (adopted with Decision No. 45, dated 1.9.2021 of the Supervisory Council of the Bank of Albania)
- Approval of one amendment to the Regulation "On liquidity coverage ratio", (adopted with Decision No. 46, dated 1.9.2021 of the Supervisory Council of the Bank of Albania)
- Approval of amendments to the Regulation "On consumer credit and mortgage credit" (adopted with Decision no. 47, dated 1.9.2021 of the Supervisory Council of the Bank of Albania)
- Approval of amendments to the Regulation "On the functioning of Credit Registry at the Bank of Albania, and the conditions and procedures on the information, use and revision of data being administered in

this Registry", (adopted with Decision No. 48, dated 1.9.2021 of the Supervisory Council of the Bank of Albania)
- Approval of amendments to the Regulation "On transparency for banking and financial products and services", (adopted with Decision No. 64, dated 24.11.2021 of the Supervisory Council of the Bank of Albania)
- Approval of the new Guideline "On the Internal Capital Adequacy Assessment Process (ICAAP)", (adopted with Decision No. 2, dated 1.12.2021 of the Supervisory Council of the Bank of Albania)
- Amendments to the Regulation "On capital adequacy ratio" (adopted with Decision No. 68, dated 22.12.2021 of the Supervisory Council of the Bank of Albania)

III. In the framework of the measures taken due to the COVID-19 situation, the following were approved:

- Approval of the Decision "On the suspension of profit distribution from Banks", adopted with Decision No. 4 dated 13.1.2021 of the Supervisory Council of the Bank of Albania.
- Approval of an amendment to the Regulation "On credit risk management in banks and branches of foreign banks" (adopted with Decision No. 5, dated 13.01.2021 of the Supervisory Council of the Bank of Albania)
- Approval of the extended effective date until 1 January 2022, of the amendments approved in September 2020 to the Regulation "On risk management from large bank exposures" and to the Regulation "On consolidated supervision", respectively with the Decision No. 6, dated 13.1.2021 and with Decision No. 6, dated 13.1.2021 and Decision No. 41, dated 4.8.2021 of the Supervisory Council of the Bank of Albania.
- Amendments to the Regulation "On capital adequacy ratio", (adopted with circulatory Decision No. 54, dated 9.11.2021 of the Supervisory Council of the Bank of Albania)

Main strategic objectives of the Supervisory Authority in 2022

Through setting priorities, the Supervision Department has sought to address the main identified risks to the supervised entities and the challenges it faces over a year's timeframe.

- Credit risk monitoring through follow-up of NPL management in banks and reaction in timely manner in order to prevent potential piling up;
- Improving supervisory review evaluation process through the revision of the relative assessment methodology;
- Reconsidering starting an equivalence assessment process after the changing of the relative assessment criteria by the European Commission;
- Revising the legislative framework with the purpose harmonizing it the EU framework in the EU accession process.

The activities of the Banking Supervisory Authority

MANAGEMENT OF THE PANDEMIC-RELATED SITUATION

In 2021, banks conducted the financial activity under the effect of the pandemic and the measures undertaken to cope with it. Needs of banks and economic agents, coupled with the uncertainty about the future developments were the main factors that drove the decision-making of the Bank of Albania to extend the regulatory measures in place for managing the situation. These extensions consisted in providing extra time for addressing the classification and provisioning of restructured credit with easier criteria, up until March 2021. The decision-making was also completed by postponing the entry into force of more restrictive regulatory criteria to 1 January 2022, from 1 January 2021.

In order to facilitate the restructuring process, the final deadline of the regulation on the out-of-court treatment of distressed borrowers was extended to 31 December 2021, as the initial deadline was 31 December 2020. In the same vein, the entry into force of the amendments in the Regulation on managing large exposures was postponed to 1 January 2022, initially planned on 1 June 2021.

Once these measures came to an end, special attention was paid to the performance of portfolios through both off-site analyses and on-site examinations, in order to identify possible negative developments with a material impact and to address them in an early stage. The situation management resulted in a stable improvement in the indicators of credit portfolio quality throughout the previous year.

In the framework of the undertaken measures, the Bank of Albania decided to suspend the distribution of dividend of banks' profits up to December 2021, and the generated profits during 2020. This measure was undertaken with a view to create capital sources for banks to cover potential capital requirements in case of negative developments, as a result of the pandemic or its secondary effects.

ASSESSMENT OF THE EQUIVALENCE OF THE ALBANIAN REGULATORY SUPERVISORY FRAMEWORK WITH THE APPLICABLE REQUIREMENTS IN THE EU

Upon receiving the candidate status in June 2014, in the framework of opening the accession negotiations of Albania to the European Union, the Bank of Albania jointly with the other public authorities has been engaged constantly in the approximation of the legislation with the EU Acquis. The regular evaluation reports have continuously highlighted the achieved progress on the implementation of the agenda of reforms in Albania, including the progress achieved by the Bank of Albania in respect of banking supervision and adoption of Capital Accord, known as Basel III.

The main goal of the equivalence assessment of the regulatory and supervisory framework according to the methodology published by the European Banking Authority (EBA) is to provide an effective cross-border cooperation under a prudent approach between the European financial institutions and those in third countries, as the latter aim at fully adhering and adopting the same high standards that are in force within the EU. To this extent, the recognition of equivalence of the regulatory and supervisory framework provides mutual benefits for both the EU and third country financial and banking institutions.

In this context, in 2021, an independent evaluation of the current regulatory framework of supervision was conducted with the technical assistance of the European Bank for Research and Development (EBRD) and PriceWaterhouseCooper (PwC), through the adoption of a comprehensive approach, based on the methodology and the questionnaire drafted by the EBA for this purpose. This analysis, which ended in December 2021, concluded that the procedural and regulatory framework, as well as the supervisory practices, is at a high degree of equivalence and approximation with the applicable standards of the EU countries. This approximation is assessed particularly high in relation to capital requirements, applicable mitigation techniques, large exposures, liquidity, financial leverage, macroprudential supervision, professional secrecy, and international cooperation.

The Bank of Albania (BoA) continues to be entirely dedicated to finalise this process. At the beginning of 2022, the BoA has required the European Commission to consider the evaluation process for Albania in accordance with the European Directive No. 575/2015)

Meanwhile, the collaboration with international partner institutions, as the IBRD, the World Bank, the IMF and other central banks part of the Eurosystem and authorities, like the BSCEE or Vienna Initiative will continue in 2022, to further update the supervisory standards and practices, as well as to improve their effectiveness.

COMPILATION OF THE REGULATORY FRAMEWORK ON PAYMENT SERVICES

Upon the approval of the Law no.55/2020 "On Payment services" and its entry into force in January 2021, the BoA is working on drafting the entire regulatory framework pursuant to this Law. The regulatory framework aims to ensure alignment with the EU Acquis and the best practices of advanced countries, guaranteeing on one hand adherence to the obligations on the approximation of the regulatory and legal framework, and on the other hand, enabling payment services providers and their clients the possibility to adopt the same standards with the EU countries as regards these services.

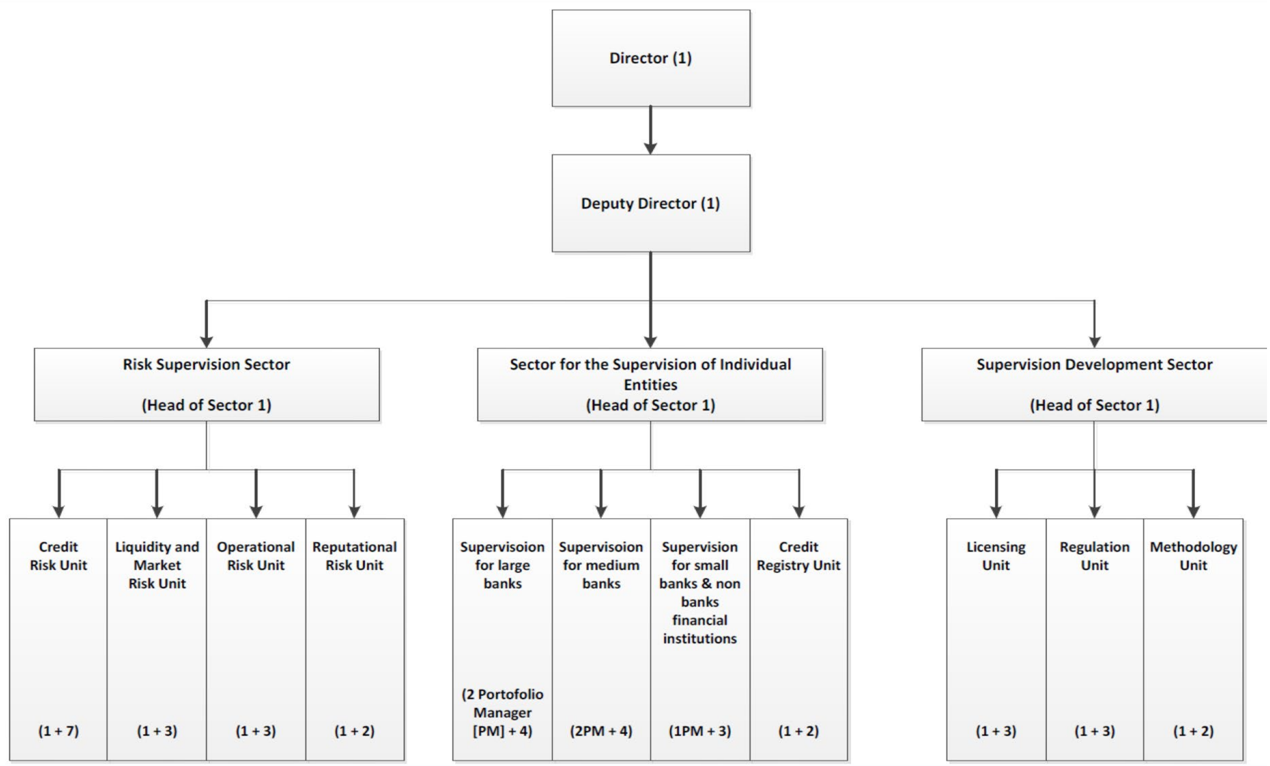
Currently, a substantial part of sub-legal acts has been approved pursuant to the Law "On Payment services," which allow new entities that require licensing as electronic payment institutions or registering as payment service providers that benefit from exceptions according to law stipulations, to commence their activity pursuant to the stipulations laid down in the Law. The other by laws are in the process of discussions and consultations with interested parties (entities and other public institutions).

IMPLEMENTATION OF RECOMMENDATIONS OF THE ASSESSMENT REPORT BY MONEYVAL COMMITTEE AND ICRG/FATF ACTION-PLAN

In the framework of implementing the recommendations from the Committee of Experts of CoE on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL), the Bank of Albania was included in the implementation of the national plan of measures, regarding both technical and effectiveness issues, in order to improve the regulatory framework and strengthen the effectiveness of the supervisory process, with the purpose of addressing the main problems evidenced in the report, whose fulfilment will continue also during 2022. In this framework, a considerable number of on- site examinations have been carried out related to anti-money laundering, particularly focusing on terrorism financing issues and implementation of the international sanctions, especially on non-bank financial institutions and foreign exchange bureaus as vulnerable entities.

Organizational chart of the Banking Supervisory Authority

The organizational structure of the Supervision Department hasn't had any changes during 2021. The last structural change was in 2016.



Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	12	12	12
Branches of foreign credit institutions	0	0	0
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**12**	**12**	**12**

Total assets of banking sector (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	12,117.52*	12,784.69*	14,688.58*
Branches of foreign credit institutions	n/a	n/a	n/a
Cooper ative banks	n/a	n/a	n/a
Banking sector, total:	**12,117.52***	**12,784.69***	**14,688.58***
y/y change (in %)	**2.93%**	**7.22%**	**14.89%**

*The values are in million Euro

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	0	0	0
Domestic ownership total	22.84%	30.58%	31.91%
Foreign ownership	77.16%	69.43%	68.11%
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	57.50	75.06	0.14
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**100.0**	**100.0**	**100.0**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	13.45%	10.65%	12.89%
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**13.45%**	**10.65%**	**12.89%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	100	100	100
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables			
Financial sector	17.98	13.86	17.57
Nonfinancial sector	36.92	36.29	36.34
Government sector	41.30	45.96	44.26
Other assets	3.80	3.89	1.83
Liabilites			
Financial sector	3.60	3.33	3.11
Nonfinancial sector	79.90	80.28	79.42
Government sector	3.26	3.2	3.74
Other liabilities	2.21	2.8	3.8
Capital	**10.45**	**10.39**	**9.91**

Capital adequacy ratio of banks

Type of financial institution	2019**	2020**	2021**
Commercial banks	18.28%	18.70%	18.00%
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**18.28%**	**18.70%**	**18.00%**

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

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

Asset classification	2019	2020	2021
Non-financial sector, including	8.37	8.11	5.65
households	5.19	5.52	4.45
corporate	10.73	9.85	6.63

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:		
Households	80.05	33.29
Corporate	16.81	62.89
Government sector	3.14	3.82
Financial sector (excluding banks)	n/a	n/a
Total	**100.0**	**100.0**

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

P&L account*	2019	2020	2021
Interest income	404.86	414.80	445.44
Interest expenses	67.00	61.63	60.97
Net interest income	277.45	285.51	384.47
Net fee and commission income	84.94	88.39	88.40
Other (not specified above) operating income (net)	178.56	151.06	100.08
Gross income	421.03	391.57	463.06
Administration costs	242.47	240.51	266.40
Depreciation	n/a	n/a	n/a
Provisions	1.76	49.99	21.45
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	n/a	n/a	n/a
Profit (loss) before tax	182.38	159.10	207.43
Net profit (loss)	157.93	136.42	179.15

**The values are in million Euro*

Total own funds in 2021 (in EUR)

Type of financial institution	Total own funds **	Core Tier 1**	Tier 1**	Tier 2**	Tier 3**
Commercial banks	1,455.67	1,299.42	1,299.42	85.26	n/a
Cooperative banks	n/a	n/a	n/a	n/a	n/a
Banking sector, total:	1,455.67	1,299.42	1,299.42	85.26	n/a

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

Macroeconomic environment in the country

The economic growth was restored in Armenia in 2021, after the economic downturn of the previous year. The economic developments of the Republic of Armenia were formed in the conditions of continuous recovery of the world economic activity, growth of the external demand, as well as the maintenance of the high level of the international copper prices. Given the active process of vaccination against COVID-19, as well as avoidance of strict anti-pandemic restrictions, the impact of successive waves of the pandemic on the Armenian economy was weaker. In the conditions of relatively favorable external and internal developments in 2021, the economic growth of Armenia made 5.7%.

In the first half of the year, economic growth was mainly due to the rapid recovery of domestic demand, which was due to the acceleration of private consumption and the reduction of private savings. In the second half of the year, the growth was due to the external demand, which, in its turn was conditioned by the restoration of tourism and the growth of exports.

Development in the banking sector (including assets total / GDP)

As of 31 December 2021, 17 commercial banks operated in Armenia. The banking system continues to play the leading role in the financial system of the Republic of Armenia, accounting for 84.0% share of assets in total. The banking system assets/GDP and loans/GDP ratios decreased by 6.7 and 10.3 percentage points, respectively, to 101.5% and 53.0%. The deposits/GDP ratio decreased less, by 2.0 percentage points to 51.8%.

Profitability of the banking sector decreased in 2021. Return on assets (RoA) and return on equity (RoE) of the banking system dropped by 0.1 and 0.3 percentage points compared to the previous year, totaling 0.9% and 7.1%, respectively.

The capital adequacy of the banking system, constantly above the minimum required level, increased slightly during the year. There is a significant increase in foreign exchange liquidity, which, in addition to the events of 2021, is also explained by the long-term policy of the Central Bank in this direction. In particular, in order to accumulate highly liquid foreign exchange reserves, starting from 2019, a gradual transition was made to FX reserve requirements for funds attracted in FX, and in 2021 new liquidity standards came into force, which are designed to address liquidity risks more accurately.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

a) Changes in the regulatory framework

In 2021, a number of changes were introduced in the framework of financial system regulation:

- From January 1, 2021, new liquidity standards, Liquidity Coverage Ratio and Net Sustainable Financing Ratio, become effective. Works on introduction of these standards were completed in 2020. The standards are designed to more effectively address liquidity risk peculiarities.

- To effectively address the impact of possible risk developments in the real estate market and given the maintained high growth of mortgage loans, the CBA has introduced a Loan-to-value (LTV) ratio requirement, which will be effective from April 1, 2022.
- The regulation on the classification of financial assets/ and the creation of reserves for possible losses was revised and a new regulation was introduced, which entered into force on July 1, 2021 and is in line with the recommendations of the BCBS.
- The CBA also adopted a new policy on international money transfers aimed at curbing the potential risks associated with the transfer of funds and operators of foreign financial systems (for example, in matters of settlement and credit risk). According to the new requirements, banks and financial organizations can carry out international money transfers exclusively through Armenian systems.

The Central Bank also continued working in the following areas to further enhance the regulatory framework of the financial system:

- Extensive work has been done in 2021 to revise the capital adequacy ratio to make it more efficient and in line with the Basel III framework.
- Together with interested state bodies, the CBA continued to work on the development of a legislative package for the development of non-cash payments. The adoption of the legislative package will increase the level of availability of non-cash payments and amenities for citizens, form a culture of implementation of non-cash payments, and expand the possibilities of financial intermediation.
- Activities continued within the framework of the "Capital Market Development Program" approved by the Government of the RA. In particular, in the various working groups formed, efforts were directed to regulating the crowdfunding framework, issuance of municipal bonds, the assessing the compliance of the regulatory landscape with international standards, developing of the money market, automated online registration of collateral of mortgage-backed securities, improving trading systems and other areas.

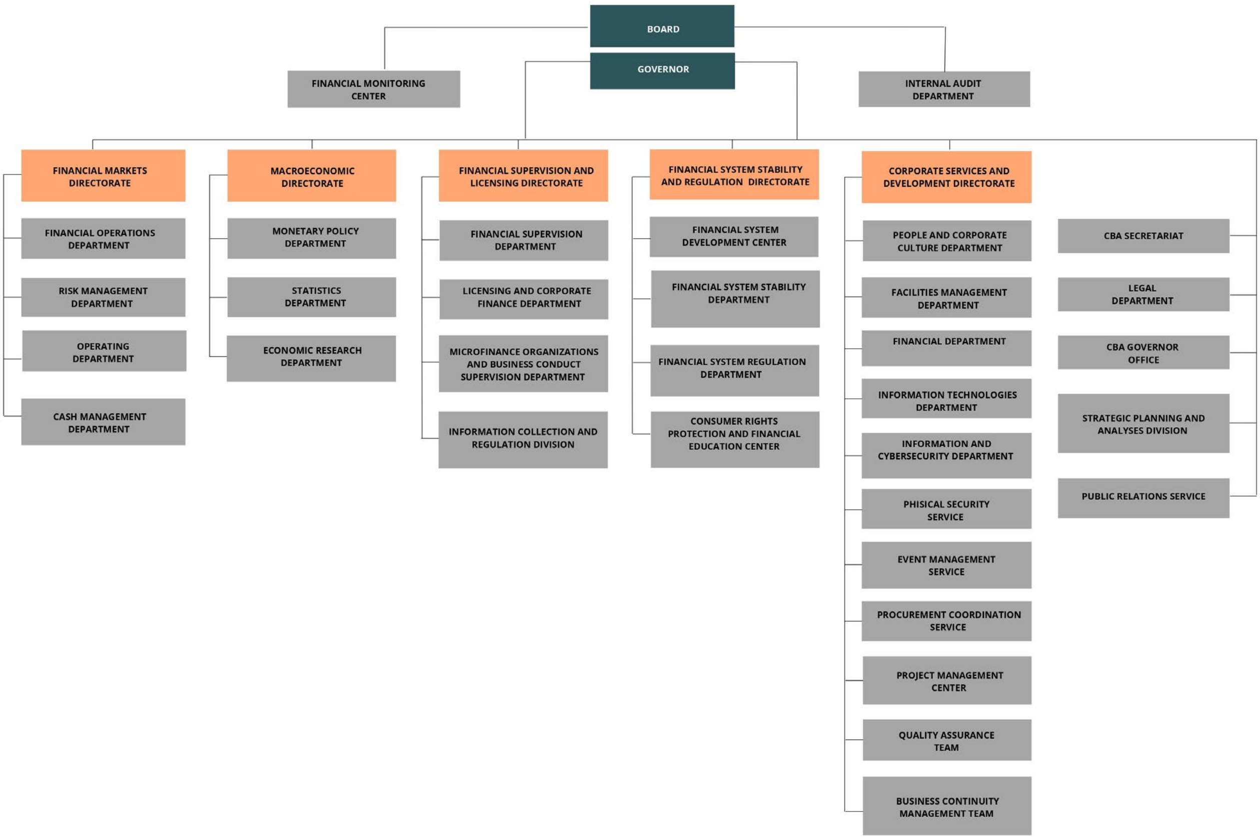
b) Legal competences of the CBA

One of the main objectives of the CBA is to ensure stability and normal activity of the financial system of the Republic of Armenia, including ensuring of necessary conditions for stability, liquidity, solvency and normal activities of the banking system of the Republic of Armenia. According to the Law on the Central Bank of Armenia, in performing the underlying objectives stipulated in the Law, the CBA shall:

- license banks, as well as other entities, in case if envisaged by law, and regulate and supervise activities thereof,
- provide loans to the banks as a last-resort-lender,
- collect, coordinate and analyze information concerning legalization of criminal proceeds and financing of terrorism, exchange and deliver such information to intra-governmental competent authorities and international organizations, and competent authorities of other countries, if stipulated by international agreements of Armenia.

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

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2021

Financial Supervision and Licensing Department (FSLD) is in charge for licensing, on-going prudential supervision and business conduct supervision, systemic assessment of financial risks and resolution of all types of financial institutions in RA in close cooperation with the Financial Monitoring Centre and Financial System Stability and Regulation Department.

The ongoing supervision of financial institutions is aimed at identifying current and expected risks, taking into consideration both the risk of an individual institution, and its impact on the overall financial system and a wide range of consumers.

In 2021, FSLD's main goal was to constantly focus supervisory potential on the riskiest areas and institutions, thereby contributing to improving the overall well-being of the population and strengthening consumer trust in the financial system.

To improve the effectiveness of these processes, FSLD main focus was on:

- Continuous development of internal capabilities and transformation of the range of influence of supervision and licensing so as to make it more modern and effective.
- Development of supervisory tools:
  - Revamping of RBS methodology
  - Implementation of SREP methodology
  - Microprudential stress testing process
  - Business model assessment process
  - ICAAP assessment process
- Communication with external and internal beneficiaries to make our actions and responses to certain situations and risks more transparent and predictable.
- Increasing capacity development of financial institutions, in particular in risk detection, crisis preparedness, as well as ensuring consumer protection to increase confidence in the financial system.

The activities of the Banking Supervisory Authority in 2021

In the aftermath of Covid-19 pandemic and military escalation the objectives of financial supervision have changed dramatically, with priority given to focused analysis and operational monitoring of crisis situations. In this regard, during 2021, a comprehensive assessment of bank recovery plans, strategies and business plans was carried out in order to understand the viability and sustainability of the financial institutions, as well as their recovery capability. The results obtained will be used to develop the capabilities of financial companies in risk mitigation and crisis management, as well as to further optimize and improve the regulatory framework.

The CBA is closely working with banks to ensure they have in place adequate AML/CFT risk identification and mitigation framework, commensurate with international best practice and standards. An active dialogue continued with management of financial institutions to discuss existing challenges and weaknesses and strategies for overcoming them, as well as to assess and identify their ability to overcome crises.

In order to ensure that financial institutions completely recognized consequences of Covid-19 related losses in their balance sheets, ongoing monitoring and assessment of credit risk and adequacy of loan loss reserves was done by FSLD.

To assess the possible impact of macro-financial developments on the prudential indicators and solvency of banks, microeconomic stress tests were developed and communicated to banks.

To further focus on consumer protection, appropriate structural changes were made to separate the function of supervising business conduct from prudential supervision.

In order to ensure a free and fair competitive environment in the financial system, measures were taken to identify and eliminate anti-competitive manifestations, including ensuring the functioning of fair pricing mechanisms in the foreign exchange market and eliminating unfair competition in the field of banking services. Competition conditions in certain financial services markets were examined with a view to introducing or revising relevant regulatory approaches.

International activities of the authority

The Central Bank of Armenia sustained its multilateral and bilateral cooperation with international financial institutions during the year. The CBA is an active member of various international and regional organizations the list of which is presented here.

In the framework of cooperation with the member countries of the EAEU, the staff of the Central Bank conducted online courses for employees of the Central/National banks of these countries on the following topics: International Financial Reporting Standard, Machine Learning, Control of Settlement and Payment Systems and Protection of the Interests of Financial Services Consumers As part of the technical assistance, a five-day training course on the topic "Cash Management" was organized by Jan Binnekamp, an expert of De Nederlandsche Bank. The Toronto Center, together with the CBA, organized a two-week online course on "Climate Risk and Ensuring Financial Stability". Moreover, during 2021, the CBA hosted world-famous experts at Dilijan Training and Research Center who shared their knowledge and experience during the lectures.

As part of the supervisory organization and crisis preparedness, the CBA continued cooperation with the World Bank, the Financial Sector Advisory Center in Vienna (FinSac), which provided technical assistance.

In the context of ensuring the long-term stability of the financial system, the Central Bank attaches great importance to the introduction of sustainable (green) financing standards in the financial system. Thus, in 2021 the CBA formed a working group on green finance. In parallel, international cooperation expanded in particular, in November 2021, the Central Bank became a member of the SBFN platform (Sustainable Banking and Financial Network).

Cooperation with other supervisory bodies in the country

The Central Bank is the sole supervisory body of the financial system of Armenia.

Other relevant information and developments in 2021

In 2021, a new Strategy of the Central Bank was adopted, which, inter alia, identified priorities for the digital transformation of the financial system. Transformation of the system towards digitalization involves, at a minimum, the development of key competencies and capabilities, including issues of technology and risk management. The latter is important, both from the prospective of ensuring financial inclusion and strengthening financial stability.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions
(at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	17	17	17
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**17**	**17**	**17**

Total assets of banking sector
(at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	10,848,309	10,438,046	13,058,211
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**10,848,309**	**10,438,046**	**13,058,211**
y/y change (in %)	**20.4%**	**-3.8%**	**25.1%**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	2.22	2.20	2.02
Domestic ownership total	37.13	37.45	39.16
Foreign ownership	60.65	60.35	58.82
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	42.7%	56.3%	888.9
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**42.7%**	**56.3%**	**888.9**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	10.24%	8.93%	7.07%
Cooperative banks	-	-	-
Banking sector, total:	**10.24%**	**8.93%**	**7.07%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	100	100	100
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables	100	100	100
Financial sector	26.63	23.62	24.89
Nonfinancial sector	58.21	58.14	52.75
Government sector	10.30	12.59	16.16
Other assets	4.86	5.66	6.20
Liabilites	85.87	86.88	87.04
Financial sector	21.5	27.21	26.42
Nonfinancial sector	59.96	54.9	56.24
Government sector	0.67	0.52	0.32
Other liabilities	3.74	4.25	4.07
Capital	**14.14**	**13.13**	**12.96**

Capital adequacy ratio of banks

Type of financial institution	2019	2020	2021
Commercial banks	17.58%	16.93%	17.20%
Cooperative banks	-	-	-
Banking sector, total:	**17.58%**	**16.93%**	**17.20%**

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

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

Asset classification	2019	2020	2021
Non-financial sector, including	5.51%	6.55%	3.52%
households	6.03%	9.84%	5.12%
corporate	5.92%	5.63%	3.87%

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	43.72	42.15
Households	26.62	20.85
Corporate	17.10	21.29
Government sector	0.27	13.05
Financial sector (excluding banks)	12.28	2.66
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	734,741.94	709,691.48	903,206.94
Interest expenses	416,141.02	389,311.85	516,977.16
Net interest income	318,599.92	320,379.63	386,229.78
Net fee and commission income	123,006.52	118,529.63	152,929.67
Other (not specified above) operating income (net)	8,984.82	32,103.55	37,113.61
Gross income	1,322,466.03	1,248,448.26	1,691,432.93
Administration costs	144,243.09	120,930.11	154,543.90
Depreciation	27,920.58	32,297.38	43,826.83
Provisions			
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	128,689.73	181,826.94	187,703.57
Profit (loss) before tax	149,737.87	122,004.66	141,489.08
Net profit (loss)	115,797.55	97,797.92	115,796.53

Total own funds in 2021 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	1,673,604	1,451,857	1,483,757	189,847	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**1,673,604**	**1,451,857**	**1,483,757**	**189,847**	**-**

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

Macroeconomic environment in the country

Since the COVID-19 pandemic took hold in Europe in spring 2020, the Austrian economy has been largely driven by the spreading of coronavirus infections and the related containment measures adopted by the government. After a steep slump in 2020 as a whole, the economy recovered quickly in 2021 (+4.6%); by early 2022, economic activity in Austria had already reached pre-pandemic levels. Russia's invasion of Ukraine has dampened the growth outlook, however. In March 2022, the OeNB revised downward its outlook for Austrian GDP growth to +3.5%, assuming that the war does not escalate and remains regionally limited. The possibility that energy, in particular gas, shipments from Russia may be cut off represents a major downside risk. An immediate stop to shipments would most likely cause at least a stagnation of economic activity.

The COVID-19 pandemic led to a sharp increase in unemployment despite comprehensive short-time work schemes. However, as containment measures were lifted and economic recovery took hold, unemployment started to fall rapidly, with unemployment rate reaching almost pre-pandemic levels in early 2022.

Recording an average inflation rate of 1.8% since the introduction of the euro in 1999, Austria has been among those countries that have successfully maintained price stability in line with the Eurosystem's definition. However, as a result of the COVID-19 pandemic and supply chain disruptions and in reaction to the war in Ukraine, energy prices have risen significantly, causing the highest HICP inflation rates since the introduction of the euro.

Austria's foreign trade in goods is well diversified both by region and product type. In 2021, more than half of foreign trade took place with other euro area countries and was therefore not exposed to any direct exchange rate risks. After Germany, which still accounted for an export share of more than 30% in 2021, CESEE is Austria's second most important export market. The share of goods exports to this region rose from 12% in 1992 to 21% in 2021. Austria's travel and tourism revenues fell significantly, given a huge drop in overnight stays by visitors from abroad as the 2021 winter season had been virtually cancelled. The resulting decline in the services account surplus was so big that it could not offset the goods trade deficit recorded in 2021. As a consequence, Austria's current account balance turned negative (–0.5% of GDP) for the first time since 2001. Still, Austria's net international investment position was positive in 2021.

In 2021, Austria's budget balance improved to –5.9% of GDP. This was mainly on account of an improving contribution of automatic stabilizers amidst the partial recovery of GDP. At the same time, the budgetary impact of discretionary fiscal measures taken to counter the impact of the pandemic was similar to that in 2020. Following a sharp increase in 2020, the debt ratio decreased slightly to 82.8% of GDP in 2021.

Development in the banking sector (including assets total / GDP)

The year 2021 marked a strong recovery for the Austrian banking sector, as the immediate impact of the pandemic slowly faded. Propelled by continued loan growth and a sharp decline in risk cost, profits nearly doubled to the highest level since the global financial crisis and total assets climbed to nearly 1,200 bn EUR (297% of GDP). Amid compressed margins, net interest income has been driven by volume growth since 2019, which raises questions regarding the sustainability of a business strategy trying to outgrow underlying profitability pressures. The share of nonperforming loans reached new lows, but still nearly a fifth of all loans are classified as having witnessed a significant increase in credit risk.

The Austrian banking sector's mortgage growth has continued to be dynamic. Over the last decade, residential real estate prices has doubled in Austria. This trend went hand in hand with an increasing deviation from fundamentally justified values, as implied by the OeNB fundamental indicator. In this regard, the significantly reduced, but still high share of variable rate loans to households also remains a matter of concern. Market conditions have continued to be driven by fierce competition, which led to increasingly unsustainable lending standards. A broad consensus emerged that risks stemming from these lending policies must be addressed not only to reduce risks for the banking sector and consequently for financial stability, but also to protect borrowers from the consequences of excessive debt. Therefore, Austria's Financial Market Stability Board advised the FMA to set legally binding borrower-based measures in the form of upper limits for loan-to-value ratios, debt service-to-income ratios and loan maturities (subject to exemptions that would give credit institutions adequate operational flexibility). The measures apply to all new mortgage lending to private households agreed on 1 August 2022 and afterwards (for details of the relevant FMA regulation see FMA Regulations - FMA Österreich).

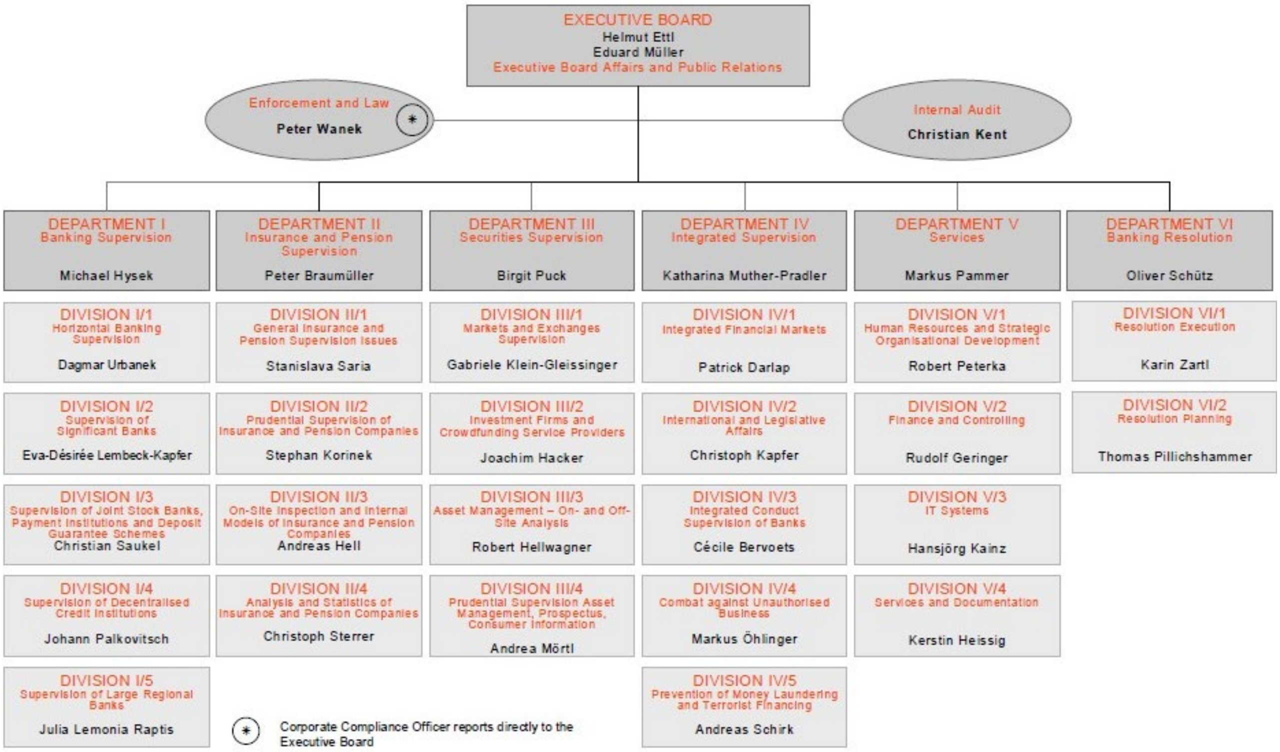
The Russian invasion of Ukraine and its consequences will affect the Austrian banking sector both directly via its subsidiaries in CESEE and indirectly via increased macro financial uncertainties. The most pressing issue relates to direct exposures to Russia, Ukraine and Belarus. Although subsidiaries in these three markets make up only two percent of the sector's total assets, they accounted for close to ten percent of its profits in recent years. As Austrian banks benefit from a well-diversified international exposure, potential losses, although painful, are considered manageable in light of the sector's solid profitability and capitalization. In addition, past macroprudential policy measures by Austrian authorities significantly helped reducing risks for Austrian parent institutions. Over the past decade, they have contributed to a significant reduction of foreign currency loans and of the need for cross-border intragroup liquidity transfers, and at the same time strengthened bank's risk bearing capacity via the systemic risk buffer. Therefore, first round effects from the war in Ukraine and the ensuing sanctions against Russia were well contained. However, second round effects, such as reduced business activities or a deterioration in credit quality are still difficult to assess and overshadow the outlook. Consequently, banks and Supervisory Authorities keep monitoring the situation very closely and are constantly assessing the impact of the war and (counter-)sanctions.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

The FMA is an independent, autonomous and integrated Supervisory Authority for the Austrian financial market, established as an institution under public law. It is responsible for supervising credit institutions together with the European Central Bank – ECB), payment institutions, deposit guarantee schemes, insurance undertakings, pension companies, corporate provision funds, investment funds, licensed investment service providers, credit rating agencies and stock exchanges, as well as for prospectus supervision. The FMA is also responsible for monitoring trading in listed securities to ensure that this is carried out properly and formonitoring issuers ' compliance with information and organization obligations. Further tasks include combating the unauthorised provision of financial services and taking preventive action against money laundering and terrorist financing. Thus, in its capacity as a cross-sectoral integrated supervisory body, the FMA is responsible for addressing the challenges created by a high degree of interweaving within the Austrian financial market due to ownership structures, sales cooperation agreements and financial transactions. The legal framework in terms of banking supervision still comprises the Austrian Banking Act (Bankwesengesetz – BWG) as well as the Bank Recovery and Resolution Act (Bundesgesetz über die Sanierung und Abwicklung von Banken – BaSAG), transposing the European Bank Recovery and Resolution Directive (BRRD) the Deposit Guarantee Schemes and Investor Compensation Act (Einlagensicherungs- und Anlegerentschädigungsgesetz

– ESAEG – revised in 2019). With effect from 1. January 2015, the FMA also holds the function of the National Resolution Authority (NRA) for banks and forms part of the Single Resolution Mechanism (SRM). The main responsibilities of the NRA are resolution planning, the analysis and elimination of obstacles to resolution, and the conducting of resolution procedures in cases of credit institutions that have failed or are likely to fail. As the NRA for Austria, the FMA is an integral part of the SRM. Lastly, the FMA is the National Designated Authority (NDA) for all macro- prudential tasks and responsibilities. With the Single Supervisory Mechanism (SSM) in place, banks in the participating Member States are now supervised by means of a decentralized system involving close cooperation between the ECB and the National Supervisory Authorities (NCAs). The FMA is the NCA in Austria. The SSM was launched on 4. November 2014 and as of 31.12.2021 Austrian banking groups in total have been classified as "significant institutions" (SIs), encompassing 74 individual credit institutions that thus fall under the direct supervision of the ECB. SI supervision takes place in so-called Joint Supervisory Teams (JSTs), consisting of the relevant NCAs and chaired by the ECB. The remaining credit institutions based in Austria, classed as "less significant institutions" (LSIs) as well as those national credit institutions that are not part of the SSM (non-CRR CI) continue to be supervised directly by the FMA. This means that the FMA remains directly responsible for currently 424 Austrian credit institutions as of 31.12.2021. Regarding LSI, the ECB only carries out indirect supervision. When supervising LSIs, the FMA bases its supervisory approach on the harmonised rules developed by the EBA as well as guidance provided by the ECB to ensure consistent SI and LSI supervision. In case of common procedures (granting and withdrawal of authorisations, qualifying holdings procedures), the decision-making competence for both SIs and LSIs lies exclusively with the ECB. However, the FMA is the entry point for notifications and prepares draft decisions for the ECB.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2021

Please see https://www.fma.gv.at/en/publications/facts-and-figures-trends-and-strategies/

The FMA is committed to the principle of transparency, engaging in open dialogue with the market and the supervised companies. It shares the main findings of its annual analysis, provides information on the main risks it has identified on the financial markets for the coming years, and gives updates on its medium-term supervisory strategy based on this analysis. Every year the FMA also publishes in detail its priorities for supervision and inspections in the coming year. These are explained in its "Facts and Figures, Trends and Strategies" publication and on the FMA website.

Please see the FMA´s priorities for supervision and inspections in 2021 in the FMA´s 2021 annual report https://www.fma.gv.at/en/publications/fma-annual-report/

Based on the risk analysis for 2021-2025, and its medium-term supervisory strategy as adapted in line with its analysis, the FMA set the following priorities in 2020 for supervision and inspections in 2021:

(1) RESILIENCE AND STABILITY: Minimising the consequences of COVID-19 and preparing for a stable return to normality.

(2) DIGITALISATION: Recognising the latest developments on the financial market and responding quickly to new risks.

(3) NEW BUSINESS MODELS: Creating positive parameters through structured dialogue and enabling new business models and innovation.

(4) COLLECTIVE CONSUMER PROTECTION: Strengthening market confidence through transparency and information, and boosting individual responsibility through financial literacy.

(5) SUSTAINABILITY: Supporting the transition to a climate-neutral economy and curbing the risks of climate change for the financial market.

(6) A CLEAN FINANCIAL CENTRE: Preserving the clean financial centre by means of targeted preventive measures.

In setting these supervision and inspection priorities for 2021, the FMA addressed current developments and trends that harbour particular risk potential for supervised companies or markets. The aim is not simply to contain risks, but also to tap into opportunities and potential. At the same time, the FMA wants to draw the attention of the supervised entities to risk areas in their business field while also giving them the opportunity to prepare in a targeted way for the risk-oriented priorities for supervision in 2021. This strengthens risk awareness and creates transparency about the challenges that the Supervisory Authority has identified and will be focusing on. And the supervised entities have targeted indications of what their priorities should be. In order to implement its supervision and inspection priorities, the FMA therefore implemented the following key projects in the reporting year.

The activities of the Banking Supervisory Authority in 2021

Please see

https://www.fma.gv.at/en/publications/fma-annual-report/
https://www.fma.gv.at/en/publications/facts-and-figures-trends-and-strategies/

International activities of the authority

The Austrian FMA is part of the European cooperation within the European System of Financial Supervision (ESFS) and contributes actively to the activities of the European Supervisory Authorities (EBA, ESMA, EIOPA) as well as the ESRB. Furthermore, the FMA is National Competent Authority within the Single Supervisory Mechanism (SSM) and National Resolution Authority within the Single Resolution Mechanism (SRM). On an international level, the FMA is an active member of the IAIS, IOPS and IOSCO and attends the Integrated Financial Supervisors Conference (IFSC) on a regular basis as well as meetings of the Basel Consultative Group (BCG), a subgroup of the BCBS. In addition to active cooperation with international organisations, the fostering of bilateral relations with other Supervisory Authorities is of particular importance. Bilateral cooperation is facilitated by memoranda of understanding on cooperation and exchange of information, which the FMA has already signed with Supervisory Authorities from 45 jurisdictions. Furthermore, the FMA has signed multilateral memoranda of understanding under ESMA, IOSCO, IAIS and the ECB.

Cooperation with other supervisory bodies in the country

In handling official activities related to supervision, the FMA must, as far as possible, draw on analyses and inspection results as well as the results of the expert opinions prepared by the Oesterreichische Nationalbank (OeNB) during model approval procedures, in addition to using information from third parties or from the respective bank. The collaborative setup calls for intensive, timely coordination between the two institutions. This reconciliation process is supported by a database, the joint information system. Various reporting data, relevant information available from the FMA's supervisory activities as well as data and results of OeNB analyses are filed in this database. This close cooperation continues within the framework of the SSM and the SRM. In line with the macro-prudential measures set out in the CRD IV the Financial Market Stability Board (Finanzmarktstabilitätsgremium) was established. Its main tasks are to promote financial market stability, reduce the systemic threat and lower the systemic and procyclical risks. It consists of representatives of the Federal Ministry of Finance, the FMA, the OeNB as well as the Fiscal Council. In accordance with the European Systemic Risk Board (ESRB) warnings and recommendations, the Financial Market Stability Board is mandated to act on a possible threatening of the Austrian financial stability amongst others with warnings and recommendations

Other relevant information and developments in 2021

Please see https://www.fma.gv.at/en/publications/fma-annual-report/

- pages 10 and 11: "2021 at a glance";
- page 15 "FMA Innovative":

The FMA is constantly workung to improve the efficiency and effectiveness of reglation and supervision in Austria and to rurther develop its organisational structure, human resources and technical infrastructure. In light of the digital revolutiion, the FMA is focusig on SupTech and RegTech tools. These are innvovative digital solutions designed to tackle regulatory and supervisory challenges.

Please see as well answer to question 5 "Main strategic objectives of the Banking Supervisory Authority in 2021".

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	162	156	151
Branches of foreign credit institutions	22	24	23
Cooperative banks	389	363	347
Banking sector, total:	**573**	**543**	**521**

Source: OeNB, unconsolidated data

Total assets of banking sector (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	536.4	592.1	624.3
Branches of foreign credit institutions	23.0	24.5	15.4
Cooperative banks	325.6	357.3	385.7
Banking sector, total:	885.0	973.8	1,024.4
y/y change (in %)	**+3.6%**	**+10.0%**	**+5.2%**

Source: OeNB, unconsolidated data in EUR bn

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	4.7	4.6	4.5
Domestic ownership total	81.1	81.1	82.7
Foreign ownership	18.9	18.9	17.3
Banking sector, total:	**100.0**	**100.0**	**100.0**

Source: OeNB, unconsolidated data.

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	40.8	52.4	777
Branches of foreign credit institutions	54.3	68.0	1,418
Cooperative banks	41.0	50.5	697
Banking sector, total:	**27.6**	**37.5**	**380**

Source: OeNB, unconsolidated data.

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	6.9	3.3	9.5
Cooperative banks	5.8	3.6	6.7
Banking sector, total:	**6.4**	**3.4**	**8.7**

Source: OeNB, unconsolidated data

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	60.6	60.8	59.0
Branches of foreign credit institutions	2.6	2.5	1.5
Cooperative banks	36.8	36.7	39.5
Banking sector, total:	**100.0**	**100.0**	**100.0**

Source: OeNB, unconsolidated data.

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

	2019	2020	2021
Receivables	n.a.*	n.a.*	n.a.*
Financial sector	n.a.*	n.a.*	n.a.*
Nonfinancial sector	n.a.*	n.a.*	n.a.*
Government sector	n.a.*	n.a.*	n.a.*
Other assets	n.a.*	n.a.*	n.a.*
Liabilites	n.a.*	n.a.*	n.a.*
Financial sector	n.a.*	n.a.*	n.a.*
Nonfinancial sector	n.a.*	n.a.*	n.a.*
Government sector	n.a.*	n.a.*	n.a.*
Other liabilities	n.a.*	n.a.*	n.a.*
Capital	**n.a.***	**n.a.***	**n.a.***

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

Capital adequacy ratio of banks

Type of financial institution	2019	2020	2021
Commercial banks	19.0***	20.2***	19.9***
Cooperative banks	18.3***	18.8***	17.9***
Banking sector, total:	**18.7*** **	**19.5*** **	**18.2*** **

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

Source: OeNB, consolidated data.

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

Asset classification	2019	2020	2021
Non-financial sector, including			
households	3.0	2.8	2.4
corporate	3.1	3.1	2.8

Source: OeNB, consolidated data.

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:		
Households	66.6	44.4
Corporate	20.4	46.0
Government sector	5.4	6.0
Financial sector (excluding banks)	5.5	3.1
Total	**100.0**	**100.0**

Source: OeNB, unconsolidated data; only domestic

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

P&L account	2019	2020	2021
Interest income	15.1	13.4	13.0
Interest expenses	6.5	4.8	4.0
Net interest income	8.6	8.6	9.0
Net fee and commission income	4.6	4.7	5.3
Other (not specified above) operating income (net)	6.5	6.0	6.9
Gross income	19.7	19.3	21.2
Administration costs	11.6	10.8	11.0
Depreciation	1.0	1.0	1.2
Provisions	0.2	2.5	-0.4
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	n.a.	n.a.	n.a.
Profit (loss) before tax	5.7	3.4	7.5
Net profit (loss)	4.8	2.7	6.5

Source: OeNB, unconsolidated data in EUR bn.

Total own funds in 2021 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	53.3***	42.7***	46.4***	6.9***	n.a.
Cooperative banks	44.3***	38.2***	40.0***	4.3***	n.a.
Banking sector, total:	**97.6*** **	**80.8*** **	**86.4*** **	**11.2*** **	**n.a.**

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

Source: OeNB, consolidated data in EUR bn.

Macroeconomic conditions

In 2021, the economy of the Republic of Belarus faced a number of unforeseen challenges (geopolitical challenges, increased sanctional pressure). Both external and domestic factors made an impact on the financial sector. At the same time, the Belarusian economy in 2021 was functioning under the conditions of recovering business activities in the countries being main trade partners. Within 2021, the demand for raw materials was growing as far as the global economy recovered. The prices for major export positions of the Republic of Belarus were increasing. The economic growth was ensured at the expense of the gradual recovery of business activities in the industries affected in 2020 by the pandemic. The positive results of foreign trade in goods and services, as a result of recovery of external demand, became the key factor of economic growth. On the whole, in 2021 the GDP went up by 2.3 percent.

Development of the banking sector (including assets/GDP)

As at January 1, 2022, the banking sector of the Republic of Belarus included 23 operating banks. Foreign capital participated in the authorized capital of 17 banks. At 14 banks the share of foreign investors in the authorized capital exceeded 50 percent, of which three banks were wholly-foreign owned and at 11 banks the share of foreign capital ranged from 50 to 100 percent.

As at January 1, 2022, there were four representative offices of foreign banks[1] in the Republic of Belarus, including those of the Russian Federation, the People's Republic of China, the Federal Republic of Germany, and the Interstate Bank. Belarusian banks had three representative offices abroad.

As at January 1, 2022, the operating banks' assets totaled BYN98.3 billion, an increase by 8.6 percent versus 2021. The share of assets in foreign exchange went down since the beginning of the year from 52.4 percent as at January 1, 2021 to 51 percent as at January 1, 2022. The ratio of the banking sector's assets to the GDP stood at 56.8 percent as at January 1, 2022.

As at January 1, 2022, the banks' aggregate registered authorized capital amounted to BYN6.6 billion, having increased over 2021 by 14.2 percent. Capital from the Russian Federation, Republic of Cyprus, Republic of Austria, Swiss Confederation, Republic of Kazakhstan, United Arab Emirates, Georgia, United Kingdom of Great Britain and Northern Ireland, Federal Republic of Germany, and other countries participated in the authorized capital of Belarusian banks.

In 2021, the banking sector maintained sustainability and improved efficiency compared with 2020. As at January 1, 2022, banks' regulatory capital totaled BYN13.9 billion, having increased over 2021 by 13.8 percent. The regulatory capital/GDP ratio was 8 percent.

In 2021, the operating banks' aggregate profit[2] totaled BYN1.3 billion, a 30.9 percent growth compared with 2020. Following the growth of profit obtained by banks, their efficiency indicators improved. Thus, return on assets went up from 1.1 percent to 1.4 percent, return on regulatory capital – from 8.9 percent to 10 percent.

Banks met the National Bank's requirements as to the regulatory capital adequacy, including with account of the values of the conservation buffer. The regulatory capital adequacy ratio totaled 17.9 percent as at

[1] For the purposes of this report:
- state-owned banks are banks in which the state owns more than 50 percent of shares (equity interest) in the authorized capital;
- foreign banks are banks in which the share of foreign investors in the authorized capital exceeds 50 percent; and
- private banks are banks other than foreign and state-owned banks.

[2] The data prior to confirmation by the audit organization.

January 1, 2022, with the prescribed minimum requirement for an individual bank being 10 percent (with account of the conservation buffer – 12.5 percent).

Banks met the secure functioning requirements with regard to liquidity. The Liquidity Coverage Ratio (LCR) for the whole of operating banks totaled 141.9 percent as at January 1, 2022, with the prescribed requirement being no less than 90 percent. The Net Stable Funding Ratio (NSFR) for the whole of operating banks totaled 123.8 percent as at January 1, 2022, with the prescribed requirement being no less than 100 percent.

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

Throughout 2021, the work on improving the regulatory legal framework in the area of banking supervision and bringing it into line with international standards and practical experience continued.

In the year under review, the National Bank enhanced approaches to the implementation of banking supervision on the consolidated basis, with individual requirements in the area of consolidated banking supervision being applied to JSC "Development Bank of the Republic of Belarus" as the parent organization of the banking holding company.

In order to continue the provision of financial support to the real sector of the economy, as well as soften the impact of negative external factors and ensure sustainable functioning of the banking sector, in 2021, the National Bank took a decision to provide banks with the possibility of applying certain already adopted countercyclical measures with regard to:

- secure functioning requirements (as relate to the regulatory capital adequacy, liquidity coverage and concentration of risk per debtor); and
- certain requirements to the classification of assets exposed to credit risk, contingent liabilities and formation of special provisions thereon.

In the year under review, within the framework of improvement of the system preventing money laundering, terrorism financing and financing proliferation of weapons of mass destruction (hereinafter – the "AML/CFT"), the work on the incorporation of the FATF[3] international standards into the legislation of the Republic of Belarus continued with a view to improving the efficiency of the internal control systems at banks, non-bank financial institutions, JSC "Development Bank of the Republic of Belarus", and non-credit financial institutions. The obligation to implement the AML/CFT measures was established for new financial market participants – providers of online borrowing services.

The results of the national AML/CFT risk assessment have been implemented into the National Bank's internal procedures for ranking banks and non-credit financial institutions by the risk levels.

[3] The Financial Action Task Force

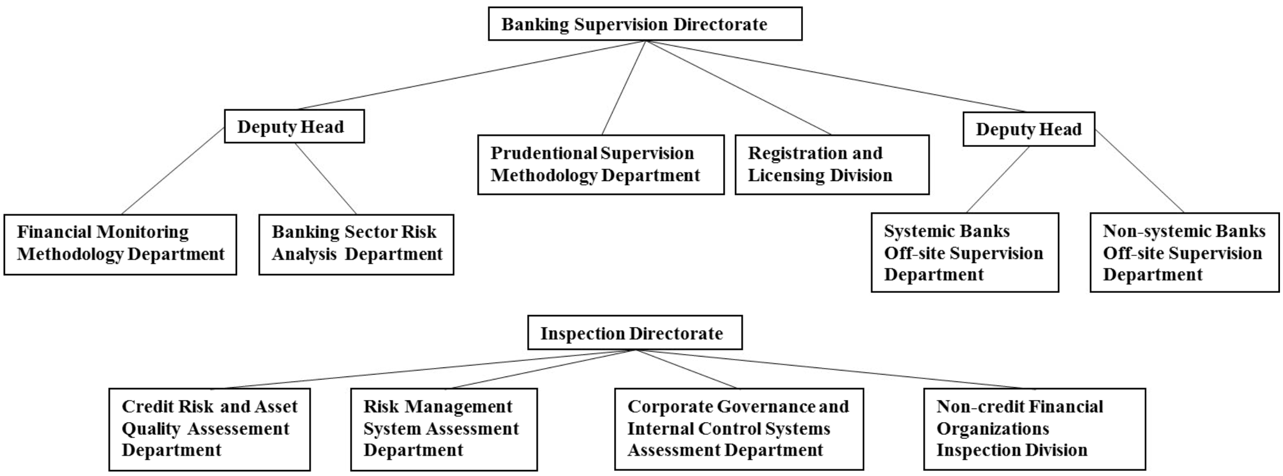
Legal competence of the Banking Supervisory Authority

The National Bank is the banking supervision authority.

In the Republic of Belarus, there is a system of banking supervision, which generally meets the world standards. It includes:

- registration and licensing of banks and non-bank financial institutions;
- off-site supervision of banks, JSC "Development Bank of the Republic of Belarus" and non-bank financial institutions on the basis of reporting and on-site supervision in the form of inspections;
- application of appropriate supervisory response measures to banks, JSC "Development Bank of the Republic of Belarus" and non-bank financial institutions in case of violation of banking legislation thereby or deterioration of their financial condition;
- reorganization and liquidation of banks and non-bank financial institutions;
- systemic analysis of the banking sector's risks; and
- regulation and control in the sphere of preventing the legalization of proceeds from crime, financing terrorist activities and financing the proliferation of weapons of mass destruction, and exercise control in the field of AML/CFT.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Supervisory Authority in 2021

In 2021, the National Bank's activities were aimed at maintaining price stability, ensuring stability of the banking system of the Republic of Belarus, and ensuring efficient, reliable and secure functioning of the payment system. The work on developing the financial market, liberalizing foreign exchange relations, strengthening confidence in the national monetary unit and decreasing the amount of foreign exchange in the economy continued.

Within the framework of the off-site supervision of banks (bank holding companies), non-bank financial institutions and JSC "Development Bank of the Republic of Belarus", the activities of the National Bank were aimed at ensuring their stable and safe functioning, protecting the interests of depositors and other creditors, including by means of reducing (limiting) risks accepted by banks.

The activities of the banking Supervisory Authorities in 2021

In 2021, in order to reveal the problems in banks' activities at an early stage of their occurrence, the early warning indicators, banks' performance efficiency indicators, levels of risks assumed by banks, as well as their compliance with the secure functioning and other prudential requirements, were monitored on a permanent basis, including with account of use by banks of countercyclical measures designed to provide banks with the opportunity to continue provision of financial support for the real sector of the economy, which were adopted by the National Bank in the year under review.

A general supervisory assessment of the activities of a number of banks (taking into account the nature, scale and complexity of their activities) over 2020 was carried out, which included a comprehensive assessment of their strategic development, performance efficiency, corporate governance systems, risk management and internal control systems, capital adequacy and liquidity to ensure their safe and stable operation. Based on the results of the assessment, appropriate recommendations were submitted to the banks.

In order to avoid the development of negative trends, resolve or prevent the situations threatening the interests of creditors and other depositors from happening, the early and/or supervisory response measures, including those aimed at increasing banks' capitalization, ensuring profitable work and stable functioning, improving corporate governance, risk management, internal control, including in the area of AML/CFT, as well as excluding participation of banks in non-core activities, were taken with respect to banks when violations and drawbacks in the banks' activities were revealed.

Based on the results of the independent audit of banks' information technologies conducted in 2021, the National Bank submitted recommendations to banks on improving the processes of managing information technologies and increasing the level of information security and cyber-resilience.

A special attention was paid to the system of corporate governance at banks. In 2021, the National Bank initiated the assessment by banks of compliance of the compensation and remuneration system at banks with the scale, results and effectiveness of their activities, as well as compliance of the procedures for the establishment and powers of the management bodies of banks with their size, structure, economic significance, scope and complexity of operations, and risk profile, followed by consideration of these issues at the meetings of collegial bodies of banks and making the necessary decisions.

Strategic plans of banks' development were considered with the purpose of assessing their ability to ensure financial reliability and sustainability in the long-term perspective. The issuance of licenses for participation of banks in the authorized capital of other legal entities, including banks, was considered with account of the assessment of effectiveness and expediency of such investments.

International activities

In 2021, the National Bank in concert with the Ministry of Finance, the Ministry of Economy and other involved agencies, developed Regulation on Cooperation of the Republic of Belarus with International Financial Organizations, which expanded the list of international financial organizations with which the cooperation and interaction is carried out on the economically beneficial terms for the Republic of Belarus.

In 2021, international economic and financial organizations continued to provide technical assistance to the National Bank in the following areas:

- convergence of the national accounting system with international financial reporting standards;
- strengthening macrofinancial stability monitoring;
- improvement of legislation in the field of protection of the rights of financial service consumers and development of factoring industry;
- improvement of the functioning of the continuous payments system; and
- development of financial education.

As part of the accession of the Republic of Belarus to the World Trade Organization, the work designed to improve the foreign trade regime in terms of liberalizing foreign exchange regulation and bringing legislation in line with the requirements of this organization was continued.

The National Bank in concert with government agencies held negotiations to conclude agreements on free trade in services and investments with the People's Republic of China, the Republic of Singapore and the Republic of Türkiye.

As of January 1, 2022, 17 bilateral agreements in the field of cross-border banking supervision were concluded by the National Bank. These agreements are focused on the information exchange in the sphere of establishing and licensing the activities of cross-border institutions, supervising their current activities, conducting inspections, making decisions on issuing the permissions to acquire shares in a credit institution in order to effectively perform their functions by banking Supervisory Authorities and ensure the stable functioning of banking systems.

Cooperation with other supervisory bodies

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

Other information and events in 2021

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

Questionnaire tables for the 2021 review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	24	24	23
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**24**	**24**	**23**

Total assets of banking sector (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	100.0	100.0	100
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**
y/y change (in %)	**6.3**	**15.6**	**8.6**

Ownership structure of banks on the basis of assets total (%)

Item	2019	2020	2021
Public sector ownership	63.0	64.6	66.5
Domestic ownership total	66.3	68.0	68.2
Foreign ownership	33.7	32.0	31.8
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	65.3	76.0	0.2
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**0.2**

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

Type of financial institution	2019	2020	2021
Commercial banks	10.92	8.86	9.97
Cooperative banks	-	-	-
Banking sector, total:	**10.92**	**8.86**	**9.97**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables	100.0	100.0	100.0
Financial sector	1.4	1.5	2.0
Nonfinancial sector	70.0	74.0	70.0
Government sector	21.7	18.6	20.1
Other assets	6.9	6.0	7.9
Liabilites	100.0	100.0	100.0
Financial sector	1.4	1.8	2.6
Nonfinancial sector	56.9	50.8	51.9
Government sector	7.8	11.0	11.6
Other liabilities	34.0	36.4	33.8
Capital	**14.8**	**14.1**	**14.7**

Capital adequacy ratio of banks (%)

Type of financial institution	2019	2020	2021
Commercial banks	17.8***	17.2***	17.9***
Cooperative banks	-	-	-
Banking sector, total:	**17.8*** **	**17.2*** **	**17.9*** **

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

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

Asset classification	2019	2020	2021
Non-financial sector, including	4.63%	4.83%	5.30%
households	0.12%	0.18%	0.13%
corporate	4.51%	4.65%	5.17%

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	84.9%	61.7%
Households	46.0%	27.2%
Corporate	34.5%	34.5%
Government sector	14.1%	34.1%
Financial sector (excluding banks)	5.4%	4.2%
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	2166.8	1725.0	2170.4
Interest expenses	957.6	808.5	1132.8
Net interest income	1209.2	916.5	1037.6
Net fee and commission income	545.8	429.6	552.7
Other (not specified above) operating income (net)			
Gross income	7126.4	6483.5	7332.1
Administration costs			
Depreciation			
Provisions	358.4	424.5	303.7
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	587.6	390.2	565.6
Net profit (loss)	499.6	321.0	461.7

Total own funds in 2021 (in million EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	4830.6***	3974.5***	3975.6***	855.0***	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**4830.6*** **	**3974.5*** **	**3975.6*** **	**855.0*** **	**-**

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

Macroeconomic environment in the country

According to the information of the BiH Agency for Statistics[1], the nominal gross domestic product (GDP) in BiH in 2021 had a nominal value of BAM 38.6 billion. The nominal increase of GDP in relation to 2020 was 12.8% while real increase was 7.5%. GDP deflator for 2021 was 4.9%. If observed by activities, significant nominal increase of the gross value added was recorded in: accommodation and food services; arts, entertainment and recreation; administrative and support services; manufacturing and electricity, gas, steam and air conditioning supply. GDP per capita amounted 11,196 BAM/5,724 EUR or 6,769 USD[2]. Average trend of the production price index in BiH in 2021 went up by a total of 9.1%[3] compared to the base average. The average annual inflation in BiH in 2021 vs. 2020 stood at 2%.[4]

The banking system in BiH is liquid, well capitalized and profitable. The balance sheet total of the BiH banking sector has been posting a continuous increase over the course of 2021, thus reaching a value of BAM 35.4 billion at the end of 2021. This represents an increase of 7.7% compared to the same period the year before. In 2021, there was an increase of assets, cash, loans, deposits and capital - all compared to the same period of the previous year. The share of non-performing loans (as a key indicator of loan quality) in total loans was reduced. Total loans in 2021 stood at BAM 21.6 billion and this total loan growth of the BiH banking system of 4.1% vs. the year before was mostly affected by the increase of loans approved to the households segment and banking institutions. Total deposits of the BiH banking system in 2021 amounted to BAM 28.7 billion, whereas the biggest contribution to the total deposit increase of 9.6% vs. the previous year came from household deposits and non-financial private companies. The BiH banking system, whose operations fall under competency of the two state entity level banking agencies, posted a net profit of BAM 410.1 million. In late 2021, return on average assets (ROAA) equaled 1.3% and return on average equity (ROAE) at 9.6%.[5]

Development in the banking sector (including the assets total / GDP)

As of 31.12.2021, there were 14 commercial banks operating in the FBIH with 527 organizational parts and a total of 6,432 employees. Despite the impact of the negative economic effects of the pandemic, positive trend in the FBiH banking sector continued, reflecting in growth of assets, loans and deposits. The share of NPLs, as a key indicator of loan quality, is the same as at the end of the previous year. What has also continued is the increase of total deposits and savings representing the most significant and the biggest segment of the deposit and financial potential of banks. As of 31.12.2021, banks in the FBiH have generated positive financial result. The FBiH banking sector is stable, adequately capitalised, liquid and profitable.

Total net assets of the FBiH banking sector amounted to BAM 25.9 billion, up by BAM 1.5 billion or 6.1% vs. YE2020. The share of total assets of the FBiH banking sector vs. the GDP in FBIH[6] was 102.8%.

Total capital as of 31.12.2021 equaled BAM 3.1 billion (shareholder capital amounting to BAM 1.4 billion), thus going up by 1.4% vs. 2020. Regulatory capital was BAM 2.9 billion and increased by BAM 154.3 million, or 5.7% compared to the end of 2020. The own funds rate of the FBiH banking sector as of 31.12.2021 was 19.7%, which is by 0.6 percentage points higher than as at YE2020, i.e. by 7.7 percentage points above the

1 BIH Agency for Statistics, Press release regarding gross domestic product in BIH – initial results, July 2022
2 BIH Agency for Statistics, Press release regarding gross domestic product in BIH – initial results, July 2022
3 BIH Agency for Statistics, industrial production price index in BIH in 2021, special bulletin No. 12
4 BIH Agency for Statistics, consumer price index in BIH in 2021, Thematic bulletin No. 09
5 Central Bank of BIH, statistical web portal, Financial soundness indicators of the banking sector and Basic information on the banking sector
6 FBIH Statistics Bureau, Press release regarding the annual gross domestic product for the Federation of BIH, 2021 - initial results, July 2022

legal minimum of 12%. At the FBiH banking sector level, other capital rates (common equity Tier 1 rate and common equity rate, i.e. CET1 and T1) also exceeded the prescribed minimum. The financial leverage rate (the ratio of common equity and total bank exposure) at the FBiH banking sector level as of 31.12.2021 was 10.1%, which is the same as at the end of 2020 (prescribed minimum being 6%).

Loans, holding a share of 61.4% in total assets, posted a rise against the end of 2020 of BAM 636.2 million or 4.2%, thus arriving to the figure of BAM 15.9 billion as of 31.12.2021. Corporate loans went up by 304.4 million or 3.8%, reaching BAM 8.3 billion of 31.12.2021 and holding 52.1% share in total loans. Over the same period, household loans achieved an increase by BAM 331.8 million or 4.6%, thus holding a share in total loans of 47.9%. Their amount as of 31.12.2021 was BAM 7.6 billion. NPLs amounted BAM 1.0 billion, thus constituting 6.4% of the total loan portfolio, which is the same as at the end of the previous year. The share of corporate NPLs in total corporate loans was 7.0%, while the share of household NPLs in total household loans was 5.8%.

Cash funds amounted to BAM 8.0 billion and represented 30.9% of total assets, up by BAM 574.6 million or 7.7% vs. YE2020.

The FBiH banking sector's deposits reached a value of BAM 21.2 billion, thus going up by BAM 1.5 billion or 7.8% and represented 81.8% of total liabilities. Savings deposits, as the most significant and the biggest segment of the deposit and financial potential of banks, increased by BAM 533.6 million or 5.4% to BAM 10.4 billion.

As of 31.12.2021 (based on final unaudited reporting data), the FBiH banking sector posted a positive financial result - profit of BAM 293.6 million, which is higher by BAM 119.3 million or 68.5% than in the same period in 2020.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

A) Prudent Regulatory Framework issued by the FBA (changes in 2021):

In the process of the FBA regulatory activities related to preparation of regulations, the following decisions were adopted in 2021:

- FBA Decisions, Instructions and Guidelines related to operations and supervision of banks, micro credit organisations and leasing companies:
  - Decision on Recovery Plans of Banks and Banking Groups[7];
  - Decision on Supervision of Banks and Procedures of the FBiH Banking Agency[8];
  - Decision on Reports Banks Deliver to the FBiH Banking Agency according to the Standardised Regulatory Reporting Framework (COREP)[9];
  - Decision on Contents, Deadlines and Manner of Data Delivery for Comparative Overview of Services Fees for Commercial Entities participating in domestic payments and interbank fees for payment card transactions[10] with accompanying instructions;
  - Decision on Internal Governance System in Banks[11];

7 FBiH Official Gazette Nos. 81/17 and 84/21
8 FBiH Official Gazette Nos. 90/17 and 94/21
9 FBiH Official Gazette Nos. 86/20 and 61/21
10 FBiH Official Gazette No. 31/21
11 FBiH Official Gazette No. 39/21

- Decision on Data and Information Disclosure by Banks[12] with accompanying instructions;
- Decision on Liquidity Risk Management in Banks[13] with accompanying instructions related to calculation, updating and populating reporting forms for LCR, as well as related to calculation, updating and reporting on NSFR;
- Decision on Supervisory Review and Evaluation Process in Banks (SREP)[14];
- Instructions related to implementation of special standards in managing individual risks in banks, bank reporting on regulatory capital, credit, operational and market risks, financial leverage ratio, large exposures, interest rate risk in the banking book, FX position of banks, outsourcing management in banks, IT system management, AML&CTF, volume of exchange office operations, domestic and international payments.

- FBA Decisions related to bank resolution:

  - Decision on Data and Information Delivered to the FBiH Banking Agency for Purpose of Developing and Updating Restructuring Plans for Banks and Banking Groups[15];
  - Decision on Conditions and Manner of Performing Supervision and Instructing Measures to ensure Implementation of Bank Resolution Competences[16];
  - Instructions for Preparing Reports Banks and Banking Groups Deliver to the FBiH Banking Agency for purpose of Resolution Plan Development and Update.

- FBA temporary Decisions and Instructions related COVID -19:

  - Decision on Temporary Measures of Banks to Mitigate Adverse Economic Consequences caused by the „COVID-19" Disease[17];
  - Decision on Temporary Measures of Leasing Companies and Micro Credit Organisations to Mitigate Adverse Economic Consequences caused by the „COVID-19" Disease[18]

B) Legal competences of the FBA:

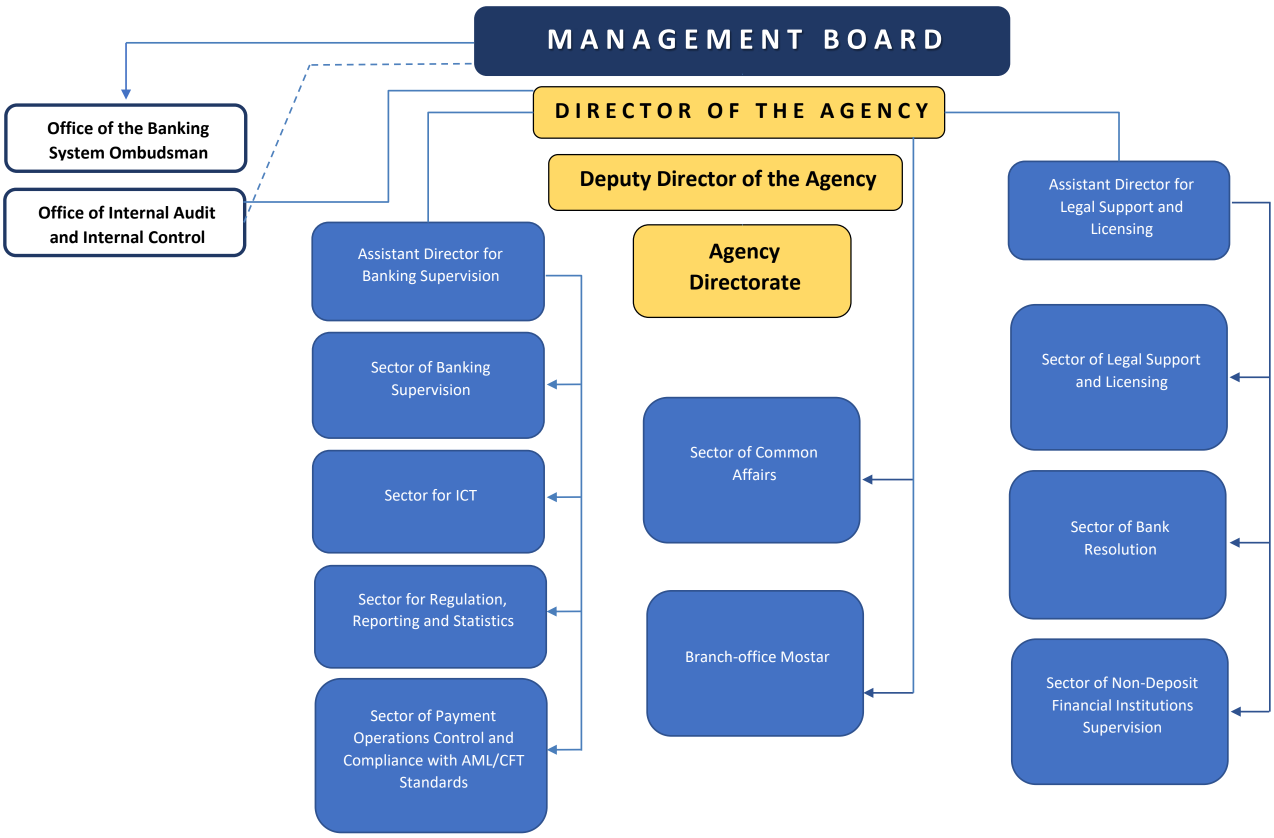
Pursuant to the Law on the Banking Agency of the Federation of BiH, the competences of the FBA are the following:

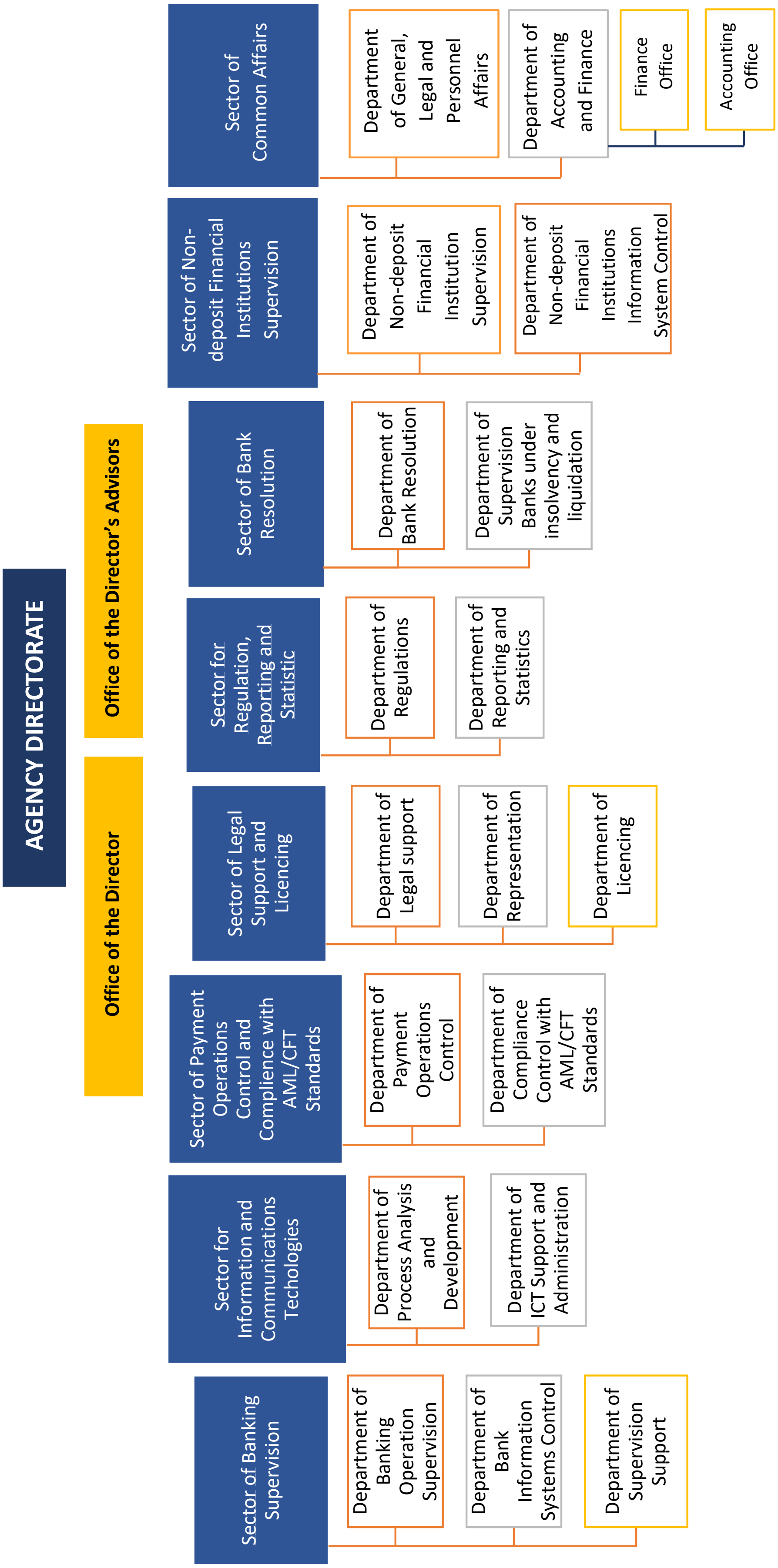
- identifying and performing activities and measures to maintain and strengthen the banking system stability,
- establishing, enforcing and supervising prudential rules regulating operations of the banking system entities (banks, banking groups, development banks, microcredit organisations, leasing companies, factoring companies, exchange offices and other financial organisations which operate under FBA supervision according to the law),
- issuing and revoking licenses and other relevant acts to the banking system entities when authorized to do so by special regulations,
- supervising operations of the banking system entities when authorized to do so by special regulations,
- supervising operations of the development bank, ordering supervision measures and other competences under regulation governing operations of the development bank and this Law,
- ordering supervision measures and other competences when authorized to do so by special regulations,
- adopting acts regulating operations of the FBA,
- adopting acts regulating operations of the banking system entities,

12 FBiH Official Gazette No. 39/21
13 FBiH Official Gazette No. 39/21
14 FBiH Official Gazette No. 94/21
15 FBiH Official Gazette Nos. 44/19, 48/19 and 61/21
16 FBiH Official Gazette Nos. 54/20 and 61/21
17 FBiH Official Gazette Nos. 60/20, 21/21, 89/21 and 104/21
18 FBiH Official Gazette Nos. 60/20, 21/21 and 104/21

- adopting acts, supervising and undertaking necessary measures related to anti-money laundering and counter terrorist financing that apply to the banking system entities in cooperation with the competent authorities and institutions in the field of anti-money laundering and counter terrorist financing under regulations governing anti-money laundering and counter terrorist financing,
- adopting acts and performing activities to protect the rights and interests of users of financial services in the banking system, performing supervision of implementation of regulations from this field and undertaking other activities and relevant measures within the scope of its authorities,
- Adopting and updating the resolution plan, establishing eligibility for initiation of bank resolution proceedings, conducting resolution proceedings, deciding on tools and measures to undertake in resolution and performing other activities relating to resolution under the law regulating banks.

Organizational chart of the Banking Supervisory Authority




AGENCY DIRECTORATE
Office of the Director
Office of the Director's Advisors
Sector of Banking Supervision
Department of Banking Operation Supervision
Department of Bank Information Systems Control
Department of Supervision Support
Sector for Information and Communications Techologies
Department of Process Analysis and Development
Department of ICT Support and Administration
Sector of Payment Operations Control and Complience with AML/CFT Standards
Department of Payment Operations Control
Department of Compliance Control with AML/CFT Standards
Sector of Legal Support and Licencing
Department of Legal support
Department of Representation
Department of Licencing
Sector for Regulation, Reporting and Statistic
Department of Regulations
Department of Reporting and Statistics
Sector of Bank Resolution
Department of Bank Resolution
Department of Supervision Banks under insolvency and liquidation
Sector of Non-deposit Financial Institutions Supervision
Department of Non-deposit Financial Institution Supervision
Department of Non-deposit Financial Institutions Information System Control
Sector of Common Affairs
Department of General, Legal and Personnel Affairs
Department of Accounting and Finance
Finance Office
Accounting Office

Main strategic objectives of the Banking Supervisory Authority in 2021

The main strategic objectives of the FBA were focused on preserving the stability of the banking system entities and their further enhancement and development through:

- monitoring of financial and operational risks as a consequence of the emergence of the viral disease "COVID-19" for all banks in FBiH. As a part of the mentioned activity, special attention was paid to implementation of temporary measures, amount and quality of the portfolio under temporary measures, classification of exposures and determination of ECL;
- continued activities on creation of the regulatory framework in line with the EU's regulatory framework, as a step of the BiH preparations towards the accession path to the EU;
- examination of banks of systemic importance for development of credit activities, as well as control of applicable practices in banks in the segment of protection of financial service users and guarantors;
- continued activities with the objective to implement recommendations of the FSAP mission related to improvement of the banking sector supervision, projects related to strengthening banking supervision within the technical assistance provided by the international financial institutions;
- strengthening bank capital;
- systemic monitoring of bank's activities on application of AML/CFT standards and enhancing cooperation with other competent institutions in this segment;
- building, expanding and improving cooperation with the competent Supervisory Authorities for supervision of banking groups from the EU whose members hold seat in the FBiH, as well from others countries, all for purpose of more efficient supervision and improvement of supervisory practices, cooperation and exchange of information with ECB and EBA in terms of the supervision and banking regulations, and international financial institutions;
- providing guidelines to banks for increased monitoring of risks and effects that are transferred to markets outside BiH, which can potentially increase the impact of credit risk and other risks.

The activities of the Banking Supervisory Authority in 2021

In cooperation with the Republika Srpska Banking Agency and EBA ((European Banking Authority), FBA has finalized the process of assessment of compliance of the regulatory and supervisory framework with the EU framework. Hence, it obtained the equivalence status, i.e. the status of a third country that applies regulatory and supervisory requirements equivalent to those being applied in the EU. This was formalized in October 2021 in the EU Official Journal.

In 2021, FBA has continued with its proactive approach and activities to ensure recovery from adverse economic consequences caused by the pandemic, thus resulting in stability of the banking and financial sectors in the FBiH and in protection of depositors. It has performed an overall reform of the regulatory framework for operations and supervision of banks. It has finalized activities on implementation of regulatory requirements related to establishment of an adequate supervisory dialogue with banks, transparency of banks (public disclosure of information and data on banks), recovery plans and bank resolutions. Activities continued regarding FINREP establishment, so regulations were revised and integrated regarding internal governance system in banks. Full SREP was performed over all banks through implementation of a new set of supervisory tools for assessment of a risk profile in banks. Reports delivered on ICAAP and ILAAP were duly assessed for all commercial banks, thus being an integral part of SREP. This also included a suitability assessment of recovery plans in banks. The second cycle of supervisory stress testing was finalized in all banks in the FBiH along with major changes to the methodological framework.

In 2021, activities related to bank resolutions were aimed towards updating and adopting resolution plans for all commercial banks in the FBiH, calculation on minimum requirement for own funds and eligible liabilities (MREL) and determination of key functions in banks, as well as updating relevant regulations regarding supervisory competences, rules and measures in this segment.

International activities of the authority

FBA continued with activities to strengthen and improve cooperation with international financial institutions and regional and other organisations, as well as to strengthen bilateral and multilateral cooperation with bank regulators from the country, the region and beyond, all subject to existing and new agreements on cooperation and information exchange.

FBA exchanges information and participates in supervisory colleges for banks whose banking groups are seated in Slovenia, Austria, and Germany. Improving cooperation with Supervisory Authorities (ECB, FMA, Bank of Slovenia, BaFin and HNB) of these parent banking groups in the domain of information exchange, joint assessment of risk profile of particular group or individual bank, evaluation of recovery plans, joint actions, interaction with banking groups and improving readiness to respond to crisis situations will all be in the focus of its supervisory activities in the forthcoming period as well.

Other important activities taken by the FBA referred to taking part in missions/visits by international financial organisations (International Monetary Fund, World Bank, etc.) in terms of providing information and trend analysis related to the FBiH banking system and bank supervision strengthening.

Cooperation with other supervisory bodies in the country

Cooperation with the competent institutions in BiH has continued. Cooperation with the CBBH is being carried out in the domain of top-down stress tests conducted by the Financial Stability Department. FBA participates in this process by providing data for conducting top-down stress tests, participating in the analysis of projections related to credit growth, and providing comments on testing methodology, while the results of top down stress tests are used in supervisory assessments. FBA submits to the CBBH the data necessary for the calculation of financial stability indicators (FSI) at the level of BiH, and regularly exchanges other relevant data and information with the CBBH (reports and information related to regulatory framework effects, network analysis of systemic risk spillovers, etc.).

Cooperation has continued with BARS and DIA (Deposit Insurance Agency) in the form of regular exchange of information and joint actions, and also with the BARS in the part of creation of new regulations, which includes cooperation with the entity's ministries of finance. In 2021, a cooperation continued with the BA BiH (Banks Association of Bosnia and Herzegovina) both in terms of implementation of the existing regulatory framework and proposals for revision, and in the process of adoption of a new regulatory framework for bank operations and supervision.

In 2021, FBA and Financial Intelligence Agency concluded a Memorandum of Cooperation to improve cooperation in the segment of access to data from the Register of Financial Statements and the Single Register of Accounts of Legal Entities. The framework for cooperation, with the intention of joint action, provides continuous access to reliable information to assess economic trends, improve operations of banking system entities, as well as assess the risks of doing business in the FBiH.

Other relevant information and developments in 2021

After implementation and full application of the new supervisory framework - Supervisory Review and Assessment Process - SREP at the beginning of 2020, the Banking Sector Strengthening Project continued in 2021, followed by activities on drafting of an internal act that should encompass all supervisory activities from off/site supervision, as well as activities on drafting of an act for the supervisory assessment of the application of IFRS 9. The Banking Sector Strengthening Project was completed at the end of June 2021. FBA, together with the Banking Agency of Republica Srpska, continues its cooperation with the World Bank on climate and environmental risks and integration of those risk into integral framework for risk management, according to the fact that climate and environmental changes represent the most dynamic area of development of financial institutions and supervision of their operations.

Within the USAID FINRA project, FBA continued to carry out planned activities to further strengthen the capacity for efficient supervision of banks and restructuring of banks, and in this sense continued with already started projects on the implementation of the by-law framework. In the resolution segment, activities are focused on further capacity building in the area of determining key functions, adopting the MREL approach, defining the indicative MREL, as well as updating restructuring plans and the possibility of using the bank's instrument for special purposes and the asset separation instrument. With the aim of improving the institutional capacity of FBA, the provision of technical assistance from USAID FINRA will continue for already initiated activities on implementation of the regulatory framework.

FBA continued its active participation in the Program for Strengthening the Capacity of Central Banks in the Western Balkans, which aims to integrate into the European System of Central Banks (ESCB project), and to improve the alignment of national regulatory frameworks with European and international standards. In the reporting period, implementation of the Program was devoted to Component II, i.e. bilateral cooperation with OeNB and FMA in the field of bank restructuring, and with the National Bank of the Czech Republic in the same field.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	15	15	14
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**15**	**15**	**14**

Total assets of banking sector (in 000 BAM) (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	24.217.016	24.396.438	25.890.828
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**24.217.016**	**24.396.438**	**25.890.828**
y/y change (in %)	**2019/2018 Index 110 (+10%)**	**2020/2019 Index 101 (+1%)**	**2021/2020 Index 106 (+6%)**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	3,3	3,6	4,1
Domestic ownership total	6,3	6,7	6,8
Foreign ownership	90,4	89,7	89,1
Banking sector, total:	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	53,0	66,7	1.286
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**53,0**	**66,7**	**1.286**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	8,8	5,8	9,3
Cooperative banks	-	-	-
Banking sector, total:	**8,8**	**5,8**	**9,3**

Distribution of market shares in balance sheet total (%)

Type of financial institution	**2019**	**2020**	**2021**
Commercial banks	100,0	100,0	100,0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**100,0**	**100,0**	**100,0**

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

	2019	**2020**	**2021**
Receivables	n/a	n/a	n/a
Financial sector	n/a	n/a	n/a
Nonfinancial sector	n/a	n/a	n/a
Government sector	n/a	n/a	n/a
Other assets	n/a	n/a	n/a
Liabilities	n/a	n/a	n/a
Financial sector	n/a	n/a	n/a
Nonfinancial sector	n/a	n/a	n/a
Government sector	n/a	n/a	n/a
Other liabilities	n/a	n/a	n/a
Capital	**n/a**	**n/a**	**n/a**

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

Capital adequacy ratio of banks

Type of financial institution	**2019**	**2020**	**2021**
Commercial banks	17,9***	19,1***	19,7***
Cooperative banks	-	-	-
Banking sector, total:	17,9***	19,1***	19,7***

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

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

Asset classification	**2019**	**2020**	**2021**
Non-financial sector, including	8,3	6,8	6,9
households	6,5	6,0	5,8
corporate	10,2	7,7	8,1

**Share of NPLs to total gross loans. Financial sector is not included.*

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	83,5	97,9
Households	52,0	50,8
Corporate	31,5	47,1
Government sector	12,5	1,5
Financial sector (excluding banks)	4,0	0,6
Total	**100,0**	**100,0**

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

P&L account	2019	2020	2021
Interest income	733.732	698.808	688.459
Interest expenses	130.668	130.227	120.198
Net interest income	603.064	568.581	568.261
Net fee and commission income	n/a	n/a	n/a
Other (not specified above) operating income (net)	n/a	n/a	n/a
Gross income	1.070.879	1.035.059	1.098.649
Administration costs	260.389	257.639	259.673
Depreciation	n/a	n/a	n/a
Provisions	77.315	182.004	75.703
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	n/a	n/a	n/a
Profit (loss) before tax	318.814	187.250	327.077
Net profit (loss)	273.889	174.265	293.560

Total own funds in 2021 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	1.458.666***	1.397.861***	1.397.861***	60.805***	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**1.458.666*** **	**1.397.861*** **	**1.397.861*** **	**60.805*** **	**-**

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

Macroeconomic environment in the country

In Republika Srpska (RS), during 2021, an increase in the consumption was recorded, primarily due to the reduction of economic uncertainty caused by the restrictions that the economy suffered during the stronger impact of the pandemic. Measures undertaken by the Government authorities as a response to COVID-19, as well as increase in credit activity of banks, influenced the growth of the volume of total investments in RS during 2021. After a GDP contraction of 2.5% per cent in 2020, the 2021 was marked by positive signs for the economy, which contributed to a strong rebound in GDP which recorded an increase of 6.9% in 2021. In 2021, the average net salary in the RS amounted to EUR 513.3 and it has increased by 5% compared to 2020. Normalization in economy flow is evident, with significant growth in industrial production and GDP during 2021.

Development in the banking sector (including assets total / GDP)

At the end of 2021 the banking sector of RS has total assets (balance sheet and off-balance sheet) EUR 5,1 billion, which is 91% of projected GDP, which represents an increase in this indicator of 3.7 percentage points compared to the previous year.

Profitability of the banking sector during all four quarters of 2021 recorded a significant increase. However, due to the increase in average net assets and total capital, ROA and ROE, after the initial increase in the first quarter, did not change significantly during the year, maintaining values above the ones achieved in the previous year. Under the influence of the pandemic during 2020 there was a decrease in the credit activity of the banks, however, during 2021 there was a recovery, especially during the first two quarters. Loans to private individuals continue to represent a generator of growth in total loans. If we look at the year 2021, the long-term trend of faster growth of loans to private individuals is confirmed as well, compared to the growth trend of loans to legal entities.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

Prudential regulation governing the **operations of banks** issued by the Banking Agency of Republika Srpska (BARS) in 2021:

- Decision on amendments to the Decision on the method of conducting bank supervision and implementing supervisory measures,
- Decision on the amendments to the Decision on calculation of capital in banks,
- Decision on liquidity risk management,
- Decision to amendments the Decision on the statement on the property status of the bank management and supervisory board members,
- Decision on unique tariff based on which fees for the performance of activities of the banking agency of Republika Srpska are charged to banks,
- Decision on the Amendments to the Decision on inclusion of special conditions for contracting long term non-purpose and replacement loans of individuals into the bank's risk management system,

- Decision on Amendments to the Decision on Credit Risk Management and Determination of Expected Credit Losses,
- Decision on the amendments to the Decision on banks' temporary measures to mitigate negative economic consequences caused by the COVID-19 viral disease,
- Decision to invalidate the Decision on manner of temporary reporting to BARS,
- Decision on management system in a bank,
- Decision on supervisory review and evaluation process of banks,
- Decision on repealing the criteria for internal ranking of banks by the Banking Agency of Republika Srpska,
- Decision on the form and content of reports banks deliver to the Banking Agency of Republika Srpska and
- Instructions for reporting on the liquidity coverage ratio.

Prudential regulation issued by the BARS in the **field of bank resolution** in 2021:

- Decision on the amendments to the Decision on data and information to be submitted to the Banking Agency of Republika Srpska for the requirements of development and updating of resolution plans of banks and banking groups,
- Decision on the manner of conducting inspection and imposing measures in order to perform tasks and objectives within the competences of bank resolution.

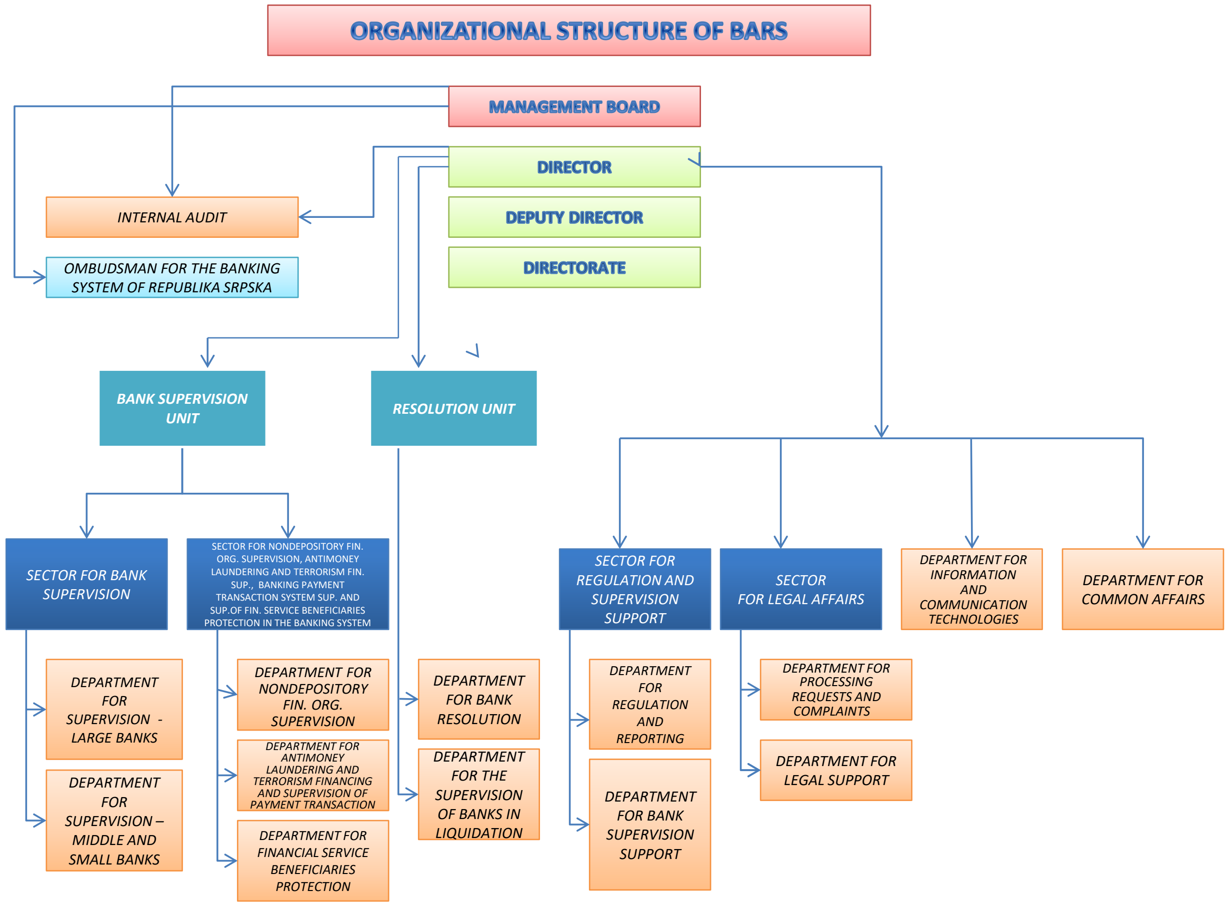
Prudential regulation governing the **operations of microcredit organizations** (MCO) issued by the BARS in 2021:

- Decision on temporary measures of microcredit organizations to mitigate negative economic consequences caused by the "COVID-19" viral disease,
- Decision on the amendments to the Decision on temporary measures of microcredit organizations to mitigate negative economic consequences caused by the "COVID-19" viral disease,
- The BARS has a mandate to regulate and supervise banks, microcredit organizations, leasing companies and saving-credit organizations. Namely, **the BARS competencies are as follows:**
- identification and implementation of activities and measures to safeguard and strengthen the banking system stability, in accordance with the law,
- adoption of regulations governing the operations of banks, microcredit organizations, saving-credit organizations, leasing providers and other financial organizations of the banking system,
- issuance and revocation of bank licenses and other corresponding by-laws in accordance with its competencies, indirect and direct supervision of bank operations, imposing and ordering measures of supervision and other competencies in accordance with the law governing banks,
- issuance and revocation of microcredit organization licenses and other corresponding by-laws in accordance with its competencies, indirect and direct supervision of microcredit organization operations, imposing and ordering measures of supervision and other competencies in accordance with the law governing microcredit organizations,
- issuance and revocation of saving-credit organization licenses and other corresponding by-laws in accordance with its competencies, indirect and direct supervision of saving-credit organization operations, imposing and ordering measures of supervision and other competencies in accordance with the law governing saving-credit organizations,
- issuance and revocation of leasing provider licenses and other corresponding by-laws in accordance with its competencies, indirect and direct supervision of leasing provider
- operations, imposing and ordering measures of supervision and other competencies in accordance with the law governing leasing providers,
- issuance and revocation of licenses for other financial organizations of the banking system and other corresponding by-laws when it is authorized for the above mentioned by this law or separate laws, indirect

and direct supervision of operations of other financial organizations of the banking system, imposing and ordering measures of supervision and other competencies in accordance with this law and separate laws,

- adoption of corresponding legislation, supervision and undertaking of necessary measures regarding the anti-money laundering and financing of terrorist activities related to banks, microcredit organizations, saving-credit organizations, leasing providers and other financial organizations of the banking system, in cooperation with competent authorities and institutions in the area of anti-money laundering and financing of terrorist activities, and in accordance with regulations governing the anti-money laundering and financing of terrorist activities,
- supervision and undertaking of necessary measures in accordance with regulations governing the introduction and implementation of specific interim measures to efficiently enforce international restrictive measures,
- adoption of by-laws and performing tasks from the area of protection of rights and interests of financial service beneficiaries in the banking system, supervision of implementation of regulations from this area and undertaking of other activities and appropriate measures within its competencies,
- determining the fulfillment of requirements for initiation of bank resolution procedure, conducting the resolution procedure, deciding on instruments and measures to be undertaken in resolution procedure and performing other tasks related to resolution, in accordance with the law governing banks,
- issuance and revocation of consents and approvals for establishing representative offices, supervision of representative office operations, imposing and ordering measures of supervision and other competencies in accordance with the law governing banks,
- imposition of fines and issuance of misdemeanor warrant and
- other competencies in accordance with this law and other laws.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2021

Main objectives of the BARS in 2021 were:

- continuous supervision of banks and other financial institutions via off- and on-site inspections,
- enhanced supervision of credit and liquidity risk,
- further development of supervisory practices, strengthening staff capacities for efficient supervision, development of information system,
- monitoring of international and EU banking and accounting standards and further development of the regulatory framework,
- active role in supervision and protection of financial services consumers' rights,
- continuation of adequate monitoring of payment transactions and activities regarding the anti-money laundering and financing of terrorism, and in this regard improving cooperation with other relevant institutions,
- continuation of cooperation with other banking supervisors,
- continuation of cooperation with external auditors,

- actively participating in the work of the Committee for Coordination of the financial sector of Republika Srpska,
- continuation of cooperation with the Banks Association, the Association of microcredit organizations in BiH and the Association of Leasing.

The activities of the Banking Supervisory Authority in 2021

In 2021 the BARS activities were aimed at maintaining the stability and improvement of the quality and legality of the RS banking system operations, based on continuous supervision of banks, microcredit organizations and leasing companies.

The BARS continued to supervise the operations of financial organizations through the off-site and on-site supervision, primarily by means of monitoring the solvency, liquidity, capitalization, and profitability of all financial organizations under its authority. The BARS activities were primarily aimed towards strengthening of capital base and improving the management of credit and liquidity risk. In addition, a special attention was also dedicated to the control segments which were related to the assessment of harmonization of banks, microcredit organizations and leasing companies with the standards for the anti-money laundering and terrorism financing, as well as ensuring and improving the protection of rights and interests of the banking service consumers.

Other activities of the BARS could be summarized as:

- BARS continued with the activities on strengthening the cooperation with international and domestic institutions, regional and other organizations,
- BARS continued to strengthen institutional capacities of the BARS and gradual transition to the new regulatory framework (harmonization with the provisions of the EU directives and Basel principles), as well as further development and improvement of the existing secondary regulatory framework.
- Ombudsman for the banking system of RS, who acts within the BARS, continued to perform the function of protection of rights of financial service consumers.

International activities of the authority

During 2021, the BARS continued with the activities on strengthening and improving the cooperation with international financial institutions, regional and other organizations, as well as bilateral cooperation with regulators from other countries. Apart from attending the meetings, the BARS responded, on a regular basis, to the inquiries, requests for data collection and questionnaires of international institutions and organizations (European Central Bank, European Banking Authority, International Monetary Fund, World Bank, EBRD, BSCEE, etc.).

In 2021 the European Commission (EC) adopted the Decision confirming the equivalence of the supervisory and regulatory framework in Bosnia and Herzegovina in relation to Regulation (EU) No. 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) no. 648/2012 (CRR) and Directive 2013/36/EU 2013 of the European Parliament and of the Council on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD).

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

Cooperation with other supervisory bodies in the country

The BARS continued to cooperate with home Supervisory Authorities through regular contacts and exchange of relevant information, sending SREP analysis and the participation of representatives of the BARS at the supervisory colleges organized by home supervisors.

In 2021, the BARS continued to actively cooperate with the Insurance Agency of RS and Securities Commission of RS in accordance with the Law on Committee for Coordination of RS Financial Sector Supervision.

Other relevant information and developments in 2021

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

Questionnaire tables for the 2021 BSCEE Review

All figures are stated in '000 EUR, unless stated otherwise.

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	8	8	8
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**8**	**8**	**8**

Total assets of banking sector (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks*	4,470,804	4,544,976	5,057,852
Branches of foreign credit institutions*	-	-	-
Cooperative banks*	-	-	-
Banking sector, total*:	4,470,804	4,544,976	5,057,852
y/y change (in %)	**2019/2018 Index 107 (+7%)**	**2020/2019 Index 102 (+2%)**	**2021/2020 Index 111 (+11%)**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	0	0	0
Domestic ownership total	34.8	36.1	37.0
Foreign ownership	65.2	63.9	63.0
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	64.6	85.8	1.753
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**64.6**	**85.8**	**1.753**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	9.7	5.1	10.4
Cooperative banks	-	-	-
Banking sector. total:	**9.7**	**5.1**	**10.4**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector. total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables	n/a*	n/a*	n/a*
Financial sector	n/a*	n/a*	n/a*
Nonfinancial sector	n/a*	n/a*	n/a*
Government sector	n/a*	n/a*	n/a*
Other assets	n/a*	n/a*	n/a*
Liabilities	n/a*	n/a*	n/a*
Financial sector	n/a*	n/a*	n/a*
Nonfinancial sector	n/a*	n/a*	n/a*
Government sector	n/a*	n/a*	n/a*
Other liabilities	n/a*	n/a*	n/a*
Capital	**n/a***	**n/a***	**n/a***

** a breakdown of the whole balance sheet into these categories is not possible because this structure is only given for loans and deposits, Loans and deposits structure is given in a table below.*

Capital adequacy ratio of banks

Type of financial institution	2019***	2020***	2021***
Commercial banks	18.3	19.3	19.2
Cooperative banks	-	-	-
Banking sector. total:	**18.3**	**19.3**	**19.2**

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

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

Asset classification	2019	2020	2021
Non-financial sector. Including	6.9	5.2	4.0
households	7.6	5.1	3.9
corporate	7.2	5.5	4.0

**Asset portfolio quality indicator is stated as: share of non-performing loans / total gross loans.*

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector. including:	82.1	87.9
Households	57.5	49.0
Corporate	24.6	38.9
Government sector	13.4	11.1
Financial sector (excluding banks)	4.6	1.0
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	150,945	150,696	157,569
Interest expenses	31,946	30,057	29,624
Net interest income	118,999	120,638	127,945
Net fee and commission income	-	-	-
Other (not specified above) operating income (net)	-	-	-
Gross income	204,933	204,936	225,083
Administration costs	114,940	122,600	125,634
Depreciation	-	-	-
Provisions	-	-	.
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans. ...)	16,582	35,227	12,785
Profit (loss) before tax	54,884	29,071	63,738
Net profit (loss)	43,397	26,999	59,030

Total own funds in 2021 (in ‘000 EUR)

Type of financial institution	Total own funds ***	Core Tier 1***	Tier 1***	Tier 2***	Tier 3***
Commercial banks	514,274	488,814	491,882	22,392	-
Cooperative banks	-	-	-	-	-
Banking sector. total:	**514,274**	**488,814**	**491,882**	**22,392**	**-**

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

Macroeconomic environment in the country

After the fall of GDP in 2020, caused by the spread of COVID-19 pandemic, in 2021 the economic activity in Bulgaria has been recovering gradually, with real GDP growth amounting to 4.2%. The supporting factors have been the improved business and household confidence, the stimulating fiscal measures, and the low interest rate environment.

In 2021 private consumption increased by 8.0% in real terms, backed by the strong growth in nominal employment income and in net fiscal transfers to households[1]. Wage growth accelerated in both the private and the public sector, as the minimum wage was raised in the beginning of the year[2]. Government consumption increased by 4.0% in real terms, supported by higher expenditure for healthcare and personnel. Fixed capital investment decreased by 11.0% in real terms in 2021, a contribution of lower public and private investment[3].

Net exports had a negative contribution to GDP in 2021 due to the trade in goods, with imports supported by rising household expenditure. The trade in services had a positive impact, as services related to travel and transport, for which Bulgaria is a net exporter, partially recovered.

Gross value added in the economy increased by 3.6% in 2021, with improvement in all main sectors of the economy.

The unemployment rate decreased to 5.5% in 2021 (7.4% in 2020) as labour market improved, backed by the gradual recovery of the economy and the continued effect of the fiscal measures adopted in 2020. Real growth in compensation per employee stood at 6.5% in 2021 (5.9% in 2020), while labour productivity[4] increased by 4.0%. Nominal unit labour costs increased by 5.4%, while decreasing by 0.8% in real terms.

In 2021, inflation in consumer prices accelerated, with HICP annual inflation reaching 6.6% at the end of the year (0.0% in end-2020), mostly reflecting the significant rise in global energy and food prices.

As of December 2021, Bulgaria's gross external debt amounted to EUR 41.5 billion (61.2% of GDP), having increased by EUR 1902.0 million compared to end-2020.

Development in the banking sector (including assets total / GDP)[5]

The recovery impulse in the economy in 2021, accompanied by the government's measures to support business and households, contributed to an increase in the total assets of the banking system by 9.3% (BGN 11.6 billion) to BGN 135.4 billion. The amount of loans and advances was higher than in 2020, while their share in the total assets decreased to 58.1% (58.9% in 2020). The share of „cash, cash balances at central banks and other demand deposits" was 21.0%, while debt securities held a 16.3% share in the balance sheet.

The ratio of the banking system's total assets to GDP was 102.0% as of end-2021.

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1 The underlying factor for growth in net fiscal transfers to households in 2021 was the substantial increase in pension costs.

2 From the beginning of 2021, minimal wage was raised from BGN 610 to BGN 650.

3 According to an assessment by the Bulgarian National Bank. Estimates of private and government investment are made using published national account data on total investment in the economy and data for the investments of the "public administration" sector for 2021, presented in the revised medium-term budget forecast 2022–2024 (published 10 March 2022).

4 Labour productivity for the economy as a whole is calculated based on real GDP. Labour productivity by sector is calculated based on value added for that sector in real terms.

5 Based on supervisory statements on an individual basis as of end-December 2021 submitted by 17 February 2022 and as of end-December 2020 revised by 24 February 2022.

Loans and Deposits

In 2021 the gross loan portfolio[6] increased by BGN 6.4 billion (9.2%), amounting to BGN 75.9 billion. Loans to households grew most significantly in absolute terms (by BGN 3.6 billion, 13.9%) and their share in the loan portfolio increased to 38.8% (37.2% in 2020). Loans to non-financial corporations also rose, while their share decreased to 53.1% (54.7% in 2020).

In 2021 gross loans and advances denominated in BGN were 63.0% of the total, while claims in EUR and in other currencies were 33.6% and 3.4%, respectively.

The deposits in the banking system increased by BGN 9.6 billion (9.1%), totalling BGN 115.4 billion at the end of 2021. Household deposits had the biggest contribution to deposit growth and amounted to 59.0% of total deposits.

Market structure

At the end of 2021, there were 25 credit institutions and foreign branches, of which one was a state-owned bank. Five banks were classified as significant institutions (SIs), which are under the direct supervision by the ECB, with 66.6% share of the total assets in the local banking system. Thirteen credit institutions were classified as less significant (LSIs), remaining under the direct supervision by the BNB, with 30.4% share in the total assets, while the share of foreign bank branches was 3.0% of the assets of the banking system.

Asset quality

The gross amount of all non-performing exposures[7] decreased to BGN 4.90 billion as of end-2021 (BGN 5.70 billion at end-2020) and their share fell to 3.8% of all exposures (4.8% at end-2020).

The share of non-performing loans was lower in all sectors, a result of the sale or write-off of non-performing loans by banks, as well as growth of the loan portfolio. Additionally, the *Procedure for Deferral and Settlement of Liabilities Payable to Banks and Their Subsidiaries*[8], in effect until the end of December 2021, helped to avoid abrupt changes in the indicators for asset quality, which may have otherwise arisen due to the economic shock from the implemented anti-pandemic measures.

Compared to end-2020, gross non-performing loans and advances in the banking system decreased by 14.2% to BGN 4.89 billion and their share in the total loans and advances (based on the narrower reporting scope[9]) was 5.9% at the end of 2021 (7.4% at end-2020). The net amount of non-performing loans and advances[10] decreased by 16.3% to BGN 2.5 billion and remained fully covered by the capital surplus above the minimum regulatory requirements and capital buffers. Calculated based on the narrower reporting scope for loans and advances, their share decreased to 3.2% at the end of 2021 (4.2% at end- 2020).

6 The scope of the loan portfolio comprises the sectors non-financial corporations, households, other financial corporations and general governments. Gross loans and advances and deposits are reported in Macroprudential Reporting Form 1 (MPF1).

7 Non-performing exposures are defined according to the broadest definition in the EBA methodology, which includes gross loans and advances (including cash balances at central banks and other demand deposits) as well as debt securities, other than held for trading.

8 On 9 April 2020, the Bulgarian National Bank approved a „Procedure for Deferral and Settlement of Liabilities Payable to Banks and their Subsidiaries – Financial Institutions", constituting a private moratorium within the meaning of the Guidelines of the European Banking Authority on legislative and non-legislative moratoria on loan repayments applied in response of the COVID-19 crisis (EBA/GL/2020/02). At the end of March 2021, the submission deadline expired and the deadline for the validity of the moratorium expired on December 31, 2021.

9 Regulation (EU) No 2020/429 amending Implementing Regulation (EU) No 680/2014 on supervisory reporting introduced changes in the scope of the reported gross loans and advances, wherein the item "cash balances at central banks and other demand deposits" is no longer reported as part of the gross loans and advances as of end-June 2020.

10 The net amount of non-performing loans and advances is calculated according to EBA methodology and their gross amount is reduced with the accumulated impairment inherent to them. When calculating their share, the net value for both non-performing loans and advances and the total loans and advances is used.

Owing to banks acquiring debt instruments of the *general governments* sector, the amount of debt securities in the balance sheet reached BGN 22.0 billion at the end of 2021 (BGN 17.6 billion at end-2020).

Profitability

The profit of the banking system at the end of 2021 amounted to BGN 1.4 billion (BGN 693 million at end-2020). After being significantly restrained in 2020, total net operating income increased by 8.8% to BGN 4.5 billion in 2021, owing to higher net income from fees and commissions, net interest income and net income from financial instruments. Additionally, impairment costs on financial assets and costs from contributions to resolution funds and deposit guarantee schemes were lower. The ratios ROA and ROE increased to 1.05% and 8.57%, respectively (from 0.56% and 4.57%, respectively, in 2020).

Impairment costs for 2021 amounted to BGN 0.6 billion (BGN 1.0 billion in 2020), while the ratio of impairment costs to net operating income fell to 14.3% (23.7% at end-2020). The cost to income ratio[11] of the banking system improved to 49.0%, from 54.3% in 2020.

Solvency

The capital position of the banking system remained stable in 2021 and the reported capital ratios were significantly above the regulatory requirements. The Bulgarian National Bank maintained its consistent conservative prudential policy, aiming to accumulate and retain capital buffers in the banking system, in combination with the macroprudential measure on profit capitalization. Own funds in the banking system increased by 5.6% and amounted to BGN 15.4 billion at the end of 2021. Tier 1 capital and Common Equity Tier 1 (CET1) capital were BGN 15.0 billion and BGN 14.8 billion, respectively. The total risk exposure amount rose by 5.7% to BGN 68.3 billion, mainly owing to the growth of risk-weighted credit risk exposures.

At the end of 2021 the ratios of CET1 capital, Tier 1 capital and total capital adequacy were 21.66%, 22.04% and 22.62%, respectively (21.61%, 22.02% and 22.66%, respectively, at end-2020). All credit institutions observed the minimum capital requirements and the capital buffer requirements[12]. The amount of capital in the banking system above the minimum capital and capital buffer requirements amounted to BGN 4.8 billion, 5.7% higher than in end-2020.

The leverage ratio of the banking system[13] was 10.50% at the end of 2021, indicating a high level of capital coverage of the banking system's total exposures. All credit institutions maintained a leverage ratio significantly above the minimum requirement of 3.0%.

Liquidity

The liquidity position of the banking system remained stable in 2021, with all credit institutions exceeding the minimum regulatory requirement for liquidity coverage of 100%. The liquidity coverage ratio (LCR) of the banking system was 274.1%, compared to 278.9% in 2020.

The liquidity buffer grew by 14.6% and reached BGN 41.5 billion, withdrawable central bank reserves amounting to 51.6% of the liquidity buffer. Net liquidity outflows increased by 16.6% to BGN 15.1 billion.

At the end of 2021, the net stable funding ratio (NSFR[14]) of the banking system was 166.0%, with all credit institutions observing the minimum requirement of 100%.

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11 The cost-to-income ratio according to the new methodology is calculated as the sum of administrative costs, amortization costs and (from June 2020) resolution fund and deposit guarantee scheme costs related to net operating income.

12 More information on the effective capital buffer rates is available on the BNB website: (Bulgarian National Bank (bnb.bg).

13 Calculated using a fully phased in definition of Tier 1 capital. The regulatory requirement for the leverage ratio was introduced on 28 June 2021 in compliance with Regulation (EU) 2019/876 of the European Parliament and of the Council, amending Regulation (EU) No 575/2013.

14 The regulatory requirement for the NSFR was introduced on 28 June 2021 in compliance with Regulation (EU) 2019/876 of the European Parliament and of the Council, amending Regulation (EU) No 575/2013.

The loan-to-deposit ratio (LTD)[15] for the banking system remained at a similar level to the year before, amounting to 69.4% at the end of 2021 (69.0% at end-2020).

Products and distribution channels

At the end of 2021 there were 52 points of sale (branches, offices, representative offices and remote workstations), 76 ATMs and 1628 POS terminals per 100 000 population.

The legal and institutional framework of the operation and supervision of financial institutions, new developments legal competence of the Banking Supervisory Authority in Bulgaria

In general, the activity of banking supervision in Bulgaria is based on the European regulatory framework for credit institutions (CRD/CRR, BRRD, AMLD, etc.), including the EC delegated acts in relevant areas, the EBA guidelines and the ESRB recommendations.

In early 2021, the National Assembly adopted amendments to the Law on credit institutions (LCI) to introduce the requirements of Directive (EU) 2019/878 of the European Parliament and of the Council amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers, and capital preservation measures. The adopted amendments include also the extended definition of 'credit institution', which already covers investment intermediaries that are significant for the EU financial system.

In connection with the amendments to the LCI, the Governing Council of the BNB adopted amendments and supplements to Ordinance No. 2 of the BNB of 22 December 2006 on the Licenses, Approvals and Permissions Granted by the Bulgarian National Bank According to the Law on Credit Institutions, which regulate the terms and conditions for issuing approval of a financial holding or a mixed financial holding under Art. 35a of the LCI, including other relevant requirements.

The corresponding amendments (related to financial holdings or mixed financial holdings) were also made in Ordinance 20 of the BNB of 24 April 2019 on the Requirements to the Members of the Management and Controlling Bodies of a Credit Institution and on the Assessment of the Suitability of Their Members and Key Function Holders.

The BNB Board also adopted amendments and supplements to Ordinance No. 4 of the BNB of 21 December 2010 on the Requirements for Remunerations in Banks, which attach greater importance to the principle of proportionality in compliance with the requirements. The range of persons to whom the remuneration policy applies shall be specified by precisely specifying the management levels and criteria for the categories of persons commensurate with persons in management positions.

Ordinance No. 7 of the BNB of 24 April 2014 on Organisation and Risk Management of Banks was amended to align it with the relevant requirements within the SSM, e.g. on the materiality threshold of the credit obligations past due under Art. 178(1)(b) of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, within the exercise of discretion under that Regulation. The

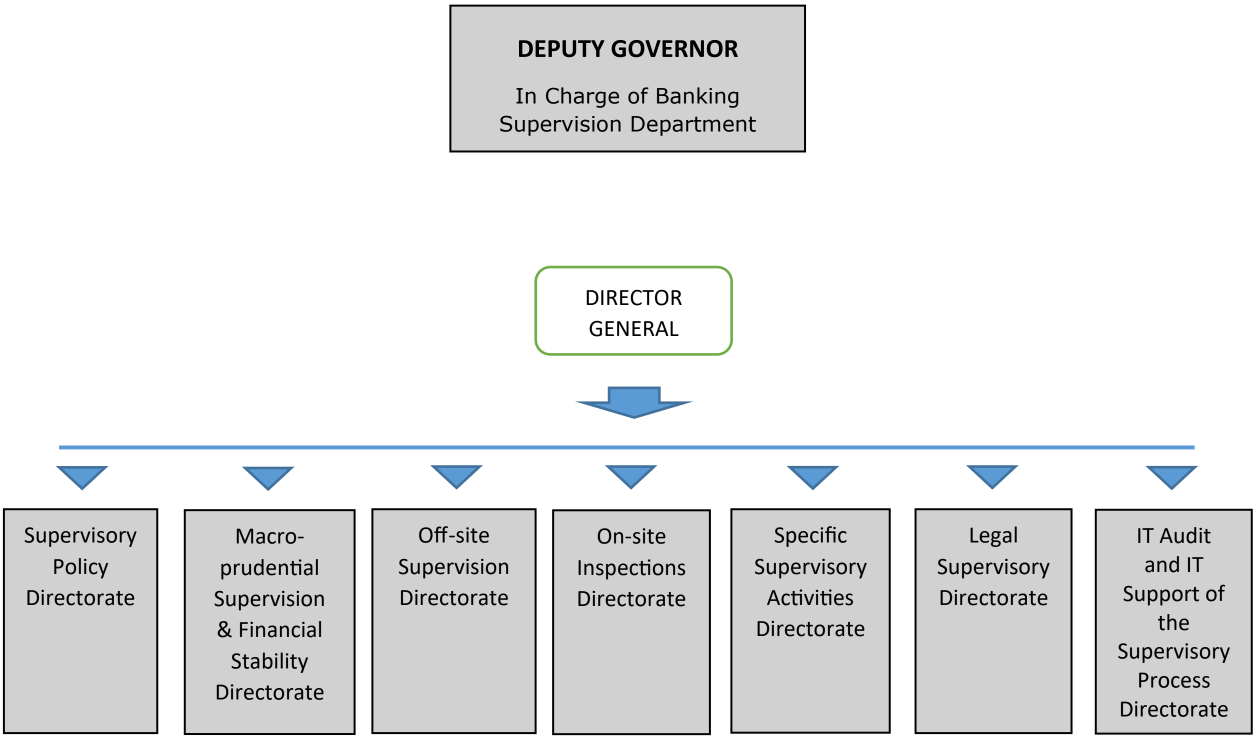
[15] Source: Macroprudential Reporting Form 1 (MPF1). The ratio is calculated excluding central banks and credit institutions from the numerator and denominator.

requirements for the management of interest rate risk in banking book, etc. have been further developed within the said amendments.

The BNB Board adopted a new Ordinance No 8 of the BNB of 27 April 2021 on Banks' Capital Buffers, resulting from the accumulation of a significant substantive changes and additions due to the extended delegation in Art. 39, para. 2 and para. 3 of the LCI. The new ordinance upgrades the rules defining the applicable levels for systemic risk buffer and of the buffer for significant institutions, and develops further the way they interact, etc.

In terms of exercising its supervisory tasks in close cooperation with ECB, by pursuing a common approach to ongoing supervision, in 2021 the BNB Governing Council took a decision for adopting the SSM's Supervisory Manual and supervisory standards. In this relation, the existing framework of internal rules of the BNB was updated.

Organisational chart of the Banking Supervisory Authority



Main strategic objectives of the supervisory authority in 2021

By joining the SSM in October 2020, the main priority tasks of the BNB continued to be bound to ensuring safe and sustainable development of the Bulgarian banking system, which is closely connected with the European one, to strengthening financial integration and the implementation of consistent supervision.

With regard to policy issues related to prudential supervision, representatives of the BNB shall participate in committees and bodies of the ECB, as well as in several vertical-and-horizontal line working structures, supporting the ECB's activity in relation to the tasks arising from the mandate conferred on it by Regulation (EU) No 1024/2013.

The activities of the Banking Supervisory Authority in 2021

In 2021, the off-site supervisory activity under the supervisory review and evaluation process (SREP) was focused on the ongoing monitoring of the risk indicators (KRI) of less significant credit institutions (LSI's) in line with the SSM methodology. Furthermore, the annual review and evaluation of banks' documents was conducted on the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP) as of 31 December 2020, as well as on their implementation by the boards for capital planning, liquidity management and budgeting. Respectively, institutions' funding plans for a three-year period (2021-2023) were reviewed. In terms of the moratorium on bank loans repayment that were applied in relation with Covid-19 anti-pandemic measures, checks and analyses were carried out on the monthly reports of the institutions.

Over the past year, within the close cooperation with the ECB, BNB experts were participating in joint supervisory teams (JST) with the SSM in the preparation of capital and liquidity assessments of SIs. In terms of supervision of less significant institutions, regular meetings were held between the relevant divisions in the BNB and the ECB where experts from both competent authorities were exchanging their expertise and experience in the SREP implementation for L-SI banks.

In 2021, the supervisory inspections were carried out in the way of "off-site", from home and from supervisory offices. They were focused on reviewing and assessing the level and management of credit risk, verifying the quality of risk reporting for supervisory purposes. Under the ECB mandate, a particular inspection of BNB was carried out for assessing the updates in internal bank models undertaken by a subsidiary bank operating in Bulgaria. In addition to carrying out ongoing supervisory tasks, representatives of the BNB in the JSTs of significant institutions took part in the annual inspection planning process, which is organised and managed by the ECB.

The BNB's macroprudential mandate is implemented through regular monitoring and analysis of the economic environment and the factors influencing the activity and state of the banking system. The object of assessment is the cyclical and structural dimensions of the systemic risk, for the mitigation of which a set of macroprudential measures and instruments is applied. The macroprudential measures implemented by the Bulgarian National Bank remained in effect for most of 2021 and included restrictions on distributions[16], limits on foreign exposures and temporary cancellation of the planned increases in the counter-cyclical capital buffer (CCyB), which stayed at 0.5%. In view of the elevated credit growth, especially in the segment of loans for house purchase, and given the uncertainty in the economic outlook, in September 2021 and December 2021 the BNB Governing Council increased the CCyB rate applicable to domestic credit risk exposures from 0.5% to 1.0% in effect from 1 October 2022 and to 1.5% in effect from 1 January 2023, respectively.

With regard to structural risks, following the 2021 review of the systemic risk buffer, the BNB Governing Council confirmed the level of 3% in order to maintain the sustainability of banks against the realization of structural risks that could affect the sustainability of the financial system in Bulgaria. Otherwise, the buffer levels for O-SIs will remain in the range of 0.5% and 1%.

The BNB continued to perform its supervisory mandate of controlling banks' adherence (significant and less significant) to the requirements of the Law on the Measures against Money Laundering (LMML) and the Law on the Measures against Financing of Terrorism (LMFT) after its accession to the SSM and the establishment of close cooperation with the ECB.

As usual, the main priority in the "specific supervisory activity" is to examine the policies and procedures implemented in banks to combat money laundering and terrorist financing. The focus in this area is placed

[16] At the end of 2020, the BNB remained in effect its macro prudential measures in a coordinated manner and in concert with the announcement of the EBA for an extension of the EU-wide supervisory measures in relation to Covid-19 pandemic (link).

on the continuous and consistent application of the requirements for thorough customer verification ("know your customer"), as well as to basic and further training of the staff, and enhancing administrative capacity in the business departments of the credit institutions and of credit intermediaries. Thematic inspections are also carried out to cover the main risks identified in the National Risk Assessment and in connection with the exchange of information with other competent authorities.

The BNB monitors the compliance with the requirements set in Art. 3a of the Law on Credit Institutions (LCI) and the BNB Ordinance No 26 for financial institutions through examinations of the accuracy of internal rules, the data contained in reports and other information needed for the control regarding the Ordinance's requirements. The regulator's efforts to take action against unregistered persons suspected of operating without registration as financial institution continued.

In 2021, supervisory inspections, e.g. in the ongoing prudential supervision, prevention of money laundering and terrorist financing, on mortgage lending for consumers, etc. were conducted mainly off-site, according to scope and intensity of national measures against Covid-19.

During the period, an IT audit framework based on a risk-based approach integrated with banking supervision processes was developed and adopted, in line with the recommendations of EBA and the SSM in this area. The framework defines the management, planning, conduct and reporting of IT audits. Risk assessments in the field of information and communication technologies (IT) used by credit institutions have been prepared.

International activities of the authority

After joining the SSM, a change in some of the activities, responsibilities and tasks of the BNB as a competent Supervisory Authority over the activities of credit institutions in Bulgaria occurred following Decision (EU) 2020/1015 of 24 June 2020 of the ECB, which established close cooperation between the BNB and the ECB starting on 1 October 2020. As a result, the BNB joined the Single Supervisory Mechanism (SSM) and acquired the status similar as of a competent authority from a participating Member State within the meaning of Art. 2, item 1 of Regulation (EU) No 1024/2013.

By decision of the Governing Council of the BNB, the Deputy Governor in charge of banking supervision was nominated and assumed his functions as a representative of the BNB in the Supervisory Board (SB) of the ECB, with the same rights and obligations as everyone else, including with voting rights. On rotation principle, the BNB member in the SB was appointed for one of the five representatives of national supervisors in the Steering Committee.

At EU level, the BNB representatives in Standing Committees and Working Groups at the EC and EBA continued their participation in meetings and TelCos. The topics discussed were related to elaboration of common policies and standards for supervision, cooperation and coordination in joint assessments and decisions within supervisory colleges, in peer reviews on the level of convergence between national practices of implementation of the EU prudential requirements and framework.

The BNB continued to participate in cooperation between member states' NCAs in the field of combating money laundering and terrorist financing, and on other topics of common interest. The most important of them concern the policies and actions of banking groups to improve the efficiency of systems for risk monitoring and minimisation, the protection of consumer rights, and the financial innovations.

In the context of the pandemic crisis, the work of the European Systemic Risk Board (ESRB) over the past year was particularly important. The BNB representatives were regularly taking part in its advisory and working structures at the respective levels. Highest priority for preserving financial stability was placed on risks in the areas of: bank profitability and sustainability, indebtedness and viability of borrowers, systemic liquidity risk, and sustainability of business models in the insurance and pension funds sectors.

In December 2021, the Technical Cooperation Program with the central banks and Supervisory Authorities of the Western Balkan – from candidate countries and potential candidates for EU membershipp was completed. It was funded by the EU and managed by the Deutsche Bundesbank. The BNB participated in the Programme, together with other central banks, members of the ESCB, and with the ECB. Experts from the BNB were lecturers in trainings for the beneficiary authorities in the field of (statistics and) banking supervision.

Bilateral consultations and activity agreed with the Central Bank of the Republic of Kosovo in the field of combating money laundering and terrorist financing have been successfully completed.

Cooperation with other supervisory bodies in Bulgaria

In accordance with their powers under the Law on Measures against Money Laundering (LMML) and the Instruction for Conducting Joint Inspections (effective from 14.02.2020), BNB experts conducted joint examinations with representatives of the Financial Intelligence Directorate to the State Agency for National Security (FID-SANS). Both authorities also developed guidelines for commercial banks regarding the application of the requirements of the LMML.

In connection with the bank deposit guarantee, the BNB keeps up a cooperation with the Bulgarian Deposit Insurance Fund (BDIF). BDIF regularly monitors the reports provided by the credit institutions, and upon request by the BDIF, Bulgarian National Bank shall conduct targeted inspections of relevant banks.

The BNB keeps a cooperation also with the Commission for Consumer Protection in cases of complaints and alerts received from consumers of banking and financial services. Supervisory experts prepare opinions and replies to the complainants and to the Commission, which has a mandate for providing protection in case of infringed consumer rights and interests.

Other relevant information and developments in 2021

from 1 October 2020, the ECB is responsible for the direct supervision of eligible significant institutions (SIs). In parallel, the ECB is also responsible for monitoring institutions identified as less significant (LSIs) and the general procedures for all credit institutions.

Since Bulgaria is not a member state of the Eurozone and the decisions of the ECB have no legal force in Bulgaria, the BNB issues individual administrative acts in respect of significant institutions at the request of the ECB.

Direct supervision of credit institutions identified as less significant continues to be carried out by the BNB in harmonisation with the supervisory process of the ECB.

Questionnaire tables for the 2021 review[17]

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	19	18	18
Branches of foreign credit institutions	5	6	7
Banking sector, total:	**24**	**24**	**25**

Total assets of banking sector (at year-end) (EUR'000)

Type of financial institution	2019	2020	2021
Commercial banks	56 601 160	61 303 530	67 163 185
Branches of foreign credit institutions	1 845 379	2 027 581	2 079 413
Banking sector, total:	58 446 538	63 331 111	69 242 598
y/y change (in %)	**8.3%**	**8.4%**	**9.3%**

Ownership structure of banks on the basis of assets total (%)

Item	2019	2020	2021
Public sector ownership	2.8	3.1	2.5
Domestically controlled total[18]	28.1	28.7	28.0
Foreign controlled total 2	71.9	71.3	72.0
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset based on market share in terms of total assets

Type of financial institution	The first three largest (%)	The first five largest (%)
Banking sector, total:	47.9%	66.9%

Return on Equity (ROE) (%)

	2019	2020	2021
Banking sector, total:	11.50	4.57	8.57

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	96.8	96.8	97.0
Branches of foreign credit institutions	3.2	3.2	3.0
Banking sector, total:	**100.0**	**100.0**	**100.0**

17 Data for 2020 is revised.

18 Based on the reporting methodology for the purposes of ECB Consolidated Banking Data.

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

Assets	2021
Cash, cash balances at central banks and other demand deposits	21.0
Financial assets held for trading	0.3
Non-trading financial assets mandatorily at fair value through profit or loss	0.5
Financial assets designated at fair value through profit or loss	0.0
Financial assets at fair value through other comprehensive income	8.7
Financial assets at amortised cost	65.5
Derivatives – Hedge accounting	0.0
Fair value changes of the hedged items in portfolio hedge of interest rate risk	0.0
Investments in subsidiaries, joint ventures and associates	0.4
Tangible assets	2.2
Intangible assets	0.3
Tax assets	0.0
Other assets	0.9
Non-current assets and disposal groups classified as held for sale	0.1
TOTAL ASSETS	**100.0**
Liabilities	**2021**
Financial liabilities held for trading	0.1
Financial liabilities designated at fair value through profit or loss	0.0
Financial liabilities measured at amortised cost	86.7
Derivatives – Hedge accounting	0.1
Fair value changes of the hedged items in portfolio hedge of interest rate risk	0.0
Provisions	0.3
Tax liabilities	0.1
Share capital repayable on demand	0.0
Other liabilities	0.5
Liabilities included in disposal groups classified as held for sale	0.0
TOTAL EQUITY	**12.3**
TOTAL EQUITY AND TOTAL LIABILITIES	**100.0**

Capital adequacy ratio of banks ***

	2019	2020	2021
Banking sector, total:	20.37	22.66	22.62

**** - for Basel III*

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

Asset classification (narrow scope)[19]	2021
Gross non-performing loans and advances to total gross loans and advances (%)	5.9
Net non-performing loans and advances to total net loans and advances (%)	3.2
Asset classification (broad scope)[20]	2021
Gross non-performing loans and advances to total gross loans and advances (%)	4.5
Net non-performing loans and advances to total net loans and advances (%)	2.4

The structure of deposits and loans and advances of the banking sector (%) (at year-end)[21]

	2020		2021	
	Deposits	Loans and advances	Deposits	Loans and advances
Central banks	0.0	0.0	0.0	0.0
General governments	2.9	1.2	2.6	1.2
Credit institutions	4.8	9.4	5.3	7.9
Other financial corporations	3.1	6.1	3.3	6.3
Non-financial corporations	30.0	49.6	29.8	48.9
Households	59.2	33.8	59.0	35.8
Total	**100.0**	**100.0**	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	1,548,946	1,535,142	1,554,747
Interest expenses	153,406	180,888	145,899
Net interest income	1,395,539	1,354,253	1,408,847
Net fee and commission income	565,554	531,182	635,504
Other (not specified above) operating income (net)	207,045	241,336	269,715
Total operating income, net	2,168,139	2,126,771	2,314,066
Administrative expenses	852,276	855,632	912,997
Depreciation	137,216	145,473	139,789
Provisions or (-) reversal of provisions	36,124	63,181	32,527
Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss	241,029	503,032	331,365
Profit or (-) loss before tax from continuing operations	928,257	397,489	812,650
Profit or (-) loss for the year	844,925	354,144	728,049

[19] The AQT 3.2.1.2 indicator introduced by the European Banking Authority (EBA) to measure the share of gross non-performing loans and advances is based on a narrower definition of loans and advances, according to which cash balances and other demand deposits are excluded. The narrow scope of loans and advances covers the credit portfolio and claims on credit institutions other than demand deposits.

[20] The AQT 3.2 indicator used by the EBA is based on a broad definition encompassing all counterparties, including cash balances at central banks and other demand deposits.

[21] Source: Macroprudential Reporting Form 1 (MPF1). Pursuant to the new reporting framework FINREP 2.9 introduced on 1 June 2020 with Regulation (EU) 2020/429 the items "cash balances at central banks" and "other demand deposits" are no longer included in the loans and advances.

Total own funds in 2021 (in EUR'000) ***

	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Banking sector, total:	**7,893,067**	**7,557,703**	**7,692,118**	**200,949**	

**** - for Basel III*

Macroeconomic developments in the country

Real gross domestic product increased in 2021 compared to 2020, when it saw a record decrease caused by the COVID pandemic. The average annual consumer price inflation accelerated in 2021, spurred by the strengthening of imported inflationary pressures, that is, the increase in prices of raw materials and some intermediate goods in the world's markets. The recovery in tourism revenues contributed the most to the increase in the current and capital account surplus, although favourable developments were offset by the increase in merchandise trade deficit and higher profits of foreign-owned banks and enterprises. The HNB continued its expansionary monetary policy; due to stable conditions in domestic financial markets, there was no need for extraordinary measures. The recovery in economic activity resulted in the improvement of the general government budget balance and a reduction in the public debt-to-GDP ratio.

Risks to financial stability gradually decreased in 2021 due to the economic recovery and good adjustment of enterprises to pandemic conditions. Growth in the income of households enabled a recovery in credit demand, while domestic demand and growing foreign demand continued to push up residential property prices. The HNB's 2021 macroprudential policy was focused on maintaining the high capitalisation of credit institutions to boost their resilience to possible losses. At the beginning of the year, the HNB thus temporarily restricted credit institutions' distributions, keeping capital buffers at the previous year's level. The HNB made a detailed analysis of the growth in housing loans and warned against excessive borrowing by certain groups of consumers.

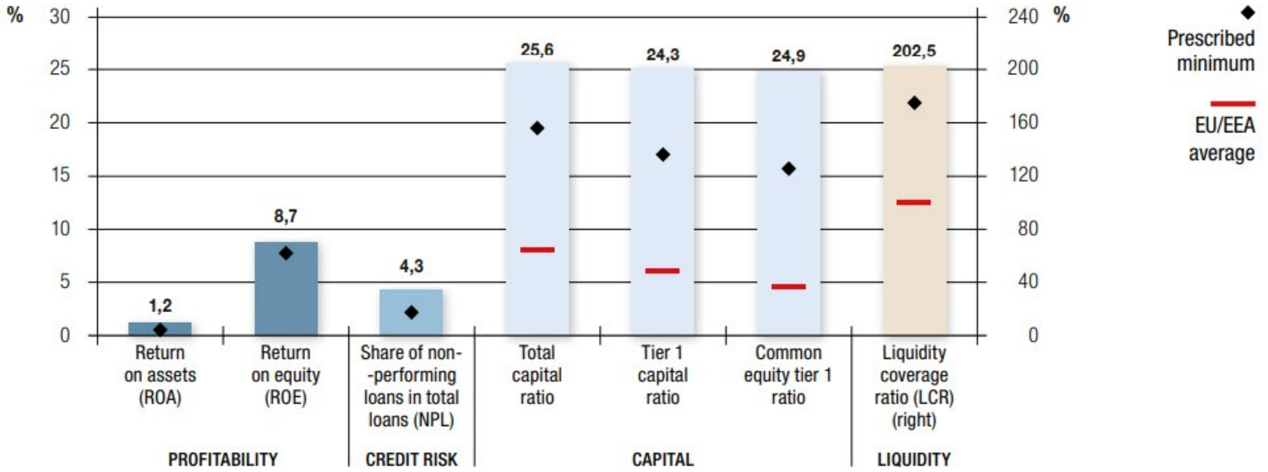
Development in the banking sector

At the end of 2021, there were 23 credit institutions operating in the Republic of Croatia: 20 banks and 3 housing savings banks, the same number as at the end of each of the previous two years. In addition, there was one branch of an EU credit institution operating in the country (BKS Bank AG, Main Branch Croatia), while around 200 institutions from the EU and the European Economic Area had notified the HNB of the intention to directly provide mutually recognised services in the territory of the Republic of Croatia.

The dominant share of credit institutions' assets, 90.6% of total banking system assets, was in the majority ownership of foreign shareholders. The years-long moderate decline in the number of employees continued, and at the end of the year 2021 the credit institutions system had 18,403 employees.

The assets of credit institutions rose to a record high of HRK 500.8 bn in 2021 and the key source of their growth was the increase in deposits on the current accounts of households and non-financial corporations. The uncertainties of the pandemic prompted credit institutions to caution in assuming additional risks, which was reflected in the increase of assets in the form of highly liquid monetary assets. The strengthening of these assets in total assets of credit institutions additionally pushed up the high level of the liquidity coverage ratio (LCR) to 202.5%, double the percentage of the prescribed 100%-minimum. The impact of these assets on the improvement in the quality of total assets was also favourable, contributing to maintaining the total capital ratio of all credit institutions of 25.6%, one of the highest ratios among EU member states.

Key banking system indicators: 31. December 2021



Source: CNB.

All credit institutions boasted total capital ratios higher than the prescribed minimum of 8%, with 10 of them, accounting for two thirds of total assets in the system, boasting total capital ratios above 20%. Credit activity in 2021 resulted in a 2.3% increase in loans. This increase was predominantly related to households, especially to the financing of housing loans facilitated by credit institutions participating in the government programme for subsidising these loans.

The quality of credit institutions' assets measured by the non-performing loans ratio, continued to improve, although this ratio, standing at 4.3%, continues to be less favourable than the EU average. Non-performing loans to non-financial corporates and households decreased, the improvement in the quality of loans to these sectors partly resulting from the sale in nonperforming claims. The share of NPLs in total loans to non-financial corporations decreased by 9.9.%, thanks to the increase in loan quality in all more important activities of this sector, except for transportation and accommodation and food service activities, especially susceptible to current economic disturbances. The share of NPLs in total loans to households was 6.6%, with the size of this share being primarily influenced by difficulties in the collection of general-purpose cash loans. Despite the improvement in the situation with NPLs, it became evident that in the performing share of the loan portfolio, which is not yet in default, the level of credit risk was high compared to the pre-pandemic period.

Credit institutions' operations in 2021 generated HRK 5.6 bn in profit, twice as much as in 2020. Profitability indicators increased as well – ROA totalled 1.2% and ROE 8.7%. In addition to value impairment costs significantly decreasing in 2021 from 2020, the increase in non-interest income, especially dividends, favourably affected profit. The main source of income, interest income, as at 31 December 2021 continued to decline under the influence of low interest rates, contained credit activity and strengthening of monetary assets in the assets of credit institutions. Credit institutions saved on general expenses, and this contributed not only to the increase in profit, but also to the better cost efficiency of their operations since they used less than half of their total net income to settle these expenses.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

Regarding new decisions, amendments and new subordinate regulations in the segment of prudential regulation, the main decisions in 2021 were:

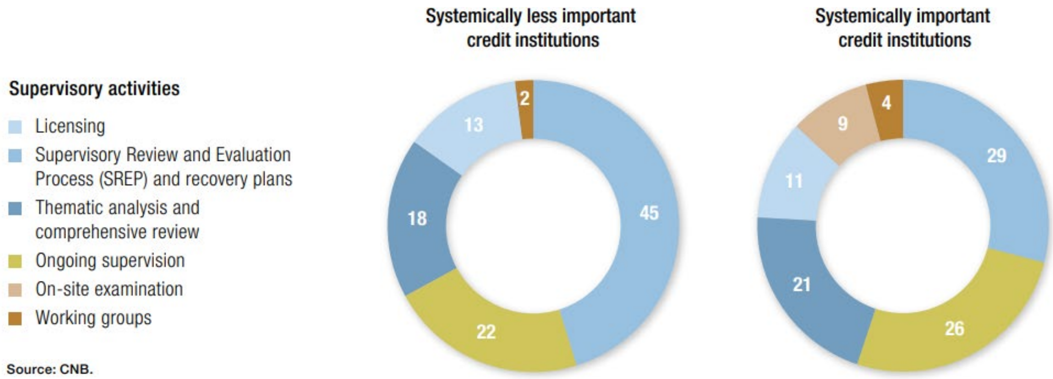
- Decision on the assessment of the suitability of the chairperson of the management board, members of the management board, members of the supervisory board and key function holders in a credit institution;
- Decision on the method of exercising supervision of credit institutions and imposing supervisory measures;
- Decision on the approval procedure for the methodology for determining the aggregate risk weight for credit institutions in the calculation of contributions to the deposit guarantee scheme;
- Decision on the cessation of effect of the Decision on the chart of accounts for credit institutions;
- Decision on resecuritisation, the disclosure of information on private securitisations, websites and supervisory fees.

The activities of the Banking Supervisory Authority in 2021

The year 2021 was the first year in which supervision functioned in the format of close cooperation with the ECB. The HNB's supervisors were fully integrated in joint supervisory teams and the Supervisory review and evaluation process (SREP) for significant credit institutions was carried out for the first time in accordance with the methodology of the Single Supervisory Mechanism.

HNB supervision continued to direct banks towards further adjustment to challenges in the pandemic environment, aiming at maintaining security, stability and confidence in the banking system.

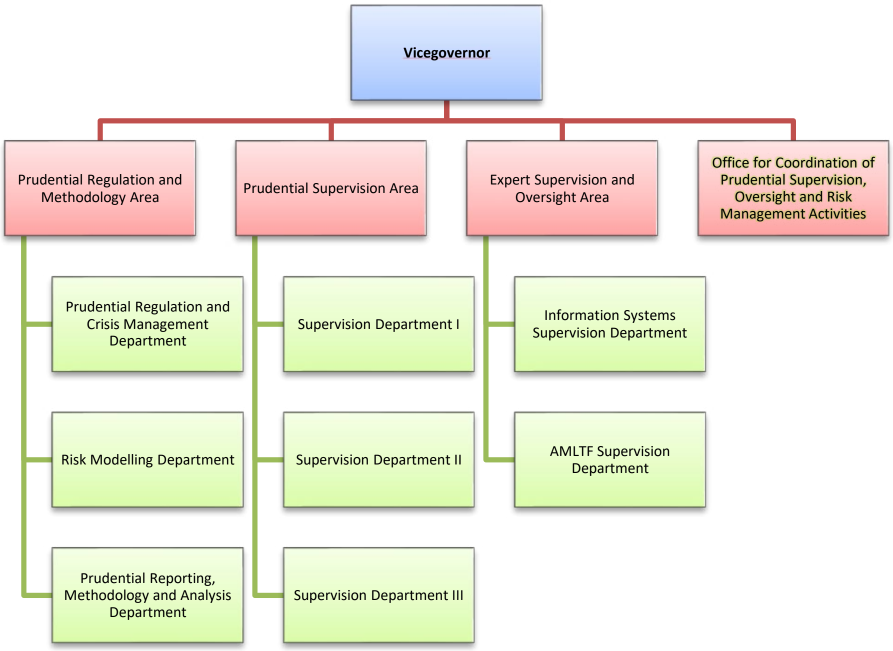
Supervisory activities were for the first time directed at the strategic guidelines and supervisory priorities of the Single Supervisory Mechanism embedded in the supervisory agenda pursuant to the principle of risk materiality and proportionality. The first year of the close cooperation with the ECB required considerable ongoing efforts to be invested in the work of joint supervisory teams for significant credit institutions and cooperation with ECB teams for monitoring the supervision of less significant credit institutions. The undertaking of 149 supervisory measures with respect to credit institutions was initiated to eliminate illegalities or weaknesses established in their operations. All credit institutions were covered by at least one of the six standard supervisory activities in 2021:



Source: CNB.

Organisational chart of the Banking Supervisory Authority:

The organisational chart of Banking Supervision function within the HNB has not been changed compared to previous year. Therefore, it consists of three main business areas and one office: Prudential Regulation and Methodology Area, Prudential Supervision Area, Expert Supervision and Oversight Area and Office for Coordination of Prudential Supervision, Oversight and Risk Management Activities.



Main strategic objectives of the Banking Supervisory Authority in 2021

Prudential supervision activities in 2021 were undertaken to ensure a safe and stable banking system. HNB supervision continued to direct banks towards adjustments to challenges in the pandemic environment, aiming at maintaining security, stability and confidence in the banking system.

The main characteristics of the banking system continue to be high capitalisation and liquidity and considerable resilience to negative shocks. The main Supervisory Priorities in 2021 were harmonised with SSM Supervisory Priorities and focused on credit risk management, capital strength, business model sustainability and governance.

Beyond these areas materially affected by the current crisis, supervisory activities were also directed at the ESG risk arena, money laundering, cyber and digitalisation risks.

Cooperation with other supervisory bodies in the country

Cooperation with other Supervisory Authorities in the country remained active throughout 2021. In COVID-19 environment, due to flexible collaboration and dedicated virtual/online sessions with other supervisory agencies the HNB managed to contribute to collective supervisory capacity. Continued communication and exchange of information enabled smoothly coordination.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	23	23	23
Branches of foreign credit institutions	1	1	1
Cooperative banks	-	-	-
Banking sector, total:	**24**	**24**	**24**

Total assets of banking sector (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	57.919,9	61.360,3	66.626,4
Branches of foreign credit institutions	370,9	391,6	432,8
Cooperative banks	-	-	-
Banking sector, total:	58.290,8	61.752,0	67.059,1
y/y change (in %)	**3,8**	**5,9**	**8,6**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	6,0	5,9	5,9
Domestic ownership total	9,5	9,3	9,4
Foreign ownership	90,5	90,7	90,6
Banking sector, total:	100.0	100.0	100.0

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	63,9	82,1	1.626,9
Branches of foreign credit institutions	100,0	100,0	10.000,0
Cooperative banks	-	-	-
Banking sector, total:	**63,5**	**81,5**	**1.606,4**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	9,8	4,4	8,8
Cooperative banks	-	-	-
Banking sector, total:	**9,8**	**4,4**	**8,8**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	99,4	99,4	99,4
Branches of foreign credit institutions	0,6	0,6	0,6
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables			
Financial sector	27,1	29,0	32,1
Nonfinancial sector	47,6	45,7	43,8
Government sector	22,8	23,0	22,0
Other assets	2,5	2,3	2,1
Liabilites			
Financial sector	9,6	10,5	9,1
Nonfinancial sector	68,7	69,4	71,4
Government sector	6,9	5,8	5,4
Other liabilities	0,9	0,8	0,9
Capital	**13,9**	**13,4**	**13,1**

Capital adequacy ratio of banks

Type of financial institution	2019***	2020***	2021***
Commercial banks	24,8	25,6	25,9
Cooperative banks	-	-	-
Banking sector, total:	**24,8**	**25,6**	**25,9**

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

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

Asset classification	2019	2020	2021
Non-financial sector, including	8,8	9,2	7,8
households	5,8	7,1	6,6
corporate	13,6	12,5	9,9

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	88,0	74,0
Households	63,3	46,4
Corporate	24,7	27,6
Government sector	6,5	16,9
Financial sector (excluding banks)	5,4	9,0
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	1.641,1	1.499,9	1.427,8
Interest expenses	206,8	163,8	135,9
Net interest income	1.434,3	1.336,0	1.291,9
Net fee and commission income	484,5	428,3	480,0
Other (not specified above) operating income (net)	268,7	185,8	352,1
Gross income	2.187,5	1.950,1	2.124,0
Administration costs	878,7	937,7	901,2
Depreciation	135,6	134,1	133,4
Provisions	174,5	85,6	138,1
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	103,9	355,9	61,3
Profit (loss) before tax	894,7	436,8	890,1
Net profit (loss)	779,5	357,3	748,9

Total own funds in 2021 (in EUR)

Type of financial institution	Total own funds***	Core Tier 1***	Tier 1***	Tier 2***	Tier 3***
Commercial banks	8.442,3	8.207,9	8.287,2	155,1	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**8.442,3**	**8.207,9**	**8.287,2**	**155,1**	**-**

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

Macroeconomic environment in the country

In 2021, the Czech economy was recovering from the economic disruption resulting from the COVID-19 pandemic. The real GDP increased by 3.3%[1], driven by the strong increase of capital expenditures and household consumption reflecting the easing of pandemic-related retail trade and services restrictions. Despite economic growth, the overall economic activity was still lagging behind the year 2019. Decrease in the foreign demand associated with global supply chain disruptions negatively affected the country's large export-oriented manufacturing industry, resulting in net exports holding back the overall performance of the economy.

The average inflation rate measured by CPI stood at 3.8% in 2021 as the consumer price index gradually increased throughout the year. The main contribution to this increase was attributable to items such as transport, housing, water, electricity, gas and other fuels, or alcoholic beverages and tobacco.

Key interest rates stayed at very low levels for most of the first half of 2021. Owing to growing domestic and foreign inflationary pressures, the CNB subsequently gradually raised its two-week repo rate to 3.75% in a total of five steps, especially during the second half of the year. The interest rates in the Czech Republic thus bounced back from the all-time lower bound of 0.25% and exceeded the pre-pandemic level of 2.25% in February 2020).

In response to the rapid widening of the interest differentials, the Czech koruna reacted to developments by appreciating significantly against all reserve currencies. However the Czech currency turned in its previous gains and closed the year lower against the US dollar, pound sterling and the Chinese renminbi as compared with the end of 2020 levels.

The domestic tight labour market cooled only partially during the pandemic with the general unemployment rate reaching 2.9%. The main contributing factor to the 0.3 percentage point year-over-year increase was the gradual termination of government support programs, which were to some extent offset by the impact of the economic recovery. The average nominal wage increased by 6.1% (2.2% in real terms).

Development in the banking sector (including assets total / GDP)

As of the end of 2021, the banking sector of the Czech Republic was represented by 23 domestic banks (including five building societies), seven credit unions and 22 branches of foreign banks. The group of four largest banks held 59.6% of the total assets of the banking sector.

The total assets of the Czech banking sector amounted to CZK 8,531.8 billion, which corresponded to increase of 6.9% year-over-year. The relative size of the Czech banking sector expressed by the ratio of total bank assets to GDP remained unchanged in 2021, as the ratio stood at 139.7%.

In terms of liquidity, the domestic banking sector enjoys long-term favourable characteristics in the context of a permanent surplus of client deposits over client loans (142.7%). The share of quick assets in the sector's total assets remained practically unchanged at 40.8%.

The loan portfolio quality improved mostly due to the lower amount of non-performing loans. The NPL ratio calculated on the total client loans basis declined to 2.4%, i.e. 0.3 percentage point lower than the previous year.

[1] Source: Czech Statistical Office - based on constant prices assumption and adjustment for seasonal and calendar effects.

A total net profit generated by banking entities in 2021 amounted to CZK 70.3 billion, i.e. 48.2% more than in the previous year. The growth was mainly driven by a reduction of impairment on financial asset losses. Return on equity expressed by the ratio of total net profit to Tier 1 capital reached 11.4%, i.e. increase of 3.2 percentage points year-over-year.

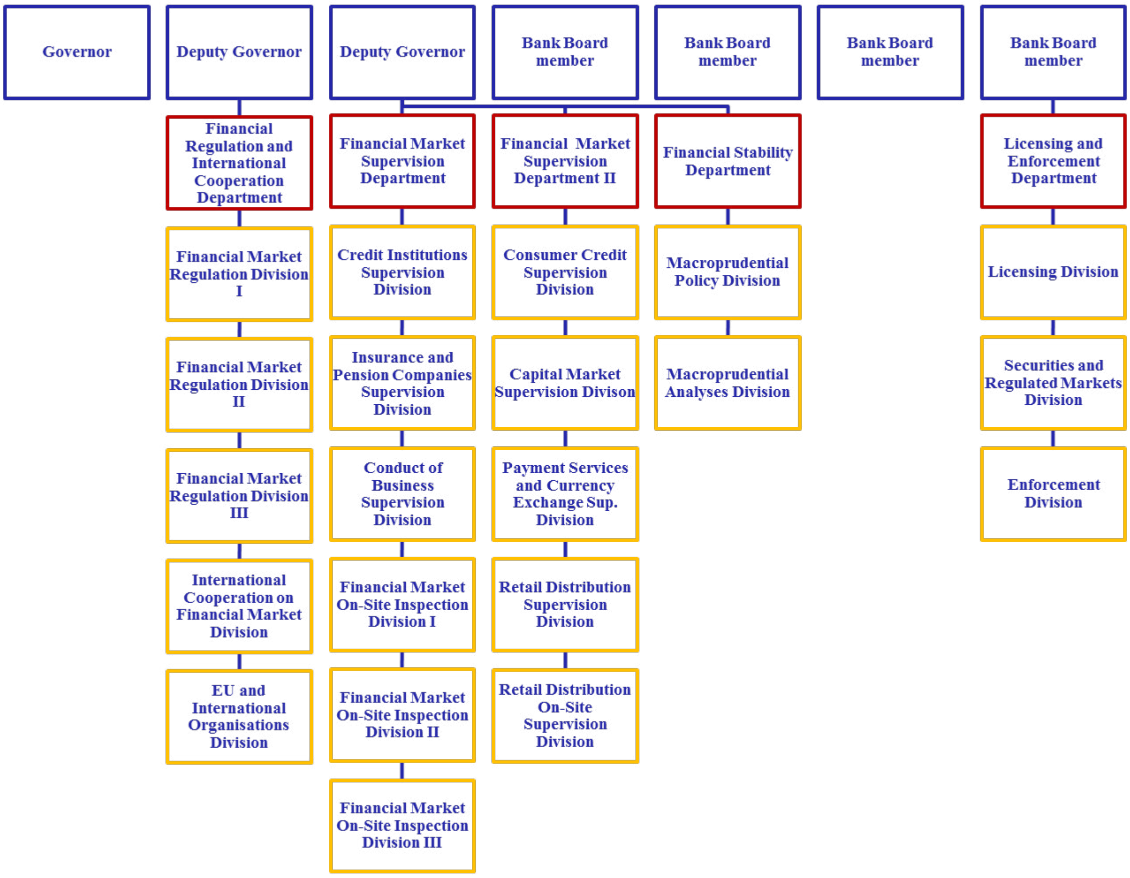
The Czech banking sector remained well capitalised, as the Tier 1 capital rose in 2021 by 5.8% to CZK 622.9 billion. The total capital ratio of banks operating in the Czech Republic was 23.5%, which corresponds to 0.8 percentage point decrease as compared with 2020. Nevertheless, domestic banks safely met the capital requirements defined by CRD IV / CRR throughout 2021.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

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

Organizational chart of the Banking Supervisory Authority

Chart 1: Simplified chart of CNB supervisory organisation as of 31st December 2021



Main strategic objectives of the Banking Supervisory Authority in 2021

As defined by Act No. 6/1993 Coll., on the Czech National Bank, the CNB's general objective in the area of supervision is to ensure financial stability and safe and sound operation of the financial system in the Czech Republic. This objective defines the CNB's area of competence as regards supervision of compliance with prudential rules and supervision of compliance with the rules of business conduct.

The CNB endeavours to supervise the banking market and its institutions in accordance with international standards. The key strategic framework for the supervisory work of the CNB is the Core Principles for Effective Banking Supervision published by the Basel Committee for Banking Supervision. The long-term strategic objectives in the area of financial (including banking) market supervision are described in Long-term supervisory strategy, which is published, on its websites.

The supervisory environment of credit institutions in 2021 continued to be affected by the pandemic. In carrying out off-site and on-site supervision, the CNB focused in particular on the monitoring of the quality of credit portfolios, the adequacy of capital and provisions to cover possible losses, changes in credit standards, approaches to risk and the profitability and feasibility of the institutions' business models. Furthermore, CNB abandoned the so-called pragmatic approach for the Supervisory Review and Evaluation Process (SREP) and returned to the standard process, which reflects risk factors related to economic recovery and structural changes more appropriately. The change allowed more attention to be given to the impact of interest rates rise on the credit portfolios quality and reliability of bank deposit models.

The activities of the Banking Supervisory Authority in 2021

The CNB´s core activities in the area of the banking supervision in 2021 were as follows:

- assessing the trends and incoming changes in the riskiness of recently provided mortgage loans, regarding their continuous substantial growing volume;
- informing about lifting dividend payout restrictions in the successive periods. CNB further announced to relevant credit institutions that any dividend payout proposals will be hereafter assessed by the standard supervisory process. Nevertheless, due to a continuous pandemic in 2021, CNB notified banks, that the subsequent dividends should be distributed cautiously in order to retain a sound level of their capital adequacy;
- examining cyber resilience of payment systems, including card payments, and new electronic financial services, related to digital transformation. Furthermore, CNB assessed the feasibility of contingency plans and the level of outsourcing management in IT services;
- performing series of thematic reviews in the area of business conduct rules, inter alia security of bank ID environment, legal risk management, remuneration procedures or checking accounts and payment cards security, etc.;
- controlling procedures in the AML/CFT area, namely by on-site supervision with an attendance of external auditors or bilateral informal meetings with deputies of relevant banks' departments. The efficiency of preventive systems was assessed both from a holistic perspective (by evaluating management and control systems) and from a fragmentary perspective (e.g., transaction monitoring, correspondence banking, business financing, and imposing business restrictions regarding international sanctions);
- examining adequacy of organizational measures to market abuse prevention and fraud detection in relevant banks;
- performing essential monitoring of banks' readiness to comply with responsibilities regarding the Sustainable Finance Disclosures Regulation (SFDR), which mainly includes disclosing relevant information on incorporating sustainability aspects in their operations;
- conducting stress tests on the domestic banking sector which were focused on assessing the sector's resilience to potential adverse developments.

International activities of the authority

The Czech National Bank actively cooperates with foreign supervisors to ensure effective supervision within its area of competence as well as to coordinate supervisory response to crisis situations. Where the CNB is the home supervisor, it manages the work of the college, taking into account the risk profile and systemic importance of the supervised group and of the individual institutions that make up the group. Where the CNB is the host supervisor, it coordinates and plans its activities in cooperation with the home supervisor.

At an international level, the CNB focuses on integration and cooperation within European structures. In 2021, the CNB cooperated with the European Banking Authority (EBA), the European Systemic Risk Board (ESRB) and the European Central Bank (ECB). The CNB also closely followed the discussions in the EU Council and its structures. Last but not least, the CNB is actively involved in the work of Basel Committee on Banking Supervision (BCBS).

Cooperation with other supervisory bodies in the country

In 2021, the Czech parliament adopted the Amendment to the Act on Banks, which should limit several risks arising from capital management. The Amendment adjusts the rules for Pillar 2 capital requirements , refines capital reserves management, imposes an obligation to appoint so-called intermediating ultimate controller for large groups from third countries, etc. The amendment implements the Directive (EU) 2019/878 (CRD V).

Other relevant information and developments in 2021

In 2021, the Parliament of the Czech Republic has adopted the Amendment to the Act on Banks, which should limit several risks arising from capital management. The Amendment adjusts the rules for calculation of Pillar 2 capital requirements , refines capital reserves management, imposes an obligation to appoint so-called intermediating ultimate controller for large groups from third countries, etc. The amendment implements the Directive (EU) 2019/878 (CRD V).

Furthermore, Parliament adopted Amendment to the Act on Czech National Bank, which, among others, widens scope of CNB in the area of preventing overindebtedness. Adopting the act, CNB granted a right to set the upper limit for one to three credit indicators related to consumer loans backed by residential real estate.

Other than one merger of one medium-sized and one small-sized bank, there were no substantial changes in the market structure or any other sector development in 2021.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	24	24	23
Branches of foreign credit institutions	25	24	22
Cooperative banks	9	8	7
Banking sector, total:	**58**	**56**	**52**

Total assets of banking sector (in billions CZK, at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	6,874.0	7,259.4	7,850.7
Branches of foreign credit institutions	688.9	708.5	672.0
Cooperative banks	10.2	10.0	9.1
Banking sector, total:	**7,573.1**	**7,977.8**	**8,531.8**
y/y change (in %)	**3.5**	**5.3**	**6.9**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	0.9	0.9	0.8
Domestic ownership total	7.7	7.2	14.5
Foreign ownership	91.4	91.9	84.7
Banking sector, total:	**100.0**	**100.0**	**100.0**

Note: Banking sector=commercial banks + bank foreign branches

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	56.0	71.2	1,262.1
Branches of foreign credit institutions	45.7	67.2	1,150.7
Cooperative banks	87.2	99.1	2,696.0
Banking sector, total:	**51.6**	**65.5**	**1,075.8**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	17.3	7.7	10.8
Cooperative banks	-2.1	-6.5	2.5
Banking sector, total:	**17.2**	**7.6**	**10.8**

Note: RoE is calculated as a ratio of (sub)sector's net profit to annual average of (sub)sector's Tier 1 capital.

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	90.8	91.0	92.0
Branches of foreign credit institutions	9.1	8.9	7.9
Cooperative banks	0.1	0.1	0.1
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables			
Financial sector	6.7	6.7	6.2
Nonfinancial sector	42.0	41.1	41.3
Government sector	0.8	0.9	0.9
Other assets	50.5	51.3	51.6
Liabilites			
Financial sector	18.2	12.3	11.8
Nonfinancial sector	54.7	58.4	58.3
Government sector	4.2	4.0	4.0
Other liabilities	14.7	16.9	17.7
Capital	**8.2**	**8.4**	**8.2**

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

Capital adequacy ratio of banks***

Type of financial institution	2019	2020	2021
Commercial banks	21.3	24.3	23.5
Cooperative banks	29.2	26.7	24.4
Banking sector, total:	**n.a.**	**n.a.**	**n.a.**

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

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

Asset classification	2019	2020	2021
Non-financial sector, including	2.3	2.7	2.4
households	1.7	1.8	1.5
corporate	3.2	4.2	3.8

Note: Banking sector=commercial banks + bank foreign branches; share of non-performing loans by sector.

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	87.7	88.7
Households	62.0	53.8
Corporate	25.7	34.9
Government sector	6.0	1.9
Financial sector (excluding banks)	6.3	9.4
Total	**100.0**	**100.0**

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

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

P&L account	2019	2020	2021
Interest income	225,926.6	186,104.6	184,672.4
Interest expenses	80,179.0	59,229.9	55,808,8
Net interest income	145,747.6	126,874.7	128,863.5
Net fee and commission income	33,050.7	30,947.4	34,910.9
Other (not specified above) operating income (net)	2,681.4	2,736.4	3,825.1
Gross income	290,885.8	248,880.3	249,918.9
Administration costs	77,717.4	73,305.7	75,524.8
Depreciation	12,366.5	12,909.0	13,501.4
Provisions	-707.0	2,528.4	568.4
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	3,818.4	29,020.5	3919.8
Profit (loss) before tax	109,210.4	57,433.4	85.526.0
Net profit (loss)	91,105.3	47,470.4	70,348.9

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

Total own funds in 2021 (in EUR) ***

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	25,865.7	24,317.7	25,054.9	810.8	n.a.
Cooperative banks	63.9	62.2	62.2	1.7	n.a.
Banking sector, total:	**25,929.6**	**24,379.9**	**25,117.1**	**812.5**	**n.a.**

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

Note: EUR= 24.86 CZK as at 31 December 2021.

Macroeconomic environment in the country

The recovery of Estonian economy from COVID-19 crisis can be described as impressive. While imposed restrictions in response to the virus lead to negative gross domestic product (GDP) growth in 2020 (Estonian economy fell 2,9% y/y in 2020), the GDP increased 8,3% in 2021. This marked one of the fastest recovery in Europe. Strong recovery also meant that Estonian GDP surpassed 2019 or pre-COVID-19 level by 5.2%.

Although accommodation and food service, passenger transport and leisure were still facing difficulties, turnover and production output in many other branches of the economy were notably higher than before the pandemic according to Eesti Pank.

Strong momentum was also reflected in unemployment rates. While in the last quarter of 2020 unemployment rate in Estonia was 7.4%, it fell to 5,2% by the end of 2021. Increasing labour shortages caused also wages to rise faster.

Purchasing power was increased by the rising incomes, and by the involuntary savings that had started to build up a year earlier and the money withdrawn from the second pension pillar, which was indicated by the strong growth in retail sales in the autumn. The growth over the year in private consumption was 6.5% in 2021.

The supply difficulties that had emerged during the pandemic did not ease in 2021. International trade continued to be hindered by rising prices for transport and inputs, and availability issues for industrial components. Although Estonia is tightly interwoven into international value chains, export volumes and corporate surveys showed that Estonia was relatively little affected among the countries of Europe by the global supply problems. On top of this, Estonia's main export markets were among the best performing, with the consequence that the highly export-dependent economy coped relatively successfully. Growth of 23% in total exports made a major contribution to the improvement in the economy in 2021.

Consumer prices rose by 4.6% in 2021, though by the end of the year the rate of inflation had reached 12.2%. The rise in inflation to extraordinarily high levels was caused by a conjunction of several factors. One was that the price falls of 2020 were being reversed, while another was the insufficient availability of many goods. Strong demand and rising labour costs were also important factors in Estonia. The cost of the consumer basket in Estonia was raised more by energy prices than those in other countries in the euro area, as these caused more than half of the rise in the cost of living at the end of the year.

Eesti Pank sees that the growth in the Estonian economy will slow in 2022 from its very strong position, when production resources were running at full capacity and supply-side restrictions were tightening. Although the outbreak of war in February and the various impacts from it overshadow the outlook for the Estonian economy, falling investments will substantially contribute to lower GDP growth in 2022, according to expectations. Eesti Pank forecasts that Estonian GDP will increase by 1.5% in 2022.

Development in the banking sector (including assets total / GDP)

At the end of the year there were 15 banks operating in Estonia, of which six were branches of foreign banks. This is one more than a year earlier as the Estonian branch of PayEx Sverige AB started its activities.

Consistent with broader economic developments, Estonian banking sector performed strongly in 2021, meaning healthy loan growth, improved credit quality, high profitability and strong capitalization.

The assets of the banking sector stood at 48 billion euros at the end of 2021, which is 152% of GDP and 7.2% more than a year earlier. The loan stock increased by 9.6% over the year to 31 billion euros. At the end of the year, 1.8% of the loan portfolio in the Estonian banking system was overdue by at least one day and 0.4% at least 90 days, this compares to 2.3% and 0.6% respectively at the end of 2020. Similar pattern is also evident in the share of non-performing loans (NPL): as end of 2020, NPL ratio was 1.7%, but a year later 1.1%.

Improved credit quality also helped to keep and even increase the sector's profitability. The return on equity (ROE) of the Estonian banking sector reached to 9.6% in 2021, compared to 8.8% in 2020.

Following aggressive liquidity pile up in 2020, Estonian banks took it more calmly in 2021, resulting slower growth for liquid assets. However, liquidity remained healthy with LCR ratio at 149% and almost on third of total assets being liquid at the end of the year. Relatively fast growth of loans and risky assets added some pressure to the capitalization as capital ratios turned somewhat lower. However, the capitalization of Estonian banking sector remained on of the strongest in European Union also in 2021.

In short, fast economic recovery in 2021 was also felt rather positively in Estonian banking sector.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

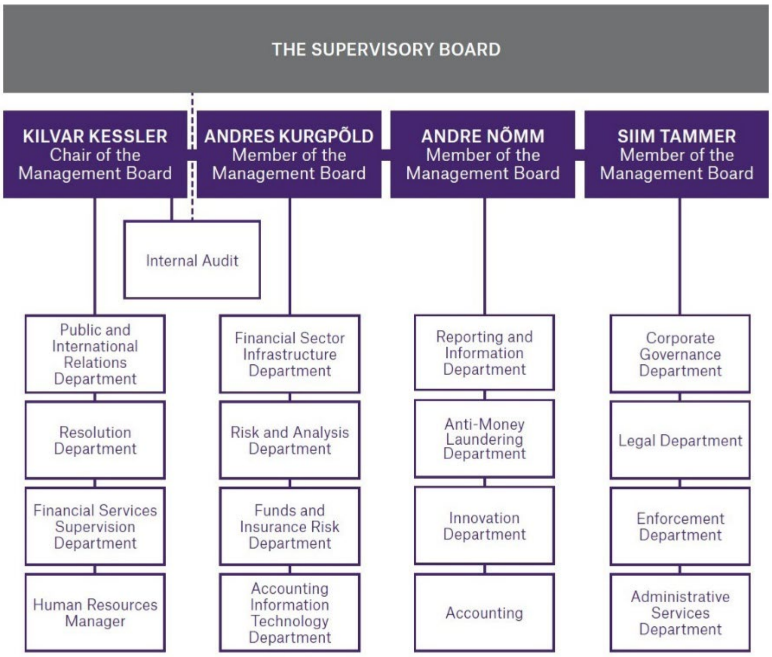
Finantsinspektsioon is an independent financial supervision and resolution authority. Finantsinspektsioon carries out state supervision over licensed banks, insurance companies, insurance intermediaries, investment firms, fund managers, investment and pension funds, payment institutions, e-money institutions, creditors and credit intermediaries, and the securities market.

Finantsinspektsioon acts on behalf of the Estonian state and works to ensure that the regulated financial market is stable, trustworthy and transparent. Finantsinspektsioon reduces the systemic risks in the financial sector and contributes within the limits of its responsibility to preventing criminal activity. Finantsinspektsioon also prioritises the sustainability of the critical functions of the banks during crises and sufficient protection for the funds of depositors, investors and other clients.

In financial supervision and in resolving financial crises, Finantsinspektsioon works for the benefit of the public interest. Its work is funded not from the state budget but by the supervision and procedural fees that are paid by the market participants. Finantsinspektsioon also carries out a large part of the duties of the Guarantee Fund under a cooperation agreement and by law.

The activities of Finantsinspektsioon are planned and controlled by the Supervisory Board. Its work is managed by a four-member management board, which takes decisions by majority vote.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2021

Finantsinspektsioon´s strategy for 2019-2021 emphasises the important values of the financial market, which are stability, reliability and openness to innovation. The main strategic goals are that: **Estonia has an effective safety net for the financial market to prevent and resolve financial crises; participants in the market have large enough financial buffers to hedge their risks; market participants have internal control systems that suit their business models, especially in relation to combating money laundering; market participants have transparent and effective funded pension products; Finantsinspektsioon has an effective but responsible enforcement policy; market participants have modern information technology infrastructure; Finantsinspektsioon recommends or makes changes to outdated rules or updates them.**

On 26 November 2021 the Supervisory Board approved the new Finantsinspektsioon strategy for the years 2022-2025. Main action points are:

- A creative, environmentally sustainable and digitally skilled Finantsinspektsioon is an efficient financial supervision and resolution authority
- Finantsinspektsioon maintains stability in the financial markets so that more value added can be created in the economy
- Finantsinspektsioon protects the interests of clients and investors to strengthen overall confidence in the financial market
- Finantsinspektsioon encourages technological innovation to help the market function more efficiently

The activities of the Banking Supervisory Authority in 2021

Finantsinspektsioon carried out many activities in 2021, some of them are described here.

Finantsinspektsioon continued assessing the impact of the pandemic on the financial indicators, operational capacity, and capitalisation of credit institutions in 2021, and analysed the need to apply supervisory measures to reduce the impact of risks being realised. The impact of the crisis on the quality of the loan portfolio of the banks, their liquidity, the possible realisation of operational risks, and their profitability and capitalisation was assessed once a month.

In early 2021, Finantsinspektsioon assessed the change in the loan quality of the loan portfolio of the banks in the period from the start of January 2020 to the end of September. This was done to assess how the pandemic might have affected the quality of the loan portfolio. The findings of the analysis were used to assess whether the banks had classified loans in accordance with the requirements during the pandemic. Finantsinspektsioon drew the attention of the banks to shortcomings that were found in the classification of loans and in the restructuring processes.

Finantsinspektsioon also carried out credit risk stress tests for all the banks operating with an authorisation in Estonia in 2021 to assess the sufficiency of their capital if they were faced with negative economic developments. Finantsinspektsioon took account of the results of the stress test by issuing a guidance on additional own funds that set the level of own funds higher than the general capital requirements for all the less systemically important banks. The aim of the own funds guideline is to ensure that credit institutions can meet the capital requirements in the event of an economic crisis.

In 2021 Finantsinspektsioon, working together with the European Central Bank for the large banks, set an own funds requirement for the banks in Estonia that exceeded the minimum requirement in law by 397 million euros, and set an additional guideline for own funds of 212 million euros. The goal of setting an own funds requirement that exceeded the minimum in law and for setting the additional own funds guideline was to ensure that there was enough capital to cover all the risks that credit institutions take in their activities, and to support stability in the financial system and sufficient capitalisation of credit institutions even if the economic environment were to take a turn for the worse.

Six on-site inspections were carried out at banks operating in Estonia in 2021, which assessed the efficiency of operation of 17 different risk areas and functions. The organisation and operation of internal control systems, general management, risk management and control, and compliance controls were inspected. Risk areas that were assessed were the management and organisation of controls for credit risk, operational risk and IT risks.

Finantsinspektsioon monitored in September 2021 how the market participants were complying with the memorandum on the restructuring of loans.

Finantsinspektsioon analysed how the assignment by credit institutions of claims arising from credit contracts affected the quality of the credit portfolio of the credit institutions and their equity. The aim was to assess what the quality of the loan portfolio of the banks and the capitalisation would be if it was no longer possible to assign non-performing claims under the same conditions.

Finantsinspektsioon analysed the capacity of small banks to assess and avoid the possible losses from rapid credit growth.

Finantsinspektsioon inspected compliance with the requirements for responsible lending in 2021 and whether the ceiling for the cost of credit was maintained. The market mapping that was started in 2020 was concluded, covering the collateral limits and loan repayment limits for loans issued by creditors, and the credit products offered by creditors. Finantsinspektsioon used the results to produce and present the Ministry of Finance a proposal for setting minimum requirements for the ratio of the principal and interest payments of loans to the income of the consumer.

Finantsinspektsioon carried out a sectoral risk analysis to assess the risks of money laundering and terrorist financing, and it found that the money-laundering risks in the financial sector were lower in early 2021 than at the start of 2014.

International activities of the authority

Finantsinspektsioon contributes to designing the financial supervisory policy of the European Union through three European Supervisory Authorities. These are the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities Market Authority (ESMA). The European Systemic Risk Board (ESRB) is also part of the European system of financial supervisors, and handles macro supervision, and Finantsinspektsioon works there also.

As Estonia is a member of the euro area, the everyday work of Finantsinspektsioon is affected by the single supervisory mechanism (SSM). This is a banking supervision system for the euro area that takes in the European Central Bank and the Supervisory Authorities of the euro area countries. The European Central Bank conducts direct capital supervision through the SSM over important credit institutions in the euro area. The banks in Estonia that met the criteria for direct supervision in 2021 were AS SEB Pank, Swedbank AS and Luminor Bank AS.

Finantsinspektsioon is also involved in crisis resolution, and works in the Single Resolution Board (SRB), which is the central resolution authority in the euro area. The Single Resolution Mechanism consists of the Single Resolution Board together with the resolution authorities of the euro area countries.

Finantsinspektsioon participates in supervisory colleges for capital supervision, anti-money laundering, and resolution to make supervision over cross-border financial intermediaries and over resolution of them as efficient as possible, and to make cooperation between the institutions responsible in different countries as effective as possible.

Finantsinspektsioon is also a member of the International Association of Insurance Supervisors (IAIS), and the International Organization of Securities Commissions (IOSCO). It also promotes cooperation between Nordic and Baltic countries in the Nordic-Baltic Macroprudential Forum (NBMF) and the Nordic-Baltic Stability Group (NBSG). It is also a member of the Group of Banking Supervisors from Central and Eastern Europe (BSCEE).

Other relevant information and developments in 2021

Crowdfunding service providers did not previously come under supervision from Finantsinspektsioon, but the European Parliament and the Council adopted a regulation on crowdfunding in October 2020 that made Finantsinspektsioon the authority responsible for supervising crowdfunding service providers. Finantsinspektsioon started to make preparations in early 2021 for the application procedures for authorisations for crowdfunding service providers and for becoming the supervisor of crowdfunding.

Finantsinspektsioon promotes consumer education through the consumer website, podcasts and online seminars. Finantsinspektsioon started to produce online seminars in 2021 to supplement its podcasts for consumers who are more interested in the financial world.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	9	9	9
Branches of foreign credit institutions	6	5	6
Cooperative banks	-	-	-
Banking sector, total:	**15**	**14**	**15**

Total assets of banking sector (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	36 294	43 664	46 843
Branches of foreign credit institutions	1 066	1 010	1 035
Cooperative banks	-	-	-
Banking sector, total:	**37 360**	**44 675**	**47 879**
y/y change (in %)	**43***	**20**	**7**

**fast growth is mainly a result of Luminor's structural change in 2019*

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership*	-	-	-
Domestic ownership total	8.5	9.4	8.6
Foreign ownership	91.5	90.6	91.4
Banking sector, total:	**100.0**	**100.0**	**100.0**

**Assuming public sector ownership is meant to be also domestic*

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	77	93	2315
Branches of foreign credit institutions	2.1	2.2	2.6
Cooperative banks	-	-	
Banking sector, total:	**77**	**93**	**2318**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	7.7%	8.8%	9.6%
Cooperative banks			
Banking sector, total:	**7.7%**	**8.8%**	**9.6%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	97	98	98
Branches of foreign credit institutions	2.9	2.3	2.2
Cooperative banks			
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables			
Financial sector	32	39	38
Nonfinancial sector	66	59	60
Government sector	1.6	1.9	1.9
Other assets	0.0	0.1	0.1
Liabilites			
Financial sector	16	17	19
Nonfinancial sector	75	72	75
Government sector	8.7	11	6.0
Other liabilities	0.0	0.0	0.0
Capital	**14**	**12**	**11**

Capital adequacy ratio of banks

Type of financial institution	2019	2020	2021
Commercial banks***	26.3	27.9	24.4
Cooperative banks			
Banking sector*, total:**	**26.3**	**27.9**	**24.4**

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

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

Asset classification	2019	2020	2021
Non-financial sector, including	2.2%	1.8%	1.2%
households	1.8%	1.7%	1.0%
corporate	2.9%	2.1%	1.5%

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	82.5	84.3
Households	45.8	49.6
Corporate	36.7	34.7
Government sector	6.5	2.6
Financial sector (excluding banks)	11.1	13.1
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	814	839	887
Interest expenses	140	127	125
Net interest income	674	712	762
Net fee and commission income	206	197	232
Other (not specified above) operating income (net)	195	292	206
Gross income	1 329	1 454	1456
Administration costs	533	542	574
Depreciation	38	41	43
Provisions			
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	61	124	32
Profit (loss) before tax	440	463	525
Net profit (loss)	370	418	466

Total own funds in 2021 (in EUR, consolidated level)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	4659	4474	4517	142	
Banking sector, total:	**4659**	**4474**	**4517**	**142**	

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

Macroeconomic environment in the country

After the ease of the pandemic-related restrictions, the Georgian economy grew by 10.4% in 2021. This growth was fueled by a release of pent-up demand as accumulated during the severe pandemic restrictions; a gradual improvement of the foreign sector, which includes increased exports of goods and remittances and a partial recovery of income from international tourists; as well as fiscal stimulus and high credit activity. Notably, GDP actually exceeded the level of 2019 by 2.9%. In terms of sectoral contributions, the gradual opening of the country's borders was important in terms of foreign tourism. Accommodation and catering (mainly restaurants and hotels), transport (with a large share of tourism), real estate, and arts, entertainment and leisure recreation (each with a high participation of international visitors) contributed a combined 3.6 pp to the total GDP. As the economy recovered, trade – the largest sector – grew by 19.9%, while contributing 2.6 pp to overall growth. Of the industrial sectors, the processing industry stands out in terms of the high weight of enterprises manufacturing export products (9.0% growth, making a 0.8 pp contribution to overall growth). In contrast, there was a significant decline in construction (a 21.8% decrease, making a -1.7 pp contribution to growth), and agriculture shrank by 1.4%, making a negative 0.1 pp contribution to the growth.

The revival of demand, following months of severe COVID-related restrictions, and the improvement of the foreign sector fueled the high economic growth seen in 2021. Therefore, 8.9 pp of the 10.4% growth was related to consumption, while the contribution of net exports equaled 4.5 pp. High growth in consumption was observed from both households and the public sector. Following the partial recovery of tourism, net exports saw a 57.1% YoY real growth in service exports. The contribution of investments to GDP growth was a negative 3.1 pp.

The current account deficit for 2021 was 9.8% of GDP, 2.6 percentage points lower than the previous year. In absolute terms, the current account deficit improved by USD 131 million to USD 1,834. The trade deficit in goods in 2021 relative to GDP remained at almost the same level (20.1% of GDP). With the gradual recovery of revenues from international travelers (129.8% annual growth, although still representing a decrease of 61.9% compared to 2019), the trade surplus in services increased and the current account deficit thus improved. Overall exports of goods increased by 27.4% annually, while imports recording annual growth of 23.8% overall. In 2021, net foreign direct investment was an important source of financing the current account deficit. Foreign direct investment in Georgia amounted to USD 1.15 billion, which was 101.6% more than in 2020, while the volume of net foreign investment increased by USD 128 million (by 23.3%).

Inflationary pressures intensified worldwide in 2021, including in Georgia. The reason for the high inflation was the extraordinary situation caused by the COVID-19 pandemic, with several factors simultaneously pushing inflation upwards. High inflation was fueled by a global price rise for consumer goods, which was triggered by a rise in food prices. World average food prices were at their highest levels in ten years in 2021 as a consequence of pandemic-related delays, poor harvests, and increased transportation costs. Moreover, with the steady restoration of mobility, demand for oil rose and prices in international markets have climbed. The steady rise in global oil prices over the course of the year has affected fuel prices in the local market. Also, the quicker-than-expected release of pent-up demand, as accumulated after the end of lockdowns, is another factor worth mentioning. Consequently, headline inflation averaged 9.6% during the year (target rate is 3%), and the NBG, considering these factors, gradually increased the monetary policy rate from 8.0% to 10.5% over the course of the year.

In 2021 unemployment rate increased by 2.1 pp compared to the previous year and stood at 20.6%.

Development in the banking sector (including assets total / GDP)

Banking is the main financial intermediary in Georgian economy. Foreign investments dominate banking sector and account for more than 85% of total equity. Banking sector assets (net of provisions) grew by 7% in 2021. Gross Credit portfolio increased also by 13% YoY at the end of 2021, less than in 2020. In total, credit portfolio accounted for 71% of GDP, which is 6 percentage points less than in 2020. As for the total assets of banking sector, they accounted for 101% of GDP that is 14 percentage points less than in 2020.

In 2021, the highest growth rate was recorded in SME (15% annually), followed by Retail and Corporate Segments. Banking sector loan portfolio break-down by products is the following: 34% accounts for corporate sector, 39% - retail sector, and 27% - SMEs.

Despite the COVID-19 pandemic, the quality of the loan portfolio in 2021 was better than in 2020: the share of non-performing loans in the total portfolio decreased from 8.4% to 5.2%, while the share of overdue portfolios decreased from 4.6% to 4%. This was affected by both the reduction of non-performing loans and new disbursements. The total portfolio reserve was within a moderate 4.6%.

In 2021, the return on assets and equity amounted to 3.6% and 30.7% respectively. This was far above the previous year's figures of 0.2% and 1.8 % respectively. The increase was largely due to the improved quality of the portfolio. Compared to 2020, the cost-to-income ratio fell from 48.3% to 41.4%. The cost-to-assets ratio was stable at 2.6%.

The volume of liquid assets remained high in 2021. Liquid assets accounted for 21% of total assets, enough to cover up to 34% of non-bank deposits.

By the end of 2021, the Georgian banking system continued to maintain an adequate level of capital under the Basel III capital adequacy framework and in consideration of the supervisory measures related to the COVID-19 pandemic. As of 2021, the Tier 1 capital ratio calculated within the Capital Adequacy Framework was 15.58% and the regulatory capital ratio was 19.57%, which are higher than the total capital adequacy requirements (considering the actions taken under the COVID-19 supervision plan) by 2.62 and 2.09 percentage points, respectively.

Dollarization remains a major challenge for the financial sector, despite significant declines in 2021. By the end of 2021, the dollarization of loans stands at 50.9%, and while dollarization of deposits decreased, making 60.1%. Accordingly, the NBG prioritizes increasing larization (de-dollarization) and aims to maintain incentive reforms.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

The National Bank of Georgia (hereinafter – the NBG) is an independent public entity and is authorized to supervise and regulate the financial services sector in Georgia (except insurance, since 2013), including commercial banks, banking groups, non-bank financial institutions - securities market, credit unions, microfinance organizations, money remittance units, currency exchange bureaus and qualified credit institutions. NBG is the sole authority, which is responsible for the supervision of commercial banks. Organic

Law "on the National Bank of Georgia" (hereinafter – Organic Law) explicitly defines NBG's functions, tasks, responsibilities and objectives. Laws and regulations are publicly available on the website of NBG.

The major legislation that applies to banking sector encompasses the Organic Law, Law of Georgia "on the Activities of Commercial Banks" and by-laws issued in form of decrees of the Governor of the NBG. In addition, NBG is publishing an annual supervisory strategy document. The document establishes the vision, goals, supervisory principles and values, strategic priorities and upcoming reforms, and offers a timeline for their implementation. The purpose of the document is to provide information to investors, international financial institutions, rating companies, the public and other stakeholders regarding the supervisory priorities, plans and upcoming arrangements of the NBG.

Throughout 2021, the NBG continued to work intensively to improve the supervisory framework, bringing it closer to advanced international practice and enhancing a number of supervisory areas. The year 2021 was important in terms of the development of special legislation on competition issues and strengthening supervision in this regard. Regulation on market analysis, submitting and reviewing concentration notifications and Regulation on investigating, filing, and reviewing a case related to a potential violation of competition were adopted based on the Law of Georgia „on Competition", the secondary legislation of the Georgian National Competition Agency and the best international practice in this area.

In 2021, the NBG resumed its work on framework for the 'fit and proper' criteria for administrators and shareholders, as well as the framework for licensing and acquisition of significant shares to ensure full compliance with best international standards.

Since the second half of 2021, the NBG has been vigorously working on the institutionalization of supervisory practices, which involved the development and improvement of a number of internal policies and procedures. An internal procedure for the General Risk Assessment Program (GRAPE) has been developed that serves to detail the process, structural units and timelines involved, as well as the decision-making process.

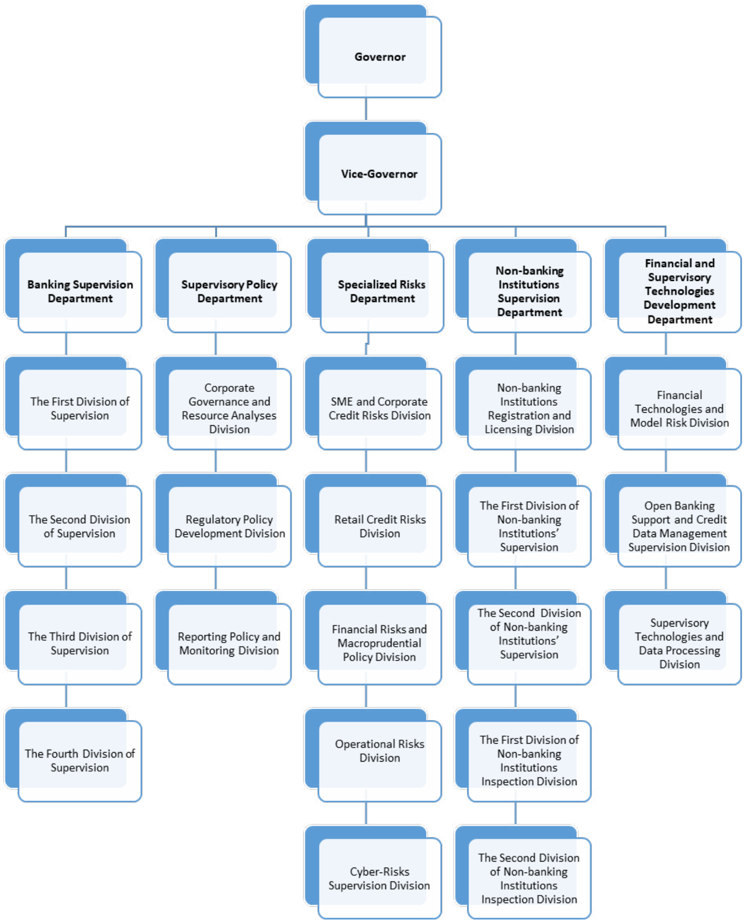
In 2021, the National Bank modified the regulations to better reflect ESG issues. The amendments defined the responsibility of the Supervisory Board for integrating ESG issues into the Bank's strategy and risk management framework and for their effective implementation. The ESG Reporting and Disclosure Principles were developed by the NBG for guidance.

In 2021, the National Bank approved amendments to the Corporate Governance Code for Commercial Banks. The changes affected the requirements for independent members of the Supervisory Board and changes related to the bank's remuneration policy.

NBG continued working on approximating its legislation and requirements on payment services to EU Directives and Regulations, that will facilitate the increased customer confidence and develop fintech areas while encouraging new types of payment system providers.

Other supervisory and regulatory developments are provided in the Annual report of the NBG for the year 2021.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2021

Starting from 2020 NBG develops and publishes a three-year Supervision Strategy Paper. It contains strategic priorities and plans for the activities required for implementation, considering the NBG mission, vision and values and implementation of its supervisory mandate. The NBG makes sure the supervision strategy document is updated on an annual basis, and is published in the first half of the year. The first supervisory strategy document included the strategic priorities for 2020-2022 and the activities planned for implementation.

Similar to 2020, the supervisory priorities defined by the National Bank's 2020-2022 strategy remained unchanged in 2021. Namely, the National Bank carried out its activities taking into account the following supervisory priorities:

- **Strengthening the corporate culture that encourages leadership and initiatives** - In 2021, discussions of various topical issues actively continued at the National Bank in the form of thematic working groups, which, among others, included the working group created in connection with competition issues, the groups for researching the possibilities of the crowdfunding platform, and the groups for the transition of supervisory reports to International Financial Reporting Standards (IFRS).

- **Strengthening the cooperation with the stakeholders** – During 2021, the representatives of the supervisory area of the National Bank participated in public professional forums and discussions, including the Basel Consultative Group (BCG), the Group of Central and Eastern European Banking Supervisors (BSCEE), the International Monetary Fund (IMF) and the World Bank (WB) platforms. In addition, cooperation with the supervisors of the countries of the region was actively carried out at the initiative of both the National Bank and fellow supervisors, in order to share knowledge and experience. Among them was the global fintech forum - Global Impact FinTech (GIFT), which is the largest, most diverse and inclusive fintech forum in the world, which brings together ecosystem leaders from 60 countries and which, among others, was held with the support of the National Bank of Georgia. Open and inclusive finance, global fintech ecosystems and policy frameworks, female leaders in fintech, etc. were reviewed within the framework of the forum;
- **Facilitation of stable functioning of the financial sector** - In order to promote the stable functioning of the financial sector, the NBG continued to work on the improvement and development of the legal framework and other technical-procedural parts during 2021. The detailed information about the implemented reforms is described in respective subsections of this chapter;
- **Approximation to international standards** – during 2021, NBG continued intensive work in the area of transferring local accounting standards to international accounting and financial reporting standards (IFRS). Also, an approximation to the best international practices and improving the framework of the criteria of compliance of administrators and shareholders, as well as the framework of licensing and the acquisition of a significant share was the priority.
- **Development of the ecosystems for sustainable financial technologies -** active work of the Office of Financial Innovations during 2021, Open Banking project are noteworthy in this regard. Detailed information on these issues is provided in respective subsections of this chapter.

In addition, detailed information about the strategic priorities of NBG for 2021 and the progress of their implementation is available on the website of the National Bank.

The activities of the Banking Supervisory Authority in 2021

Throughout 2021, the National Bank of Georgia continued to work intensively to improve the supervisory framework, bringing it closer to advanced international practice and enhancing a number of supervisory areas. In addition to the issues described in the new legal developments, following developments are also noteworthy:

To improve the corporate governance of the banking sector and to align it with international best practice, considerable changes were made to the Corporate Governance Code in 2021. More specifically, it now includes more specific clauses on how to define a material risk taker. A list of functions and responsibilities assigned to a supervisory board was added in order to strengthen the board. The remuneration requirements were expanded and specified to ensure a sound remuneration system. To promote the long-term sustainability of the banking sector, the environmental, social and governance (ESG) commitments of banks were expanded by adding gender and climate change and related disclosure procedures. Banks were required to comply with these changes by 31 December 2021.

In the context of maintaining the stability of the financial system and ensuring smooth lending to the economy, on 16 June 2021 the NBG announced a plan to restore the capital buffers and provided dates for their gradual replenishment, giving the banking sector sufficient time to replenish the buffers. As per the decision of the Financial Stability Committee, the recovery of the buffers released at the beginning of the COVID-19 crisis will begin on 1 January 2022 and will last for two years.

In 2021, work was completed on the update of the reporting forms to be submitted to the NBG in accordance with IFRS requirements, a draft IFRS-9 asset pro visioning policy was developed, and an initial version of the capital-based method was prepared.

A significant step was taken to improve effective communication with auditors in 2021. As indicated in the Guide to Effective Communication between Audit Firms and the NBG, which was published in 2020. Meetings were organized between representatives of the NBG and audit firms to discuss complex matters related to audit reports and recommendation letters. Other meetings were organized to discuss important topics, as needed. The guide will gain more importance as the IFRS project is completed.

Throughout 2021, the NBG team was dynamically working on researching and analyzing local and international practices, including the EBA's Guidelines on Connected Clients and the Basel Committee's Supervisory Framework for Measuring and Controlling Large Exposures. A series of discussions involving various stakeholders was held and an internal version of the instructions was prepared. From 1 January 2022, an updated version of the Regulation on Concentration of Risk Exposures and Large Risks in Commercial Banks enters into force.

To align with international best practice and meet growing public interest in the financial sector, changes were made to the disclosure procedures under Pillar 3 in 2021. These required commercial banks to disclose additional information on the following key issues from the second quarter of the year:

- Qualitative indicators of the loan portfolio, including the share of non-performing loans, loan loss reserves, overdue loans and write-offs.
- Other characteristics of the loan portfolio, such as residual loan maturity, collateral ratio, business sector and borrower type.
- Distribution of debt securities, off-balance sheet products and secured loans by qualitative classification and overdue status.

In addition, a new requirement was added to the regulation from the third quarter of 2021 related to the disclosure of general and quality information about retail products. Also, from the second quarter, banks started publishing the Net Stable Funding Ratio, which includes information on the availability and need for stable funding and the ratio calculated according to these data.

The regulations related to the supervision of Credit Bureau have changed at certain intervals with the purpose of improving the functioning of the industry and to reflect the experience of the sector in practice. In the second half of 2021, a new package of amendments were prepared that covered the following areas: the market entry of entities whose functions are similar but not the same as those of the bureau; the adherence to a strong authentication rule when remotely obtaining consent from a data subject; preparation of reports on income from remittances, etc. The changes also affected existing records on consumer protection. Approval of the final draft of these changes is scheduled for the first half of 2022.

In 2021, the NBG started working on the implementation of the Commercial Bank Recovery and Resolution Framework. The planning component of this is in continuous operation, serving as a kind of pre-crisis preparation exercise enabling better organization and management of processes when the need arises. The first recovery plans for 2021 were drawn up by all participants in the banking sector. These included measures to be taken by commercial banks to improve their financial positions, and to restore and maintain their critical functions in the event of significant financial difficulties or delays to those critical functions.

International activities of the authority

Year 2021 was quite successful and active for NBG on international level. Besides the participation in a number of international events and conferences, NBG has gained international recognition in various directions.

Global Finance, a renowned international publication, named the Governor of the NBG, for the fourth year in a row, among the best governors of central banks.

NBG was also awarded two awards by Central Banking, a reputable international publication, in the categories of "Best Risk Manager of the Year" and "Most Transparent Central Bank" and also, won the Best Fintech Policy Award of the Year in Central Banking's annual Fintech & RegTech competition.

NBG governor made a presentation at a Columbia University conference dedicated to the challenges of monetary and fiscal policy in countries with small open economies. Held online this year, the event was attended by various central bank governors, finance ministers, former bankers, academics and financial sector leaders from around the world.

The Governor of the NBG also took part in the fifth Istanbul Economic Summit to discuss the importance of the green economy and sustainable finance, and to find ways to help further develop it.

In 2021, the European Bank for Reconstruction and Development (EBRD) Annual Meeting and Business Forum was held and the Governor of the NBG was invited as a speaker at the session. The event focused on the development of capital markets.

Initiated by the NBG and supported by the World Bank, a working meeting was held on the topic of "Global Economic Challenges and Their Impact on the Georgian Economy". A joint presentation from the NBG and the World Bank featured the World Bank's 2021 Global Economic Outlook and a review was prepared by the NBG.

The NBG also hosted an online forum on sustainable finance. The event was organized in cooperation with the International Finance Corporation (IFC, a member of the World Bank Group) and the IFC Sustainable Banking and Finance Network (SBFN), with the support of the Swiss State Secretariat for Economic Affairs (SECO). The online forum was attended by European and Central Asian central banks and financial market regulators, representatives of SBFN member countries, IFC experts and other stakeholders.

The NBG Governor also delivered a speech at a conference dedicated to the 30th anniversary of the Central Bank of Moldova. On the occasion of the anniversary, the Central Bank of Moldova organized an international conference entitled "Post-pandemic Economic Recovery: Reality and Perspective".

Other representatives of the NBG also participated in a number of important conferences held around the world during the year. The main topics of such meetings were the measures taken by the central banks during the COVID-19 pandemic, financial inclusion, and sustainable finance.

Cooperation with other supervisory bodies in the country

Based on the amendments made to the Law of Georgia on Competition and the Organic Law on the National Bank of Georgia in 2020, in 2021 the NBG approved legal acts regulating competition policy for regulated entities, during which expert assistance was provided from representatives of the World Bank, along with intensive involvement and consultation with the Competition Agency and the financial sector.

In 2021, the Law of Georgia on Information Security was updated: entities with critical infrastructure were divided into three categories. The three banks deemed to be of systemic importance fell into the third category of this list. They will be subject to the Law of Information Security and other minimum security requirements as defined by the legal acts and regulations developed by the Digital Governance Agency. Within the context of the three systemically important banks, the NBG worked scrupulously to define boundaries and regulatory scope in terms of the new regulatory requirements for the financial sector as defined by the updated Law.

Considerable actions were also taken in 2021 to introduce and develop Open Banking with the involvement of the NBG, the Bankers' Association, and commercial banks. This would allow third-party financial service providers to access the banking and financial data of clients (upon their request and consent) through Application Programming Interfaces (API's).

Other relevant information and developments in 2021

In 2021, the NBG hosted a joint mission of the International Monetary Fund and the World Bank under the Financial Sector Assessment Program (FSAP), for which the NBG had been preparing intensively since the second half of 2020.

In efforts to improve the exchange of supervisory reports and data quality, the NBG, in cooperation with a top British company, "Corefiling", introduced the International Standard XBRL (Extensible Business Reporting Language) information system. This has two important components: a reporting portal and a Taxonomy Management System (TMS).

In 2021, NBG was keen to share knowledge both within the NBG and with other partners. The National Bank of Poland is cooperating intensively with the NBG within the framework of the EU Twinning Mission with the common goal of the successful implementation of ongoing projects. Work is also underway with the Central Bank of the Netherlands to develop a data strategy that covers, among other areas, granular data processing, bulk data processing, and the development of a structure fitted for the DPM data view architecture.

Also, in 2021 NBG worked on further development to some important projects and was paving the way for the availability of basic Fintech infrastructure by developing various supervisory approaches:

- During 2021, the office hosted a number of important meetings with about 200 individuals with innovative ideas and those interested in entering the financial sector. Many of them subsequently started successful cooperation with the financial sector or are vigorously working on the introduction of new financial technologies in the sector.
- One important event promoting the use of Open Banking technology was a project supported by USAID's Economic Security Program. Implemented in April 2021, this addressed the importance of Open Banking for Fintech companies. In May, a panel discussion on Open Banking was held in collaboration with the Bankers' Association that helped to inform and actively involve the sector in this initiative.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	15	15	14
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**15**	**15**	**14**

Total assets of banking sector (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	47,183,026,805	56,870,926,138	60,568,300,187
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**47,183,026,805**	**56,870,926,138**	**60,568,300,187**
y/y change (in %)	**18.90%**	**20.53%**	**6.50%**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership			
Domestic ownership total	12%	12%	13%
Foreign ownership	88%	88%	87%
Banking sector, total:	**100%**	**100%**	**100%**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	79.75%	85.79%	28.66%
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**79.75%**	**85.79%**	**28.66%**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	17.75%	1.82%	30.38%
Cooperative banks			
Banking sector, total:	**17.75%**	**1.82%**	**30.38%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	100.00%	100.00%	100.00%
Branches of foreign credit institutions	0.00%	0.00%	0.00%
Cooperative banks			
Banking sector, total:	**100**	**100**	**100**

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

	2019	2020	2021
Receivables	100.00%	100.00%	100.00%
Financial sector	1.37%	0.93%	0.89%
Nonfinancial sector	62.44%	62.55%	66.45%
Government sector	3.91%	3.75%	3.82%
Other assets	32.27%	32.77%	28.85%
Liabilites	87.82%	89.72%	87.24%
Financial sector	2.10%	1.44%	1.34%
Nonfinancial sector	53.93%	9.07%	7.44%
Government sector	1.65%	1.37%	2.78%
Other liabilities	30.15%	77.83%	75.67%
Capital	**12.18%**	**10.28%**	**12.76%**

Capital adequacy ratio of banks

Type of financial institution	2019	2020	2021
Commercial banks	19.41%	17.59%	19.56%
Cooperative banks			
Banking sector, total:	**19.41%**	**17.59%**	**19.56%**

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

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

Asset classification	2019	2020	2021
Non-financial sector, including	1.96%	2.31%	1.90%
households	1.41%	1.58%	1.40%
corporate	2.32%	2.78%	2.23%

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	95.47%	98.47%
Households	54.35%	38.39%
Corporate	41.13%	60.08%
Government sector	4.53%	0.31%
Financial sector (excluding banks)	0.00%	1.22%
Total	**100**	**100**

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

P&L account	2019	2020	2021
Interest income	3,663,335,867	4,037,403,688	4,819,259,900
Interest expenses	1,732,915,557	2,188,353,998	2,333,418,242
Net interest income	1,930,420,310	1,849,049,690	2,485,841,658
Net fee and commission income	421,851,708	368,240,090	517,440,238
Other (not specified above) operating income (net)	455,331,337	506,567,508	677,644,777
Gross income	4,540,518,913	4,912,211,286	6,014,344,914
Administration costs	730,245,358	692,117,351	798,417,530
Depreciation	189,325,528	218,419,501	227,082,638
Provisions	385,261,724	1,329,203,782	(179,929,352)
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	385,261,724	1,329,203,782	(179,929,352)
Profit (loss) before tax	1,067,114,438	78,814,348	2,336,786,113
Net profit (loss)	953,294,854	99,261,850	2,082,014,688

Total own funds in 2021 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	2,899,430,325	1,998,531,439	2,309,032,262	590,398,063	2,899,430,325
Cooperative banks					
Banking sector, total:					

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

Macroeconomic environment in the country

Following a successful restart, the Hungarian economy continued to grow at an accelerating rate, with gross domestic product expanding at a year-on-year rate of 7.1 percent in 2021. At the same time, as a result of external effects the annual average inflation was 5.1 percent. The budget deficit amounted to 6.7 percent, while current account deficit rose to 3.2 percent of GDP.

The GDP exceeded its pre-pandemic level in the second quarter of 2021. From the expenditure side, all items made positive contributions (household consumption accounted for almost half of the expand) to annual GDP growth. In a European comparison, Hungary's economic performance is at the first third of the ranking.

Rise in households' disposable income was supported by the historically high employment, favorable income developments (rising wages) and various government measures (gradual reintroduction of the 13th-month pension, pension premium) in 2021. These items increased household consumption expenditures by 4.6 percent in year-on-year terms. The recovery in the consumption of services and credit markets were the main contributors to the expansion in household consumption.

Gross fixed capital formation rose by 5.9 percent in 2021 in year-on-year terms. Both the private and corporate sectors contributed to the growth. Corporate lending was stimulated by the low real interest rate, banks' ample lending capacities, the expansion of subsidized credit schemes and - to a lesser degree - an extension of the moratorium in a narrowed form. The upswing in corporate borrowing and investment was supported by state loan and guarantee programs as well as by the Bond Funding for Growth Scheme. Household investment increased as a result of favorable income developments and the Government's home creation programs, while public investment – due to moderate progress of the developments implemented by the government sector – decreased on an annual basis.

Intra-year developments in inflation were significantly affected by the rise in commodity, oil, and energy prices, transportation costs and the phases of the fight against the global coronavirus pandemic, causing higher volatility in consumer price changes than in previous years. International experiences show that the countries characterized by faster reopening of the economy registered a higher price increase. At the time of the global opening of the economy, supply was unable to keep abreast with soaring demand. Due to this, bottlenecks first developed in the commodity and shipping markets. Energy prices rose significantly from the middle of the year. Rising commodity prices first affected producer prices and finally also impacted the price of finished products. The Hungarian labor market proved to be resistant to the pandemic. Labor market recovery continued, and employment was at a historical high, while the number of vacancies had also increased. Corporate labor demand was growing both in manufacturing and the service sector. In 2021, the number of people in private sector employment rose by 0.6 percent. The unemployment rate was 4.1 percent.

In 2021, the current account deficit rose to 3.2 percent of GDP, and in parallel with this the economy registered net borrowing. The underlying reason was the continued decline in the trade balance: on the exports side, the global semiconductor shortage and weakening external demand undermined the balance, while on the imports side the pick-up in domestic demand and rising commodity and energy prices had a similar effect.

Development in the banking sector (including assets total / GDP)

Growing lending, coupled with liquidity support measures, helped to keep the banking system's balance sheet total on a growth path in 2021. Reflecting buoyant credit growth and the additional impact of the general payment moratorium on loan repayments, the total assets-to-GDP ratio (excluding state-owned specialised banks) increased by 7 percentage points to 103 percent at the end of 2021 relative to the end of 2020. However, the liquidity support measures should be considered temporary factors.

In 2021, lending by Hungarian credit institutions to the household sector expanded by 15 percent year-on-year. The amount of new credit dropped slightly in Q1, related to the third wave of the coronavirus pandemic, but the rest of the year saw a record volume of lending. The value of new contracts was up by 22 percent from 2020, largely due to the home creation measures available from 2021. During the year, disbursement of all retail loan products increased except the volume of prenatal baby support loans which contracted, although these loans accounted for over HUF 1 500 billion by the end of the year, representing 17 percent of retail loans. Subsidised loans related to the family protection and home creation programmes continue to support retail lending, with the subsidised schemes (family home creation allowance "CSOK", rural CSOK and prenatal baby support loans) making up 29 percent of the volume issued.

At the end of 2021, the annual growth rate of corporate credit amounted to around 11 percent, while the growth rate of lending to SMEs was 16.8 percent. The volume of corporate credit increased by HUF 1 000 billion in 2021, up by 28 percent from the previous year. Along with the loan and guarantee schemes of government institutions, this continued growth was greatly facilitated by the general payment moratorium extended until the end of October 2021 as well as by the Funding for Growth Scheme Go! ("FGS Go!") Programme of the Magyar Nemzeti Bank (the Central Bank of Hungary, "MNB"). The total allocated amount under the FGS Go!, terminated at the end of September, was used up, with 62 percent of the total loan volume going to micro and small enterprises. Demand remained robust in the corporate credit market even after the FGS Go! was discontinued, and credit institutions signed new, non-overdraft contracts worth over HUF 1 000 billion in Q4, while the share of market loans increased. Market-based lending accounted for 78 percent of the total loans disbursed in Q4, substantially exceeding the ratio of 45 percent registered a year earlier.

After having reached a historic low, the share of the banking system's non-performing loans increased slightly both in the corporate and household segments as the general moratorium was phased out at the end of October 2021. The share of non-performing loans climbed to 4.2 percent in both segments (the household NPL ratio stood at 3.1 percent and the corporate NPL ratio at 3.5 percent at the end of 2020). Within the corporate credit portfolio, problem-free (Stage1) loans accounted for 78 percent, heightened-risk (Stage2) loans for 19 percent, and NPLs (Stage 3) for 3 percent at the end of December 2021. In the household segment, the corresponding shares were 74, 22 and 4 percent, respectively.

Based on individual (unconsolidated) reporting data, profit after tax of the credit institutions sector amounted to HUF 550 billion in 2021, reflecting an increase of HUF 346 billion from the previous year. The 12-month rolling return on equity (ROE) rose by 6.7 percentage points to 11 percent, while profit on assets increased by 52 basis points to 0.95 percentage points. Growth in profit after tax was mostly supported by the reduction in risk costs and the expansion in net interest income, although the rise in the latter – besides the rising interest rates – was mainly due to the temporary measures related to the coronavirus pandemic. Net commission and fee income also grew considerably in annual terms, due in part to the recovery in economic activity as the coronavirus pandemic abated, as well as to lending and payments. The banking system's consolidated capital adequacy ratio rose to 18.6 percent by the end of the year. This was mainly attributable to a slower increase in total risk exposure.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

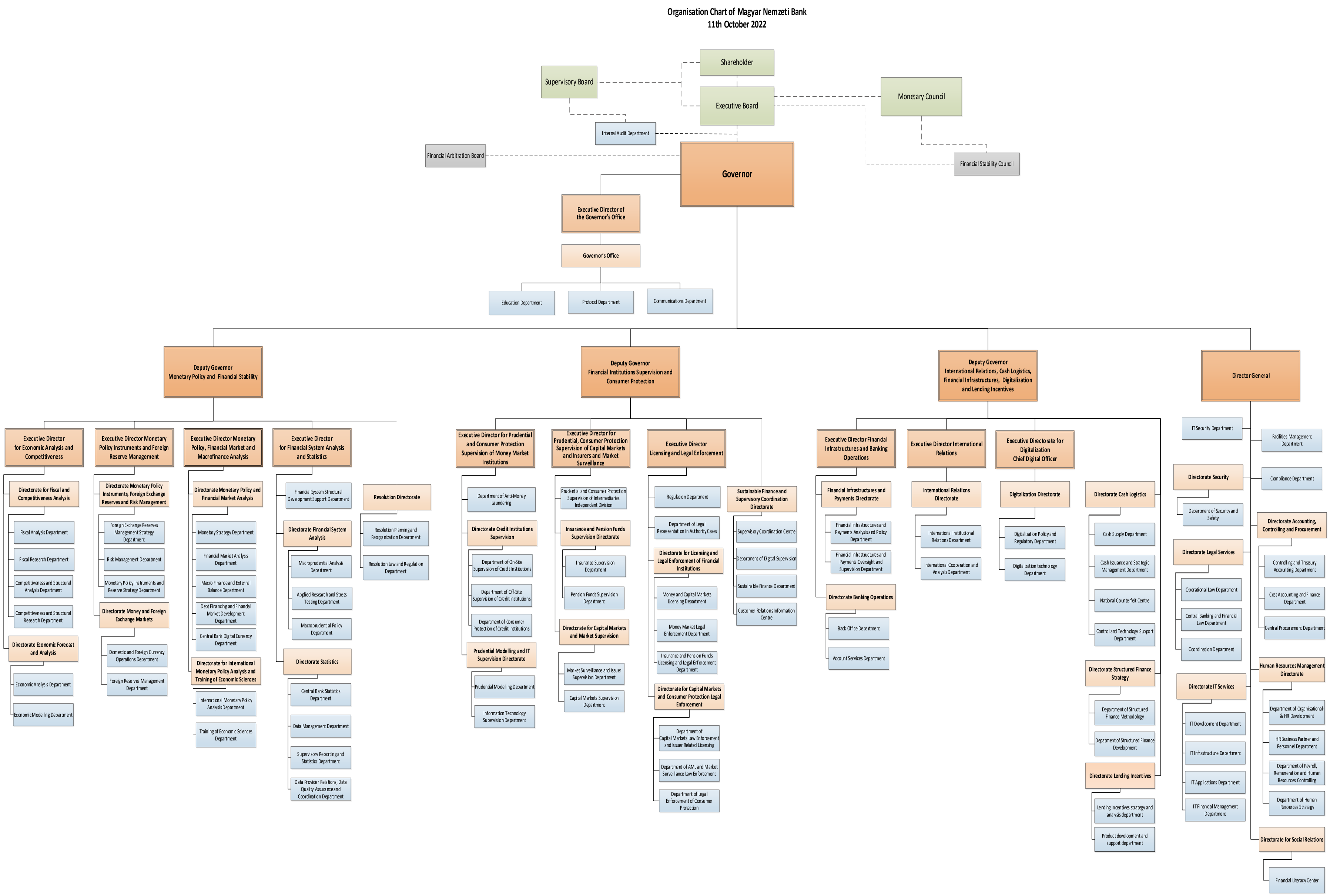
The supervisory and consumer protection tasks of the MNB are performed according to the Act CXXXIX of 2013 on the Magyar Nemzeti Bank.

The MNB issues binding MNB decrees and non-binding recommendations, documents with information purposes and CEO letters (the latter also called "Executive Circulars") – in order to give information and guidance for the supervised institutions in connection with the detailed rules and supervisory interpretation of the sector-specific legislation and the expectations of MNB.

Regarding the legislative developments in 2021, the Act LVIII of 2021 on amending the laws affecting certain elements of the financial intermediation system for the purpose of legal harmonization should be mentioned. As regards of banking regulations, the main purpose of this Act was the implementation of EU legislation and making further clarifications thereto, of which the following can be highlighted:

- Covered Bonds Directive [Directive (EU) 2019/2162 of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU];
- Crowdfunding Regulation [Regulation (EU) 2020/1503 of the European Parliament and of the Council on European crowdfunding service providers for business, amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937];
- PEPP Regulation [Regulation (EU) 2019/1238 of the European Parliament and of the Council on a pan-European Personal Pension Product (PEPP)], Hungarian regulations are applicable from 11 April 2022;
- AMLD [Directive (EU) 2019/2177 of the European Parliament and of the Council amending Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), Directive 2014/65/EU on markets in financial instruments and Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money-laundering or terrorist financing].

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Supervisory Authority in 2021

The MNB's supervisory strategy for the period covering 2020–2025 was approved by the Financial Stability Board in December 2019. The strategy determines the mission of the MNB, according to which it aims at maintaining and even strengthening the stability of the financial system and at deepening the participants' confidence both in the system as a whole and individually in each other. The vision of the MNB has also been updated, and the long-term objective is to have a developing, competitive and sound financial sector, supported, shaped and efficiently overseen by the MNB. To achieve this, it is necessary to support and deepen the stability of the financial system, with special focus on consumer protection, digitalization and sustainability. The management of the MNB defined confidence and stability as priority values for the supervisory area for the aforementioned period.

Healthy competition for customers could be strengthened by expanding the range of certified consumer-friendly products under the new strategy. Consumers should be able to compare products of the same type, with the development of the MNB's consumer-friendly comparison sites and consistent supervisory expectations for market calculators. Furthermore, as part of strengthening its consumer protection activities, the MNB pays special attention to cross-border financial activities.

Financial institutions need to incorporate environmental sustainability considerations into their corporate governance and risk management systems. The MNB establishes a cooperation network with the involvement of market participants, governmental, civil, interest representation and university organizations in order to develop green financial and capital market services and promote sustainable investments.

Supervisory and regulatory systems must also be prepared for the digital future, as more and more information technology systems supporting the business process come to the attention of consumers and the MNB. Thus, the basic goal is to modernize the regulatory environment related to IT technologies, and to develop supervisory methodologies and new IT supervision methods.

The strategy contains clearly set objectives for the forthcoming years regarding the supervised markets. Moreover, the MNB has internal, organizational goals as well that it endeavors to achieve with the assistance of the instruments at its disposal. Every supervised sector and supervisory area has its own tasks to be fulfilled in order to be able to achieve the long-term objectives.

The activities of the Banking Supervisory Authority in 2021

The MNB's supervisory activity related to the financial market sector is based on inspections (on-site supervision) and continuous assessment of the data and information provided by the supervised institutions (off-site supervision). In course of off-site supervision, the risk assessment is mainly based on the continuous analysis of statistical data and the review of the documents provided by the various internal committees of the institutions. Communication and meetings with the management of the supervised institutions are also contributing to the final supervisory assessments.

In 2021, in the frame of off-site supervision the MNB conducted 89 prudential meetings with senior managements of the supervised institutions and participated in 137 board and other working group meetings. Regular (quarterly) risk assessments based on qualitative and quantitative information are summarized in viability assessments during the annual supervisory cycle, which provides feedback for the senior management of supervised institutions within the framework of SREP CEO meetings.

In 2021 within the framework of the supervision of credit institutions, financial enterprises, payment institutions and money market intermediaries, the MNB concluded 25 targeted, thematic, follow-up and 16 comprehensive and focused internal capital adequacy assessment process ("ICAAP") / business model analysis ("BMA") inspections. Moreover, supervisors conducted simplified ICAAP review exercises at small institutions that pose a lower level of systemic risk.

As a result of the completed inspections 340 million HUF prudential fine was imposed on credit institutions, emphasizing that the MNB is taking a stand firmly against infringements and the institutions that had failed to comply with the former resolutions.

In 2021, internal liquidity adequacy assessment process ("ILAAP") was launched at 33 credit institutions, with 17 of these procedures closed by the end of the year. During the annual planning of inspections, institutions can be classified into three risk categories based on their riskiness and impact rating, complete with an appropriate review type (simplified, focused, comprehensive). To reduce the burden caused by the pandemic, the comprehensive category was modified to focused in several cases, and therefore the MNB audited the institutions via off-site inspections. In the inspections, only minor shortcomings were identified, which were pointed out to the institutions by the MNB during its continuous off-site supervision. Additional liquidity requirements were only set in the case of a concentration of depositors, and no further requirements in excess of this were laid down during the ILAAP reviews.

During the pandemic in 2021, the MNB closely monitored the institutions in relation to their compliance with the legal provisions ordering and stating the detailed rules of payment moratorium and examined the related information given by financial institutions to consumers.

During the comprehensive inspections there were multiple findings regarding the work of the supervisory board, the internal control and in general with the average quality of the control points implemented in the different processes. Regarding the credit risk the MNB has found that in multiple cases the credit risk processes were not supported properly with efficient controls, there were problems with the evaluation of collaterals, with client and transaction rating procedures and with the IFRS9 provision calculation models and methods.

During the reporting period the MNB actively participated in the risk assessment of the international banking groups as home and as host authority. In course of the college activity, under the joint decision the MNB urged requirements for the institutions, active in Hungary that ensure the risk-awareness and effective functioning of these banks from a micro-prudential aspect. As result of the intensive cooperation the recovery plans have been adopted, which ensure that an institution hit by crisis to be capable of operating and restoring the course of business without any state aid.

Due to the pandemic, on-site inspections were mostly conducted by remote access provided by electronic means, during supervisory activities more emphasis was given to the tools of off-site supervision, and data collection and processing via extraordinary data requests and questionnaires. The MNB issued a modified executive circular on using macroeconomic information and the factors indicating a significant increase in credit risk under the IFRS 9 standard, and in line with the EU-wide approach the MNB has introduced restrictions on dividend payments and remuneration.

In 2021 a thematic inspection was launched by the MNB in connection with the payment moratorium introduced in 2020. The investigation covered 16 financial institutions' practice, focusing on the amendment of the maturity of consumer credit contracts following the termination of the moratorium.

International activities of the authority

ESRB

The MNB actively participates in the workstream of the ESRB both at managerial and expert levels through several working groups and expert groups. The leaders of national Supervisory Authorities and central banks meet four times per year in General Board ("GB") sessions, while members of the Advisory Technical Committee meet with the same frequency preceding the GB meetings. Regular discussion topics at these sessions include risks and vulnerabilities, the capital and liquidity position of banks, the ratio of non-performing and restructured loans, the banking sector stress tests, the cross-border effects of macro-prudential policy, macro-prudential instruments for insurance, countercyclical capital buffers, shadow banking and other key issues related to financial stability. In 2021 the ESRB General Board virtual meetings focused primarily on the key systemic risks to financial stability in the EU, as well as public policy priorities to address them.

FSB Regional Consultative Group for Europe

The MNB and the Ministry of Finance both are members of the FSB's regional substructure. The MNB was represented at managerial level at the virtual meetings of the FSB European Regional Consultative Group in May and in December 2021. Participants exchanged views on the lessons learnt by financial authorities from COVID-19 and issues arising from recent developments, including those stemming from the rise in indebtedness across sovereigns, non-financial corporates and households and implications for interest rate markets of increases in inflation expectations.

EBA

The experts of MNB actively participated in the professional work of the EBA, mainly in the framework of EBA's various working groups. There is a constant effective communication between the MNB and the EBA, as well as the Hungarian BoS Member is a substitute member of the EBA Mediation and Breach of Union Law (BUL) Panels.

Memorandum of Understanding

On 14 July 2021 the MNB and the Astana Financial Services Authority (AFSA) signed an MoU concerning consultation, cooperation and exchange of information related to the supervision of AIFMD entities.

On 26 July 2021 the MNB signed an MoU with the China Securities Regulatory Commission regarding securities and futures regulatory co-operation.

On 20 September 2021 the MNB signed an MoU with the Central Bank of the Republic of Uzbekistan on information sharing, AML/CFT cooperation, among others.

On 24 December 2021 the MNB and the National Bank of Cambodia signed a cooperation agreement to enhance the economic awareness and financial skills of the society.

Supervisory colleges

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

Since European Central Bank ("ECB") is the consolidating (home) supervisor in case of parent institution of the financial group in SSM-countries, colleges are organized and led by the joint supervisory team (JST) representing ECB and national Supervisory Authority supervising the parent institution (former home supervisor). College members (home and host supervisors) regularly exchange information on the group concerned, assess risks of the group, parent company and subsidiaries, evaluate the appropriateness of the group's and subsidiaries' recovery plan and may request each other to carry out supervisory procedures. The framework of this cooperation is stated in Written Coordination and Cooperation Arrangements ("WCCA"). As a result of colleges' work college members made joint decision on capital and liquidity adequacy and group recovery plan assessment. In total, the MNB participates in 9 banking colleges as host supervisor authority.

As home supervisor, the MNB leads the banking supervisory college of OTP Group. In 2021, due to the exceptional circumstances caused by the pandemic, one online college meeting was organized via Webex and the practice of a regular Covid reporting implemented in 2020 continued. The college work resulted among others in the joint decision on capital and liquidity adequacy and on group recovery plan assessment. The WCCA of the supervisory college that has been signed lately by all college members (home, host and observer supervisors) in December 2020 was updated with the contact data of the signing parties (these are listed in the annexes) in December 2021.

Cooperation with other supervisory bodies in the country

The MNB performs supervisory and consumer protection tasks as well. The MNB monitors and supervises the activities of financial and capital market institutions, funds, insurance companies, pension funds, intermediaries and institutions of the financial infrastructure as well, furthermore, it carries out investor protection tasks and it operates the Financial Arbitration Board[1] and the Financial Consumer Protection Center[2].

The MNB and the Ministry of Finance ("Ministry") are the most important Hungarian organizations responsible for the establishment and maintenance of financial stability hence the MNB cooperates closely with the Ministry, first and foremost, in the area of legislation.

Furthermore, the MNB collaborates with other competent Hungarian authorities as well, such as the Ministry for Innovation and Technology in charge of General Consumer Protection Activities.

Other relevant information and developments in 2021

Supervisory measures to mitigate the impact of COVID-19:

The **MNB took several measures to support corporations, households and the banking system** in a difficult situation or potentially facing difficulties due to the coronavirus epidemic. The measures – which were **published through several executive circulars (CEO letters), press releases and Q&As** – reduced the administrative burden on banks and have allowed for the flexible application of macro- and micro-prudential rules. These measures helped to address expected temporary difficulties and maintain the lending capacity of the banking system.

Based on the above, the **MNB issued executive circulars (CEO letters)** as follows:

- In line with the ECB approach, the MNB **recommended credit institutions not to pay dividends or not to make any irrevocable commitment to pay dividends after the 2019 and 2020 financial year, or from previous years' profits, until 30 September 2021.** Furthermore, the central bank suggested that **credit institutions should refrain from share buybacks aimed at shareholders' remuneration** (share buybacks for management remuneration purposes are allowed). The banks should also consider more conservative variable remuneration pay-outs (e.g. higher ratio to be deferred, for a longer period).

[1] a professionally independent alternative forum for resolving disputes

[2] it supplies consumers with comprehensive and easy to understand information about the products and processes in the financial sector and handles consumer claims

- **The MNB maintained its previous decision to temporarily release the O-SII buffers from 1 July 2020**, institutions will be required to rebuild the buffers gradually in three years starting in 2022. The MNB also declared in this circular that **it won't impose sanctions until 31 December 2021 if credit institutions breach their P2G requirement.** Furthermore, **the non-fulfilment of capital conservation buffer (CCB) will be temporarily tolerated** by the central bank, but banks should rebuild at least 50% of this buffer until 30 June 2022 and 100% until 1 January 2023. Moreover, meeting the level of MREL requirement postponed by 6 months (first binding interim MREL target date: 1 January 2022).
- **Banks have to monitor their loan portfolio closely due to the limited visibility of NPL changes under the moratorium.**
- **Regarding IFRS9-related measures the MNB requires banks**
    - **to have minimum impairment level** (shall not result in a lower average impairment coverage rate than that of the end of July 2020),
    - **to use overlay approach** (recommended to perform expert adjustment to the models and to apply and recognise the related portfolio-level management correction),

Questionnaire tables for the 2021 BSCEE Review[3]

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	30	29	29
Branches of foreign credit institutions	8	8	8
Cooperative banks	0	0	0
Banking sector, total:	**38**	**37**	**37**

Total assets of banking sector (at year-end, in HUF million)

Type of financial institution	2019	2020	2021
Commercial banks	37 066 732	45 619 416	53 050 390
Branches of foreign credit institutions	3 462 173	3 863 626*	4 142 589
Cooperative banks	-	-	-
Banking sector, total:	**40 528 905**	**49 483 042***	**57 192 979**
y/y change (in %)	**9.4%**	**22.1%**	**15.6%**

** Data correction due to the availability of audited data*

Ownership structure of banks on the basis of assets total*

Item	2019	2020	2021
Public sector ownership	3.7%	4.4%	0.0%
Domestic ownership total	48.6%	49.8%	51.0%
Foreign ownership	51.4%	50.2%	49.0%
Banking sector, total:	**100.0%**	**100.0%**	**100.0%**

** Banks controlled by strategic foreign owners are considered in foreign ownership.*

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	44.4%	59.4%	0,111
Branches of foreign credit institutions	72.9%	92.1%	0,276
Cooperative banks	-	-	-
Banking sector, total:	**41.2%**	**55.1%**	**0,097**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	12.6%	5.1%	10.2%
Cooperative banks	-	-	-
Banking sector, total:	**12.6%**	**5.1%**	**10.2%**

[3] Without 3 Special Financial Institutions (MFB, EXIM, KELER)
Based on individual data

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	91.5%	92.2%	92.8%
Branches of foreign credit institutions	8.5%	7.8%	7.2%
Cooperative banks	-	-	-
Banking sector, total:	**100.0%**	**100.0%**	**100.0%**

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

	2019	2020	2021
Receivables			
Financial sector	33.0%	35.2%	40.4%
Nonfinancial sector	42.5%	39.6%	38.6%
Government sector	21.5%	22.7%	19.3%
Other assets	3.0%	2.5%	1.7%
Liabilities			
Financial sector	29.3%	30.6%	31.9%
Nonfinancial sector	51.2%	51.6%	52.2%
Government sector	3.3%	3.5%	3.7%
Other liabilities	5.5%	5.3%	3.8%
Capital	10.7%	9.0%	8.4%

*Capital adequacy ratio of banks****

Type of financial institution	2019	2020	2021
Commercial banks	22.1%	22.3%	21.4%
Cooperative banks	-	-	-
Banking sector, total:	**22.1%**	**22.3%**	**21.4%**

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

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

Asset classification	2019	2020	2021
Non-financial sector, including*	3.7%	2.9%	3.7%
households	4.2%	3.1%	4.2%
corporate	3.2%	2.8%	3.2%

** Domestic loans*

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	84.4%	91.4%
Households	38.1%	45.4%
Corporate	46.3%	46.0%
Government sector	5.8%	2.3%
Financial sector (excluding banks)	9.8%	6.3%
Total	**100.0%**	**100.0%**

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

P&L account	2019	2020	2021
Interest income	1 143 603	1 233 058*	1 527 934
Interest expenses	404 608	384 422*	505 060
Net interest income	738 995	848 636*	1 022 874
Net fee and commission income	569 276	600 373*	671 347
Other (not specified above) operating income (net)	296 444	215 417*	294 417
Gross income	1 604 715	1 664 426*	1 988 638
Administration costs	939 833	1 038 863*	1 147 176
Depreciation	95 237	120 418	132 149
Provisions	-27 370	-249 948*	-144 408
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	0	0	0
Profit (loss) before tax	542 275	255 198*	564 904
Net profit (loss)	499 098	222 591*	501 002

** Data correction due to the availability of audited data*

Total own funds in 2021 (in EUR)***

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	13 300 939 400	11 632 806 010	11 881 979 452	1 418 959 948	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**13 300 939 400**	**11 632 806 010**	**11 881 979 452**	**1 418 959 948**	**-**

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

Development in the banking sector (including assets total / GDP)

By 2021 the banking sector consisted of 10 banking business firms, including 3 banks, 3 branches and 4 credit providers. By 2021 the total amount of assets constituted to 1,020,665 thousand of USD. More data on the banking sector is displayed in the questionnaire tables below.

By 2021 the following banks became the Participants of the AIFC:

- Al Saqr Islamic Bank Ltd.
- Brillink Bank Corporation Limited

As of the end of 2021, the AIFC financial services framework included:

- 29 types of regulated activities:
- 6 types of market activities;
- 5 types of ancillary services.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

2021 marked introduction of a number of important changes in banking regulatory framework of AIFC as follows:

1) **Currency Regulation and Information Exchange Rules in AIFC**. In 2021AFSA completed a series of workstreams and negotiations with the National Bank of the Republic of Kazakhstan (NBK) and the Agency for Regulation and Development of the Financial Markets of the Republic of Kazakhstan (ARDFM), with the involvement of all main stakeholders including the Governor, the AIFC Authority, the Astana International Exchange Ltd (AIX) and AIFC participants.

The rules incorporate the following conditions: (1) AIFC participants will be able to provide some financial and professional services in foreign and national currencies to residents of Kazakhstan; (2) AIFC participants may conduct export-import operations through second-tier banks of Kazakhstan; (3) Currency exchange operations with the national currency must only be implemented through second-tier banks regulated by the NBK; (4) AIFC banks may carry out some transactions in the national currency through their correspondent bank accounts in second-tier banks of Kazakhstan; (5) AIFC banks may provide export-import operations only through second-tier banks; and (6) Export-import operations of AIFC participants nominated in the national currency may only be implemented through second-tier banks of Kazakhstan.

In addition to above, the rules added clarity on operations of banking business in AIFC, including (1) ability to provide loans to legal entities of the Republic of Kazakhstan in foreign currency only and (2) taking deposits in foreign currency from non-residents and AIFC participants controlling shareholder of which is non-resident etc.

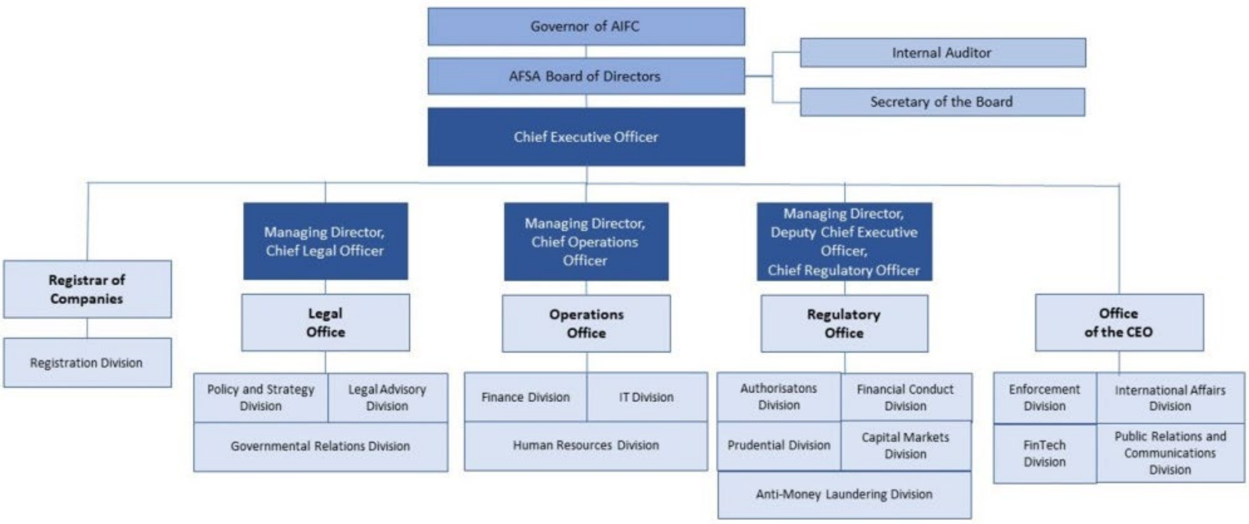
The Act was signed on 10 November 2021 by both the AIFC Governor and the NBK Governor.

2) **Amendments and enhancements to the AIFC Banking Business Framework**. With the purpose of aligning the AIFC Banking Business Framework with best practice jurisdictions and making certain provisions clearer, AFSA initiated amendments to the definition of "Credit Providers", which previously did not have to comply with the AIFC Banking Business Prudential Rules. A six-month transition period was provided to existing Credit Providers for compliance with the amendments enacted in December 2021.

During 2021, as part of implementing the SREP approach in prudential supervision, AFSA approved guidelines on the implementation of SREP following the conclusion of the introduction and testing period.

In addition, AFSA developed and approved a Supervisory Policy Statement on its approach to branch supervision, which sets out general expectations that underpin AFSA's ability to effectively supervise firms operating through branch offices in the AIFC that are part of international groups and/or headquartered overseas. Applying this Supervisory Policy Statement based on the experience of the Prudential Regulatory Authority of UK will provide an objective approach to simplifying prudential supervision of branch offices of non-AIFC incorporated firms.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2021

AFSA pursued its activities in 2021 guided by the AIFC Development Strategy 2021 – 2025, adopted by the AIFC Management Council on 2 July 2020. Specifically, AFSA focused on implementing the AIFC's objectives, as envisaged in the Constitutional Statute and contributing to the relevant reforms necessary for the proper functioning of the financial sector. AFSA made contributions to the implementation of the AIFC strategy through a number of initiatives including:

(i) the enhancement of AIFC regulatory frameworks
(ii) expansion of access for AIFC participants to the financial markets of Kazakhstan
(iii) growing the AIFC participant community
(iv) further streamlining the registration and authorisation process
(v) aligning financial services regulation to international standards and
(vi) expanding AFSA's presence in the international arena.

The activities of the Banking Supervisory Authority in 2021

The activities of AFSA in 2021 focused on following workstreams: (1) development and enhancement of legal framework with a view of further improvements of banking regulation; (2) further alignment with international standards; (3) combating money-laundering; (4) supervision; (5) promotion of FinTech.

1) AFSA developed and adopted the following Rules and regulatory materials relating or impacting banking sector:

   - Rules on Currency regulation and provision of information on currency transactions in the AIFC
   - Rules on the Substantial Presence of the AIFC Participants Applying Tax Exemptions for the payment of Corporate Income Tax, Value Added Tax
   - AIFC Multilateral and Organised Trading Facilities Rules
   - Supervisory statement on bank branch supervision

2) AFSA enhanced the following legislative frameworks:

   - AIFC Banking Business Prudential Rules
   - AIFC Legal Entities Framework
   - AIFC Anti-Money Laundering, Counter-Terrorist Financing and Sanctions Rules
   - AIFC Digital Assets Framework

3) Commitment to International Standards and International Cooperation:

   - **Prevention of Harmful Tax Practices**: AFSA, working jointly with the tax authorities of Kazakhstan and OECD, introduced the AIFC Substantial Presence Rules in support of the OECD guidance on Base Erosion Profit Shifting package. This allowed integration of regulatory provisions to prevent harmful tax practices in the AIFC.
   - **Enhancement of anti-money laudering standards**: Demonstrating its commitment to aligning the AIFC framework with the best international standards, AFSA carried out major enhancements to the Anti-Money Laundering and Combatting Terrorism Financing (AML/CFT) Framework in accordance with the recommendations of the Financial Action Task Force (FATF).
   - **IOSCO's Objectives and Principles of Securities Regulation**: In 2021, AFSA undertook a benchmarking of the regulatory framework against IOSCO's objectives and principles of securities

regulation following the self-assessment in 2020. The work proposed the introduction of amendments to the AIFC regulatory framework in 2022 – 2023, subject to needs assessments and work priorities.

- **IAIS ICPs**: To ensure compliance with the IAIS standards and principles, AFSA conducted a self-assessment against ICPs 1 -10 in 2021. This will help to introduce corresponding amendments to the AIFC regulatory framework in 2023 – 2024.
- Insurance Core Principle 9-10. AFSA participated in the IAIS Peer Review Process (PRP) for ICP 9 - 10, which focuses on conduct of business pending an official report from the IAIS.
- **IFSB Standards**: AFSA participated in a self-assessment exercise against IFSB standards, which demonstrated compliance of AIFC regulations and rules with the standards and principles of Islamic finance regulation.

4) Combating money laundering:

- 124 AIFC firms were subject to financial monitoring for AML supervision purposes
- Further enhancement AML/CTF supervisory framework
- Preparation for the FATF-EAG Mutual Evaluation was started

5) Supervision of firms, including banks:

- supervised 39 prudentially regulated firms
- 46 firms and 137 ancillary service providers were under conduct supervision

6) Promotion of FinTech and Innovations in the AIFC and beyond:

- Received and processed 71 applications and accepted 9 firms to the FinTech Lab.
- By the end of 2021, there were 40 firms in total accepted to the FinTech Lab with another 24 applicants recognised as being eligible from 20 jurisdictions offering 7 different types of innovative financial services in the areas of money services/banking, digital assets, investment business, Islamic finance, crowdfunding and factoring.

International activities of the authority

2021 marked significant progression of AFSA's international profile through several initiatives, including (1) the chairmanship in the Group of Banking Supervisors from Central and Eastern Europe (BSCEE), a regional consultative group under the Basel Committee on Banking Supervision; (2) hosting a high-level meeting on Regulatory Co-operation in Central Asia, involving Central Banks and supervisory authoirities; (3) formalisation of co-operation with securities regulators of the European Union through the European Securities and Markets Authority; (4) assumption of the role of Regional Co-ordinator for the IAIS MMoU in the CEET area.

AFSA further strengthened its bilateral relations with peer regulators from Europe and Asia, enhancing its ability to exchange information and experience with regulators on supervisory issues. AFSA formalised co-operation with 19 peer regulators through bilateral agreements and memoranda, including 17 MoUs relating to the Alternative Investment Fund Managers Directive (AIFMD) and 2 MoUs with regulatory authorities of Kyrgyz Republic and UAE. This has brought the total number of agreements and memoranda concluded by AFSA to 43.

AFSA actively contributed to the activities of global standard-setting organisations. The main avenues for AFSA's involvement were (1) through its membership of 15 committees and working groups of international organisations (AFSA joined the Technical Committee of the Islamic Financial Services Board (IFSB) in 2021); (2) its contribution to research and survey initiatives globally; and (3) attendance at international forums discussing and expanding the global regulatory agenda.

Cooperation with other supervisory bodies in the country

2021 saw a period of significant strengthening of AFSA's cooperation with rewgulatoty bodies in Kazakhstan.

AFSA has worked closely with the Kazakhstani authorities, the National Bank of the Republic of Kazakhstan (NBK) and the Agency for Regulation and Development of the Financial Markets of the Republic of Kazakhstan (ARDFM), to develop Currency Regulation and Information Exchange Rules in AIFC as discussed above.

AFSA have also formalised co-operation with the Agency for Financial Monitoring of the Republic of Kazakhstan (AFM) by entering into a Memorandum of Understanding in order to unite efforts on AML/CFT in Kazakhstan and work together in preparing for the mutual evaluation against FATF recommendations in 2022-2023.

Co-operation with the Ministry of Justice, Ministry of Finance and State Revenue Committee allowed the further enhancement of incorporation, registration, and taxation issues in the interest of supporting a robust financial sector while improving the ease of doing business in the AIFC. As discussed above co-operation with the State Revenue Committee led to joint adoption of AIFC Substantial Presence Rules in line with OECD standards on Base Erosion Profit Shifting and in order to introduce standards on prevention of harmful tax practices in the AIFC.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks		1	3
Branches of foreign credit institutions	2	3	3
Cooperative banks			
Banking sector, total:	**2**	**4**	**6 ***

** the figure excludes other banking business firms, such as credit providers and representatives offices.*

Total assets of banking sector (at year-end) in USD mln

Type of financial institution	2019	2020	2021
Commercial banks		10,1	106,3
Branches of foreign credit institutions	212,5	388,5	907,6
Cooperative banks			
Banking sector, total:	**212,5**	**398,6**	**1 013,9**
y/y change (in %)			

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership			
Domestic ownership total		2,5%	3,4%
Foreign ownership	100	97,5%	96,6%
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	89,5%	89,5%	
Branches of foreign credit institutions	9,7%	11,5%	
Cooperative banks			
Banking sector, total:	**99,2%**	**100%**	

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks		0	-0,01%
Cooperative banks		0	
Banking sector, total:		**0**	**-0,01%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks		2,5%	3,4%
Branches of foreign credit institutions	100%	97,5%	96,6%
Cooperative banks			
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables			
Financial sector		45%	23%
Nonfinancial sector	100%	43%	60%
Government sector		10%	17%
Other assets		2%	>1%
Liabilites			
Financial sector	100%	38%	73%
Nonfinancial sector		39%	11%
Government sector			
Other liabilities		21%	16%
Capital		3%	2%

Capital adequacy ratio of banks

Type of financial institution	2019	2020	2021
Commercial banks			75%***
Cooperative banks			
Banking sector, total:			

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

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

Asset classification	2019	2020	2021
Non-financial sector, including		0/0	0/0
households		0/0	0/0
corporate		0/0	0/0

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:		
Households		
Corporate	100%	100%
Government sector		
Financial sector (excluding banks)		
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	304 000	12 653	18 623
Interest expenses	181 000	9 900	13 247
Net interest income	123 000	2 753	5 376
Net fee and commission income	-106 000	24	- 369
Other (not specified above) operating income (net)	0	16	- 207
Gross income	15 000	2 793	4 800
Administration costs	928 000	4 620	5 563
Depreciation	67 000	434	434
Provisions	527 000	166	1 145
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	527 000	166	1 145
Profit (loss) before tax	-1 506 000	-2 427	- 2 341
Net profit (loss)	-1 506 000	-2 427	- 2 341

Total own funds in 2021
in thousand USD

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	21 761***	21 776***	21 776***	21 776***	
Cooperative banks					
Banking sector, total:	**21 761*** **	**21 776*** **	**21 776*** **	**21 776*** **	

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

Macroeconomic environment in the country

In 2021, the Covid-19 pandemic continued, and the measures restricting the spread of the virus were reimposed during the year. However, as foreign demand recovered, households and companies were able to adjust and the government provided support, the economic activity increased, resulting in a GDP growth by 4.2%. The economy recovered to the pre-crisis level in the second quarter of 2021, but in the second half of the year economic activity was limited by factors such as material and labour shortage, as well as rising costs, in particular energy costs.

Along with positive economic growth, unemployment decreased to 7.6% compared to 2020. Most of furloughed employees affected by the pandemic returned to their jobs after the expiry of the benefit period as full-time staff.

Although the recovery of labour market was not uniform, Latvia experienced a strong increase in wages (11.8%), partially because sectors more directly affected by the crisis (such as accommodation and catering) were those with relatively lower wages. Meanwhile, in some other sectors the number of jobs remained almost the same (e.g., education, healthcare, information technologies), and the wages kept increasing.

At the beginning of 2021, prices in Latvia had almost not changed, but during the year they increased, and the inflation reached a 10-year maximum (7.9% in December). Increase of the inflation (3.2% on average per year) was mostly driven by global factors: higher energy prices and other supply factors.

In 2021, the growing external demand continued to be the main factor that led to the growth of manufacturing and goods exports. Export growth as well as build-up of inventories to mitigate the supply-side bottlenecks induced strong import growth. These developments in combination with the recovery of foreign investors' profits, which slightly exceeded the pre-pandemic level, led to current account deficit of 2.9% of GDP.

A financial support from Latvian government was provided to businesses and households, increasing the fiscal deficit to 7.3% of GDP. Government spending on mitigating Covid-19 effects (2.1 billion euro) was almost 2.2 times higher than in 2020. The flexible crisis framework of the European Union (EU) fiscal rules made this expansive fiscal policy possible. State support widely available during the Covid-19 pandemic significantly mitigated the negative effects on the economy, protected the economy from sustained negative consequence and reduced profitability fluctuations and prevented mass bankruptcies. During the crisis, the government debt increased to 14.7 billion EUR (44.8% of GDP) at the end of 2021.

Development in the banking sector (including assets total / GDP)

A number of structural changes took place in the Latvian banking sector during 2021. At the beginning of the year, the transaction started in December 2019 was concluded between Citadele Banka, the third largest bank in Latvia, and UniCredit S. p. A, as a result AS Citadele Banka became the 100% owner of SIA UniCredit Leasing in the Baltics. In September TF Bank AB Latvian branch, registered in Sweden, started its activities. In October, Rigensis Bank AS, one of the smaller banks previously oriented on servicing non-resident clients, carried out reorganization by re-registering it as a commercial company the activities of which are not related to the activities of credit institution. Later in October, following the consent of the European Central Bank (ECB) and other Supervisory Authorities, the shares of the Swedbank Group banks in the Baltics were transferred to the holding company Swedbank Baltics AS registered in Latvia. Consequently, at the end of the reporting year, 12 banks and four branches of foreign banks of the EU countries were operating in Latvia, as well as one financial holding company.

The increase in assets was determined by the dynamics of deposits. The total amount of assets in the Latvian banking sector grew by EUR 1.0 billion or 4.2% during the year, while excluding the impact from the reorganization of Rigensis Bank AS business, by 5.6%. This was primarily determined by a relatively rapid increase in deposits, but the repayment of the ECB's targeted longer-term refinancing operation (TLTRO III) loan by one credit institution had negative impact on total asset growth. Despite the growth of total assets ratio to GDP ratio decreased from 82% to 77%.

Deposits of non-bank customers continued to rise in 2021. Total deposits increased by EUR 1.3 billion or 7.1% during the year, based on a significant increase in domestic deposits, which was EUR 1.6 billion at the end of the year, or 10.5% higher than 2020. This was mainly due to an even faster upsurge in household deposits than in the previous year, by EUR 1.3 billion or 15.2%, as well as by non-financial corporations whose deposits had increased by EUR 490 million or 8.8%. At the same time, the deposits of foreign customers continued to fall (by 8.4% or EUR 288 million). The share of domestic deposits in total deposits reached 84.3% at the end of the year.

Although the liquidity coverage ratio decreased, it remained at a high level. The average EU harmonised liquidity coverage rate of Latvian banks reduced to 320.4%, which was slightly lower than at the end of the previous year. The decrease in the liquidity ratio was mainly affected by the reduction of claims against affiliated institutions, with the corresponding placement of balances in the central bank that had a negative impact on the indicator.

The stable funding ratio improved. Since the end of Q2 of 2021, the ratio had climbed from 165.7% to 172.6%. For individual banks, it ranged from 120% to 292%. The majority of the required amount of stable funding was determined by loans granted to non-bank customers and the available stable funding – the deposits of individuals or small and medium-sized enterprises.

The total amount of loans granted to non-bank customers by the Latvian banking sector increased by 12.2% over the year, including 7.5% for domestic customers. That rapid increase was mainly due to the strategic transaction carried out by AS Citadele Banka, as well as the purchase of the mortgage loan portfolio of ABLV Bank AS in liquidation, thus returning this portfolio back to the active bank data. This resulted in an increase in the loan portfolios across all borrower segments, including households (12.9%) and non-financial corporations (9.4%).

By excluding the impact of AS Citadele Banka, the increase of customer loan portfolio was more moderate in the reporting year. The total loan portfolio grew by 3.6% and was driven by 4.1% growth in the domestic portfolio. The amount of loans granted to domestic non-financial corporations did not change significantly during the year (-0.3%). The domestic households' portfolio was gradually growing (up 4.7% year-on-year) with remaining high interest in financing the housing purchase. The foreign customers loan portfolio continued to decrease (by 3.6%), although the lending of Baltic customers increased significantly, the total amount of loans to customers from other EU countries declined by 37.6%.

The quality of loans to non-bank customers continued to improve, with the share of non-performing loans (NPL) in the non-bank loan portfolio reducing to 3.6% at the end of December. During the year, asset quality improved in both domestic and foreign loan portfolios, with the share of NPL decreasing to 2.4% and 10.1%, respectively. In the domestic household segment, credit quality gradually improved, with the NPL ratio shrinking to 1.8%. During the year, the share of NPL in loans issued by domestic non-financial corporations reduced rather significantly (by 1.1 percentage points to 3.1% at the end of the reporting period).

Improvements in the profitability of the banking sector were determined by a number of factors. In 2021, the banking sector earned EUR 292 million, i.e., 94% above its profits in 2020. Profit growth was driven by factors such as the low base level of 2020, structural changes in the banking sector, individual one-off factors, as well as increased overall economic activity and business volumes. Consequently, the main impact on profit growth was directly on the growth of core operating income, which was EUR 120 million in 2021, or 17.1% higher than in 2020. At the same time, the improvement in profits was also driven by significantly lower provision expenses (- 57.7 million euro or 88.5%). With earnings growth, the return on equity (ROE) also improved from 5.4% to 10.2%. Two less-significant banks closed the year 2021 with losses.

Capital ratios remained stable at high levels. At the end of 2021 total capital ratio was 24.2%, while the Common Equity Tier 1 (CET1) capital ratio - 23.2%. However, compared with the end of the previous year, when figures were 26.7% and 24.3%, respectively, there was a decline in indicators. This was due to a relatively rapid decrease in capital ratios in the first quarter of the year affected by the strategic transaction carried out by Citadele Banka, with a negative impact on the total capital ratios.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

Financial and Capital Market Commission (FCMC) has been operating as an autonomous public institution since 1 July 2001, regulating and monitoring Latvian financial and capital market, ensuring protection of the interests of customers, and promoting the stability, competitiveness and development of the whole sector. The scope of the FCMC competence is set forth in the Law on the Financial and Capital Market Commission and relevant sectoral laws[1]. The activities of the FCMC are managed by its Board – the Chairperson and two Board members.

As regards the supervision of banking sector, the FCMC has authority to issue regulations and guidelines governing activities of banks, to request and receive information from banks necessary for the execution of its functions, to impose restrictions on the activities of banks, to examine compliance of the activities with the legislation and the FCMC regulations, and to apply sanctions set forth by the regulatory requirement on banks and their officials in case of any violations of regulatory requirements.

Since introduction of the Single Supervisory Mechanism (SSM) in November 2014, the FCMC has been sharing banking supervision powers with the ECB. Three banks in Latvia are classified as significant credit institutions and thus subject to the ECB direct supervision, while other banks operating in Latvia are subject to direct FCMC and indirect SSM supervision. However, monitoring of AML/CTF still remain within the FCMC competence.

Resolution and Protection Schemes Department of the FCMC operates in the capacity of a national resolution authority and forms part of the Single Resolution Mechanism (SRM), its activities and functions are separated from the supervision functions. In addition, the Department is also responsible for administering the Latvian Deposit Guarantee Fund, the Fund for the Protection of the Insured and the Investor Protection Scheme.

The FCMC is also a designated authority for implementation of macro-prudential instruments according to the EU legislation.

Legislative developments in 2021

On 23 September 2021, the Parliament of the Republic of Latvia adopted a new Law on *Latvijas Banka*[2] providing for the incorporation of the FCMC into the structure of the national central bank as of 2023. Thus, intensive work on integration at various levels of administration of both authorities already took place during

1 E.g., Credit Institution Law, Insurance and Reinsurance Law, Law on the Financial Instruments Market, Private Pension Fund Law etc.
2 https://likumi.lv/ta/id/326575-latvijas-bankas-likums

2021, to ensure the smooth integration of the FCMC by the end of 2022. Taking the first practical step towards the integration the FCMC has delegated the financial literacy function to the *Latvijas Banka* already as of 1 January 2022.

In 2021, the FCMC continued to improve the legal framework governing the activities of the participants of the financial and capital market, by implementing the requirements of the EU directives and guidelines issued by the EU institutions, ensuring the application of a directly applicable EU legal framework, as well as by improving the macroprudential legal framework and applying instruments set therein.

As to the developments in national regulatory framework for banking sector, in 2021, the FCMC Board adopted changes in the FCMC regulations for remuneration policy, set new requirements in the field of credit risk management and regarding outsourcing arrangements. Changes mainly were driven by the legislation adopted within the EU framework and recent market developments.

Organizational chart of the Banking Supervisory Authority

Last amendments to the FCMC organizational structure were introduced in end-2020, no changes managed during 2021.

Main strategic objectives of the Banking Supervisory Authority in 2021

The following five priority areas set in the FCMC Operational Strategy for 2019 – 2023 served as main FCMC strategic objectives also during 2021:

- to ensure consistent and professional supervision of the financial sector by developing an appropriate and proportionate regulatory environment of the financial sector, promoting a high level of compliance of the financial sector, and mitigating the risks, inter alia, in the AML/CTF field;
- to continue developing as a professional, accountable and responsible organisation with effective corporate governance and procedures;
- to actively involve in regular and coordinated dialogue with the financial sector, develop strategic communication with the public, and to continue promoting public financial literacy;
- to facilitate a business environment favourable to innovative and secure financial services;
- to ensure effective mechanism for financial sector crisis management and resolution.

Taking the strategy of FCMC and priorities for 2021 into account, specific structural and individual goals in the field of sustainability, financial innovations, development of Latvian capital market, monitoring of Covid-19 situation and other priority areas were set for 2021 by the Board of the FCMC.

The activities of the Banking Supervisory Authority in 2021

Prudential supervision

In 2021, the FCMC continued ensuring a comprehensive supervisory process of credit institutions, with a special focus on the assessment of the impact of the Covid-19 pandemic. Based on the assessment of the risks inherent to the operation of credit institutions and trends in the financial system, as well as taking into account the priorities set by the ECB and the EBA, at the beginning of 2021 the FCMC identified the following priorities in the supervision of credit institutions:

- Strategy, business model and profitability, with a focus on the bank's business models, fulfilment of strategies and recovery capacities;
- Internal governance and sustainability, with a focus on the bank's stress testing approach, sustainability risk management and MLTPF risk management;
- Credit risk and adequacy of provisions, with a focus on the impact of the Covid-19 pandemic and NPL management.

In the field of strategy, business model and profitability, an in-depth evaluation of progress of the banks in the process of transforming business models was carried out. Special attention was also paid to the viability, sustainability and profitability of the banks, inter alia, under the influence of the Covid-19 pandemic. The FCMC continued active dialogues with the banks, ensuring regular mutual communication and facilitating the transparency and efficiency of the supervisory process.

Work continued in the field of internal governance and strengthening risk management functions, by evaluating the MLTPF risk management process and improvement thereof in the banks. At the same time, a brand-new risk management area was outlined, which pertains to the sustainability risks. By understanding the significance and topicality of sustainability risks both in the short run and in the long run, the FCMC commenced working on integrating the framework of management of these risks into supervisory processes.

Within the scope of credit risk management, greater attention was paid to the evaluation of the impact of the Covid-19 pandemic on asset quality, as well as the quality of credit risk management in the banks. This evaluation encompassed both standard activities within the scope of the SREP and horizontal inspections and dialogues with market participants.

AML/CTF supervision

Active work performed by the FCMC in the previous years in the field of ML/TF risk management was positively assessed by the IMF, which, in its report of 2021, pointed out the significant progress achieved by Latvia in strengthening the field of ML/TF risk management. In 2021, the FCMC continued strengthening ML/TF risk management, setting the building of quality and efficiency of supervision and strengthening the dialogue with market participants as key priorities.

FCMC paid special attention to enhancing off-site supervisory measures, e.g., plan for the prevention of deficiencies for improving the supervisory processes and enhancing the methodology for the assessment of banking risks and their management. The ML/TF risk assessment are being integrated into joint supervisory process and represent one of the factors that can influence the supervisory priorities. Dialogue between the FCMC and market participants was significantly strengthened both by organising training seminars and discussions (for example with public organisations, entrepreneurs) and by providing explanations and significantly supplementing a manual for the application of AML/CTF requirements in cooperation with the Finance Latvia Association.

During the reporting year, the FCMC conducted 23 inspections (five on-site full inspections, seven on-site targeted inspections and 11 off-site targeted inspections) in banks in the field of AML/CTF. Three on-site target inspections were conducted with a focus on the field of international sanctions.

International activities of the authority

Year 2021, also in the field of international cooperation was the second year under the influence of Covid-19 where international co-operation was highly digital, with no possibilities for expansion of direct contact networking, which had previously been an integral part of international co-operation.

As in previous years, at the international scale, the activities of the FCMC focused on the cooperation and exchange of information with supervisory and resolution authorities of other (mainly EU) countries and participation in the SSM and SRM as well as cooperation with the European authorities – ECB, European Supervisory Authorities (EBA, ESMA, EIOPA), and Single Resolution Board. FCMC continued to maintain close contacts with national supervisory and resolution authorities from other countries. An essential part of the banking supervision constitutes the cooperation with home supervisor authorities, also participating in the work of the supervisory and resolution colleges for cross-border banking groups.

During the reporting year, the FCMC continued its co-operation, exchange of information and representation of Latvia's interests in the Nordic-Baltic cooperation forums, the European Forum of Deposit Insurers, Moneyval, BSCEE and the IOSCO.

The FCMC also provided support to ministries and other state institutions, contributing to the representation of Latvia's interests and the preparation of opinions on issues relevant to the financial market in the work of the EU Council working parties, European Commission's Expert Groups and the OECD, as well as preparing information for various EU, OECD, IMF reports and reviews on Latvia.

Cooperation with other supervisory bodies in the country

The FCMC is a unified financial sector Supervisory Authority in the Republic of Latvia. Nevertheless, the FCMC works in a close cooperation with different national public authorities and institutions, i.e., the Bank of Latvia (macroeconomic, macro-prudential and financial stability issues), the Ministry of Finance (preparation of national legislation and collaboration in development of financial policy issues), the Financial Intelligence Unit (FIU) of Latvia (AML/CTPF issues), Ministry of Justice, Consumer Rights Protection Centre and other government bodies.

The FCMC cooperates and consults also with all the relevant sector associations, especially within the processes of preparation of regulations, recommendations and guidelines.

Other relevant information and developments in 2021

More detailed information about the developments in the banking sector and banking supervision in Latvia is available on the FCMC website: https://www.fktk.lv/.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	14	13	12
Branches of foreign credit institutions	5	3	4
Cooperative banks	0	0	0
Banking sector, total:	19	16	16

Total assets of banking sector (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	17 652 267	20 270 764	20 836 641
Branches of foreign credit institutions	4 853 172	4 024 983	4 466 727
Cooperative banks	0	0	0
Banking sector, total:	22 505 439	24 295 747	25 303 369
y/y change (in %)	-0.1	8.0	4.1

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	0	0	0
Domestic ownership total	14.7	13.4	44.0
Foreign ownership	85.3	86.6	56.0
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	81.7	93.4	0.242
Branches of foreign credit institutions	98.4	100.0	0.703
Cooperative banks	-	-	-
Banking sector, total:	67.2	88.0	0.186

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	3.1	5.3	10.0
Cooperative banks	-	-	-
Banking sector, total:	3.1	5.3	10.0

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	78.6	83.4	82.3
Branches of foreign credit institutions	21.4	16.6	17.7
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables			
Financial sector	32.3	36.3	32.2
Nonfinancial sector	58.0	52.0	55.3
Government sector	3.7	4.4	9.7
Other assets	6.0	7.3	2.8
Liabilities			
Financial sector	9.6	11.8	8.2
Nonfinancial sector	69.6	71.0	73.2
Government sector	4.0	1.8	1.3
Other liabilities	7.4	5.4	7.0
Capital	9.4	10.0	10.3

Capital adequacy ratio of banks

Type of financial institution	2019***	2020***	2021***
Commercial banks	21.08	26.85	25.34
Cooperative banks	-	-	-
Banking sector, total:	21.08	26.85	25.34

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

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

Asset classification	2019	2020	2021
Non-financial sector, including	7.1	4.9	3.8
households	4.9	3.7	2.3
corporate	8.9	5.9	5.0

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	92.0	93.9
Households	57.4	43.9
Corporate	34.6	50.0
Government sector	1.6	2.0
Financial sector (excluding banks)	6.5	4.1
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	543 609	505 744	529 984
Interest expenses	103 716	81 062	63 818
Net interest income	439 893	424 683	466 166
Net fee and commission income	228 787	207 897	234 899
Other (not specified above) operating income (net)	117 618	48 052	75 960
Gross income	786 298	680 632	777 025
Administration costs	471 833	423 441	437 129
Depreciation	38 472	34 410	38 919
Impairment and Provisions	185 154	67 932	6 142
Profit (loss) before tax	90 839	154 869	294 834
Net profit (loss)	83 935	150 355	285 660

Total own funds in 2021 (in EUR)***

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	2 335 461	2 241 534	2 242 634	92 827	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	2 335 461	2 241 534	2 242 634	92 827	-

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

Macroeconomic environment in the country

Lithuania's economy successfully resisted the challenges posed by the COVID-19 pandemic in 2021 and adapted to the new operational conditions, but the rapid recovery was brought to a halt by the outbreak of Russia's war against Ukraine.

The challenges of recent years have confirmed that Lithuanian business has learnt from the past: exports of goods and services to Russia and Belarus have for some time been relatively small. Unfortunately, as a result of the war, exports to Ukraine have been partially reduced but we hope that this is temporary.

The ECB responds to rising inflation through monetary policy decisions, which open the door to other, faster decisions. The experience gained dealing with the challenges caused by the COVID-19 pandemic, implementing the Pandemic Emergency Purchase Programme (PEPP) and other monetary policy measures together with the Eurosystem, which also includes the Bank of Lithuania, is of great importance. Last year alone, the Bank of Lithuania injected €1.6 billion into the country's financial system through asset purchase programmes. As a result, the Lithuanian Government saved over €30 million by issuing bonds between March 2020 and the end of last year. Throughout the validity period of bonds, this amount will exceed €600 million.

The increase in prices of energy resources is a clear sign of the urgent need to invest in renewable energy, thus reducing dependence on both polluting fossil fuels and unreliable external energy suppliers. In addition to helping tackle climate change, climate-friendly investments would create added value for the country's economy. Managing climate risks is one of the strategic objectives of the Bank of Lithuania for 2022–2025. We assessed our CO2 footprint (a three-fold decrease compared to 2020) and published a report. We will continue to reduce our environmental impact, for example, by using green electricity. In accordance with the common climate change and responsible investment principles agreed by the Eurosystem, we will restructure the investment portfolio of financial assets. We have already made the first investment of €60 million in shares in line with the principles of sustainable investment. This will allow further mitigation of the impact on climate change.

Development in the banking sector (including assets total / GDP)

In 2021, the Bank of Lithuania received 9 applications for a specialised bank licence and carried out 7 preliminary assessments of potential applications for a specialised bank licence. The final decision on the licensing of specialised banks is taken by the ECB.

While financial market participants have risen to the challenges posed by the pandemic, Russia's invasion of Ukraine requires continued vigilance, close monitoring of the liquidity situation, credit risk and other supervisory indicators of the financial sector and, if necessary, supervisory action. The Bank of Lithuania supervises the compliance of financial institutions with the requirements of ICT and cybersecurity risk management and its readiness to ensure business continuity. The Bank of Lithuania warned financial market participants about the increased interest of individuals in crypto-assets and the resulting risks of money laundering, fraud and terrorist financing.

Despite the ongoing global coronavirus pandemic and lockdowns in Lithuania, the banking sector was profitable and continued to be financially sound, with solid capital adequacy and liquidity. In 2021, according to unaudited data, Lithuania's banking sector earned a profit of €329 million, 17.6% more than in 2020, almost reaching the pre-pandemic level (€334 million in 2019). All banks complied with the established capital adequacy and liquidity requirements.

In 2021, some performance indicators of banks improved significantly, banks became more digitalised; they created and offered customer-friendly, accessible channels for the delivery of products and services. It should be noted that timely state aid and business adaptability prevented the banking sector from facing a more significant increase in credit risk: the loan portfolio quality indicators improved. In addition, lending to citizens and businesses increased, while deposits in banks continued to grow, although their annual growth rate slowed down.

The banking sector remains concentrated, but new market participants are gradually increasing the existing assets. The banks which launched their operations in the past few years now hold 3.2% of the market in terms of assets (0.9% a year ago). At the end of the year total banking system assets to GDP comprised 79,36%.

Credit unions operating in the country were profitable and complied with all prudential requirements. In 2021, credit unions grew in assets and share capital and actively lent to citizens and businesses. Credit unions' assets increased by 16% over the year and, according to unaudited reports, amounted to €1,119.7 million. Asset growth was driven by an increase of deposits in credit unions. In 2021, loans grew faster than deposits: 20% for loans and 13.8% for deposits. Increased lending was the main contributor to the performance of the credit union sector. They earned an unaudited profit of €9.5 million, i.e. €3.2 million more than in 2020.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

Given the relevance of cyber risks, the Bank of Lithuania assessed how 8 banks and 2 central credit unions managed ICT and security risks. The results demonstrated that credit institutions should pay more attention to the following three areas: operational security, monitoring and response as well as protection of the management of access rights.

A thematic analysis of anti-money laundering measures and de-risking policies applied by Lithuanian financial institutions found that they do not significantly reduce the availability of payment services to individual user groups, but there are several difficulties encountered by the country's payment service users as a result of these procedures. The Bank of Lithuania announced a public consultation on measures to improve the experience of payment service users in the application of anti-money laundering and terrorist financing (AML/CTF) measures and that it would take steps to remedy the situation. The Bank of Lithuania will continue to monitor the application of de-risking policy and, if it identifies indications of undesirable consequences of de-risking policy, will take appropriate action and also actively engage in the document drafting process of the European Banking Authority (EBA) to ensure a balance between payment services and the AML/CTF legislation.

Since the risks related to ML/TF are one of the greatest concerns not only for the financial system in Lithuania but across the EU and for the security of citizens, in 2021, the Bank of Lithuania focused on AML/CTF. The Bank, together with the Financial Crime Investigation Service (FNTT), developed guidelines to help financial market participants to better identify fictitious companies and prevent their activities.

The Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL) highlighted the progress made by Lithuania in strengthening the fight against ML/TF in the area of supervision of financial institutions and in applying the risk assessment methodology and decided to improve Lithuania's rating, which reflects the implementation of the recommendations of the Financial Action Task Force (FATF) on the regulation and supervision of the activities of financial market participants. Lithuania will continue to implement MONEYVAL's recommendations and measures to manage these risks as part of the strengthening of the AML/CTF. For more details, see MONEYVAL press release.

Organizational chart of the Banking Supervisory Authority

Main strategic objectives of the Banking Supervisory Authority in 2021

The Bank of Lithuania strategic directions for 2021–2024 are Value, Sustainability, Progress.

VALUE (a financial sector that generates value for consumers)

I. Employing regulatory and supervisory measures to pursue conformity between the features of financial products and public needs, aiming that financial services consumers can make effective financial decisions
II. Improving penetration of and accessibility to means of payment
III. Strengthening reliability of the financial sector

SUSTAINABILITY (Promoting sustainable economic development)

I. Manage and mitigate climate risks
II. Ensure sustainable activities of the Bank of Lithuania

PROGRESS (a progress-oriented organisation)

I. Increase the maturity of data Management
II. Digitalizing processes and services of the Bank of Lithuania
III. Increasing the financial system's resilience to internal and external shocks
IV. Being one of the top three most efficient central banks in the Nordic-Baltic region

The activities of the Banking Supervisory Authority in 2021

A favourable environment has been created for the establishment of financial institutions and development of their new products in Lithuania. The Bank of Lithuania has already launched a one-stop shop, allowed foreign citizens to submit documents to obtain a licence in English, published a Licensing Guide in Lithuanian and English, and practical advice on how to prepare properly for the licensing process. A section dedicated to the Newcomer Programme has been created on the Bank of Lithuania's website, providing a concise and clear presentation of the key information for new market participants.

The Bank of Lithuania holds annual meetings with supervised financial market participants. The aim of these meetings is to contribute to the prevention of breaches and to boost confidence in the functioning of financial market supervision units as well as to develop a consistent long-term relationship with key stakeholder groups in the financial market. The results of the previous year, supervisory plans for the new (current) year are presented and future changes to the regulatory environment are discussed during the meetings. Periodic meetings are organised with compliance experts of financial market participants to discuss problems faced by financial market participants, expectations of financial market supervisors and other relevant topics. In line with the expressed needs of financial market participants, annual consultation events are organised on relevant topics. In 2021, 18 events on different topics were organised for different financial market participants. On average, 126 attendees participated in each event.

A survey of financial market participants carried out in 2021 showed that 75% of respondents are satisfied with supervision (65% in 2018), 86% consider their supervision to be effective (84% in 2018), 88% are of the opinion that communication with their company is appropriate (84% in 2018) and 84% believe that advice is properly provided to their company (82% in 2018).

The Bank of Lithuania has published on its website a plan for inspections of financial market participants, which aims at smooth cooperation between the Supervisory Authority and financial market participants. Early publication of this plan is also a preventive measure as financial institutions can assess and address potential operational weaknesses in advance. The main area under scrutiny in recent years has been the prevention of money laundering.

International activities of the authority

In 2021, a consortium of the national central banks of Lithuania and Poland implemented the EU Twinning project "Strengthening the institutional and regulatory capacity of the National Bank of Ukraine to implement the EU-Ukraine Association Agreement". The project aims to support the capacities of the central bank of Ukraine in the following key areas: banking supervision, payment system development, strategic planning and cooperation with international institutions. In addition, in early June the Bank of Lithuania and the central bank of Ukraine signed a Memorandum of Understanding, Cooperation and the Exchange of Information Related to Insurance Supervision.

On 18 October 2021, a consortium of the national central banks of Lithuania, Romania and the Netherlands launched the EU Twinning project "Strengthening supervision, corporate governance and risk management in the financial sector" in Moldova. The project aims to support the National Bank of Moldova in strengthening its capacity in macroprudential oversight, the supervision of the insurance sector, non-bank credit institutions, payments and financial market infrastructure. The implementation of the project will take 24 months with a total budget of €2 million financed by the EC. This project is the third project led by the Bank of Lithuania as a junior partner. In 2018-2019, the Bank of Lithuania together with the national central banks of Germany and Poland participated and successfully implemented the EU Twinning Programme project in Belarus.

Cooperation with other supervisory bodies in the country

In mid-May, the Ministry of Finance, the Bank of Lithuania and eight commercial banks established the Centre of Excellence in Anti-Money Laundering, followed by cooperation agreements with law enforcement authorities. Bringing together public and private sector representatives, the Centre of Excellence shares expertise in AML/CTF typologies and helps financial market participants properly identify and manage risks. It also carries out evaluations and analyses, together with the Bank of Lithuania and other institutions, develops trainings, guidelines, recommendations, methodologies and legislative initiatives to strengthen resilience to AML/CTF risks.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	10	11	12
Branches of foreign credit institutions	8	6	6
Cooperative banks	65	62	62
Banking sector, total:	**83**	**79**	**78**

Total assets of banking sector (at year-end in m EUR)

Type of financial institution	2019	2020	2021
Commercial banks	21 978,2	27 968,3	33 567,9
Branches of foreign credit institutions	8 707,4	9 777,0	9 264,8
Cooperative banks	791,3	964,9	1 119,7
Banking sector, total:	**31 477**	**38 710,3**	**43 952,4**
y/y change (in %)	**7,2**	**23,0**	**13,5**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	-	-	-
Domestic ownership total	10,0	9,8	10,5
Foreign ownership	90,0	90,2	89,5
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	94,7%	98,4%	3734,5
Branches of foreign credit institutions	93,9%	98,7%	5743,0
Cooperative banks	16,6%	25%	290,4
Banking sector, total:	**79,1%**	**90,5%**	**9768,3**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	10,8	10,5	10,1
Cooperative banks	6,27	8,91	10,64
Banking sector, total:	**-**	**-**	**-**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	69,8	72,3	76,4
Branches of foreign credit institutions	27,7	25,3	21,1
Cooperative banks	2,5	2,5	2,5
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2019	2020	2021
Commercial banks	19,49***	23,98***	23,51***
Cooperative banks	14,5**	16,43**	17,65**
Banking sector, total:	**19,45**	**23,73**	**23,32**

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

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

Asset classification	2019	2020	2021
Non-financial sector, including	1,63	1,27	0,65
households	2,14	1,86	1,01
corporate	3,11	3,75	1,85

The structure of deposits and loans of the banking sector in 2021 (%)
(at year-end)

	Deposits	Loans
Non-financial sector, including:	88,1	94,8
Households	60,4	53,7
Corporate	27,8	41,1
Government sector	8,7	1,6
Financial sector (excluding banks)	3,1	3,7
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	558,8	579,7	586,6
Interest expenses	80,2	82,1	96,7
Net interest income	478,6	301,5	489,8
Net fee and commission income	232,2	72,7	254,2
Other (not specified above) operating income (net)	74,8	90,1	312,0
Gross income	796,3	825,5	1048,1
Administration costs	348,5	366,8	607,9
Depreciation	30,5	37,1	39,3
Provisions	-4,2	2,5	0,2
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	21,9	54,6	-5,2
Profit (loss) before tax	386,7	272,7	387,3
Net profit (loss)	324,7	272,7	318,8

Total own funds in 2021 (in m EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	2378,9	2349,2	2349,2	29,7	-
Cooperative banks	93,5	-	75,6	17,9	-
Banking sector, total:	2472,4	2349,2	2424,8	47,6	-

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

Macroeconomic environment in the country

Economic activity

In 2021, GDP increased by 13.9% compared to 2020, mostly supported by domestic demand from the population in the context of increasing disposable income, a favourable environment with relatively low interest rates, a rich harvest, and positive economic activity in the region, which has gradually recovered from the adverse effects associated with the pandemic. Structurally, this dynamic was mainly determined by developments in consumption and gross capital formation. In this respect, household consumption was 15.5% higher than in the previous year, determined mainly by the increase in household disposable income and credit growth, while gross capital formation contributed 5.7 percentage points to GDP growth. Exports increased by 17.5% compared to 2020, as external demand recovered, and the agricultural sector had a good harvest. Public administration consumption increased by 2.0% compared to the previous year. Increasing domestic demand led to a positive dynamic in imports, which were 19.2% higher than in the previous year. Within the sectors of the national economy, the most pronounced positive impact was exerted by the dynamics of the agricultural sector. This sector[1]in the context of favourable agrometeorological conditions, registered an increase of 45.0% compared to 2020. At the same time, a pronounced positive contribution was determined by the increase in gross value added in trade and transport, sectors that recovered after being severely affected by the 2020 COVID-19 restrictions. Positive developments were also recorded in financial, industrial, communications, social assistance, and medical sectors. On the other hand, a negative dynamic in 2021 can be seen in the construction sector.

Inflation

In 2021, the average annual CPI inflation rate was 5.1%, 1.3 percentage points higher than in 2020. During 2021, the annual inflation rate showed a significant upward trend. It increased from 0.4% in December 2020 to 13.9% in December 2021. The upward trend in the annual inflation rate was supported by higher prices for food, oil, and other commodities on the international market, which was reflected in higher prices for these products on the local market. A pronounced impact was determined by the adjustment of gas and heat tariffs in November 2021 in the context of rising natural gas prices on the regional market. At the same time, the increase in inflation in 2021 was supported by demand-side pressures against the background of rising disposable income of the population, as well as increased lending. Inflationary pressures were also exerted by exchange rate dynamics in 2021. The good harvest in 2021 temporarily delayed, during the summer months, the propagation of the effects of the sharp rise in food prices observed on the international and regional markets. Subsequently, however, in the last months of the year, with the substitution of domestic fruits and vegetables by imported ones, food prices on the domestic market accelerated markedly, generating the largest impact on the annual CPI rate.

As net FX demand from businesses continued to rise, mirroring the widening trade balance deficit, a moderate deficit on the domestic FX market put downward pressure on the nominal exchange rate in the first three quarters of 2021. The fourth quarter of 2021 saw the start of the energy crisis and rapidly rising natural gas and oil prices, which significantly worsened the FX market deficit. Overall, the National Bank of Moldova (NBM) has intervened on the domestic FX market, to smooth exchange rate fluctuations, with net sales of USD 305 million in 2021, most of the interventions being conducted in the last quarter. In these conditions, the MDL has depreciated, in nominal terms, by 3.1% versus the USD at the end of 2021, while appreciating by 4.9% against the EUR, compared to end-of-2020 levels.

The international reserves, already at robust levels according to commonly known reserve adequacy metrics, have increased by around 3%, up to USD 3.9 billion.

[1] Agriculture, forestry, and fishing.

External sector

According to the preliminary data, in 2021, the **current account** balance of the Republic of Moldova recorded a deficit of US$ 1,590.1 million, 78.2% higher as against 2020. The CAB to GDP ratio was -11.6% (-7.7% in 2020). This dynamic was driven by the considerable decrease in the foreign trade in goods deficit and by the decrease in primary income surplus, while secondary income and services balances surpluses increased.

The *trade deficit in goods and services* totalled US$ 3,732.8 million, increasing by 37.6% as compared to 2020. The exports of goods and services amounted to US$ 4,196.8 million, increasing by 30.3%. This evolution was determined by the increase in both physical volumes and prices of exported goods. The imports of goods and services amounted to US$ 7,929.6 million, increasing by 33.6%. The increase in imports was determined by the recovery in both households and public administration final consumption considering relaxed macroeconomic policies and also the increase in real income, number of employees and inflows of personal remittances.

The *primary income* surplus decreased by 3.5% in 2021, as against 2020 and amounted to US$ 376.9 million. This dynamic was driven by more significant increase in outflows (+9.1%) as in primary income inflows (+3.4%). Thus, direct investment income outflows increased by 12.8%, while the compensation of resident employees by non-resident employers went up by 5.4%.

The *secondary income* surplus increased by 23.6%, up to US$ 1,765.8 million as compared to 2020. Personal transfers from abroad received by Moldovan residents increased by 15.5% and totalled US$ 1,220.8 million. The total amount of technical assistance, humanitarian aid and grants received by all sectors within international cooperation by all sectors practically doubled in 2021 and amounted to US$ 349.0 million.

Personal remittances (the sum of net compensation of employees, of personal transfers and of capital transfers between households) received by Moldovan residents in 2021 increased by 12.0% as compared to 2020 and totalled US$ 2,028.1 million, which represents 14.8% as a ratio to GDP.

The **capital account** recorded a negative balance amounting to US$ 51.0 million, down by 22.4% as compared to 2020. This balance stemmed from capital outflows recorded by the private sector (US$ 75.7 million), while the inflows of external assistance received by the general government for the financing of investment projects totalled US$ 24.7 million.

The **financial account** recorded a net capital inflow of US$ 1,602.6 million, resulting from the net increase in residents' liabilities to non-residents by US$ 1,147.1 million in actual transactions, along with the net decrease in residents' foreign financial assets by US$ 455.4 million.

Liabilities grew, mainly due to increase, by US$ 360.5 million, in liabilities in the form of trade credits and advances from non-resident partners and due to net drawings of US$ 301.2 million on external loans. In 2021, the general government made drawings on new loans amounting to US$ 378.8 million from the following creditors: IMF – US$ 79.8 million, IDA – US$ 76.4 million, EIB – US$ 61.7 million, European Commission – US$ 57.7 million, CEB – US$ 44.4 million, EBRD – US$ 41.3 million, IBRD – US$ 12.8 million, IFAD – US$ 4.3 million and other creditors. The repayments made by the general government in the same year amounted to US$ 141.2 million. The NBM repaid US$ 45.6 million on previously contracted loans. Commercial banks made net repayments on external loans amounting to US$ 45.1 million, and other sectors – net drawings amounting to US$ 64.1 million.

Liabilities in the form of direct investment increased by US$ 244.8 million during 2021. This dynamic was driven by the reinvestment of earnings amounting to US$ 123.1 million, by the net increase in equity belonging to non-residents, by US$ 100.5 million, as well as net drawings of US$ 21.3 million on loans previously received from direct investors.

The increase in liabilities, during 2021, was also determined by IMF allocation of SDRs in order to combat the global economic crisis, amounting to US$ 234.5 million.

The net decrease in external financial assets was driven by the net reduction in currency and deposits assets by US$ 625.7 million (of which assets of other sectors decreased by US$ 834.2 million, while the assets of commercial banks decreased by US$ 208.5 million). At the same time, the NBM's official reserve assets increased by US$ 205.8 million.

Non-resident trading partners made net repayments amounting to US$ 49.8 million on trade credits and advances previously received from residents, contributing in this way to the decrease in total financial assets. Residents' foreign assets in the form of loans increased by US$ 15.8 million and direct investment – by US$ 5.9 million.

The gross external debt of the Republic of Moldova grew by 6.8% and amounted to US$ 9,013.7 million as of 31.12.2021, which is 65.9% as a ratio to GDP.

Development in the banking sector (including assets total / GDP)

The share of banking sector assets in GDP decreased during 2021 by 1.3 pp, reaching the level of 49.0 percent as of December 2021. The negative growth was caused by an increase of 14,2% in banking sector assets, which was offset by a 17,2% increase in GDP. The assets of systemic important (institutions) banks accounted for just over ¾ of total banking assets.

Total own funds amounted to 15 178,8 million lei, increasing during 2021 by 11,4% (1 552,8 million lei). The increase in own funds was mainly determined by the recognition reflection by the banks of the eligible profits after annual general meetings of the shareholders and after obtaining the NBM's permission regarding the inclusion in the own funds of the profits made in the total amount of 1 405,2 million lei. The total ratio of own funds in the banking sector according to the data presented by banks was 25,9%, decreasing by 1,4 percent compared to the end of the previous year.

Assets amounted to 118 501,9 million lei, increasing compared to the end of the previous year by 14 728,3 million lei (14,2%).

On 31.12.2021, the gross loan portfolio constituted 47,6% of total assets or 56 359,2 million lei, up by 23,5% (10 716,0 million lei) compared to the end of the previous year. During 2021, the share of non-performing loans (substandard, doubtful and compromised) in total loans decreased by 1,2 p.p., constituting 6,1 percent as of 31.12.2021. In the context of risk distribution, the largest share of the total loan portfolio was held by credits granted to trading– 21,5% or 12 136,6 million. lei, followed by the share of loans granted for the purchase/building real estate-20,3% (11 427,5 million lei) and consumer loans -18,6% (10 483,8 million lei).

On 31.12.2021, the level of net profit was 2 286,8 million lei. Compared to the end of the previous year, profit increased by 52,3 percent (785,6 million lei), largely due to the increase in interest income by 739,2 million lei (16,9%), income from fees and commissions by 545,7 million lei (27,7%), simultaneously with the decrease in the depreciation of financial assets that are not measured at fair value through profit or loss by 365,6 million lei (71,5%).

Return on assets and return on capital at 31.12.2021 constituted 2,0 percent and 12,3 percent, increasing compared to the end of the previous year by 0,5 p.p. and 3,5 p.p. respectively.

Banks maintained high liquidity ratios, respecting all prudential limits related to liquidity indicators.

Thus, the value of the long-term liquidity indicator (principle I of liquidity) was 0,74 (the admissible limit for each bank ≤ 1), being practically at the same level as at the end of the previous year.

The current liquidity on the system (principle II of liquidity) constituted 48,6% (the admissible limit for each bank ≥ 20%), being by 2,1 p.p. lower than at the end of the previous year.

Principle III of liquidity, which represents the ratio between the actual adjusted liquidity and the required liquidity on each maturity band (limit ≥ 1), is also respected by all banks, varying from 1,69 per maturity band up to one month inclusive, up to 120,89 on the maturity band between one month and 3 months inclusive.

The liquidity coverage ratio (LCR) was 358,3% (minimum requirement for 2021 ≥ 70%), being an increase compared to 31.12.2021 by 31,3 p.p.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

The banking system in the Republic of Moldova consists of two levels: the National Bank of Moldova and 11 licensed banks. The National Bank of Moldova regulates and supervises the banks in accordance with the Law on the National Bank of Moldova and the Law on banking activity, which provide the competence, main objective, basic attributions of the National Bank, its relationship with banks and other Competent Authorities, in the process of performing the supervisory function.

According to the Law on the National Bank of Moldova, the National Bank is exclusively responsible for the licensing, supervision and regulation of the banks and foreign banks' branches' activity. To that end, the National Bank is empowered:

a) to issue the necessary regulations and to take the proper actions in order to perform its powers and duties under the mentioned law and Law no. 202/2017 on banking activity, by way of licensing banks and elaborating supervision standards and establishing the way of implementing the regulations and measures mentioned above;

b) to perform, through its staff or other qualified professionals involved for this purpose, inspections over all banks, and to examine theirs books, documents and accounts, conditions in which the business is carried out and the compliance with the legislation;

c) to require any employee of the bank to provide the National Bank with the information necessary for the purpose of supervision and regulation of the banks' activity;

d) to prescribe to any bank, to its shareholders, to the members of the bank's management body, to the persons holding key positions within the bank, supervisory measures or to apply the sanctions and sanctioning measures foreseen in the Law no.202/2017 on banking activity, if they have violated the provisions of the mentioned law, of the normative acts or other acts issued for its application;

e) to act as a resolution authority for the banks in accordance with the Law no. 232/2016 on banks' recovery and resolution.

Therefore, in order to implement the provision of the Law no. 202/2017 on banking activity, in the context of transposing the requirements of the Basel III capital agreement, during the 2021 year has been amended a number of normative acts applied to banks.

The amendments to the *Regulation on Own Funds of Banks and Capital Requirements* provide that banks may include in common equity Tier 1 capital the interim profits or end-of-year profits (when the annual financial statement has not yet been approved by the shareholders) only with the prior approval of the National Bank of Moldova. The profits in question should be audited by an audit firm, and that audit consisted of a financial statement audit report or a FINREP financial statement review report, which record that the given profits have been adequately reflected by the bank in accordance with the principles set out in the accounting framework. At the same time, was stipulated the need to obtain approval for profit distributions to shareholders and/or the payment of interest to holders of additional tier 1 own funds instruments, if the NBM considers that this will not lead to non-compliance with the requirements related to own funds or other prudential indicators or to jeopardizing the stability of the bank.

The *Regulation on holdings in bank equity* and the *Regulation on Requirements Regarding the Members of the Governing Body of the Bank, the Financial Holding Company or Mixed Holding, the Heads of a Branch of a Bank from Another State, the Persons Holding Key Positions and the Liquidator of the Bank in Liquidation Proces***s** have been amended in order to regulate the way of obtaining in electronic form, through the WEB portal of the NBM Information System, the NBM approvals for the acquisition of the shares of a bank or for the appointment by the bank of the members of the bank's management body/ managers of the bank's branch from another state/ persons holding key functions.

The possibility to obtain the mentioned approvals in electronic form will reduce the costs, efforts, time allocated and will streamline the process both for the applicant, as well as for the NBM.

The amendments to the *Regulation on outsourcing the bank's activities and operations* aim to enhance the regulatory framework by improving the process of performing the external audit of activities of material importance related to the processing of payments with payment cards, that have been outsourced by the bank.

The *Regulation on the audit of financial statements and the audit for other purposes of banks* has been amended by excluding the certificates of qualification of the auditor of financial institutions issued by the National Bank of Moldova due to the amendment provided by the Law no. 271/2017 on audit of financial statements.

In 2021 entered into force the amendments to the Instruction on COREP reports submitted by banks for supervisory purposes – that provide the format and frequency of the report on liquidity coverage requirement, counterparty's credit risk, credit valuation adjustment risk and information on the leverage indicator.

The National Bank of Moldova continues to draft and revise, as appropriate, the secondary legislation in order to implement the Law no. 202/2017 on banking activity.

Alignment of the Republic of Moldova's banking legislation with international standards by improving quantitative and qualitative mechanisms for managing banks will help to promote a safe and stable banking sector, to increase the transparency, confidence, attractiveness of the domestic banking sector for potential investors, depositors and customers, to develop new financial products and services.

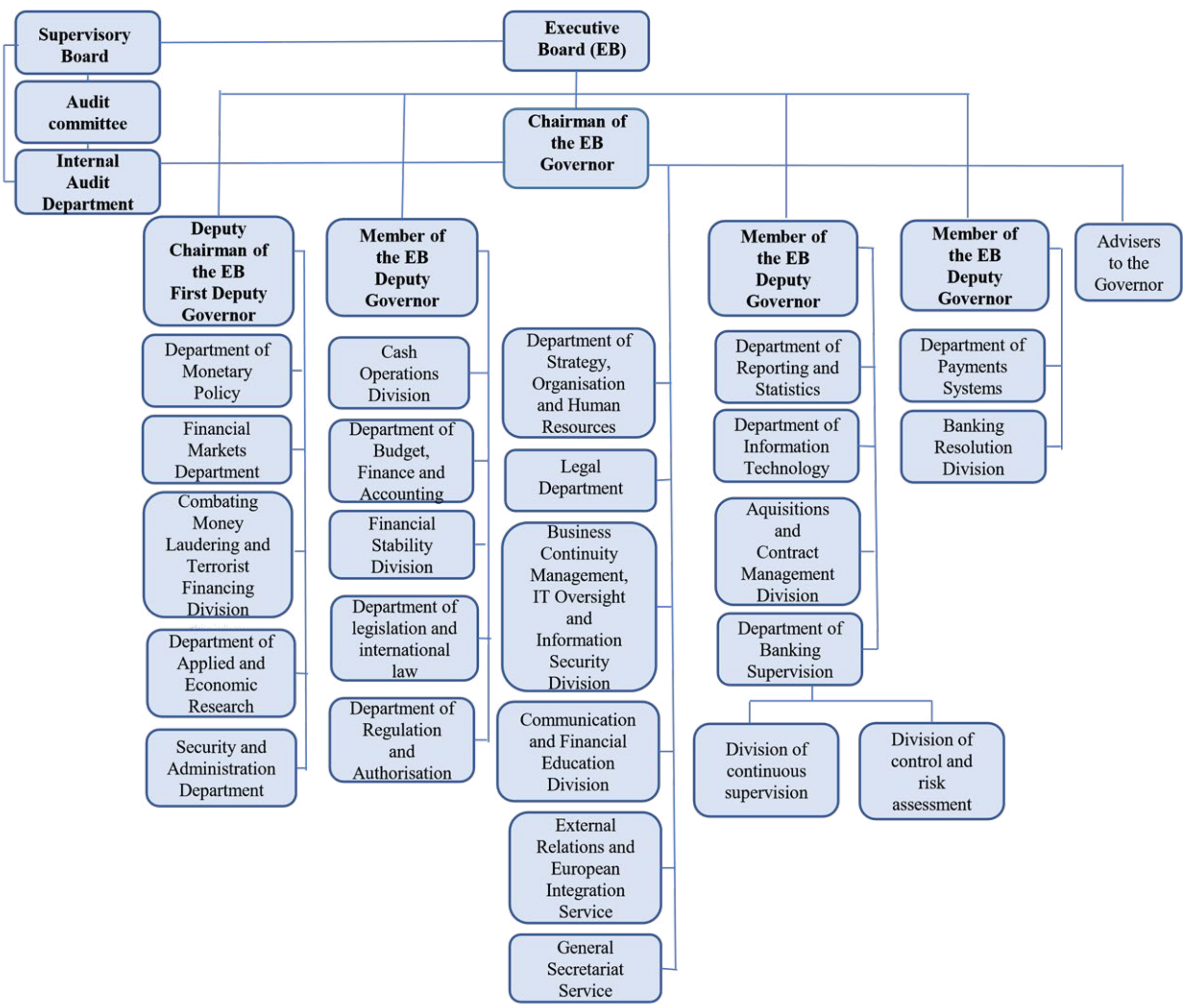
Thus, through a number of requirements provided through the normative acts, the National Bank of Moldova maintains the mechanism of supervision and regulation of banks' activity in the Republic of Moldova, based on international accepted principles.

Anti-money laundering and counter terrorist financing (AML/CFT) supervision

The National Bank of Moldova as a Supervisory Authority is involved in the process of control over compliance with anti-money laundering and counter terrorist financing normative acts by banks, foreign exchange units and nonbank payment service providers. In this context, in 2021, NBM approved normative acts and guidelines; licensed the supervised entities and authorized its management members; performed off and on site controls; identified and assessed the ML/FT risks in the supervised sectors and applied risk based supervision; applied fit and proper requirements for supervised entities shareholders and management members; applied sanctions to supervised entities for noncompliance with AML/CFT requirements; cooperated with other stakeholders in the supervisory process, etc.

NBM continued to perform regular offsite analysis and onsite inspections to the supervised reporting entities and informs the Office for Prevention and Combat of Money Laundering (Moldovan FIU) if any suspicious of money laundering or terrorism financing are found during the inspections. Thus, during inspections, NBM revealed some suspicious pattern of money laundering and terrorism financing and non-compliance by the reporting entities with the AML/CFT requirements in force. As a result, in 2021 NBM issued 1 warning to a bank and has addressed 19 letters to the Office for Prevention and Combat of Money Laundering informing about the identified suspicions.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2021

The development of banking supervision function remains an objective of strategic importance to the National Bank of Moldova. In order to strengthen the capacity in banking regulation and supervision field, the National Bank of Moldova undertakes a number of activities directed towards achieving the implementation of the requirements of Basel III. The National Bank of Moldova continues to adjust the normative acts in order to implement the provisions of the new Law on banking activity, in the context of harmonization of the national banking legislation with the international standards.

Given the fact that the effects of the COVID-19 pandemic persisted during 2021 the NBM recommended licensed banks to apply a prudent approach to the analysis of the decision to distribute dividends, to exhaustively analyze the macroeconomic circumstances, the results of the stress tests as well as the adequacy of the capital taking into account the materialized and subsequent impact and effects of the pandemic on the quality of assets. If, as a result of the analysis, it will be considered appropriate to distribute the capital in the form of dividends, licensed banks are recommended to limit them to no more than 25% of the accumulated profit for the years 2019 and 2020.

Additionally, following the assessment of the main risks and challenges related to the banks' activity, have been established the most important areas on which the NBM focused its banking supervision process for 2021, both during off-site and on-site supervision:

I. Credit risk;
II. Risk associated with information and communication technologies (ICT);
III. Internal governance, risk management and the internal capital adequacy assessment process (ICAAP);
IV. Combating money laundering and terrorist financing;
V. Payment systems and IPN reports.

During 2021, NBM also continued to apply the international standards on the prevention and combating of money laundering and terrorism financing and will step up its efforts to efficiently implement the recommendations of the Council of Europe's MONEYVAL Committee.

The activities of the Banking Supervisory Authority in 2021

During the 2021 year, a number of actions have been taken to maintain banking system stability and to ensure its further development. To this end, the National Bank of Moldova amended a number of normative acts, based on the provisions of the Law no. 202/2017 on the activity of banks and amendments to the Directive 2013/36/EU and Regulation 575/2013, which implement the provisions of the international regulation framework Basel III.

In 2021, the NBM continued the supervision of banks based on the SREP supervision and evaluation process. Thus, the results of the supervision and evaluation process (SREP) with the imposition of specific capital requirements for each bank according to the individual risk profile were approved by the NBM Executive Committee.

Off-site controls

The National Bank carries out off-site supervision based on the annual prudential supervision program. For the year 2021, the prudential supervision program included various actions of a current nature (monitoring of key indicators, analysis of financial reports presented by banks, external audit reports, monitoring of remedial plans as a result of field controls), as well as actions for drawing up the SREP report (business model assessment, governance and internal control analysis, recovery plan assessment, etc.).

In 2021, credit risk remained one of the important areas of supervisory priorities. NBM has examined off-site each bank's loan portfolio based on the Credit Risk Register, with the aim of monitoring and identifying imprudent practices. In case of credit classification was contrary to the regulations, the NBM requested the removal of the detected violations.

The National Bank will continue to act in accordance with the legislation in force and the best international practices, applying all the instruments assigned by law and statute, in order to increase the level of transparency of the ownership structure and ensure a prudent and healthy management of the licensed banks.

On-site controls

During 2021, 7 planned thematic on-site inspections were carried out at licensed banks. In order to remove the violations and deficiencies found during the controls, supervisory measures were prescribed for two banks and one bank was sanctioned with a warning.

In general, violations and deficiencies identified in thematic controls relate to credit risk management, internal governance and internal control functions, ICT-related risk and the payment systems business area.

In 2021, NBM developed the draft amendments to the NBM Recommendations approved for the reporting entities on monitoring of the transactions and activities of their customers; on implementing a risk-based approach for application of CDD requirements and identification and assessment of ML/FT risks; and, on implementing AML/CFT requirements when establishing cross border relationship. The Recommendations aim to guide reporting entities on how to act in situations that are more complex derived from the implementation of the AML/CFT requirements, for example: monitoring of unusual and complex transactions, implementing the risk-based approach, determining high risk factors, determining shell companies, etc. (now being in the process of internal review).

NBM has concluded the 3rd round external audit review process for the banking sector, which has the aim to assess how commercial banks comply with AML/CFT requirements (this review process, which is conducted regularly, started in 2018). NBM reviewed the reports submitted by external audits companies assigned to conduct ML/FT compliance assessments to banks. At the same time, NBM asked banks to develop a proper mitigation plan following the external audits reports and to report on the actions performed.

In order to improve NBM's capacity to analyse and monitor commercial banks' activity in AML/CFT field and shareholder transparency, the NBM on the 1st of April 2021 started the implementation of an IT solution. The aim of the solution is to support NBM in carrying out the identification of the AML/CFT risks in the banking sector, as well as identifying at an earlier stage different ML/FT suspicious activities related to payments performed by individuals and legal persons through the banking system.

In December 2021, NBM approved a Methodology for identification and assessing of ML/FT risks in the supervised sectors and implementation of risk-based supervision. The Methodology establishes in detail the mechanism for assessing the ML/FT risks in supervised sectors, as well as for determining the potential higher risk sectors/entities that need enhanced supervisory measures. NBM also drafted an Instruction for supervised reporting entities aiming to develop the e-KYC (Know-Your-Customer) procedure.

In addition, during the reporting year, NBM organized, with the support of its local and foreign partners, training events related to the implementation of national legislation and international standards in the field of AML/CFT. The trainings were organized mainly to banks, non-bank payment service providers and foreign exchange offices employees. The main seminars organized in 2021:

- AML Conference, by PRIA events, in collaboration with NBM (March 2021);
- Preventing and combating money laundering and terrorist financing, organized by IDG/FSTA, in collaboration with NBM (March 2021);
- Risk assessment in the context of preventing and combating money laundering and terrorist financing, in collaboration with NBM (June 2021);
- Counter proliferation finance training, hosted by King's College London in partnership with the James Martin Center for Nonproliferation Studies (June 2021).

International activities of the authority

In order to strengthen the regulatory and supervisory framework of the Moldovan financial and banking system, the National Bank of Moldova cooperates with international organizations, foreign central banks and other development partners.

Between September 27th and October 15th, 2021, an **International Monetary Fund (IMF)** mission conducted discussions based on Article IV of the IMF's Articles of Agreement and held virtual meetings in response to a request by the Moldovan authorities, including NBM, for a new IMF program. At the end of the discussions, the IMF staff and the Moldovan authorities have reached an agreement on a 40-month economic reform program to be supported by Extended Credit Facility and Extended Fund Facility (ECF/EFF) arrangements, subsequently approved by the Executive Board of the IMF. Also, the IMF officials noted essential progresses in reforming the banking sector and strengthening macro-financial stability.

In the context of implementing the common objectives of the Association Agreement between the Republic of Moldova and the **European Union (EU)**, NBM continued strengthening the cooperation between the central banks from EU responsible for the supervision of EU credit institutions with subsidiaries in the Republic of Moldova. Thus, in 2021, the NBM concluded a cooperation agreement with the National Bank of Romania, which proposes a deeper approach in affirming the efforts of both parties for the development of the financial and banking systems according to European standards. In the same year, 2021, NBM continued the negotiations with the Banking Regulation and Supervision Agency of the Republic of Turkey for concluding a memorandum of understanding. Also, NBM initiated a dialogue with the Financial Supervision Commission of Bulgaria for the conclusion of a memorandum of understanding.

In 2021, the NBM has also maintained the dialogue with the **World Bank**, by providing all the necessary information for a fair and objective assessment of the situation of domestic financial system, in order to support decision-taking related to further financing in various priority areas for the Republic of Moldova.

The NBM is constantly cooperating with the **European Bank for Reconstruction and Development** (EBRD) to increase and enhance the resilience of the domestic banking sector, in the context of implementation the EBRD Moldova Country Strategy for the period 2017-2022.

During 2021, the NBM continued to cooperate with the **European Automated Clearing House Association** (EACHA) by exchanging information and experience regarding the activity of clearing houses. Furthermore, the NBM continued to participate in activities carried out by **the International Operational Risk Working Group** (IORWG), providing responses to the requests and studies undertaken by the IORWG. Likewise, the cooperation with the **Center of Excellence in Finance** (CEF), Ljubljana, Slovenia, was continued, by participating in the activities organized by CEF, including online training courses. At the same time, the NBM continued to cooperate with the members of the **Group of Banking Supervisors from Central and Eastern Europe** (BSCEE) through exchanges of information and experience in the field of banking supervision and regulation.

In 2021, NBM received technical assistance from the external development partners in order to strengthen its institutional competences for various areas specific to central banks.

In this regard, but also to achieve its medium-term strategic objectives, in 2021, the NBM continued to benefit from the assistance of the IMF.

The European Union remains one of the main development partners for the NBM. In 2021, the NBM continued to receive the assistance of the EU High-Level Adviser for the Financial sector, in the context of the EU High Level Adviser's Mission for the Republic of Moldova for the period 2019 – 2021, which provided policy advice to the NBM in the field of banking supervision and the implementation of risk-based supervision, effective communication, as well as in order to facilitate the cooperation of the NBM with various national and international authorities.

In October 2021, the Twinning project „Strengthening supervision, corporate governance and risk management in the financial sector" was launched, implemented in the Republic of Moldova by the EU. This project will help the NBM to further develop its capacities, following the EU best practices to ensure a high level of financial sector stability for the benefit of citizens and businesses. Likewise, thanks to the support provided by the EU through the Twinning instrument, the NBM received assistance within the project "Enhancing the system of prevention and combating money laundering and terrorism financing in the Republic of Moldova".

Also, the representatives of the Financial Sector Advisory Center (FinSAC) of the World Bank continued to support the NBM in the field of banking recovery and resolution.

During 2021, the NBM continued to intensify bilateral technical cooperation with central banks (of Belgium, French Republic, Federal Republic of Germany and Ukraine), in order to benefit from good practices in the areas of competence and to provide support to institutions with similar attributions in other states.

In order to carry out the banking authorization function in accordance with the Law no. 202/2017 on banking activity and normative acts of the National Bank in force in 2021, the NBM has provided the exchange of information with the following Supervisory Authorities: National Bank of Georgia, Central Bank of the Republic of Uzbekistan, Ministry of Finance of the Republic of Macedonia, National Bank of Ukraine, Bank of Italy, National Bank of Romania, Bulgarian National Bank, Banking Agency for the Federation of Bosnia and Herzegovina, Financial Supervision Commission of Bulgaria.

Cooperation with other supervisory bodies in the country

According to the legal framework in force and bilateral agreements, the National Bank of Moldova cooperates with other Supervisory Authorities from the Republic of Moldova. Thus, during 2021, in order to efficiently perform its functions, the National Bank of Moldova collaborated with the National Commission of the Financial Market of the Republic of Moldova.

In addition, for the purposes of banking authorization, the National Bank of Moldova cooperates with other competent authorities, such as Office for Prevention and Combating of Money Laundering, National Anticorruption Center, Security and Intelligence Service, Office the Prosecutor General of the Republic of Moldova, and other.

Other relevant information and developments in 2021

In addition to the minimum own funds requirement, banks are obliged to maintain additional capital buffers. For the end of 2021, capital conservation buffer rate equaled 2,5%, countercyclical capital buffer rate for Republic of Moldova was established at 0% and systemic risk buffer rate for all banks was set at the level of 1% (depending on banks' shareholders structure systemic risk buffer rate of 3% applies for several banks). At the same time, buffer for other systemically important institutions (O-SIIs) was established for 4 largest banks (ranging from 0,5% to 1,5%).

Resolution financing arrangements

In 2020, the bank resolution fund became functional. It was established to cover the needs related to the effective application of resolution tools in accordance with the provisions of the Law No 232/2016 on Banks Recovery and Resolution.

The bank resolution fund is financed by:

- annual contributions from banks, in order to reach the target level established by the law;
- extraordinary contributions from banks, in case the annual contributions are insufficient in the opinion of the resolution authority;
- loans and other forms of support.

The resources of the bank resolution fund are managed by the Bank Deposit Guarantee Fund, which, as the manager of the bank resolution fund, has the obligation to invest the available financial resources of the fund in low-risk assets. The use of the resources of the bank resolution fund shall be decided by the NBM, as the resolution authority, for the purposes described in Law No 232/2016. The calculation and payments of contributions by banks shall be performed according to the Regulation on the method of calculation and payment of contributions to the bank resolution fund, approved on April 30, 2020.

According to the law, the financial resources of the bank resolution fund are forecast to reach 3% of the amount of guaranteed deposits of all licensed banks on the territory of the Republic of Moldova until the end of 2024. This amount was approximately MDL 515.5 million at the time of calculating the last annual contributions, for 2022. As of December 31, 2021, the banks have fully paid the annual contributions calculated by the NBM for 2020 and 2021. As a result, at the end of 2021, the resources of the resolution fund constituted MDL 186.8 million.

Furthermore, the National Bank has notified the licensed banks regarding the amounts, tranches, deadlines, and forms of payment of contributions to the bank resolution fund, which are to be paid by the end of 2022. The amount of annual contributions to be paid during 2022 by all banks is MDL 146.3 million.

The establishment of the resolution fund contributes to the strengthening of the banking sector and its credibility, supporting the depositors' interests.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	6	6	6
Branches of foreign credit institutions	5	5	5
Cooperative banks	-	-	-
Banking sector, total:	**11**	**11**	**11**

Total assets of banking sector (at year-end, million MDL)

Type of financial institution	2019	2020	2021
Commercial banks	53,009.6	61,533.7	72,444.8
Branches of foreign credit institutions	37,668.6	42,239.9	46,057.1
Cooperative banks	-	-	-
Banking sector, total:	**90,678.2**	**103,773.6**	**118,501.9**
y/y change (in %)	**9.0%**	**14.4%**	**14.2%**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	0.0	0.0	0.0
Domestic ownership total	31.95	32.08	33.1
Foreign ownership	68.05	67.92	66.9
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	55.65	59.86	1 434.0
Branches of foreign credit institutions	32.51	38.87	436.9
Cooperative banks	-	-	-
Banking sector, total:	**88.16**	**98.73**	**1 870.9**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	14.6	8.74	12.25
Cooperative banks	-	-	-
Banking sector, total:	**14.6**	**8.74**	**12.25**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	58.46	59.30	61.13
Branches of foreign credit institutions	41.54	40.70	38.87
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables	5.79	5.79	4.92
Financial sector	31.78	28.98	29.03
Nonfinancial sector	45.18	43.27	46.10
Government sector	7.06	11.57	13.04
Other assets	10.19	10.39	6.91
Liabilites			
Financial sector	1.46	1.70	1.69
Nonfinancial sector	73.71	74.51	73.86
Government sector	0.31	0.59	0.53
Other liabilities	6.44	5.97	7.54
Capital	18.08	17.23	16.38

Capital adequacy ratio of banks *

Type of financial institution	2019	2020	2021
Commercial banks	24.8	27.3	25.9
Cooperative banks	-	-	-
Banking sector, total:	**24.8**	**27.3**	**25.9**

*(Please, mark for each item: * for Basel III)*

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

Asset classification	2019	2020	2021
Non-financial sector, including	8.49	7.38	6.14
households	3.66	5.10	4.21
corporate	11.12	8.70	7.46

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	97.84	95.57
Households	62.18	38.88
Corporate	35.66	56.69
Government sector	0.48	1.23
Financial sector (excluding banks)	1.68	3.20
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	234.06	206.74	254.2
Interest expenses	72.40	62.26	61.90
Net interest income	161.66	144.48	192.24
Net fee and commission income	59.58	56.26	71.6
Other (not specified above) operating income (net)	-10.4	-9.4	-16.9
Gross income	387.44	369.32	447.03
Administration costs	117.45	112.82	140.9
Depreciation on financial assets and non financial assets	-17.56	33.24	4.39
Provisions	5.3	5.6	10.8
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-14.91	18.53%	0.33% 4.84%
Profit (loss) before tax	131.38	78.43	129.5
Net profit (loss)	117.33	71.06	113.8

Total own funds* in 2021 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	755.39	-	734.57	20.81	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**755.39**		**734.57**	**20.81**	**-**

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

As of December 31.12.2021, 1EUR=20,0938

Macroeconomic environment in the country

The Montenegrin economy recorded a significant recovery in 2021 after suffering the largest decline of all European countries in the previous year, as a result of the crisis caused by the COVID-19 pandemic. According to preliminary data from MONSTAT, based on quarterly estimates, real GDP growth of 12.4% was recorded. The main indicators point to positive trends in most sectors, with the highest growth in the tourism sector and related activities, which were most affected by the crisis in previous years. Forecasts of international institutions published at the end of the year and the beginning of 2022 indicated a strong continuation of the recovery of the Montenegrin economy, which went up to 6.4% of the annual GDP growth rate (according to European Commission projections). However, the situation in Ukraine has affected the revision of the initial projections towards their reduction. Consequently, in 2022, GDP growth is expected to range from 3.5% to 3.8%.

Annual inflation in December 2021 in Montenegro, measured by CPI was 4.6% or 4.5% measured by the HICP (Harmonized Index of Consumer Prices) while the average inflation was 2.4%.

Budget deficit of Montenegro is estimated at 99.51 million euros or 2.03% of GDP and it was 326.65 million euros lower compared to cash deficit and by 340.90 million euros compared to the adjusted deficit from 2020. At end-2021, the net public debt of Montenegro, as per the Ministry of Finance and Social Welfare data, amounted to 3.70 billion euros or 75.29% of the estimated GDP for 2021. Compared to end-2020, net public debt increased by 4.56%. In the structure of external government debt, a special place is occupied by debt based on the issue of Eurobonds, which accounts for 47.45% of external debt, while China's Exim Bank is the largest individual creditor with 18.73% share in external debt.

According to the data of the Employment Agency, the registered unemployment rate at the end of 2021 was 24.73% and was higher by 4.25 pp compared to the end of the previous year. According to the Labour Force Survey, published by MONSTAT on a quarterly basis, the unemployment rate was 19.38% in the first quarter, 17.13% in the second quarter, 14.78% in the third quarter and 15.36% in the fourth quarter.

Monstat data show that an average gross wages and salaries in Montenegro in 2021 amounted to 793 euros, being 1.28% higher than in the previous year. The average salary without taxes and contributions amounted to 532 euros, i.e. it increased by 1.53%.

In 2021, current account deficit recorded a decline. According to preliminary data, the current account deficit this year amounted to 453.43 million euros or 9.23% of GDP, which represents a significant decrease compared to 26.05% of GDP recorded in 2020. The decline in the deficit is predominantly the result of an increase in the surplus on the services account, which was achieved thanks to a significant increase in revenues from travel and tourism services. These revenues amounted to 15.43% of GDP and are the result of a partial recovery from the crisis caused by the COVID-19 pandemic of 2020. The services account in the observed period generated a surplus of 955.65 million euros, which is a year-on-year increase of 441.31%.

In the financial account in 2021, net foreign direct investments amounted to 551.98 million euros or 18.06% more than in the same period of the previous year, accounting for 11.24% of GDP. This growth is the result of an increase in inflows, mostly on the basis of investments in real estates, where an increase of 161.91 million euros was recorded compared to the previous year.

Development in the banking sector (including assets total/GDP)

At the end of 2021, 11 banks operated in Montenegro, after the merger of Komercijalna Bank AD Podgorica and NLB Bank AD Podgorica on 12 November 2021.

In the one-year comparative period, all key balance sheet items are growing. Total loans (gross loans and receivables from banks and customers) increased by 6.37%, total assets of banks by 16.18%, total bank deposits (with funds on escrow accounts by 24.56%), while total capital recorded a growth of 4.21%. Total assets to GDP at the end of 2021 was 108.49%.

At the end of December 2021, the share of non-performing loans in total loans amounted to 6.17% and was 0.70 pp higher compared to the level of this indicator in the same period last year (5.47%). Loans that are overdue by more than 30 and 90 days also recorded an increase in the observed one-year period by 13.90% and 7.09%, respectively.

Banks' liquidity during 2021 was high, and total liquid assets of banks increased by 388.7 million euros or 38.26% year-on-year and amounted to 1,404.8 million euros. The share of liquid assets in total assets at the system level was 26.36% (increase in share by 4.25 pp).

Financial result on the aggregate level was positive, and in 2021, the banks recorded profit in the total amount of 31.4 million euros. At end-2021, nine banks in the system operated with profit, while two banks reported negative financial results as an outcome of the implementation of the AQR results.

At end-2021, banks' total capital amounted to 614.3 million euros, recording the year-on-year increase of 24.8 million euros or 4.21%. The solvency ratio at the aggregate level was 18.50% at 2021, while in the same period last year it was 18.52%.

Total loans (gross loans and receivables from banks and clients) amounted to 3,360.3 million euros and show growth of 201.1 million euros or 6.37% in relation to the previous year.

At end-2021, total deposits of banks (with funds on escrow accounts) amounted to 4,201.2 million euros or 24.56% more in relation to the previous year. Retail deposits increased by 24.73%, while deposits of legal persons increased by 24.38%.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

during 2021, the Central Bank, within its mandate, carried out a number of important activities related to the improvement of the regulatory framework. The reform of the regulatory framework continued and it was aimed at its further alignment with the EU Acquis and the implementation of modern prudential supervisory standards, as one of the obligations of Montenegro in the process of accession to the European Union.

In addition, the Law amending the Law on Credit Institutions and the Law amending the Law on Resolution of Credit Institutions were adopted on 20 January 2020, which prescribed the postponement of their implementation until January 2022. Credit institutions used this period to prepare their operations in accordance with the new regulatory framework.

With the aim of meeting the obligations related to Negotiating Chapter 9 - Financial Services, the Central Bank is obliged to align its laws and enabling regulations governing banking operations with the Directive 2013/36/EU, i.e. to create a legal basis for the adoption of a set of enabling regulations that will implement the Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms.

In this regard, during 2021, the Central Bank prepared 11 enabling regulations that were aligned with the aforementioned Regulation, with the accompanying technical standards that are an integral part of this Regulation, and the guidelines issued by the European Banking Association (EBA). The adopted regulations further aligned other regulations with the new regulatory framework. The adoption i.e. implementation of the new laws and enabling regulations aligned, to the greatest extent, the aforementioned legal acts with those regulations that are currently in force in the European Union in the area of prudential requirements for credit institutions.

The aforementioned regulations determine, inter alia, the rate and the method of maintaining the buffer for structural systemic risk for all credit institutions. Changes were made related to the criteria and method of asset classification and calculation of provisions for potential credit losses of credit institutions in order to improve the existing solutions. Further harmonisation was carried out in connection with prudential requirements for large credit institutions and investment firms related to the criteria for evaluating exceptional cases of exceeding the limits of large exposures, as well as in connection with liquidity requirements and public disclosure of data of credit institutions. Non-performing and forborne exposures' management was further harmonised as well as the limitation of exposures to shadow banking entities. Also, the harmonisation with the EU Aquis was made in the area of ICT risks management and interest rate risk arising from non-trading book activities. Furthermore, interim measure of reducing the percentage of demand deposits when calculating past due obligations from 30% to 20%, initially motivated by mitigating the negative impacts of the COVID-19 epidemic, was introduced into the regulatory framework, which enabled credit institutions to continue applying this measure even after its termination. In accordance with the new regulatory framework, the method of calculating and reporting lending effective interest rate on loans granted and the deposit effective interest rate on deposits received, as well as the method of informing clients and the public about the level of effective interest rates, has been established. Also, adjustments were made to certain tariffs/fees provided for the performance of tasks and services performed by the Central Bank in accordance with the new legislative framework.

Main strategic objectives of the Supervisory Authority in 2021

Activities of the Central Bank during 2021 were primarily focused on mitigating the adverse effects of the COVID-19 pandemic on the financial system and finalizing asset quality review process (AQR).

The AQR in Montenegro was carried out in period from March 2020 to September 2021, which was characterised by the challenges of the COVID-19 pandemic and the measures implemented to counteract adverse effects on citizens and economy of Montenegro, as well as merger of the CKB and Podgoricka Banka, which represented at the same time the largest merger of banks in the Montenegrin market so far. The Central Bank was the first central bank outside the EU that carried out the AQR in accordance with the ECB methodology.

Total effects of the AQR related to the impact on capital at the level of the banking market resulted in the decline of average solvency ratio by 1.6 percentage points. The AQR-adjusted average solvency ratio at the level of the banking sector amounts to 16.2%, which is substantially above the statutory minimum of 10%.

The activities of the Banking Supervisory Authority in 2021

despite working in aggravating circumstances due to the pandemic also during 2021, the banking system in Montenegro was continuously supervised by the Central Bank, through off-site monitoring, as well as through numerous planned, targeted on-site examinations of banks.

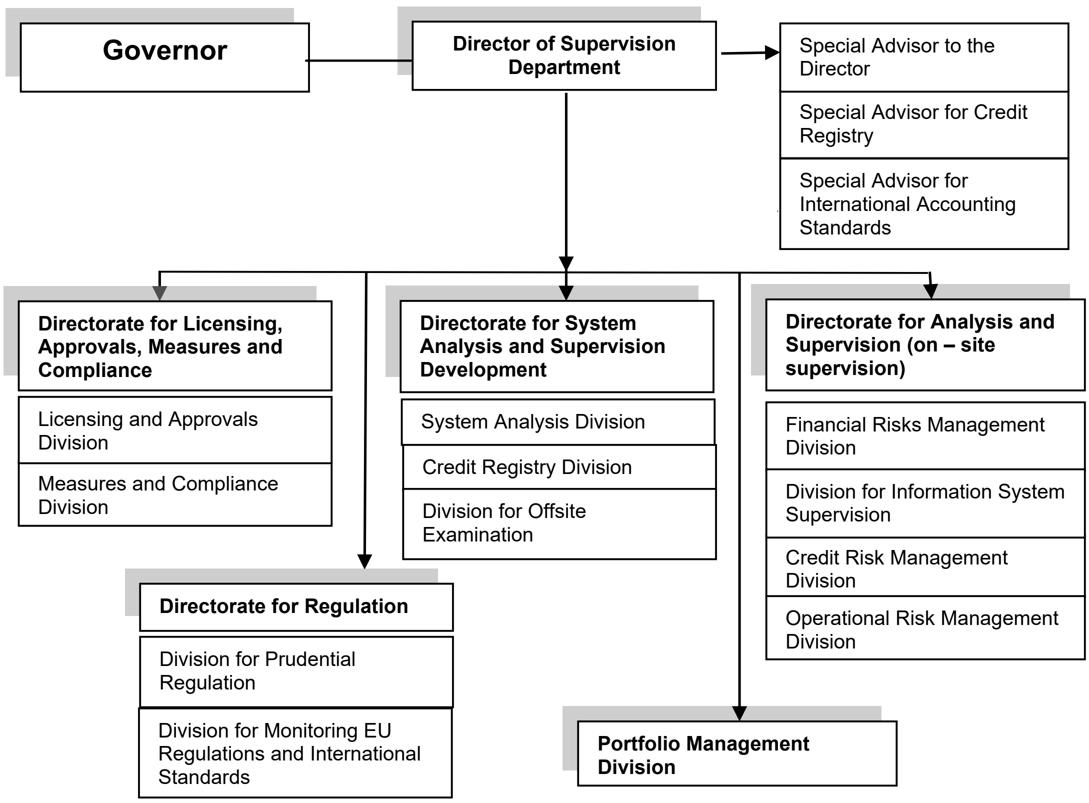
In 2021, ten on-site examinations were carried out. The scope of on-site examinations primarily covered the following: assessment of capital adequacy, credit risk, liquidity risk, operational risk and the adequacy of the information system. In addition, the on-site examinations in some banks included also the assessment of internal audit and the functioning of the internal controls system.

Within its supervisory activities, the Central Bank imposed, due to the irregularities found in the operations of one bank, a measure against that bank by way of a written warning for removing irregularities found in its operations. Furthermore, pursuant to Article 165 of the Banking Law, the Central Bank initiated misdemeanour proceedings against five banks and their responsible persons.

In addition to the aforesaid, the Central Bank regularly monitored the development of the COVID-19 pandemic and its impact on the financial stability in Montenegro, which related to the previously adopted interim measures. The Central Bank regularly monitored their implementation and worked on their further development in accordance with needs and the situation in the system. These measures covered four types of moratoria, whereby two of them were general moratoria, while others were targeted to specific economic sectors and certain categories of natural persons which were hit the most by the crisis caused by the coronavirus pandemic. The measures also included measures of restructuring, as well as other measures aimed at maintaining stability in the banking sector, such as: prohibition of dividend pay-out to banks' shareholders, the possibility of increasing banks' exposure to a single person and a group of connected persons above the prescribed exposure limits, the reduction of bank's exposure to a single person and a group of connected persons, reduction of reserve requirement for banks, as well as measures to incentivise lending activity.

Bearing in mind positive effects of these measures on the system stability and taking into consideration the implementation of the AQR results and findings, it has been determined that certain measures should be terminated, which resulted in the adoption of the last four sets of interim measures to mitigate i.e. reduce negative impact of the COVID-19 pandemic on the financial system. The effects of these measures have been continuously monitored (a total of 11 sets of measures was adopted).

Organizational chart of the Banking Supervisory Authority



International activities of the authority

during 2021, an intensive cooperation with the supervisory bodies of parent banks, in particular with the National Bank of Hungary, has continued. A regular annual supervisory meeting was held with this supervisor, while monthly and quarterly information were exchanged on the financial situation in banks that are members of the OTP Group, adverse effects of the pandemic in the countries in which head offices of the members of the OTP Group are located, as well on the measures carried outs in these countries aimed at suppressing these effects. Furthermore, supervisory meetings were also held with the competent authorities for the NLB Group (the European Central bank and Bank of Slovenia), for Addiko Bank (Austrian Financial Market Authority) as well as with the Croatian National Bank for Erste Bank and Hipotekarna Bank. The communication with other supervisors coming from the Central and Eastern Europe was made through BSCEE Secretariat (Banking Supervisors from Central and Eastern Europe).

Cooperation with other Supervisory Authorities in the country

in 2021, the Central Bank continued successful cooperation with other regulators in the country, which is based on the regular exchange of information in accordance with the objectives defined in the concluded bilateral agreements and MoUs, and which largely relate to the exchange of information regarding the acquisition of qualified participation with financial market participants and AML/TF information.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	13	12	11
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**13**	**12**	**11**

Total assets of banking sector (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	4603931	4586507	5328574
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**4603931**	**4586507**	**5328574**
y/y change (in %)	**6.61**	**-0.38**	**16.18**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	-	-	-
Domestic ownership total	19.73	19.67	20.04
Foreign ownership	80.27	80.33	79.96
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	52.79	74.03	1397
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**52.79**	**74.03**	**1397**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	8.66	4.10	6.07
Cooperative banks	-	-	-
Banking sector, total:	**8.66**	**4.10**	**6.07**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	100	100	100
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2019**	2020**	2021**
Commercial banks	17.73	18.52	18.54
Cooperative banks	-	-	-
Banking sector, total:	**17.73**	**18.52**	**18.54**

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

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

Asset classification	2019	2020	2021
Non-financial sector, including*	99.8	99.9	99.8
households	37.7	33.45	30.83
corporate**	62.0	66.31	68.97

**excluding government sector and financial institutions; share of total NPL*

***state companies, private companies and entrepreneurs; share of total NPL*

The structure of deposits and loans of the banking sector in 2021 (%)
(at year-end)

	Deposits	Loans
Non-financial sector, including:	92.0	81.7
Households	51.3	43.2
Corporate	39.1	38.1
Government sector	6.6	7.8
Financial sector (excluding banks)	1.4 (1.0)	10.5 (0.35)
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	173390	152807	170322
Interest expenses	22247	21192	22376
Net interest income	151140	131618	147945
Net fee and commission income	35339	24310	37872
Other (not specified above) operating income (net)	18509	13971	14246
Gross income	278286	230874	281181
Administration costs	121785	95778	103428
Depreciation	10700	14983	15647
Provisions	10582	29551	31288
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	53574	24551	41280
Net profit (loss)	48652	22335	36233

Total own funds in 2021 (in EUR)

Type of financial institution	Total own funds **	Core Tier 1	Tier 1**	Tier 2**	Tier 3
Commercial banks	529043	-	497869	32276	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**529043**	**-**	**497869**	**32276**	**-**

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

Macroeconomic environment in the country

After the economic recession in 2020 caused by the COVID-19 pandemic, the global economy swiftly recovered in 2021, supported by the gradual opening of the economies and the lifting of the containment measures amid the started process of mass immunization and ample fiscal and monetary stimulus that was introduced in response to the crisis. However, despite the economic recovery, pandemic-related risks continued to linger throughout the year, while in the second half, some new risks emerged related to disruptions in global supply chains and rising commodity prices on world markets.

The recovery of the Macedonian economy started in the second quarter of 2021, and for the year as a whole real GDP grew by 4%. The recovery was mainly driven by domestic demand, particularly from personal consumption and investments, supported by a more favorable environment, a strong fiscal stimulus, and a loose monetary policy. On the other hand, net exports had a negative contribution to GDP on the back of accelerating imports, especially in the last quarter, partly due to the pressures from the energy crisis.

Average inflation accelerated moderately in 2021, which is a global phenomenon primarily driven by rising food and energy prices. The annual inflation amounted to 3.2% on average in 2021, compared to 1.2% in the previous year. Higher inflation is mainly a consequence of global supply-side factors that pushed the prices of primary products, especially towards the end of the year. Core inflation recorded an annual growth of 2.4%.

In 2021 labor market stabilized, supported by the economic recovery, yet the number of employed people is still below the pre-pandemic level. The unemployment rate slightly declined (by 0.7 p.p.) to a historical low of 15.7%. Wages continued to increase in 2021 in one part due to the carryover effect of the minimum wage increases in 2020 and the regular increase of the minimum wage in 2021. Additional structural factors were also in play, such as labor shortages in some specific segments and the effect of the crisis by reducing the number of employees with a salary lower than the average. Thus, the nominal net and gross wages recorded an annual growth of 5.7%, respectively (7.8% and 8.3%, respectively, in 2020). All sectors registered an upward correction of net wages. High growth mainly came from the activities that were initially most affected by the pandemic and the activities related to rising digitalization that was accelerated by the pandemic. Labor productivity increased in 2021 by 2.8%, after a decline in the year before, but is below the wage growth.

The budget deficit in 2021 recorded a moderate narrowing and amounted to 5.4% of GDP, after a significant deepening of 8.2% of GDP in the previous year. The fiscal consolidation came from both the expenditure and the revenue side of the budget, amid more moderate growth of the budget expenditures and increased growth of budget revenues supported by the economic recovery. Most of the increase in total revenues results from increased tax revenues. External government borrowing was the primary source of financing of the budget deficit in 2021. In 2021, the central government's debt saw no changes from the previous year and amounted to 51.7% of GDP. The total public debt at the end of 2021 was 60.8% of GDP (61% of GDP in the previous year), with a slight reduction of external public debt (from 40.7% to 39.8% of GDP) and negligible growth in domestic public debt (from 20.3% to 21% of GDP).

The gross external debt at the end of 2021 amounted to 80.2% of GDP and increased marginally (by 0.1 pp. of GDP). The public sector's debt declined by 0.7 pp. of GDP, while private debt grew by 0.6 pp of GDP. The lower debt of the public sector is the result of the reduction of the debt of the central government (due to repayment of a Eurobond), the debt of public enterprises (disbursement based on long-term loans), while the general allocation of SDRs from the IMF contributed to the increase of the debt of the Central bank. On the other hand, the annual growth of private debt mainly results from the higher intercompany debt while simultaneously reducing the debt of other sectors due to the lower long-term loans.

In 2021 a moderate deficit of 3.5% of GDP was realized in the current account, which is almost at last year's level. The trade deficit increased, partly due to the strengthening of economic activity, the growth of energy prices, and disruptions in global supply chains. On the other hand, contrary to the previous year, private transfers were normalized following the loosened measures for cross-border movement in the second year of the pandemic. Foreign direct investment increased and reached 3.7% of GDP. Foreign exchange reserves were higher year-on-year and continued to be maintained at an adequate level that supports the strategy of fixed exchange rate of the Denar against the Euro.

The revival of economic activity in the post-pandemic period and beyond is a priority task for policymakers. However, considering the unfavorable circumstances of the global environment, macroeconomic trends will continue to be accompanied by uncertainty. The risks for the next period are related to the consequences of the pandemic at the national and global level, the uncertainty regarding the duration of the health crisis, and the speed of the vaccination process. Also, starting with the second half of 2021 and most notably towards the end of the year, some new risks came to the fore related to disruptions to global supply chains, rising inflation pressures, and the energy crisis. Moreover, those risks intensified with the escalation of the Russian-Ukrainian crisis and the military actions in the first months of 2022 that weigh adversely on the global economic conditions and inflation prospects.

Development in the banking sector (including assets total / GDP)

The banking sector retained the leading role in the Macedonian financial sector, with banks' assets accounting for 79.1% of the total financial sector's assets in 2021. The number of banks operating in the country equaled 13, and compared to the previous year was reduced by one due to the merging process of two banks. For the same reason, the system noticed an increase in market concentration, with the top three banks holding 58% of total banking sector assets, while the top five banks account for 81%.

In 2021, the banking system assets to GDP ratio was reduced by one percentage point relative to the previous year and amounted to 88,3%. The share of total credit to the non-financial sector to GDP showed a slight downward trend at 53% in 2021, as well as the share of total deposits, which amounted to 64,8%. Financial intermediation indicators saw a decrease in 2021, primarily due to the high initial base in 2020 and the fall in GDP last year. The rate of non-performing loans decreased to the historically lowest level of 3.2%, which is lower than the pre-pandemic period. Improving the rate of non-performing loans was supported by the banks' intensified collection of "bad" loans and accelerated credit growth in conditions where there was still a certain materialization of the credit risk during the year. Non-performing loans are in the large portion covered by impairment (66.3%), despite the reduction in the ratio compared to 2020.

The solvency of the banking system improved. As of 31.12.2021, the capital adequacy ratio equaled 17.3%, which is 0.6 pp higher compared to the end of 2020. The growth of own funds was primarily a result of the reinvested earnings, the issue of new shares, and subordinated instruments, which contributed the most to the increase in the capital adequacy ratio. Over 90% of the own funds account for the Common Equity Tier I capital, which represents the highest-quality segment of the banks' regulatory capital. Analyzed by use, more than half of own funds refer to Pillar 2 capital add-ons, capital buffers, or are "free" over the minimum supervisory and regulatory level, which is particularly important amid a downward change in the economic cycle in conditions of crisis, when these capital layers could be used to meet different challenges. In addition, the stress testing of the resilience of the banking system and individual banks to simulated shocks showed improved resilience in 2021.

In 2021, the banking system made a profit from operations which compared to the previous year is higher by 26.2%. The most significant contribution to the profit growth was the income from the collection of written-off claims, which has more than doubled in 2021. In addition, an important contribution was made by the net income from fees and commissions (which increased by 15.5%), the reduced costs for impairment, and higher net interest income. Accomplished levels of ROAA (1.5%) and ROAE (12.9%) are above the ten-year level average of these indicators (1.1% and 9.4%, respectively) but are almost twice as low as the observed maximum in the analyzed period (3.1% and 28%, respectively, achieved as of 31.3.2018).

On the funding side, deposits' annual growth accelerated compared to 2020. Households, traditionally the most significant depositor in the Macedonian banking system, increased their funds deposited in banks by 6.9% (compared to 4.5% in 2020). On the other hand, the deposits of non-financial companies increased by 11.8% (10.9% in 2020).

In the banking system's assets, loans recorded the highest growth (8.5%), whose annual rate exceeded that achieved in 2020 and the pre-pandemic year 2019. Annual credit growth was almost equally distributed between enterprises and households and was mostly in domestic currency. Higher liquid assets of banks also had a more significant contribution to the yearly growth of the banking system's assets.

In 2021, in conditions of further growth of the liquid assets of the Macedonian banking system, the liquidity indicators remained stable and on a satisfactory level. New Decision on the methodology for liquidity risk management has been applied since the beginning of 2021, which introduced a requirement for the banks to maintain a minimum level of so-called liquidity coverage ratio. As a result, as of 31.12.2021, the liquidity coverage ratio of the banking system was 292.2% (the regulatory minimum of this ratio is 100%), suggesting that the so-called high-quality liquid assets of the banking system are almost three times higher compared to the net cash outflows over a 30 days stress period. Furthermore, the regular simulations of individual and combined liquidity shocks confirm the sufficient volume of liquid assets of domestic banks and their adequate liquidity management that allows for sufficient resilience to hypothetical extreme liquidity outflows.

At the beginning of 2022, with the beginning of the conflict between Russia and Ukraine, the geopolitical risks to which the Macedonian economy is exposed intensified. The negative, primarily indirect, effects on North Macedonia coming from the materialization of these risks are relatively uncertain and are not yet fully known. Hence, the environment in which the domestic banking system operates is even more complex, given the risks associated with the further evolution of the health crisis, but also with the disruptions in the global supply and production chains, as well as the ongoing energy crisis. Thus, the growth dynamics of the economic activity and the activities of the banking system in the coming period will be largely conditioned by the intensity of mentioned risk factors and the success in dealing with the negative effects of each of them. Therefore, the National Bank expects the banks to remain cautious in undertaking and managing risks and maintaining their capital position.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

The National Bank of the Republic of North Macedonia is the Banking Supervisory Authority responsible for licensing and supervision of banks and savings houses in the Republic of North Macedonia. The Supervision Sector, through its three departments, Off-site Supervision and Licensing Department, On-site Supervision Department and Information Systems Supervision Office performs the supervisory function. At the end of 2021, the Financial Stability, Banking Regulations and Bank Resolution Department was divided in two separate organizational units, i.e. the Financial Stability and Macroprudential policy Department (responsible for analysis of the financial system and the financial stability in the country and for development of adequate macroprudential policy) and the Banking Regulations and Bank Resolution Department (responsible for development of relevant banking regulation in line with international standards and best practices, as well as for performing the resolution function which will be fully put into operation upon the adoption of the relevant regulation).

These competences of the National Bank are regulated with the Law on the National Bank of the Republic of North Macedonia and the Banking Law.

The most significant activities of the National Bank in 2021 in the field of banking regulation can be divided into three groups:

(1) Monitoring of the trends in the banking system as a result of the negative effects of the pandemic with the Covid-19 virus infection, monitoring of the impact of the measures taken by the National Bank in 2020 for mitigation of the health crisis effects on the domestic banking system and the domestic private sector, as well as identifying and undertaking appropriate measures to further strengthen the capacity of banks to deal with the adverse impact of this crisis. Thus, in February 2021, the National Bank Council adopted a Decision on temporary restriction of dividend distribution and payment to bank shareholders, in order to further increase the resilience of the banking system and maintain its stability. Following the example of supervisory bodies in the region and beyond, the National Bank has temporarily restricted the payment of dividends to banks shareholders. With the adoption of this measure, it was emphasized that it is of a temporary nature and will be valid until December 31, 2021, and by September 30, 2021 at the latest, the National Bank Council was supposed to re-assess the circumstances that led to the adoption of this measure. The re-assessment determined that the non-performing loans ratio was maintained at a relatively low level. Banks have allocated a larger impairment for the clients affected by the pandemic, compared to the average level of impairments for the total performing loan portfolio, which allows for adequate risk mitigation. Consequently, such developments and conditions indicated the need for early abolition of the Decision on temporary restriction of dividend distribution and payment to bank shareholders, in August 2021.

(2) Further strengthening and improvement of the domestic regulations. The following activities were undertaken in 2021:

   a. National bank continued its activities related with the development and adoption of adequate bank resolution legislation, in accordance with the European Directive (BRRD);

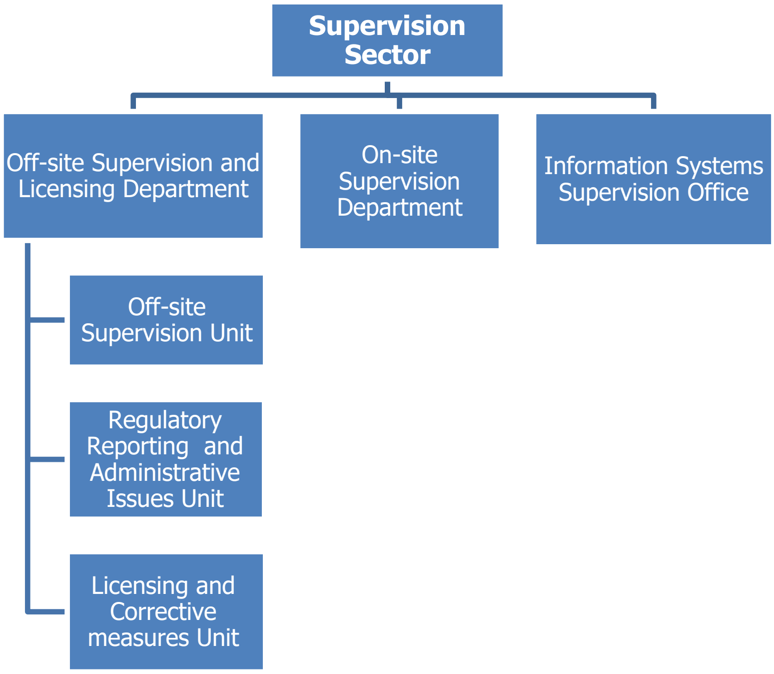
   b. The Law on Financial Stability will enable establishment of a legal framework for the implementation of macroprudential policy, will determine the competencies of the Financial Stability Committee (FSF) as an inter-institutional body responsible for monitoring the implementation of macroprudential policy in the country and for coordination of activities in identifying and monitoring systemic risks in certain segments of the financial system, in taking macroprudential measures and in preparing and managing a financial crisis. The National Bank will play a leading role in creating and implementing macroprudential policy and maintaining financial stability.;

c. The drafting of a new Banking Law has started, which should enable further harmonization with the EU Directive 2013/36/EU (CRD) and Regulation (EU) No.575/2013 (CRR). It should be noted that the draft also takes into account the proposed amendments to the CDR and CRR which were published in October 2021;

d. Preparation of new draft regulations for publication of data and information by banks and adoption of a new regulation on the content of the audit of the annual financial statements and the operation of the bank. The need for the development of both regulations arose from the changes that were made in previous years in several bylaws of the National Bank related to corporate governance, risk management, exposure limits, introduction of the liquidity coverage rate and the like. The novelties introduced by these bylaws have required for appropriate updating of the provisions of these two regulations. In addition, these regulations will enable further harmonization with the relevant requirements of the EU Regulation 575/2013.

e. Drafting of a new regulation on credit risk management with an aim of implementing the EU definition of non-performing exposures. For the purpose of adequate implementation of the definition, the National Bank performed a Quantitative Impact Study, requiring banks to determine the effect of this new definition on their balance sheet, as well as on their profitability. Based on the results and the questions raised by the banks during this process, a draft regulation was developed and will be adopted during 2022.

Organizational chart of the Banking Supervisory Authority



The supervisory function is performed by a separate organizational part (Supervision Sector) The organizational structure of this Sector has changed in 2021. In December 2021, Information Systems Supervision Office was established, following the trend from the other central banks in EU and region regarding the supervision of IT risks and cyber risks. The Office is a new organizational part within the Supervision Sector. The supervision of IT and cyber risks in the licensed entities by the National Bank was previously conducted within On-site Supervision Department. The structure of the Off-site Supervision and Licensing Department has remained unchanged.

The cooperation between the Supervision Sector, Financial Stability and Macroprudential Policy Department and Banking Regulation and Resolution Department is channeled through a separate Committee for supervision, financial stability and resolution. The Committee serves as a platform for exchanging relevant information and data among these organizational units and it is an integral part of the complete decision-making process within the National Bank.

Main strategic objectives of the Banking Supervisory Authority in 2021

As over the previous year, the main objectives of the supervision were to maintain stable and reliable banking system as the main prerequisite for financial stability and sustainable economic growth of the country. In 2021, the supervision of banks was focused on regular assessment of the risk profile, the required level of capital of individual banks and timely taking of appropriate supervisory action. Credit risk, continues to be in the focus of supervisory activities, this year, specifically having in mind the portfolio that was affected by the effects from Covid 19 and increased inflatory pressures mainly coming from increased energy prices in Q4 of 2021. Also, corporate governance, liquidity risk operational risk, and within its framework, especially the risk arising from the information system security and the risk of money laundering and financing of terrorism, were primarily subject of assessment this year.

In addition, the National Bank continued to strengthen the existing supervisory capacity and continued its activities to follow and harmonize the regulatory framework with the international standards and the European legislation in the field of banking operation.

The activities of the Banking Supervisory Authority in 2021

Activities of the Off-Site Supervision Department

The activities of the Off-site Supervision and Licensing Department continued on regular basis. It means, that the Department determines the overall risk profile of the bank, which includes an assessment of: the business model, the corporate governance, the liquidity position and the risks to the bank's capital position. Also, it has continued with its activities for determining banks' minimum capital requirement (Pillar 2) which is communicated with the banks at least once a year. The Department was engaged in the assessment of the recovery plans submitted by all systemically important banks. As in previous years, the National bank gave the banks recommendations for further enhancements of their recovery plans.

In 2021, the National Bank continued to strengthen the institutional capacity for evaluating ILAAP reports of the banks. The National bank has allocated its resources in the process of preparing of the by-laws for licensing and supervision of payment institutions. Also, it has continued to increase the efficiency of the process of informing the physical entities with the data from the Credit Registry.

Within its legal authorization, the off-site supervisory function of the National bank was involved in issuing licenses and approvals to banks and savings houses and undertaking corrective measures. During 2021, The Governor of the National bank has issued 71 licenses, which were related to: approvals for appointment of members of Supervisory Board and Management Board of banks, amending and/or supplementing the Statutes of banks, approvals for commencement of new financial activities by banks, approvals for acquiring ownership in banks and change the address of the bank. In order to maintain the stability and safety of the banking institutions and banking system, the National bank undertook corrective measures towards banks and saving houses where illegitimacies, irregularities and non-compliance with Law on Banks and by-laws were determined during on-site inspections.

Activities of the On-Site Supervision Department

Having in mind the post Covid-19 circumstances in 2021, the on-site supervisory activities were performed by hybrid approach with half of the activities conducted with physical presence and half of the activities performed off site via on-line meetings and review of the documentation submitted by the banks in electronic format. During 2021 on-site examinations were performed in 9 banks, 2 saving houses and 104 exchange offices. Focus of the banks on-site examinations was given on assessment of the management with credit risk, liquidity risk, ML/TF risk, corporate governance, operational risk and banks' responsiveness on measures from previous examinations.

Main focus for the credit risk assessment was given on credit quality review, governance, organizational framework, credit risk appetite and the banks' strategy. Additionally, attention was given on the adequacy of the process for classification and provisioning, credit risk limits, monitoring of regular credit portfolio and management of the NPL /forborne loans, management information system, stress-testing and the adequacy of the internal audit.

Liquidity risk was focused on the assessment of the organizational framework, policies and procedures, risk profile and risk strategy, operational liquidity management and internal liquidity indicators, effectiveness of the process for measurement and monitoring of liquidity, stress testing. Also inspections were focused on the assessment of the contingency planning in the event of an emergency and the internal audit involvement.

AML/CFT examinations were focused on customer due diligence (process for monitoring of the business relationship and transactions), quality of STRs and feedback from the FIU, process of determining of inherent and residual risk, entity risk assessment, management information system, adequacy of the AML/CFT information system and identification of the suspicious transactions, AML/CFT roles and responsibilities, internal audit of AML/CFT function etc.

Operational risks examinations were focused on risk identification, source of operational risk and its measurement, analysis of the harmful events basis, internal audit, outsourcing etc.

ICT risk examinations were focused more on the systematic level to raise the cybersecurity maturity level of each bank.

Supervisory activities in the area of corporate governance consisted of assessment of roles and responsibilities of the management and supervisory bodies, remuneration process, risk management function, compliance function and internal audit function.

Focal points of the exchange office controls were manner of exchange of foreign currencies with denars and implementation of AML/CFT measures and activities.

International activities of the authority

On October 1, 2021, the European Commission adopted a Decision (EU) 2021/1753, which confirms the equivalence of the supervisory and regulatory requirements of Republic of North Macedonia with the capital requirement standards prescribed with the EU Regulation no. 575/2013 on prudential requirements for credit institutions. With this Decision, the Republic of North Macedonia is included in the list of countries, for which it has been determined that their regulation and supervision is equivalent to the regulation and supervision of the European Union for the establishment and operation of credit institutions.

In September 2021 the National Bank's supervisory staff attended supervisory college for Slovenian subsidiary. Also, the National bank has continued the cooperation with the ECB/JST team for a Greek banking group. In October 2021, another meeting was held, at which both institutions exchanged information regarding SREP results for the supervised parent bank and its subsidiary. In November 2021, National bank attented the supervisory college for AML/CFT for the Greek banking group which was established by the Bank of Greece and held for the first time. In early 2022, the cooperation and information sharing in respect of AML/CFT was formalised by signing the Terms of participation by the National bank as an observer in the AML/CFT college.

Supervisors took part at the Moneyval (Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism) plenary meetings in 2021 where latest information of the 5th round of evaluation were discussed.

Cooperation with other supervisory bodies in the country

In the domain of financial stability, the cooperation with other regulatory bodies is realized through Financial Stability Committee (FSC) that serve as principal domestic coordination body for macro prudential policy and crisis management. FCS comprises of all the regulatory and Supervisory Authorities in the country (National Bank of the Republic of North Macedonia, Ministry of Finance, Agency for Insurance Supervision, Securities and Exchange Commission and Agency for Supervision of Fully Funded Pension Insurance) and Deposit Insurance Fund providing a platform for joint risks assessment and policy coordination among different authorities. In support to the FSC, two sub-committees are operationalized – Sub-Committee for monitoring systemic risk and recommendation of macro prudential measures and Sub-Committee for preparing financial crises management, both working under the guidelines of FSC. Also, bilateral cooperation, mainly in the domain of exchange of data and information for the purposes of supervision, licensing and systemic oversight are realized through signed memorandums of cooperation between National bank and each financial regulator.

During 2021, National bank submitted two semi-annual reports to the Financial Intelligence Office for the examinations performed for the AML /CFT risk. Also, National bank sent copy of the examination report to the Financial Intelligence Office with the parts covering AML/CFT findings for separate bank and exchange office.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	15	14	13
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**15**	**14**	**13**

Total assets of banking sector (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	549,969	585,501	638,666
Branches of foreign credit institutions	0	0	0
Cooperative banks	0	0	0
Banking sector, total:	**549,969**	**585,501**	**638,666**
y/y change (in %)	**9.2%**	**6.5%**	**9.1%**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	1.9%	2.0%	2.3%
Domestic ownership total	28.2%	28.1%	28.9%
Foreign ownership	71.8%	71.9%	71.1%
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	58,0%	81,0%	1,477
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	**58,0%**	**81,0%**	**1,477**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	11,7%	11,3%	12,9%
Cooperative banks	/	/	/
Banking sector, total:	**11,7%**	**11,3%**	**12,9%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	100%	100%	100%
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2019	2020	2021
Cash, balances and deposits with central bank (National Bank)	17.1%	16.7%	16.4%
Placements in securities	12.7%	14.1%	13.9%
issued by domestic government sector	7.7%	12.0%	11.8%
issued by central bank (National Bank)	4.5%	1.7%	1.6%
other (including non residents)	0.5%	0.4%	0.6%
Loans, deposits and accounts with financial institutions (excluding central bank, including non residents)	7.7%	7.3%	8.1%
Loans with non-financial sector (including non residents)	58.5%	57.5%	57.5%
loans with domestic government sector	0.3%	0.3%	0.3%
Other assets	3.9%	4.5%	4.2%
Total	**100.0%**	**100.0%**	**100.0%**
Liabilities	**2019**	**2020**	**2021**
Deposits of financial institutions (including non residents)	5.5%	5.3%	4.8%
Deposits of non financial sector (including non residents)	73.7%	73.6%	73.4%
deposits of domestic government sector	0.2%	0.2%	0.2%
Borrowings, issued securities and liabilities on the basis of subordinated and hybrid instruments (including non residents)	6.7%	6.8%	7.2%
domestic financial sector	1.8%	1.9%	2.0%
domestic government sector	0.1%	0.0%	0.01%
other	4.8%	4.9%	5.1%
Other liabilities	1.7%	1.4%	1.6%
Equity and reserves (including loss in current year)	11.0%	11.6%	11.6%
Profit after tax in current year	1.4%	1.2%	1.4%
Total liabilities	**100.0%**	**100.0%**	**100.0%**

Capital adequacy ratio of banks

Type of financial institution	2019***	2020***	2021***
Commercial banks	16,3%	16,7%	17,3%
Cooperative banks	/	/	/
Banking sector, total:	**16,3%**	**16,7%**	**17,3%**

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

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

Asset classification	2019	2020	2021
Non-financial sector, including	4.8%	3.4%	3.2%
households	2.0%	1.6%	2.0%
corporate	7.6%	5.2%	4.5%

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	94.4%	99.8%
Households	62.2%	51.0%
Corporate	28.7%	47.8%
Government sector	0.3%	0.5%
Financial sector (excluding banks)	5.6%	0.2%
Total	**100.0%**	**100.0%**

P&L account of the banking sector (at year-end) in millions of Macedonian Denar

P&L account	2019	2020	2021
Interest income	19,247	18,525	18,726
Interest expenses	-4,232	-3,451	-3,067
Net interest income	15,015	15,074	15,660
Net fee and commission income	5,075	4,844	5,594
Other (not specified above) operating income (net)	3,004	3,951	5,000
Gross income	23,093	23,869	26,253
Administration costs*	-10,427	-10,374	-14,580
Depreciation	-1,050	-1,084	-1,185
Provisions**	392	-57	148
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)***	-4,496	-4,429	-3,853
Profit (loss) before tax	7,514	7,925	10,035
Net profit (loss)	6,685	7,252	9,150

** Administration costs include all operating expenses, except for depreciation.*

*** Provision items include: impairment losses of non-financial assets, provisions for off-balance sheet items and other provisions.*

**** Presented on net basis.*

Total own funds in 2021 (in EUR)

Type of financial institution	Total own funds***	Core Tier 1***	Tier 1***	Tier 2***	Tier 3
Commercial banks	1,270,802,155	1,153,362,886	1,158,254,589	112,547,566	/
Cooperative banks	/	/	/	/	/
Banking sector, total:	**1,270,802,155**	**1,153,362,886**	**1,158,254,589**	**112,547,566**	**/**

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

1 EUR = 61.6270 MKD, as of 31.12.2021

Macroeconomic environment in the country

In 2021, both the economic and the financial market situation in Poland were still under the influence of the COVID-19 pandemic, although to a lesser extent than in 2020. The emergence of a new variant of coronavirus increased uncertainty and thus increased risk aversion in the financial market.

According to preliminary estimates of Statistics Poland (Polish: Główny Urząd Statystyczny) Poland's GDP in fixed prices increased by 5.7% in 2021, making up for the losses on growth incurred as a result of the pandemic in 2020 (a 2.5% decrease in the GDP). As shown by detailed data on the GDP structure, the main determinant for the increase in the domestic level of the Gross Domestic Product in 2021 was still the domestic demand, which increased in real terms by 8.2% compared to 2020 (when a 3.4% decrease was reported). As part of domestic demand, total consumption (an increase of 4.8%), including household consumption (i.e. individual consumption), which increased by 6.2%, had a material effect on real GDP growth. Gross fixed capital formation increased by 8% (in 2020, decreased by 9%). In addition, imports of goods and services exceeded exports, with a negative impact of the trade balance on the rate of GDP growth.

Both high prices of raw materials (in particular coal, natural gas, crude oil and certain agricultural raw materials) and the prolonged disruptions in global supply chains and high international transport prices resulted in a significant increase in inflation around the world. In many countries, including Poland, inflation reached levels that had not been recorded for decades. In the domestic market, average annual CPI inflation in 2021 stood at 5.1% compared to 3.4% in 2020. The significant increase in that index resulted mainly from the impact of the external factors specified above. Price movements were also positively affected by the ongoing economic recovery, including demand driven by an increase in household income. In the face of inflationary pressures, in 2021 the Monetary Policy Council decided to raise interest rates three times. The reference rate was increased by a total of 165 basis points, from a record low of 0.1% to 1.75 % at the end of 2021.

2021 saw the weakening of the Polish zloty against the euro, the U.S. dollar, and the Swiss franc. At year-end, the average exchange rate of the Polish zloty (PLN) against the U.S. dollar (USD) was 4.06 compared to 3.70 at the beginning of the year. The 2021 weakening against the euro (EUR) was relatively less pronounced: from 4.55 to 4.60 at year-end. However, the exchange rate of the Polish zloty (PLN) against the Swiss franc (CHF) fell from 4.21 to 4.45. At year-end, the interest rate on 10-year Treasury bonds amounted to 3.71% and was nearly three times higher than the year before (1.25%).

Development in the banking sector (including assets total / GDP)

At the end of 2021, the KNF Board supervised 30 commercial banks (2 affiliating banks), 1 state bank (Bank Gospodarstwa Krajowego), 2 institutional protection systems, 511 cooperative banks, and 36 branches of credit institutions. In 2021, the KNF Board approved the merger processes for twenty six cooperative banks and made one decision on a take-over.

The balance sheet total of the Polish banking sector at the end of December 2021 amounted to PLN 2 572.5 billion (an increase of 9.5% as compared with the end of December 2020). Domestic commercial banks (with foreign branches) account for 89.7% of the sector's assets, 3.1% for branches of credit institutions and 7.2% for cooperative banks.

In the structure of assets, 55.6% (PLN 1 430.7 billion) were loans and other receivables, 18.8% (PLN 482.9 billion) were available-for-sale financial assets, 1.9% (PLN 48.6 billion) were held-for-trading financial assets, and 5.8% (PLN 149.8 billion) were cash, cash at central banks and other demand deposits. As for liabilities, deposits accounted for 72.7% of total liabilities (PLN 1 870.4 billion), and equity for 7.9% (PLN 202.4 billion).

In 2021, gross receivables from the non-financial sector increased by 5.3%, reaching PLN 1 197.4 billion at the end of December.

An important component of the banking sector's assets are housing loans, including loans denominated in or indexed to Swiss franc (CHF). In 2021, for another year running, there was a clear decrease in the volume of loans in CHF; their sum decreased from CHF 21.4 billion at the end of December 2020 to CHF 17.5 billion at the end of December 2021, i.e. a decrease of 18.5% over the year and 41.8% over five years (from CHF 30.0 billion at the end of December 2017). At the same time, the quality of housing loans, including those denominated in CHF, remains good in 2021 it was at a level similar to the previous year. The share of non-performing loans in the portfolio of housing loans is the lowest of all loan portfolios.

The net financial result of the banking sector in 2021 amounted to PLN 8.9 billion. In 2021, 16 commercial banks and 8 branches of credit institutions paid a total of PLN 4.7 billion on account of the banking tax. It is PLN 0.2 billion (+4.3% year-on-year) more than in 2020. The net interest income amounted to PLN 46.6 billion (-1.2% YOY), of which the interest income amounted to PLN 51.1 billion (-9.9% YOY), and interest expenses to PLN 4.5 billion (-53.1%). The commission income remained at PLN 17.2 billion (+15.6% YOY). Banks' operating expenses were 2.2% higher than in the previous year and amounted to PLN 35.5 billion, and impairment write-downs of financial assets decreased by 44.5% YOY to PLN 6.8 billion.

At the end of 2021, the Polish banking sector assets in relation to the Polish GDP was at the level of 98%. Whereas the domestic financial system's assets to GDP ratio at the end of 2021 was 133%.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

The Polish Financial Supervision Authority (*Polish:* Urząd Komisji Nadzoru Finansowego, UKNF) and the KNF Board *(Polish*: Komisja Nadzoru Finansowego) operate pursuant to the Act on financial market supervision. The UKNF has the status of a state legal person, the bodies of which are the KNF Board and the Chair of the KNF Board. The Chair of the KNF Board manages the activities of the KNF Board and the UKNF and represents them externally.

The KNF Board is competent for supervision of the financial market, which under the legal framework as at 31 December 2021 included:

- banking supervision,
- pension supervision,
- insurance supervision,
- capital market supervision,
- supervision of payment institutions, small payment institutions, account information service providers, payment services offices, electronic money institutions, branches of foreign electronic money institutions,
- supervision of credit rating agencies,
- supplementary supervision of credit unions, insurance undertakings, reinsurance undertakings and investment firms included in a financial conglomerate,
- supervision of credit unions and the National Association of Credit Unions,
- supervision of mortgage credit intermediaries and their agents,
- supervision as provided for in Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 and supervision as provided for in Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 .
- supervision as provided for in Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector

The purpose of supervision of the financial market is to ensure its proper functioning, stability, security and transparency, confidence in the financial market, and to ensure that the interests of market participants are protected. That purpose is also to be achieved through reliable information concerning the functioning of the market, through the pursuit of objectives stated in, in particular, the Banking Law, the Act on insurance and pension supervision, the Act on supplementary supervision, the Act on capital market supervision, the Act on credit unions, and the Act on payment services.

Main strategic objectives of the Supervisory Authority in 2021

In 2021 the activities of the KNF Board (and subsequently – the UKNF) focused primarily on the objectives set out by the Act on financial market supervision i.e.: ensuring the proper functioning of the financial market, its stability, security and transparency, confidence in the financial market, and ensuring that the interests of market participants are protected.

However, on the 15th anniversary of the enactment of the Act on financial market supervision (21 July 2021), Mr Jacek Jastrzębski, Chair of the KNF Board, announced the UKNF Strategy for 2021—2025. It is the first Strategy in the history of the UKNF. The UKNF Strategy has been designed as a set of objectives in three directions: more effective and more efficient use of data, information and knowledge, more proactive supervision, and better organisation management. When performing its tasks and contributing to the achievement of statutory objectives, the UKNF keeps in mind its mission and values, which are provided in the table below:

Mission	We ensure the orderly functioning and safe development of the financial market.	
Vision	The financial market is a safe place for all its participants. We act proactively. We manage information and knowledge using modern technologies. We enjoy a high level of trust among supervised entities and stakeholders in the financial market.	
Values	**Responsibility**	We take responsibility for our actions and hold ourselves accountable for everything we do. We carry out our duties with due care and professionalism.
	Respect	We respect others. We engage in dialogue and listen to arguments.
	Objectivity	We are objective and independent in our views. We make decisions based on facts and reliable information.
	Openness	We understand and we are interested in the trends and innovations in financial markets. We share experiences.
	Commitment	We are fully committed to the cases we handle. We have an active approach and show willingness to act.
	Loyalty	We carry out our duties while remaining loyal to the Republic of Poland and its authorities, the UKNF, our superiors and colleagues.
	Professionalism	We perform the tasks of the State drawing on the best knowledge and experience, and we continuously improve the quality of our services.

The activities of the Banking Supervisory Authority in 2021

2021 was another year in which the COVID-19 pandemic determined the supervisory approach in many areas. Both the national economy, which accelerated significantly after the 2020 downturn, and the financial market (including banks), were still facing the negative effects of the COVID-19 pandemic. The supervisory activities in the banking sector in 2021 covered the full supervisory process: the licensing process, the off-site supervision and the inspection activities carried out on-site and sanctioning.

In 2021 the foreign-currency mortgage loans received much attention of the Supervisory Authority. The legal risk associated with the portfolio of housing loans denominated in Swiss franc still represented one of the main risks in the banking sector. Some banks offered their customers the ability to enter into out-of-court settlements based on the terms proposed by the Supervisory Authority (i.e. the proposed form of alternative dispute resolution consists in a loan being settled as if, from its starting date, it was a loan taken and repaid in the Polish currency) or based on own terms. The UKNF monitors the impact of those trends on the situation of each bank.

The UKNF provided the borrowers and banks with the possibility of alternative resolution of disputes over Swiss franc loans through out-of-court settlements, widely concluded as part of mediation before the Arbitration Court attached to the KNF Board. In 6 639 mediation proceedings concerning that type of loan (nearly 42%), the participants in the proceedings concluded their talks, and in 5 815 such proceedings the parties reported to the Arbitration Court that they had reached a settlement. The alternative dispute resolution meets the expectations of a large group of borrowers, allowing them to avoid lengthy and costly trial. The project is a response to one of the key issues the financial market has been facing in recent years, according to the concept of conversion of foreign-currency denominated or indexed lo ans.

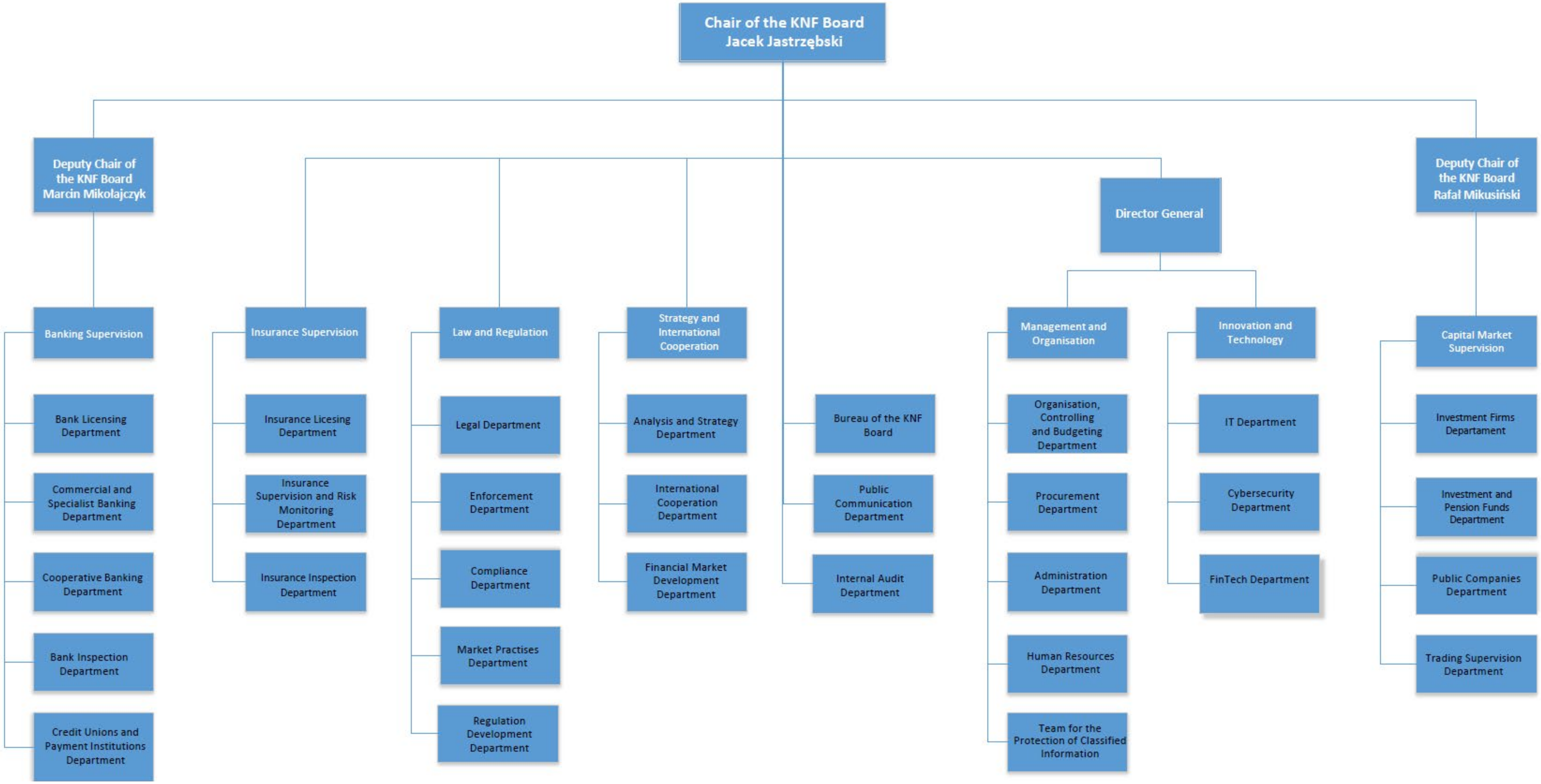
In 2021, the UKNF performed the annual stress tests in the commercial banks sector. The exercise focused on credit risk, which results from the nature of the domestic sector, where the key variable determining the amount of profit is loss allowance . A further review covered the components of net interest income , in terms of revenue and expenses . In 2021, stress tests were also performed to examine banks' resilience to increased credit risk in case of an interest rate increase. The results of the stress tests and the test of exposure of credit portfolios to the interest rate risk provided grounds for setting a capital add-on under the Pillar II requirement (P2G). In addition to estimation of resilience, the UKNF carried out analyses regarding liquidity.

Following the adoption of the UKNF Strategy for 2021-2025, the UKNF also revised and started adapting its tasks and competences related to the implementation of the Strategy's objectives, including in particular the engagement of supervised entities in sustainable development (ESG goals) and considering the current challenges arising from innovation and technological development in supervisory processes.

Significant market developments –with a high impact on banki9ng sector - were seen in relation to benchmarks. A number of LIBOR benchmarks were abolished, including CHF LIBOR — a very important benchmark for the financial market in Poland. The 2022 will bring further changes in LIBOR benchmarks., with the UKNF closely monitoring the process of domestic entities shifting from USD, GBP and JPY LIBOR benchmarks, which are still to be used, though to a limited extent.

Organizational chart of the Banking Supervisory Authority

[as of 31 .12.2021]



International activities of the authority

Involvement of the UKNF in international fora was an essential element in the process of building a stable regulatory environment for financial market participants in Poland. The international cooperation, both in the form of bilateral and multilateral cooperation, including through supervisory colleges, represents an important factor supporting the achievement of the supervisory objectives of the KNF Board. A particularly important area of the UKNF's international cooperation with respect to banking-related issues is the European System of Financial Supervision (ESFS). This is due to the fact that the key legal acts (e.g. CRD and CRR) setting the framework for the functioning of financial institutions are adopted at the EU level. In 2021 the day-to day involvement of the UKNF employees in the activities of the European Banking Authority (EBA) remained crucial from the banking supervision perspective.

As in previous years, in 2021 the UKNF representatives participated in meetings of supervisory colleges organised by the European Central Bank (consolidating supervisor) for international banking groups whose subsidiaries are present in the Polish market. The colleges are to coordinate supervisory activities with regard to banking groups.

In 2021 the UKNF continued developing bilateral relations with banking supervisors, which covered the exchange of supervisory information, opinions and experiences, and occurred primarily at the working level. Bilateral cooperation were facilitated by the memoranda of cooperation and exchange of information signed by the KNF Board with other supervisory institutions .

Cooperation with other supervisory bodies in the country

In 2021 the KNF Board took part in the works of the Financial Stability Committee (KSF) – a body comprising: (i) The KNF Board, (ii) the National Bank of Poland, (iii) the Ministry of Finance and (iv) the Bank Guarantee Fund. The KSF is responsible for both: (1) macroprudential supervision (operating under the chairmanship of the President of the NBP), and (2) crisis management in the financial system (operating under the chairmanship of the Minister of Finance). The KSF decided to submit to the Minister of Finance and the KNF Board a recommendation regarding a temporary change in risk weights for credit institutions actively involved in the process of voluntary settlements between banks and borrowers that took out foreign-currency housing loans. At the request of the KNF Board, the KSF also issued an opinion on the identification of other systemically important institutions (O-SII) and the imposition of an O-SII buffer.

As in the previous years, the KNF Board continued its permanent bilateral cooperation also with:

- the National Bank of Poland (NBP) reg. exchange of information necessary to perform the statutory tasks of both - the central bank and the financial supervision authority;
- the Bank Guarantee Fund (BGF) reg. information on the scores assigned to banks under the Supervisory Review and Evaluation Process and quarterly assessments of the level of risk existing in banks' operations, as well as information on the economic and financial standing of banks, including their liquidity and capital position;
- the General Inspector of Financial Information (GIFI): under the Act on the prevention of money laundering and terrorist financing, the KNF Board i.a. acts as a body cooperating with the GIFI which, as part of its supervisory powers, carries out inspection and analytical activities in the area of prevention of money laundering and terrorist financing at obliged institutions under the KNF Board supervision.

Other relevant information and developments in 2021

In 2021 the KNF Board revised the list of O-SIIs (Other Systemically Important Institutions) and the buffer rates imposed on the identified O-SIIs. Following the review, the KNF Board confirmed the identification of ten credit institutions as O-SIIs. On that basis, the KNF Board also decided to set appropriate buffer rates, ranging from 0.1% to 1.0%. The list of the identified entities is subject to annual review (under the Act of 5 August 2015 on macroprudential supervision) and, if necessary, the buffer rates are adjusted accordingly.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	30	30	30
Branches of foreign credit institutions	32	36	37
Cooperative banks	538	530	511
Banking sector, total:	**600**	**596**	**578**

Total assets of banking sector (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	1 780 157 094 516	2 106 035 795 905	2 307 868 040 416
Branches of foreign credit institutions	69 290 186 151	76 847 609 684	79 625 625 722
Cooperative banks	150 684 769 806	167 174 803 181	184 975 951 823
Banking sector, total:	**2 000 132 050 473**	**2 350 058 208 770**	**2 572 469 617 961**
y/y change (in %)	**5.62%**	**17.50%**	**9.46%**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	40.96%	44.95%	46.94%
Domestic ownership total	13.70%	12.22%	11.09%
Foreign ownership	45.34%	42.83%	41.97%
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	45.33%	63.28%	1 034.3
Branches of foreign credit institutions	35.86%	49.31%	767.3
Cooperative banks	4.92%	6.92%	39.1
Banking sector, total:	**40.67%**	**56.77%**	**833.4**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	6.88%	-0.32%	3.01%
Cooperative banks	4.70%	3.61%	5.22%
Banking sector, total:	**6.74%**	**-0.08%**	**3.14%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	89.00%	89.62%	89.71%
Branches of foreign credit institutions	3.46%	3.27%	3.10%
Cooperative banks	7.53%	7.11%	7.19%
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables	100%	100%	100%
Financial sector	9.23%	9.31%	10.69%
Nonfinancial sector	57.42%	49.00%	46.96%
Government sector	9.33%	10.44%	10.43%
Other assets	24.02%	31.24%	31.92%
Liabilites	89.53%	90.65%	92.25%
Financial sector	20.54%	23.03%	22.67%
Nonfinancial sector	70.91%	67.36%	65.29%
Government sector	4.76%	5.64%	7.56%
Other liabilities	3.80%	3.97%	4.48%
Capital	10.47%	9.35%	7.75%

Capital adequacy ratio of banks ***

Type of financial institution	2019	2020	2021
Commercial banks	19.18%	20.78%	19.36%
Cooperative banks	17.71%	18.93%	18.53%
Banking sector, total:	**19.09%**	**20.67%**	**19.31%**

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

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

Asset classification	2019	2020	2021
Non-financial sector, including	6.68%	7.00%	5.81%
households	5.68%	6.01%	5.06%
corporate	8.65%	9.12%	7.42%

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	86.31%	78.72%
Households	70.21%	67.20%
Corporate	27.75%	32.06%
Government sector	10.06%	7.07%
Financial sector (excluding banks)	3.63%	0.10%
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	66 022 972 895	56 700 767 953	51 093 282 268
Interest expenses	16 907 276 786	9 561 881 458	4 485 736 654
Net interest income	49 115 696 109	47 138 886 495	46 607 545 614
Net fee and commission income	13 363 364 420	14 849 790 555	17 155 705 117
Other (not specified above) operating income (net)	8 147 983 136	-24 508 162	3 608 389 445
Gross income	70 627 043 665	61 964 168 888	67 371 640 176
Administration costs	34 818 276 985	34 706 629 780	35 459 073 780
Depreciation	4 429 096 652	4 593 023 921	4 637 773 681
Provisions	2 405 534 620	5 495 912 408	8 317 389 962
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	9 566 108 776	13 348 231 900	7 147 163 500
Profit (loss) before tax	19 324 005 973	3 760 510 335	12 110 444 970
Net profit (loss)	13 806 199 663	-322 044 496	5 975 990 351

Total own funds in 2021 (in EUR)***

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	44 701 377 775.36	39 919 891 583.25	39 917 325 619.43	4 781 486 192.11	
Cooperative banks	2 872 912 368.35	2 788 962 289.65	2 788 264 010.09	83 950 078.71	
Banking sector, total:	**47 574 290 143.71**	**42 708 853 872.90**	**42 705 589 629.52**	**4 865 436 270.82**	

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

Macroeconomic environment in the country

In Romania, the macroeconomic landscape was mixed in 2021: on the one hand, economic activity posted robust growth (5.9 percent), allowing real GDP to surpass the pre-pandemic level; on the other hand, twin deficits remained elevated and inflation rate saw its upward trend steepen significantly in the final part of the year amid the heightening energy crisis at European level. However, the evolution of economic activity was not steady throughout the year, with a slowing trend becoming increasingly manifest in 2021 H2, under the impact of supply-side constraints – bottlenecks in global value and supply chains, hikes in commodity prices and transport costs –, but also of the new pandemic waves across Europe and domestically during this period. The prospects of a rebound in 2022, which emerged in the context of an alleviation of these constraints, receded subsequently amid the outbreak of the Russia-Ukraine war.

The annual inflation rate stood at 8.19 percent at end-2021 (versus 2.06 percent at end-2020), about 80 percent of this rise coming from the hikes in prices of natural gas, electricity and fuels, all of them exogenous components of the CPI.

The capacity to service foreign debt improved. Specifically, the gross external debt-to-GDP ratio went down 1.9 percentage points to 56 percent and gross external debt as a share of exports of goods and services shed 18.6 percentage points to 137.2 percent, while Romania's international reserves further displayed an adequate level. The reserve adequacy indicators staying within the recommended limits enhances the capacity of the Romanian economy to withstand potential adverse shocks on financial markets and acts towards limiting the government's and local companies' financing costs.

Development in the banking sector (including assets total / GDP)

The prudential and financial position of the Romanian banking sector has remained at adequate levels in 2021.

The aggregated balance sheet assets amounted to lei 640.0 billion at December 2021, up by 14.2% against the previous year level, and held a share of 54.1 % in GDP. The total number of credit institutions operating in Romania remained unchanged during 2021, respectively 26 banks, Romanian legal entities and 8 branches of foreign banks, the changes occurring at the level of their size or the shareholding structure. The share of credit institutions with majority foreign capital in aggregate capital of the banking sector (including branches of foreign credit institutions) declined from 61.9 percent at 31 December 2020 to 60.4 percent at 31 December 2021, while the share of credit institutions with Romanian capital increased from 38.1 percent to 39.6 percent.

Prudential indicators recorded adequate levels in 2021, although slightly lower than that of the previous year, in case of solvency ratios. The liquidity indicators further stood at comfortable levels as of December 31, 2021, considerably above the regulated requirements, with liquidity coverage ratio (LCR) and the net stable funding indicator (NSFR) standing at 238.8 percent and 174.9 percent, respectively. In the liabilities side, the deposits taken from non-bank clients expanded by 13.4 percent compared to end-2020.

The relevant asset quality indicators saw an improvement over 2021, as the non-performing loan ratio (according to the EBA definition) was 3.4 percent in December 2021, compared to 3.8 percent at bend-2020, remaining however in the medium-risk bucket. NPL coverage by provisions has increased further since the beginning of this year, reaching 66.1 percent in December 2021. The profitability of the banking sector remained high during 2021 as well, with the financial performance at system level being superior to that of the previous year. At the end of 2021, return on assets (ROA) reached 1.4 percent, higher by 0.4 percentage points compared to the previous year, and return on equity (ROE) came in at 13.3 percent, higher by 4.6 percentage points from end-2020.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

The National Bank of Romania (NBR) is the competent authority for the regulation, licensing, prudential supervision and resolution of credit institutions, and shall monitor the activities of credit institutions, as well as, where it is the authority responsible for supervision on a consolidated basis, the activities of financial holding companies and mixed financial holding companies, for the provisions applicable to them, so as to assess compliance with the prudential requirements of the Banking Law, of Regulation (EU) no.575/2013 and of the applicable regulations. In the area of prudential regulation and bank recovery and resolution, during 2021 the following progress was observed:

- transposition at national level of the provisions of Directive (EU) 2019/878 of the European Parliament and of the Council of May 20, 2019 amending Directive 2013/36/EU in regard of the exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures;
- transposition at national level of the provisions of Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amending Directive 2014/59/EU as regards the loss-absorbing capacity and recapitalization of credit institutions and investment firms and Directive 98/26/EC.

This approach was performed by amending the legislative framework applicable to credit institutions, thus, the following legal documents were adopted:

- Law no. 319/2021 for amending and supplementing Government Emergency Ordinance no. 99/2006 on credit institutions and capital adequacy, which transposed a series of provisions of Directive (EU) 2019/878 on additional own funds requirements, the procedure for the approval by the National Bank of Romania, as consolidating supervisor, of certain financial holding companies and mixed financial holding companies, elements regarding the credit institutions' activity management framework, the supervisory measures and competences of the National Bank of Romania, as well as the collaboration of the National Bank of Romania with other competent authorities and national and international institutions/bodies;
- Law no. 320/2021 for amending and supplementing Law no. 312/2015 on the recovery and resolution of credit institutions and investment firms, as well as for amending and supplementing certain regulatory acts in the financial field, transposing a number of provisions of Directive (EU) 2019/879, inter alia: i) introduction of new concepts such as 'resolution entity' and 'resolution group' based on which a number of provisions that are governing the resolution planning are restructured, as well as the determination of the minimum requirement for own funds and eligible liabilities; ii) rules on the sale of debt instruments eligible for the calculation of the MREL requirement to retail customers in order to avoid their excessive sale; iii) extending the application of the provisions aimed at conversion and decrease in value to eligible debt instruments; iv) introduction of provisions on the contractual recognition of powers to suspend obligations in the event of resolution for financial contracts governed by the law of a third state; v) new powers for the resolution authority in relation to issues such as resolving breaches of the MREL requirement, suspending a credit institution's pre-resolution payment obligations, including on eligible deposits, under certain conditions laid down by law (known as a 'moratorium instrument').

Other relevant regulations issued by the NBR during 2021:

- NBR Order no. 6/2021 for the amendment of the NBR Order no. 12/2015 on the capital conservation buffer and the countercyclical capital buffer, issued for the implementation of the National Committee for

Macroprudential Oversight Recommendation no. R/7/2021 on the countercyclical capital buffer. According to it, starting with October 17, 2022, the countercyclical capital buffer rate applicable to credit exposures in Romania, held by the credit institutions, as defined by Article 4 para. (1) point 1(a) of Regulation (EU) no. 575/2013, is 0.5 percent of the total risk exposure value, calculated in accordance with art. 92 para. (3) of Regulation (EU) no. 575/2013;

- NBR Order no. 7/2021 on the buffer related to credit institutions authorized in Romania and identified as other systemically important institutions (O-SIIs), issued for the implementation of the Recommendation of the National Committee for Macroprudential Oversight no. R/8/2021 on the capital buffer for other systemically important institutions in Romania. According to it, starting with January 1, 2022, the O-SII institutions in Romania maintain an O-SII buffer, the level of which is provided in the order and is determined on the basis of the total risk exposure value, calculated in accordance with Article 92 para. (3) of Regulation (EU) no. 575/2013 of the Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) no. 648/2012;
- Regulation no. 4/2021 regarding the reporting of statistical data and information to the National Bank of Romania, issued by the National Bank of Romania.

Organizational chart of the Banking Supervisory Authority

Organisation Chart of the National Bank of Romania

BOARD OF DIRECTORS

The Audit Committee

Governor **Mugur Isărescu**

- The Monetary Policy Committee
- The Supervisory Committee
- The Foreign Reserve Management Committee

First Deputy Governor **Florin Georgescu**

FINANCIAL STABILITY DEPARTMENT
- Macroprudential Policies Division
- Systemic Risk Monitoring Division
- Quantitative Assessment Division

REGULATION AND LICENSING DEPARTMENT
- Financial Activities and Non-bank Financial Institutions Regulation Division
- Foreign Exchange and Accounting Regulation Division
- Licensing Division
- Prudential Banking Regulation Division 1
- Prudential Banking Regulation Division 2

SUPERVISION DEPARTMENT
- Inspection Division
- Bank Supervision Division 1
- Bank Supervision Division 2
- Assessment and Supervisory Policy Division
- Non-bank Financial Institutions and Payment Institutions Supervision Division
- Prevention of Money Laundering and Terrorist Financing & Intl. Sanctions Enforcement Supervision Division.
- Legal Advice on Supervisory Acts and Petitions Office

ISSUE, TREASURY AND CASH MANAGEMENT DEPARTMENT
- Issue Division
- Cash Management Division
- Central Vault Division
- Cash Processing Coordination Division

ACCOUNTING DEPARTMENT
- Operational Accounting and Internal Accounting Rules Division
- Internal Administration Accounting-Financial Issues Division
- Internal Administration Accounting-Fixed Assets Division

ESTATE MANAGEMENT AND INVESTMENT DEPARTMENT
- Investment Division
- Movable Assets Division
- Immovable Assets and Management Division

Deputy Governor **Eugen Nicolăescu**

STATISTICS DEPARTMENT
- Monetary and Financial Statistics Division
- Balance of Payments Division
- Direct Statistical Reporting Division
- Statistical Data Processing Division
- SIRBNR Data Management Division
- Credit Risk Statistics Division

BANK RESOLUTION DEPARTMENT
- Resolution Strategies and Policies Coordination Division
- Resolution Decisions Preparation and Implementation Division
- Monitoring of the Implementation of Measures for Resolvability Enhancement Division
- Resolution Planning and Decisions Implementation Division

IT DEPARTMENT
- IT Systems Division
- Network Administration Division
- IT Support Division
- IT&C Security Division

PROCUREMENT DEPARTMENT
- Standardisation, Planning and Monitoring Division
- Procurement Contracts Award Division
  - > EPCO Related Procurements Office
- Purchase Order Division
- Methodology and Contracting Division

FINANCIAL EDUCATION AND MUSEUM DEPARTMENT
- Museum
- Financial Education Division

PAYMENT AND SETTLEMENT SYSTEMS REGULATION AND OVERSIGHT UNIT
- Financial Market Infrastructures Oversight Division
- Payments and Payment Instruments Oversight Division

Deputy Governor **Leonardo Badea**

MACROECONOMIC MODELLING AND FORECASTING DEPARTMENT
- Macroeconomic Forecasting Models Division
- Macroeconomic Assessment Models Division

PAYMENTS DEPARTMENT
- ReGIS Division
- Financial Instruments Depository and Settlement Division
- Financial Messages Processing Division
- TARGET2 Division
- Business Continuity Division

INTERNATIONAL RELATIONS DEPARTMENT
- European Banking System Division
- International Financial System Division
- International Financial Conditions Analysis Division

SECRETARIAT
- Documents Registration, Dispatching and Check-in Desk Division
- Archives, Library and Publications Dissemination Division
- Events Organisation and Protocol Division

TECHNICAL AND MAINTENANCE DEPARTMENT
- Buildings Maintenance Division
- Equipment and Installations Maintenance Division
- Administrative Maintenance and Utilities Division

LEGAL DEPARTMENT
- Banking and Financial Law Division
  - > Prudential Legislation and Corporate Law Office
- Banking and Financial Law & International Legal Cooperation Division
  - > Prudential Legislation & Banking and Financial Activities Office
- Litigation and Legal Assistance Division
  - > Legal Advice and Assistance Office

TRAINING AND SOCIAL EVENTS FACILITY DEPARTMENT
- Training Support Division
- Social Events Division
- Auxiliary Activities Division
- Cafeteria Division
- Training and Social Events Units

COMPLIANCE DIVISION

REGIONAL BRANCHES AND AGENCIES

Governor

INTERNAL AUDIT DEPARTMENT*
- General Audit Division 1
- General Audit Division 2

CHANCELLERY
- The Euro Office
- Financial Economy - Real Economy Office
- Role, Developments and Prospects of Central Banks Office
- Cryptocurrency and Digital Currency Office
- Sustainability and Green Economy Office
- The Executives' Offices and Document Management
- Governor's Control Office
- Board Secretariat Division
- Information Management and Protection Division
- Administration of Special Computer Systems and Personal Data Protection Division

MONETARY POLICY DEPARTMENT
- Monetary Policy Analysis and Strategy Division
- Liquidity Management Division

MARKET OPERATIONS DEPARTMENT
- Monetary Policy Operations Division
- State Treasury Operations Division
- Foreign Reserves Management Division
- Back Office Division
- Foreign Reserves Risk Management Division

ECONOMICS DEPARTMENT
- Economic Analysis and Short-Term Forecasting Division
- Publications Division
- Translation and Editing Division

COMMUNICATION AND PUBLIC RELATIONS DEPARTMENT
- Media Relations Division
- Intranet and Internal Communication Division
- Online Communication Division
- Multimedia Support Division
- Public Relations and Documentation Division

HUMAN RESOURCES DEPARTMENT
- Organisation and Planning Division
  - > Payroll Office
- Human Resources Management Division
- Training and Career Development Division

BUDGET AND FINANCIAL ANALYSIS DEPARTMENT
- Budget and Financial Analysis Division
- Preventive Financial Control Division
- Risk Monitoring Division

SECURITY DEPARTMENT
- Crisis Management & Business Continuity Division
- Internal Protection Division
- Special Transport Division
- Security Systems Division
  - > Emergency Intervention Office
- Transport and Maintenance Division
- Territorial Network Coordination Division

Note:
Colour patterns show the departments' coordination.
*The Internal Audit Department reports functionally to the Audit Committee and administratively to the Governor of the National Bank of Romania.

Main strategic objectives of the Banking Supervisory Authority in 2021

Starting 2021, the NBR aims to correlate the national supervisory objectives with the strategic supervisory priorities established at the level of the European Union. These priorities are added to those established according to the specificities of the national banking system, its vulnerabilities and the main risks it may face. In this context, the NBR reflected in its activity program for the year 2021 the two strategic priorities discussed and agreed at the EU level, priorities consisting in the sustainability of the business model and the adequate governance of credit institutions.

The activities of the Banking Supervisory Authority in 2021

During 2021, supervisory actions were conducted under the annual inspection programme at every of 26 credit institutions, Romanian legal entities. In addition to the scheduled inspections, 9 thematic inspections were also conducted at credit institutions, with specific supervisory objectives. The priorities and specific risks assessed during the supervisory actions conducted under the annual inspection programme were established based on the risk profile of each credit institution as shown in the latest assessment. The thematic objectives focused on the viability and sustainability of the business model, internal governance and institution-wide controls, the assessment of risks to capital and capital adequacy, the assessment of risks to liquidity and liquidity adequacy, as well as on verifying the implementation of the measures imposed by the NBR and of the action plan prepared by the credit institution. Following the SREP assessment conducted in 2021, the assigned scores were as follows: 31 percent of the 26 credit institutions were assigned an overall score of 2, 54 percent an overall score of 3, 15 percent an overall score of 4, and none received an overall score of 5. In addition, the average and median of total SREP capital requirements (TSCR) across the banking system were of 12.2 percent and 12.3 percent, respectively.

International activities of the authority

As regards the responsibilities of the National Bank of Romania concerning the alignment to the European regulatory and supervisory framework, the NBR have been pursued the harmonization efforts with regard to the supervision of credit institutions through the participation of Romania in a number of working groups set up at the EBA level. At the same time, the oversight activity continued through JSTs (Joint Supervisory Teams). In the supervision of cross-border banking groups, the NBR has maintained its cooperation with the other Supervisory Authorities through the Supervisory Colleges, structures that ensure both optimal dissemination of information and joint decisions on capital adequacy and liquidity or recovery plans of supervised credit institutions.

Regarding the structures and substructures of the EBA, the NBR, as the regulatory and Supervisory Authority of the banking sector in Romania, is a member of the European Banking Authority.

We also mention that, due to the pandemic caused by the SARS-CoV-2 virus in Europe, starting with March 2020, the meetings of different working structures and substructures were held using facilities of remote communication, throughout 2020 and 2021.

Cooperation with other supervisory bodies in the country

The cooperation and coordination between local supervisory bodies is mainly ensured by the National Committee for Macroprudential Oversight (NCMO), established by virtue of Law No. 12/2017 on the macroprudential oversight of the national financial system, as an inter-institutional cooperation structure without legal personality. Four meetings were held in 2021 by written procedure between representatives of the National Bank of Romania (NBR), the Financial Supervisory Authority (FSA) and the Government within NCMO. Thus, in 2021, the NCMO recommended the NBR, in its capacity as competent authority, to take among others the following actions in relation to credit institutions:

- to maintain the countercyclical buffer (CCyB) rate at 0 (zero) percent and to closely monitor developments in structural imbalances and indebtedness at aggregate and sectoral levels.The decision to keep the CCyB rate at zero percent was in line with the persistence of uncertainties about the evolution of the economy and of lending and considering that several EU Member States have taken macroprudential policy easing measures;
- to raise, starting 17 October 2022, the countercyclical buffer rate to 0.5 percent from 0 percent as of 17 October 2022. The decision to raise the CCyB rate at 0.5 percent was in line with the acceleration in the dynamics of loans to the private sector, amid the recovery from the sharp economic contraction seen in the context of the pandemic outbreak, and the persistent tensions surrounding macroeconomic equilibria;
- to extend until 30 September 2021 the restrictions on dividend distribution by credit institutions, following the publication of Recommendation ESRB/2020/15 amending Recommendation ESRB/2020/7 on restriction of distributions during the COVID-19 pandemic;
- to impose, starting 1 January 2022, a capital buffer for other systemically important institutions (O-SII buffer), on an individual or consolidated basis, as applicable, calculated based on the total risk exposure amount for all the credit institutions identified as having a systemic nature based on the data reported as at 30 June 2021.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	26	25	25
Branches of foreign credit institutions	7	8	8
Cooperative banks	1	1	1
Banking sector, total:	**34**	**34**	**34**

Total assets of banking sector (mill. RON) (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	433,282.3	488,054.5	560,303.9
Branches of foreign credit institutions	60,457.8	70,389.8	77,751.5
Cooperative banks	1,474.1	1,589.9	1,699.1
Banking sector, total:	**495,214.2**	**560,034.2**	**639,754.5**
y/y change (in %)	**+9.8%**	**+13.1%**	**+14.2%**

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

Item	2019	2020	2021
Public sector ownership	8.2	10.6	11.5
Domestic ownership total	26.3	29.5	31.8
Foreign ownership	73.7	70.5	68.2
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	50.2	69.8	1211
Branches of foreign credit institutions	95.2	98.5	6082
Cooperative banks	-	-	-
Banking sector, total:	**44.0**	**62.5**	**1019**

Return on Equity (ROE) by type of financial institutions (%) (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	11.13	8.30	12.35
Cooperative banks	1.41	2.09	1.61
Banking sector, total:	**12.21**	**8.68**	**13.28**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	87.5	87.1	87.5
Branches of foreign credit institutions	12.2	12.6	12.2
Cooperative banks	0.3	0.3	0.3
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables	100.0	100.0	100.0
Financial sector	19.9	22.5	22.0
Nonfinancial sector	53.9	49.9	50.3
Government sector	-	-	-
Other assets	26.2	27.6	27.7
Liabilities	88.9	89.1	90.3
Financial sector	6.0	5.1	6.2
Nonfinancial sector	78.9	79.8	79.1
Government sector	-	-	-
Other liabilities	4.0	4.2	5.0
Capital	11.1	10.9	9.7

Capital adequacy ratio of banks (%)
(at year-end)

Type of financial institution	2019***	2020***	2021
Commercial banks	22.0	25.1	23.3
Cooperative banks	28.4	28.9	28.0
Banking sector, total:	**22.0**	**25.1**	**23.3**

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

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

Asset classification	2019	2020	2021
Non-financial sector, including	5.4	5.3	4.7
households	4.0	4.1	3.8
corporate	7.1	6.6	5.6

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	86.2	60.1
Households	53.3	31.6
Corporate	32.9	28.5
Government sector	10.0	33.1
Financial sector (excluding banks)	3.8	6.8
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	18,831.7	19,179.9	19,178.8
Interest expenses	3,581.8	3,755.3	3,215.6
Net interest income	15,249.9	15,424.6	15,963.2
Net fee and commission income	4,152.7	3,841.6	4,579.6
Other (not specified above) operating income (net)	3,561.1	3,676.1	3,691.6
Gross income	22,963.7	22,942.3	24,234.4
Administration costs	10,758.1	10,552.1	11,251.8
Depreciation	1,716.2	1,800.0	1,814.2
Provisions	1,613.8	518.0	-6.8
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	1,164.9	3,835.3	1,322.8
Profit (loss) before tax	7,817.2	6,103.6	9,830.9
Net profit (loss)	6,334.3	5,024.8	8,167.5

Total own funds in 2021 (in mill. EUR)

Type of financial institution	Total own funds***	Core Tier 1***	Tier 1***	Tier 2***	Tier 3***
Commercial banks	11,631.1	10,347.4	10,395.6	1,235.5	-
Cooperative banks	69.4	68.9	68.9	0.5	-
Banking sector, total:	**11,700.5**	**10,416.3**	**10,464.5**	**1,236.0**	**-**

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

Macroeconomic environment in the country

COVID-19 and the global recession had a weaker impact in Serbia than in other European countries, due to the good economic bases before the outbreak of crisis (macro, financial and fiscal stability, strong growth, enough fiscal space for measures). After 0.9% drop in GDP in 2020 which was one of the smallest declines in economic growth in Europe, the pre-crisis level was reached already in the first quarter of 2021, which was one quarter earlier than expected. According to our estimate level of GDP was at the end of year 5% higher comparing to the pre-crisis level. According to SORS data, real GDP growth amounted to 7.4% in 2021, above our projection in a range of 6.5-7%.

On the production side, real GDP growth was driven by faster growth in all sectors, except agriculture, which was hit by drought. On the expenditure side, main contribution came from private consumption and fixed investments, while negative contribution came from net exports, although export of goods and services increased almost 20% in real terms.

Cumulative growth in two pandemic years amounted to 6.4% and it was driven by domestic demand, which was supported by the continued implementation of infrastructure projects and the timely and adequate response of economic policy makers in Serbia. On that basis favorable financing conditions has been preserved and also production capacities and jobs. In addition, the growth of export capacities along with the normalization of global economic flows due to the continuation of the vaccination process and the gradual recovery of external demand also contributed to double-digit growth in exports.

When it comes to external developments, CAD amounted to EUR 2.3 billion in 2021 (-4.3% of GDP). Categories which contributed to the negative side of the current account by EUR 368 mn compare with the 2020, are the trade of goods (EUR 723 mn), partly due to the deterioration of the terms of trade, and the primary income account (EUR 633 mn) due to higher dividends payments. On the other hand, the secondary income account and services account, recorded a surplus increase (EUR 692 mn and EUR 297 mn).

In 2021, exports of goods increased by 29,3% and imports by 25,5% in nominal terms. As for the export of goods, the export of agricultural products grew, as well as mining, but the biggest growth contribution came from the manufacturing. Regarding goods imports, the contribution to the growth during 2021 came was mostly driven by the growth of imports of intermediate products, primarily energy, while the recovery in imports of equipment and consumer goods indicates a continued recovery of investment and personal consumption.

In 2021, the surplus on the services account increased by EUR 297 million, with the growth of exports of services of 26.0%. and imports of services of 25.8%. The largest contribution regarding exports increase was made by tourism services, as well as ICT services. As for services imports increase, biggest contribution came from tourism and transport.

In 2021, the gross inflow of FDI amounted to EUR 3.9 billion (27.9%), while the net inflow amounted to EUR 3.7 billion which was more than enough to fully cover CAD. The net inflow of FDI was higher by 24.4% than in 2020 and exceeded the pre COVID level, as well as the record net inflow from 2019.

Average inflation in 2021 was 4.0% and despite major challenges coming from the pandemic and the global uncertainty, remained within the target corridor (3% +/- 1.5%). The increase in inflation during 2021, and particularly from August 2021, was driven by - an increase in prices of vegetable, fruit, meat, global oil prices, raw materials as well as supply chain bottlenecks. Almost 3/4 of 7.9% y-o-y inflation in December was determined by factors that are not under the direct influence of monetary policy– the prices of food and energy. On the other hand, the core inflation (CPI excluding the prices of food, energy, alcohol, and cigarettes), which is more affected by monetary policy measures, was much lower than headline inflation in December, equalling 3.5%. Overall, in 2021, core inflation averaged around 2.3%.

When it comes to fiscal movements, a consolidated budget posted a deficit in 2021 of RSD 259.4 bn (4.1% of GDP), which is significantly less than in pandemic 2020 when it amounted to RSD 442.8 bn (8.0% of GDP). Also, the mentioned deficit was RSD 45.1 bn lower than the level envisaged by the plan in Fiscal Strategy for 2021 (4.9% of GDP, RSD 304.5 bn). The deficit in 2021 was mostly influenced by the new stimulus package in the amount of EUR 2.2 bn (4.2% of GDP). In addition, CAPEX amounted to 7.5% in 2021 and are expected to remain at a similar level in the coming years. At the same time, the share of central government public debt in GDP remained below the Maastricht criteria and stood at 56,5% at the end of 2021.

Development in the banking sector (including assets total / GDP)

The Serbian banking sector (which comprises more than 90% of its total financial sector) remained adequately capitalized and highly liquid throughout 2021. The National Bank of Serbia preserved financial stability while non-performing loans were further reduced, which kept the banking sector attractive for reputable investors. The banking sector profitability was also satisfactory in 2021, pre-tax profit being EUR 458.1 million, with ROA of 1.12% and ROE of 7.5%.

At the end of 2021, 23 banks were operating in Serbia, 2 of which were majorly owned by the Republic of Serbia with a share of 7.3% in banking sector's total assets, 2 banks were majorly owned by private shareholders with a share of 5.7% and 19 banks were majorly owned by foreign shareholders with a share of 87%. Since branching is not allowed in Serbia, all banks operate as independent legal entities. Banks that are majorly foreign-owned are parts of banking groups from 13 countries. Italian major shareholders were dominant with 25.4% share in total banking sector assets, followed by Austrian (14.9%), Hungarian (13.2%) and Slovenian (11.4%) shareholders. All other foreign shareholders account for 22.1% of total banking sector assets. Banking sector assets to GDP ratio was over 80% at the end of 2021.

Total net balance sheet assets of the banking sector in Serbia reached EUR 42.9 billion at the end of 2021 which is an increase of 9.7% compared to the end of 2020.

The level of competition in Serbian banking sector is at a satisfying level. Top five banks have a market share of 56.9% of net assets, 57.4% of total gross loans and 57.4% of deposits. HHIs of assets, lending and deposits are below 1,000.

Total gross loans amounted to EUR 25.21 billion, which is a growth of 10.3% compared to 2020. Loans to corporates made 50.5% of total loans and amounted EUR 12.72 billion, while loans to households made 46.1% and amounted EUR 11.61 billion. Loans for liquidity purposes and current assets financing and investment loans had almost equal share in total corporate loans in 2021, while cash and housing loans dominate households lending.

As a result of numerous supervisory and regulatory measures adopted by the NBS with the aim of reducing NPL in banks' portfolios (especially The Strategy for NPL resolution adopted in August 2015 and The Decision on Accounting Write-off of Balance Sheet Assets adopted in 2017), the gross NPL ratio has been steadily declining since 2015 to reach one of its lowest levels of 3.57% at the end of 2021. Since the adoption of the Strategy for NPL Resolution, the gross NPL ratio was reduced by 18.68 p.p.

The corporate sector refers to 47.0% of total NPLs (EUR 435.6 million at the end of 2021). The NPL ratio for corporates was reduced from 4.03% in 2020 to 3.35% in 2021. Households NPLs make 51.7% of total NPLs

(EUR 479.7 million at the end of 2021). The households NPL ratio increased from 3.61% in 2020 to 4.09% in 2021. The coverage of NPLs by total loan provisions amounted 88.49% at the end of 2021.

At the end of 2021, total deposits were at the level of EUR 30.91 billion, which is an increase by 13.5% compared to the end of 2020. Household deposits made 54.7% of total deposits and amounted EUR 16.9 billion while corporate deposits made 35.7% of total deposits and amounted EUR 11.0 billion.

Regulations harmonized with "Basel 3" and EU capital and liquidity rules that the NBS had adopted in 2017 have provided an incentive for banks to build significant capital buffers and liquidity reserves, making them capable to cope successfully with the risks that may arise in the system and maintain banking sector stability in case of disturbances. The capital adequacy ratio at the banking sector level was 20.77% at the end of 2021, which is significantly above the regulatory minimum of 8%. In addition to the high capital adequacy ratio, Serbian banking sector is characterized by favorable capital structure, bearing in mind that Tier 1 capital makes almost 95% of total regulatory capital. The high solvency of the banking sector is also indicated by the (Basel III) leverage ratio, which amounted 11.07% at the end of 2021. The proportion of balance sheet capital to total assets stood at 14.26% at the end of 2021.

The average regulatory liquidity ratio for the Serbian banking sector in December 2021 was 2.11, indicating that liquid assets (core liquid assets and receivables maturing within the next 30 days) were more than twice as large as liabilities without maturity and liability maturing within 30 days. Liquid assets comprised 37.35% of total assets and 49.20% of total short-term liabilities at the end of 2021. The funding of the banks' lending activity is adequate, having in mind that gross loans to nonfinancial sector are fully covered with nonfinancial sector's deposits (loan to deposit ratio was 83.46% at the end of 2021). Liquidity coverage ratio of 199.82% also confirmed high liquidity of Serbian banking sector.

In the aim of taking proactive action regarding unsecured retail lending under unjustified long tenors, The Decision on Managing Concentration Risk Arising from Bank Exposure to Specific Products was adopted by the NBS at the end of December 2019. Through this Decision, a new indicator - Concentration Risk Indicator was introduced. The numerator of this indicator comprises the existing portfolio of cash, consumer, and other loans (that are not mortgage loans nor overdrafts) with contractual maturity above eight years. The denominator is the sum of regulatory capital (minus regulatory adjustment, current and previous years losses and unrealized losses) and dinar liabilities whose remaining maturity is more than 5 years. This indicator represents additional regulatory and supervisory instrument bearing in mind that it defines the "cap" of the bank's exposure to certain unsecured long-term retail loans. The effects of measures taken by the NBS are already visible through continuous reduction of Concentration Risk Indicator (10.12% in December 2021, by 3.04 p.p. less than in December 2020).

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

In the observed period, exercising its regulatory competences in bank supervision, the NBS adopted the following regulation:

The Decision Amending Decision on Temporary Measures for Banks to Enable Adequate Credit Risk Management amid COVID-19 Pandemic adopted at the session of the Executive Board held on March 11, 2021 provides regulatory solution where the borrower is entitled to facilities (providing prior orderliness in settling its liabilities to the bank) if as at February 28, 2021 is more than 30 days past due in a materially significant amount on any obligation to the bank arising from products to which this Decision applies. Thus, the scope of the borrowers who were entitled to facilities in accordance with the Decision was expanded (having in mind that the one new objective criteria for the application of the facilities was prescribed). Still, in accordance with the Decision, a borrower could apply for the prescribed facilities to the bank by April 30, 2021.

Performing it's regulatory and supervisory function, and on the other hand having in mind the fact that the negative development of the epidemiological situation caused by the COVID-19 pandemic continued, NBS several times has postponed the application of measures that discourage the approval of new, non-purpose and non-investment, foreign currency indexed loans and loans in foreign currency to debtors from the non-financial and non-government sector, adopted in December 2019, in the part of those measures related to capital by amending the Decision on Capital Adequacy of Banks. According to the last Decision Amending the Decision on Capital Adequacy of Banks[1], due to the postponement the application of measures for the additional twelve months, it should be noted that for the calculation of the deductible from Common Equity Tier 1 would be relevant newly approved FX-indexed and FX loans from July 1, 2023. Consequently, the deductible shall apply if the bank's exposures under FX-indexed dinar loans and FX loans extended as of 1 July 2023 to debtors from the non-financial and non-government sector exceed:

1) 71% of the amount of the bank's exposure under dinar loans (including FX-indexed loans) and FX loans, extended to those debtors as of 1 July 2023 – in the period from 1 July 2023 to 30 June 2024.
2) 64% of the amount of the bank's exposure under dinar loans (including FX-indexed loans) and FX loans, extended to those debtors as of 1 July 2023 – in the period from 1 July 2024 to 30 June 2025.
3) 57% of the amount of the bank's exposure under dinar loans (including FX-indexed loans) and FX loans, extended to those debtors as of 1 July 2023 – in the period from 1 July 2025 to 30 June 2026.
4) 50% of the amount of the bank's exposure under dinar loans (including FX-indexed loans) and FX loans, extended to those debtors as of 1 July 2023 – in the period from 1 July 2026.

At the session of the Executive Board held on December 9, 2021, NBS adopted the Decision amending the Decision on Temporary Measures for Banks to Facilitate Access to Financing for Natural Persons. The adoption of the decision extends for 12 months the effect of temporary measures prescribed by the Decision on Temporary Measures for Banks to Facilitate Access to Financing for Natural Persons ("Official Gazette of RS", No. 108/2020). This means that until December 31, 2022, banks will be able to apply measures to facilitate access to housing loans for citizens, approving relief to citizens in repaying housing loans (an extension of loan maturity) and approving loans of up to 90,000 dinars with the maturity of up to two years under the simplified procedure (by accepting the signed statement of employment and wage/pension given under full criminal and material liability).

AML

On May 2021, the National Bank of Serbia (hereinafter: NBS) adopted the Decision on Amendments to the Decision on Guidelines for the Application of the Provisions of the Law on the Prevention of Money Laundering and Terrorism Financing for Obligors Supervised by the National Bank of Serbia („Official Gazette of the Republic of Serbia", No. 49/2021) in order to harmonize these guidelines with the Law on Amendments of the Law on Prevention of Money Laundering and the Financing of Terrorism („Official Gazette of the Republic of Serbia", No. 153/2020), i.e. its novel/amended provisions concerning digital currencies.

[1] The application of measures had been postponed by adopting the decisions on May 2020, November 2020 and June 2021 while the last postponement of the application of measures was on June 9, 2022 by adopting the Decision Amending the Decision on Capital Adequacy of Banks Decision Amending the Decision on Capital Adequacy of Banks, Decision on deadlines for compliance of banks' internal acts on risk management and for reporting by banks and Decision Amending the Decision on Reporting Requirements for Banks.

Bearing in mind that the NBS is authorities competent for licensing digital assets service providers and for supervision of issuing digital assets and providing services related to digital assets in respect to virtual currencies, during 2021. the NBS adopted a set of by-laws regulating the implementation of Law on Digital Assets („Official Gazette of the Republic of Serbia", No. 153/2020), inter alia, closely regulating licensing and supervision over digital assets service providers.

On the basis of Law on Digital Assets, the NBS established Records of Virtual Currency Holders (Decision on Detailed Conditions and Manner of Keeping Records of Virtual Currency Holders – „Official Gazette of the Republic of Serbia", No. 49/2021), as well as the Register of Virtual Currency Service Providers (Decision on the Content of the Register of Virtual Currency Service Providers and Detailed Conditions and Manner of Keeping That Register – „Official Gazette of the Republic of Serbia", No. 49/2021) which enables payment services providers to more easily identify transaction connected to transfers of digital assets.

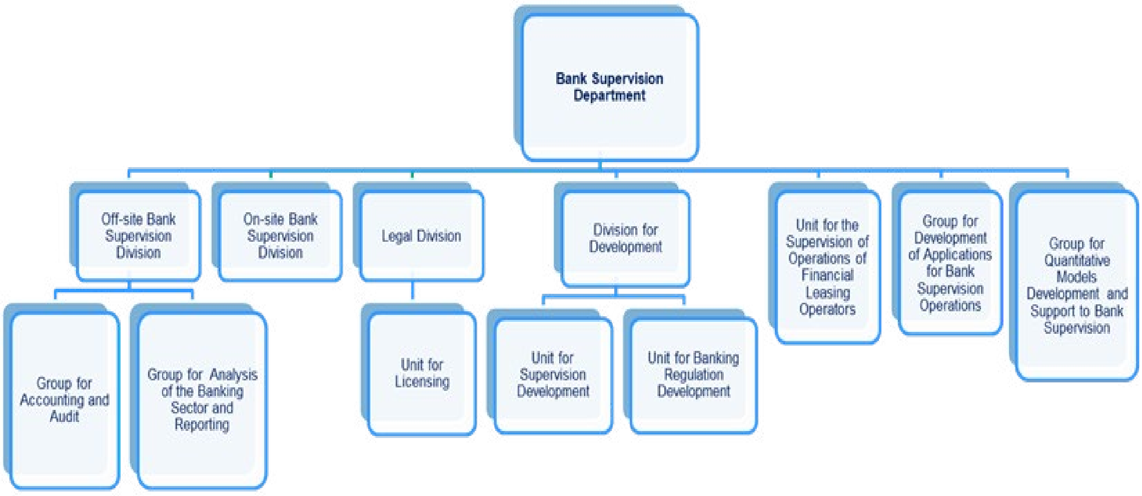
Given that the Government of the Republic of Serbia adopted the new National Strategy for the Fight against Money Laundering and the Financing of Terrorism for the period 2020 – 2024 (hereinafter: AML/CFT Strategy), and the Action Plan for the implementation of the AML/CFT Strategy (2020-2022), during 2021, authorities have continued with their implementation.

Also on 4 March 2021. the Government of the Republic of Serbia established a Working Group to update the 2018 National ML/TF Risk Assessment, bearing in mind that this was one of the planned activities in the Action Plan for the Implementation of the AML/CFT Strategy. The task of the Working Group was to review the assessed ML/FT risks identified in the risk assessment at the national level conducted in 2018, as well as to determine the possible existence of new risks. A novelty in this cycle of national risk assessment is that the Republic of Serbia has, for the first time, conducted a risk assessment for ML/FT using digital assets (according to the methodology provided by the Council of Europe) and a risk assessment for financing the proliferation of weapons of mass destruction (with the support of a specialized project implemented, organized and financed by the US government). On September 30, 2021, the Government of the Republic of Serbia passed the Conclusion on the adoption of the National Money Laundering Risk Assessment and the National Terrorism Financing Risk Assessment, Money Laundering and Terrorism Financing Risk Assessment in the Digital Assets Sector and the Risk Assessment of the Financing of Proliferation of Weapons of Mass Destruction.

The overall ML risk in Serbia was assessed to be 'medium' and overall TF risk assessment as medium low. The risk of weapons of mass destruction (hereinafter: WMD) proliferation financing was assessed to be low-to-medium.

On December 2, 2021, the Government of the Republic of Serbia established the National Coordinating Body for the Fight against the Proliferation of Weapons of Mass Destruction (hereinafter: WMD Coordination Body). The basic tasks of that body, in addition to the coordination of activities on the prevention and fight against the proliferation of WMD, is monitoring the implementation the Strategies to prevent the proliferation of WMD for the period from 2021 to 2025, the National Action Plan for the implementation of United Nations Security Council Resolution 1540 on the prevention of the proliferation of WMD.

Organizational chart of the Banking Supervisory Authority



The NBS performs the function of supervisor for the major part of the Serbian financial sector, and (among the others) is in charge for the prudential supervision of banks, as well as insurance companies, financial leasing companies, voluntary pension fund management companies, payment institutions and electronic money institutions. Furthermore, the NBS is in charge for the supervision of the exchange and foreign exchange operations.

When it comes to performing supervision of the banks, the relevant organizational units are the Bank Supervision Department, the AML Supervision Centre and the Centre for Information Systems Supervision. Also, the Department for Financial Consumer Protection is in charge of consumer protection for: banks, leasing companies, insurance companies, voluntary pension funds management companies, payment institutions or electronic money institutions.

The Bank Supervision Department is in charge of the supervision of banks and financial leasing companies. Please find below the organizational chart of the Bank Supervision Department.

The Bank Supervision Department consists of seven lower-level organizational units: Off-site supervision division (with two lower-level organizational units: Unit for banking sector analyses and supervisory reporting and Unit for accounting and auditing), On-site supervision division, Legal division (with lower-level organizational unit: Unit for licensing), Division for development (with two lower-level organizational units: Unit for supervision development and Unit for banking regulation development), Unit for the supervision of operations of financial leasing operators, Group for development of quantitative models and support to bank supervision and Group for development of applications for bank supervision operations.

Main strategic objectives of the Banking Supervisory Authority in 2021

The regulatory activities of the NBS in 2021 were primarily aimed at the further facilitating the position of citizens and at preserving and strengthening the stability of the financial system.

AML

Main strategic objectives of the Supervisory Authority in Republic of Serbia in the field of prevention of ML/FT, in addition to further improving the quality of supervisory activities, were implementing AML/CFT Strategy through measures and activities contained in the Action Plan for the implementation of this Strategy, and active participation in the process of updating the national AML/CFT risk assessment, as well as creating completely new risk assessments in the digital assets sector and of the financing of proliferation of WMD.

The activities of the Banking Supervisory Authority in 2021

Measures Against Banks

During 2021, in the process of banks supervision, the National Bank of Serbia has taken 50 control procedures.

Licensing and Approvals regarding Banks

In 2021 the National Bank of Serbia granted 128 prior consents regarding acquisition of ownership in banks, merging by aquisition of banks, amendments of banks' founding acts and their articles of association, appointment of managing and executive board members, inclusion in calculation of the common equity tier 2 of element of the capital – subordinated obligation, distributing bank's profit through payment of dividends to its shareholders, acquisition of subordinated company in financial sector, not to include a subordinated company in financial sector in revision of consolidated financial statements, for the bank not to include a subordinated company which is not bank, in revision of annual finacial statements for 2020, inclusion in the calculation of the common equity tier 1 - of the elements of that capital referred to in item 7, paragraph 1, provision under 1) of the Adequate Decision Capital banks by increasing the basic share capital, reducing the value of the elements of the tier 2 capital and for reducing the value of the elements of the tier 1 capital.

Also, the National Bank of Serbia processed 363 notifications from banks regarding outsourcing of their business activities, intended assignment of the bank's claims and of consent to the bank not to include the exposure to a member of the group in the calculation of the limit of large exposures to related parties.

AML

In the area of AML/CFT supervision activities in banks, in 2021 the NBS conducted regular off-site supervisions activities by analyzing bank's responses to submitted questionnaires on their operations in the area of ML/CFT risk management, monitoring of compliance submitted internal acts with AML/CFT regulations, monitoring of internal controls finding etc. Also, in 2021, NBS's, performed targeted AML/CFT on-site controls in 6 banks, and in case of iregularety imposed corrective measures and fines.

In order to strengthen administrative capacity the NBS organised internal trainings for its employees in AML/CFT area. In the same period, the NBS representatives participate in online trainings organised by the FATF, the Council of Europe, the Administration For the Prevention of Money Laundering, the Ministry of European Integration, OEBS etc.

International activities of the authority

The NBS cooperates with foreign regulatory authorities, for the purposes of cooperation and exchange of data (information) with a view to exercising and promoting its supervisory function.

In that respect in 2021, the NBS continued to implement the Memorandums of Understanding (hereinafter: the MoUs) signed with foreign regulatory authorities in the field of banking and insurance supervision.

The NBS has very successful cooperation with all of the home supervisors of the banks whose subsidiaries are conducting its business in Serbia, through the Supervisory colleges, conference calls, joint on-site review etc.

Regarding the competencies of the NBS, which is the central bank in the Republic of Serbia, and the Supervisory Authority of the largest part of the financial system in RS, its general empowerment for the cooperation with foreign central banks and regulatory authorities is defined by the Law on NBS and sectoral laws (such as the Law on Banks).

Despite the possibility of exchanging information without concluded MOUs, the NBS has numerous bilateral and multilateral agreements with Supervisory Authorities from foreign countries.

The NBS most frequently exchanges information with its counterparts about the main findings on performed controls, as well as the information needed in the licensing process.

AML
The Delegation of the RS (consisting of representatives from the Administration for the Prevention of Money Laundering, the NBS and the Ministry of Internal Affairs) participated in the 62th Plenary meeting of the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and Financing of Terrorism of the Council of Europe (MoneyVal).

Cooperation with other supervisory bodies in the country

The NBS successfully cooperates with all Supervisory Authorities in the country whenever there is a need for sharing information in accordance with signed MoUs.

Regarding its supervisory task, National bank of Serbia has signed MoUs with following domestic bodies and authorities: Deposit Insurance Agency, Securities Commission, Administration for the Prevention of Money Laundering, Tax Administration of the Republic of Serbia, Commission for Protection of Competition, Association of Serbian Banks and the Belgrade Stock Exchange.

The NBS successfully cooperates with all before mentioned domestic Supervisory Authorities whenever there is a need for sharing information in accordance with provisions of MoUs signed.

AML
During 2021 the NBS actively participated in the work of the AML/CFT Coordination Body and WMD Coordination Body, which were set up by the Government of the Republic of Serbia to improve coordination and efficiency of cooperation of all actors in the AML/CFT system and in prevention of the proliferation of WMD in the Republic of Serbia.

Thanks to the successful cooperation of all actors in the system in the Republic of Serbia, in 2021 was successfully carried out a national risk assessment (National Money Laundering Risk Assessment, National Terrorism Financing Risk Assessment, Money Laundering and Terrorism Financing Risk Assessment in the Digital Assets Sector and the Risk Assessment of the Financing of Proliferation of Weapons of Mass Destruction).

Other relevant information and developments in 2021

Thanks to the continuous activities that NBS have been carrying out for years, and the awareness of the importance of the areas that we are authorized to control, we were adequately prepared for dealing with new risks, including health risks, as well as the risks arising from geopolitical developments.

The National Bank of Serbia is an example of a responsible institution as a prerequisite for creating a stable environment where risks are assessed in a timely manner and in accordance with local characteristics.

AML

With the aim of fulfilling MoneyVal's recommendations for improving the effectiveness of the system in the Republic of Serbia, for the purposes of drawing up the fourth report on the monitoring of MoneyVal, the NBS, in cooperation with other competent authorities, in February 2021, reported to that body on the activities carried out in the Republic of Serbia in areas of prevention of ML/FT. Those activities were discussed at the 62th plenary session of that body in December 2021.

On 13 December 2021, MoneyVal published on its website information on the assessment of the progress of the Republic of Serbia in the implementation of AML/CFT measures, contained in the Forth Follow-up Report of that body (information and the report can be found at the following link: https://www.coe.int/en/web/moneyval/-/new-moneyval-report-on-serbia-improvements-in-fighting-money-laundering-and-terrorist-financing-have-led-to-upgraded-rating-minor-deficiencies-remain). The statement emphasized that the Republic of Serbia has improved measures to combat money laundering and terrorist financing, showing significant progress (compared to the first report published in 2016) in the level of technical compliance of its system with the FATF recommendations, which raised its rating by three additional FATF recommendations. In this regard, the Republic of Serbia was assessed as "compliant" or "largely compliant" for 39 of the 40 FATF recommendations.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	26	26	23
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**26**	**26**	**23**

Total assets of banking sector (at year-end) in EUR thousand

Type of financial institution	2019	2020	2021
Commercial banks	34,731,173	39,132,130	42,931,356
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**34,731,173**	**39,132,130**	**42,931,356**
y/y change (in %)	**8.77**	**12.67**	**9.71**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	16.8	7.1	7.3
Domestic ownership total	24.3	14.0	13.0
Foreign ownership	75.7	86.0	87.0
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	38.6	56.9	867
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**38.6**	**56.9**	**867**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	9.8	6.5	7.5
Cooperative banks			
Banking sector, total:	**9.8**	**6.5**	**7.5**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables			
Financial sector	13.1	14.4	14.7
Nonfinancial sector	58.2	57.4	58.1
Government sector	17.4	17.0	16.2
Other assets	11.3	11.2	11.0
Liabilites			
Financial sector	9.9	8.7	7.9
Nonfinancial sector	68.9	71.9	74.3
Government sector	2.7	2.5	2.4
Other liabilities	1.3	1.3	1.2
Capital	17.3	15.6	14.3

Capital adequacy ratio of banks

Type of financial institution	2019	2020	2021
Commercial banks	23.4	22.4	20.8
Cooperative banks			
Banking sector, total:	**23.4**	**22.4**	**20.8**

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

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

Asset classification	2019	2020	2021
Non-financial sector, including			
households	3.94	3.61	4.09
corporate	4.37	4.03	3.35

The structure of deposits and loans of the banking sector in 2021 (%)
(at year-end)

	Deposits	Loans
Non-financial sector, including:	94.76	97.74
Households	54.67	46.06
Corporate	35.70	50.45
Government sector	2.43	1.71
Financial sector (excluding banks)	2.81	0.55
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	1,293,036	1,279,362	1,265,118
Interest expenses	197,855	178,702	166,925
Net interest income	1,095,181	1,100,660	1,098,193
Net fee and commission income	357,878	345,342	474,050
Other (not specified above) operating income (net)	95,905	170,478	62,656
Gross income	1,548,964	1,616,480	1,634,899
Administration costs	909,026	918,507	998,805
Depreciation	104,448	114,949	112,989
Provisions			
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	60,011	224,902	96,173
Profit (loss) before tax	575,576	391,928	458,121

Total own funds in 2021 (in EUR thousand)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	5,331,972	5,045,077	5,058,460	273,512	N/A
Cooperative banks					
Banking sector, total:	**5,331,972**	**5,045,077**	**5,058,460**	**273,512**	**N/A**

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

Macroeconomic environment in the country

Gradual recovery from corona crisis in 2021 combined with easing of pandemic-related measures was interrupted by outbreak of the invasion in Ukraine in February 2022. Slovak economy grew by 3% in 2021 and kept this pace also in first quarter 2022, what was, however, far below expectations. Net exports had mixed contribution to the GDP growth, after negative contribution in 2021 caused by supply chain bottlenecks it turned to be positive in last two quarters. Private consumption rose continuously since summer last year, due to their effort to catch up on deferred consumption. Despite these facts Slovak economy stood 0.8% below its pre-pandemic level at the end of 2021. Prices started to accelerate since summer last year, reaching 5.1% at the end of 2021 and 12.6% in June 2022. Especially energy and food prices recorded strong hike. Despite glooming situation, labor market continued in recovery, with unemployment rate decreasing to 6.8% at the end of 2021. Despite rapid growth in nominal wages, increased inflation is cutting of from the real wages. The economic outlook is rather unclear with lots of down side risks depending on evolution of the war conflict in Ukraine.

Development in the banking sector (including assets total / GDP)

Despite economic slowdown expansionary tendencies in the financial sector have gathered further momentum. Retail loan growth has already attained 8.8% in December 2021. Credit growth was predominantly driven by housing loans. Also, loans to NFC sector added to its pace, reaching 4% in December 2021. Assets of Slovak banking sector increased on annual basis by more than 7% amounting 111% of GDP at the end of 2021. Profitability of Slovak banks has recovered after deep slump in corona crisis, however remained on the edge of first quartile in comparison with the EU banks. Good news is that banking sector remained well capitalized even after the corona crisis with the aggregate total capital ratio at 20.1% in the fourth quarter 2021. NPL ratios remained lowered. Pressures on low interest margins are gradually abating due to increase in interest rates. This may moderate strong expansionary pressures on credit market in coming period.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

The National Bank of Slovakia (NBS) was established as the independent central bank of Slovakia on 1 January 1993, under Act no. 566/1992 Coll. On Národná banka Slovenska.

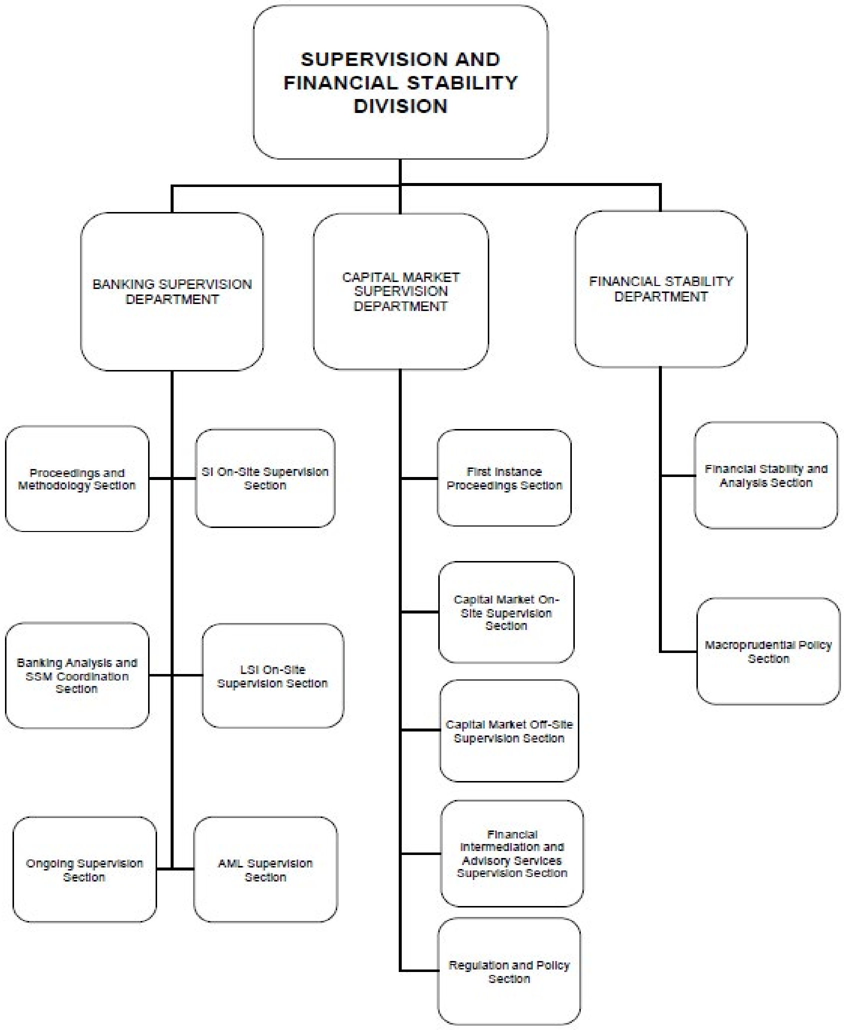
In 2021 NBS carried on with the Eurosystem membership, which includes the European Central Bank (ECB) and the national central banks (NCBs) of those countries that have adopted the euro. NBS had joined the Eurosystem on 1 January 2009, the date on which Slovakia adopted the euro. The NBS Governor continued to be a member of the ECB's Governing Council, the Eurosystem's highest decision-making body. Thus NBS, together with other NCBs and ECB, contributed to achieving the common goals of the Eurosystem. NBS participated in activities of the Eurosystem and the ESCB through its involvement in the Eurosystem and ESCB committees.

As the national Supervisory Authority in Slovakia, NBS has been part of the EU's Single Supervisory Mechanism (SSM) – a mechanism for exercising supervision over credit institutions in participating EU Member States – since the SSM came into operation on 4 November 2014.

The NBS participated in specific supervisory tasks of the ECB through the direct involvement of staff members of the NBS Financial Market Supervision Unit in Joint Supervisory Teams and through cooperation in the drafting of ECB decisions. As regards the supervision of significant banks, NBS exercised supervision over the banks' activities on a daily basis and continuously monitored quantitative data and oversaw risk management processes.

Slovakia's Resolution Council was established in January 2015 as part of the EU's Single Resolution Mechanism – the second of the Banking Union's three pillars – with NBS assigned the role of providing expertise to the Council and organising its functioning.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2021

When setting the priorities of the single supervisory mechanism for the year 2021, it was based, as in previous years, on the assessment of key risks and weak points that the supervised institutions face in the current economic, regulatory and supervisory environment. The ongoing COVID-19 pandemic continued to affect the real economy and is testing the resilience of banks, while its overall impact in the short to medium term cannot be estimated with certainty. The ECB's banking supervision focused the supervisory activities of the SSM on four priority areas, significantly affected by the current pandemic.

a) Credit risk management (adequacy of management, processing, monitoring and reporting of credit risk, creation of provisions, IFRS 9, NPL)

b) Capital adequacy (ICAAP, capital requirements and RWA),

c) Sustainability of business models (business strategy, digitization, profitability, climate and environmental risks),

d) Management (strategy, implementation of the risk appetite framework with a focus on credit risk, data aggregation and reporting).

The activities of the Banking Supervisory Authority in 2021

The year 2021 was also marked by a pandemic. NBS supervision focused mainly on ensuring that the Slovak financial sector remained stable and resilient. The risks directly associated with the corona crisis gradually decreased during the year.

In the banking sector, supervision focused on the adequacy of capital to ensure its resilience and on the stability of banks. Since the beginning of the pandemic, the banks' capital has been increased by more than EUR 800 million., while the capital reserve reached 3.8%. The performance of banks stabilized, but the pressure on their efficiency is increasing in an environment of low interest rates. The annual assessment of the banks confirmed their stability, the banks weathered the crisis period and stabilized their businesses. Banking supervision returned to a full-fledged evaluation of banks and the re-establishment of prudential requirements.

The identified SSM priorities were transformed into the SSM and NBS supervision plan in the form of campaigns focused on credit risk, the sustainability of the business model and profitability. The campaign for internal capital adequacy assessment processes (ICAAP) started in 2020 was also continued. In the field of internal model review, the deadline for implementing changes within the IRB Repair program1 of the European Banking Authority (EBA) resonated, together with the evaluation of corrective measures from the targeted assessment of internal models (TRIM) and changes in the default definition.

International activities of the authority

European structures. Increasing international cooperation in financial markets requires the respective Supervisory Authorities to work more closely together. Thus, through the European System of Financial Supervision (ESFS), the activities of NBS as supervisor of the domestic financial market were closely coordinated with those of other Supervisory Authorities in the EU.

The single supervisory regime works on basis of continual cooperation between the ECB and the national Supervisory Authorities. NBS participated especially in supervisory tasks of the ECB through involvement of NBS staff in Joint Supervisory Teams and in the drafting of ECB decisions during 2021.

In total, banking supervision took part in 7 international supervisions in major banks, also carried out 2 on-site supervisions and a horizontal area review of the application of the so-called "Dear CEO letter" regarding the identification and measurement of credit risk in the context of the pandemic in less significant banks based in the Slovak Republic and 3 on-site inspections in branches of foreign banks, aimed at checking the setting of systems before legalizing income from criminal activity.

As a part of the European system of financial supervision, NBS continued in co-operation with the European Systemic Risk Board (ESRB), the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA). NBS's ongoing cooperation with the EBA focused, in 2021, on the drafting of implementing technical standards (ITSs), regulatory technical standards (RTSs) and guidelines required under the EU's Capital Requirements Regulation and Directive (CRR/CRD IV) and related legal acts. NBS cooperated with the EBA at all levels of competence, from working groups to the highest approval bodies.

In 2021, the Brussels-based Single Resolution Board (SRB) and the Resolution Council, as the national resolution body, continued on preparations to handle the resolution of the potential crisis situations. The Council and the SRB worked together with the banks as a matter of priority to improve the resolvability of the possible crisis situations in the area of operationalization of the capitalization resolution tool ("bail-in playbooks"), management information systems (MIS) and liquidity and financing in the resolution.

Cooperation with other supervisory bodies in the country

One of the main priorities of the Ministry of Finance of the Slovak Republic and NBS in 2021 was the transposition of the EU Covered Bonds Directive into the Banking Act. The directive harmonizes the European market with covered bonds, which are to be among the main financial instruments for economic recovery in the EU in the post-covid period, as well as in the recovery program – Next Generation EU. It brings new types of covered bond programs to the Slovak banking market, which opens up new business opportunities and risk diversification for banks issuing covered bonds. Issuers (banks) will be able to issue covered bonds also secured by underlying assets, which could not be used until now. On the other hand, protection for investors is strengthened in the form of new rules for the supervision of covered bonds as well as for transparency, as a result of which they will have more regular and detailed information about the development and status of their investments.

The second important area of cooperation was the working coordination with the Ministry of the Interior of the Slovak Republic, specifically with the financial intelligence unit. NBS expert teams from the entire supervisory department participated in the evaluation of the implementation of the fourth EU AML directive. The manager of the project was the financial intelligence unit of the Presidium of the Slovak Police. The NBS participated in the evaluation of the implementation of those parts of the directive in which it has competence and responsibility as a financial market supervisory body. The assessment visit of Council of Europe experts took place in November 2021.

Other relevant information and developments in 2021

Despite the pandemic, NBS worked intensively to support innovation and fintech. A regulatory sandbox was being prepared - a platform that allows the participant, based on consultations with the NBS, to set up a financial innovation in accordance with the regulation and practically test it on real clients on the Slovak financial market.

Due to the strong financial cycle, the NBS is relatively active in the field of macroprudential policy. NBS made several detailed analyses aimed at a deeper understanding of loan growth and possible risks, as well as the residential real estate market. The analyses were mainly based on the assessment of the financial situation of individual clients in the banks' portfolios.

Taking environmental, social and governance risks into account is also becoming a new trend in the management and supervision of banks. As part of the supervision carried out, the NBS monitors compliance with the new rules, the aim of which is to increase transparency in connection with the inclusion of risks threatening sustainability.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	12	12	11
Branches of foreign credit institutions	15	15	15
Cooperative banks	0	0	0
Banking sector, total:	**27**	**27**	**26**

Total assets of banking sector (in EUR thousands) (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	73 968 089	79 617 275	91 400 102
Branches of foreign credit institutions	10 697 315	12 018 938	13 408 401
Cooperative banks	-	-	-
Banking sector, total:	**84 665 404**	**91 636 213**	**104 808 503**
y/y change (in %)	**5.8%**	**8.2%**	**14.4%**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	0,66	0,60	0,50
Domestic ownership total	0,32	0,23	0,18
Foreign ownership	99,02	99,17	99,32
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	71.2%	89.4%	1927
Branches of foreign credit institutions	68.6%	82.7%	2811
Cooperative banks	-	-	-
Banking sector, total:	**62.1%**	**79.3%**	**1511**

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

Type of financial institution	2019	2020	2021
Commercial banks	8.73%	5.94%	9.03%
Cooperative banks	-	-	-
Banking sector, total:	**8.73%**	**5.94%**	**9.03%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	87.4%	86.9%	87.2%
Branches of foreign credit institutions	12.6%	13.1%	12.8%
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables	100.0%	100.0%	100.0%
Financial sector	11.4%	13.8%	19.1%
Nonfinancial sector	74.1%	72.1%	67.7%
Government sector	12.1%	12.0%	11.5%
Other assets	2.5%	2.2%	1.6%
Liabilites	92.0%	92.0%	92.7%
Financial sector	17.3%	16.8%	23.1%
Nonfinancial sector	67.9%	68.3%	62.6%
Government sector	2.5%	2.5%	2.6%
Other liabilities	4.3%	4.4%	4.4%
Capital	8.0%	8.0%	7.3%

Capital adequacy ratio of banks (%)

Type of financial institution	2019	2020	2021
Commercial banks	18.21% ***	19.67% ***	19.81% ***
Cooperative banks	-	-	-
Banking sector, total:	**18.21% *** **	**19.67% *** **	**19.81% *** **

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

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

Asset classification	2019	2020	2021
Non-financial sector, including	2.91%	2.57%	2.17%
households	2.85%	2.43%	2.02%
corporate	3.46%	3.32%	2.95%

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	92.89%	91.53%
Households	69.29%	63.23%
Corporate	23.6%	28.3%
Government sector	4.15%	2.11%
Financial sector (excluding banks)	2.95%	1.48%
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	1 986 132	1 871 379	1 835 867
Interest expenses	264 094	216 578	218 290
Net interest income	1 722 038	1 654 801	1 617 577
Net fee and commission income	621 842	622 313	658 438
Other (not specified above) operating income (net)	-192 614	-189 565	-73 110
Gross income	2 231 211	2 234 502	2 380 994
Administration costs	1 151 047	1 116 811	1 127 773
Depreciation	165 520	162 123	167 750
Provisions	135 361	348 051	125 014
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	148 516*	312 697*	113 116*
Profit (loss) before tax	804 393	602 172	930 408
Net profit (loss)	636 027	469 916	738 157

*Note: * Data for Commercial banks only, according to FinRep Profit and Loss Account, for years 2019-2021.*

Total own funds in 2021 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	7 682 289 134	6 607 519 978	7 087 519 978	594 769 155	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**7 682 289 134**	**6 607 519 978**	**7 087 519 978**	**594 769 155**	**-**

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

Macroeconomic environment in Slovenia

After a sharp decline in GDP during the pandemic crisis of 2020, Slovenia recorded its highest economic growth to date. GDP rose by 8.1% in 2021, 2.8% percentage points more than the euro area average. The growth was mainly driven by private consumption, which recovered strongly as soon as the most-stringent containment measures were relaxed. Private consumption increased by 11.4% last year and exceeded even the pre-pandemic levels in 2019. Firms survived the pandemic crisis well, given their high build-up of savings. Along with the favourable financing conditions and the robust demand, firms invested heavily last year, and were joined in doing so by the government. Through sharp growth in foreign demand for the Slovenian export sector, the strong recovery in the global economy prompted a 13.2% real increase in exports. Since domestic demand was even stronger, real growth in imports amounted to 17.4%, and net trade thus made a negative contribution to GDP growth. Amid minor adverse effects from disruptions to global supply chains, value-added was up 9.7% in industry, and up 9.6% in private-sector services, despite the containment measures in international tourism and other recreational services.

Developments in the banking sector

The number of credit institutions in Slovenia, which has been falling in recent years, remained unchanged last year – there were 16 of them. At the end of 2021 there were 11 banks, three savings banks and two branches of foreign banks operating in Slovenia. Banks dominate the banking system, with a market share of 91.1%, while savings banks held a share of 5.2% and branches of foreign banks a share of 3.7%. The trend of a falling number of banking institutions will presumably continue, since the largest banking group acquired a small bank in the beginning of March 2022.

The banking system's balance sheet total increased by 8.1% in 2021 to EUR 48.3 billion. The main factor on the funding side were deposits by the non-banking sector, which have increased the most, namely by EUR 2.9 billion. On the investment side the increase was once again most evident in the most-liquid forms of assets, i.e. claims against the central bank, which increased by EUR 2.7 billion. The ratio of the banking system's balance sheet total to GDP dropped last year to 92.8%, down 2.4 percentage points amid the increase in nominal GDP and balance sheet total growth.

Lending to the non-banking sector strengthened throughout 2021. Year-on-year growth peaked to 6.3% in December, even though it was still negative in the first quarter of 2021. Growth in housing loans remained stable in the first quarter of 2021, but on the back of favourable terms of financing and a downward trend in fixed interest rates in particular, it reached the highest level in the last ten years in December, at 9.1%. A reduction in the growth of consumer loans, which started after the introduction of binding macroprudential restrictions on household lending in November 2019 and became intensive with the outbreak of the pandemic, dropped by 8.6% year-on-year in February 2021. The decrease continued throughout the year, as the volume of repayment of existing loans compared to the volume of newly granted loans was considerably higher. Lending to non-financial corporations has slowed down rapidly following the start of the pandemic, even though firms on average entered the adverse economic situation in good financial shape, and adapted their operations to maintain liquidity while deferring planned investments. After March 2021, when the year-on-year growth hit bottom with -3.6%, loans to non-financial corporations recovered swiftly and increased to 6.3% by December.

NPEs continued to decrease in 2021. In the non-financial corporations (NFC) portfolio, the NPEs dropped faster in 2021 to stand at 2.3%. The accommodation and food service activities stood out as the only activities with an increasing share of NPE, and not only in 2021 but throughout the pandemic period over two years the share of NPE in these activities increased to 13.2%. Such a significant increase in spite of the largest share of deferred loans among activities shows that the pandemic support measures only managed to mitigate but not prevent the deterioration of the asset quality due to the limitations on the operations of these activities. After rising in the first half of the year, the NPE ratio in the consumer loans portfolio stabilised at 3.7% in the second half, while housing loans stayed on a downward trend in 2021 as well, until reaching 1.6% in December.

The banking system's capital position remained solid last year, but there are still considerable variations from bank to bank as regards resilience to systemic risks. The total banking system capital adequacy ratio increased by 0.1 percentage points to 18.4% on a consolidated basis in 2021, remaining below the euro area average, while the common equity Tier 1 capital ratio increased by 0.2 percentage point to 16.9%, still exceeding the average of the euro area. The capital adequacy ratios of some banks dropped. These are the banks in which strengthened lending to non-financial corporations and households caused increase in the risk-weighted assets that outpaced the increase in regulatory capital. The latter increased due to the macroprudential restriction of distributing bank profits and by retaining profits from past operations, which remains an important factor in maintaining stable capital adequacy.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of Banka Slovenije

Banka Slovenije is a member of the Single Supervisory Mechanism (SSM), one of the three pillars of the EU banking union, which complements the economic and monetary union (EMU) and the single market by coordinating the responsibility for bank supervision, resolution and funding at the EU level, ensuring a level playing field for banks across the euro area. Alongside the SSM, which has been in operation since November 2014, the other two pillars consist of the Single Resolution Mechanism (SRM) since January 2015, and the European Deposit Insurance Scheme (EDIS), which is still being established.

The establishment of the SSM saw supervision of significant institutions (SIs) in the EU transferred to the ECB in 2014, although this supervision is conducted in operational terms via joint supervisory teams (JSTs). The JST for each bank consists of a coordinator from the ECB, and members from the national Supervisory Authority and the ECB. The national Supervisory Authorities (the Bank of Slovenia in Slovenia's case) participate in all the supervisory activities, while the supervisory decisions with regard to these banks are made by the ECB. The supervision of banks and savings banks that do not meet the criteria for being classed as significant institutions, i.e. less significant institutions (LSIs), is conducted by national supervisors, in accordance with national and EU legislation, having regard for the rules and methodology of the ECB and SSM. National supervisors regularly submit supervisory data for less significant institutions to the ECB, and inform it of the material findings of their supervision. The new arrangements allow the ECB to directly take over the supervision of less significant institutions at the proposal of the national supervisor, at its own initiative in the event of the potential occurrence of a systemic crisis, or if the national supervisor is failing to conduct adequate supervision.

According to the Bank of Slovenia Act (ZBan-3) the central bank carries out supervision of credit institutions in order to maintain the stability and security of their operations, and to maintain confidence in the banking system among savers and depositors. In accordance with the statutory mandate of the Banking Supervision of the Bank of Slovenia tasks include the performance of licensing (i.e. authorisation and notification procedures for the work of the institutions, giving consent for members of management boards, and other authorisations and consents prescribed by The Banking Act), the performance of on-site inspections in banks, collecting and analysing quantitative and qualitative information from supervised entities and other sources, cooperation with other supervisors in the country and outside, active participation at international supervisory forums, working groups and colleges.

Banka Slovenije also participates in the activities of the European Banking Authority (EBA), an independent EU authority, whose purpose is ensuring effective and consistent prudential regulation and supervision in the European banking sector by putting in place a single European banking rulebook. The vice-governors of Banka Slovenije are members of the most senior decision-making bodies of the EBA, whereas our representatives collaborate with permanent committees and numerous working groups to contribute to drafting and implementing regulatory technical standards, guidelines and recommendations aimed at ensuring a uniform method of implementing rules and standardising of supervisory practices.

Organizational chart of Banka Slovenije

Main strategic objectives of Banka Slovenije in 2021

We set the following supervisory priorities in 2021, which also formed the starting point for the supervision of Slovenia's banks:

1. credit risk management:

- early detection of the deterioration of asset quality;
- adequate creation of impairments;
- management of non-performing assets including identification and management of exposures to vulnerable sectors;

2. capital strengthening:

- adequacy of dividend distribution policy;
- planning of capital in unfavourable and changing conditions;
- supervisory stress tests;

3. business model sustainability:

- supervision and liability of bank managements;
- sustainability of business models and business strategy;
- digitalisation strategy and bank progress;

4. management:

- crisis management framework and stability in a time of crisis;
- information management and aggregation;
- management of IT and cyber risks and outsourcing.

In 2021 we returned to the implementation of SREP in common and comprehensive scope, after using a pragmatic approach in 2020 in view of the Covid-19 epidemic. In accordance with the previous SREP cycle and the priority tasks from the 2021 supervision, most of the measures were related to credit risk deficiencies (the process of identifying and processing of groups of related persons, limit system, monitoring and reporting process, probability of default process) and internal governance (internal control functions and functioning of supervisory boards).

The activities of Banka Slovenije in 2021

At times of increased uncertainty, including the Covid-19 epidemic, credit risk management – and above all the identification, classification and measurement of credit risk in a suitable and timely manner – was crucial for assuring that banks were able to provide quick and feasible solutions to debtors in distress. We presented the supervisory expectations in this respect to the banks within the framework of ECB and BS. In 2021 we assessed the banks' risk management practices in line with these expectations, and found that there is still room for improvement in the future. The main expected improvements are related to early warning systems, classification (including the assessments of deviation and probability of payment) and to the practices of establishing impairments. The identified issues are of a structural nature and are important in the context of the Covid-19 epidemic as well as in normal times.

In 2021 we continued with thematic reviews in the area of IFRS 9 in three less significant banks. The objective of the reviews was to establish the adequacy of the identification of a significant increase in credit risk and the inclusion of forward-looking information in the calculation of expected credit losses. Deficiencies were identified in both areas, and measures were imposed on the banks that were subject to the review. An enhanced due diligence of IFRS 9 was conducted in one of the significant banks.

Eight planned prudential inspections in less significant banks have been conducted, namely two in the area of operational risks, two in the area of managing the internal capital adequacy assessment process (ICAAP), two in the area of interest rate risk and two in the area of credit risk.

Following the publication of the ECB Guide on climate-related and environmental risks in the framework of the ECB we asked all significant banks to make an assessment considering those expectations and submit their action plans with details on how they would align their practices with the expectations. The supervisory assessment showed that more comprehensive activities will have to be implemented by banks in this area in order to meet all the supervisory expectations, even though the banks have adopted the initial steps to include the climate-related risks in their risk management practices. We also reviewed the disclosures of climate and environmental risks of significant banks. Banks were sent feedback with expectations to improve disclosures. In 2022 we will continue the work in the area of climate and environmental risks, namely in the form of thematic reviews and stress tests.

At the end of 2020 the banks again submitted updated recovery plans, which were reviewed and assessed in accordance with Article 220 of the Banking Act.

As part of our prudential supervision we also granted several different authorisations in connection with the exclusion of a subsidiary from prudential consolidation, the inclusion of capital instruments in the calculation of additional capital, the acquisition of a qualifying holding, migration to the standardised approach for the calculation of capital requirement for credit risk, reduction of capital without substitution and ex-emption from the approval of financial holding and approval of financial holding.

Supervision of the operations of the two branches of foreign banks and banking groups from other Member States (one from Austria and one from France) was conducted via regular reports, requests for additional clarification, and the monitoring of the liquidity positions.

International activities of Banka Slovenije

European Union
There were two informal meetings of the ECOFIN (the EU's council of economics and finance ministers, joined by the EU central bank governors) in 2021. The first meeting was held in Lisbon and the second took place in Brdo pri Kranju as part of the Slovenian Presidency of the EU Council. On that occasion, Banka Slovenije held a working lunch at which it hosted the President of the ECB and the governors of the EU national central banks.

In 2021 the Economic Financial Committee (EFC) addressed the growing prices of energy and inflationary pressures, as well as matters related to finalising the banking union, establishing a union of capital markets and financing the recovery instrument *NextGenerationEU*. It also discussed the current proposed legislative packages of the European Commission (preventing money laundering, Basel III, the capital markets union) and issues related to international meetings on the global level.

International Monetary Fund;
Slovenia is a member of the IMF, and the Governor of Banka Slovenije is a member of the IMF Board of Governors. Slovenia's quota at the IMF stood at 586.5 million SDRs at the end of 2021, or 0.12% of the total IMF quota. A Banka Slovenije delegation attended the annual and spring meetings of the IMF and the World Bank in 2021. While the spring meeting took place virtually, the Banka Slovenije delegation attended the meeting in October 2021 in Washington, as it was carried out in a hybrid format. The main topics of the meetings were current developments in the global economy and on international financial markets, the outlook and the potential policy responses in light of the pandemic, and measures to alleviate its impact on the global economy.

Bank for International Settlements;
The Governor of Banka Slovenije attends meetings of central bank governors of members of the Bank for International Settlements, which are held every two months. The meetings discuss developments in the global economy and on the financial markets. The governors' meetings are also an opportunity to exchange views on various central banking issues, in 2021 most notably on managing foreign exchange reserves and central bank risks, tackling climate change, methods of work after the pandemic and multilateral payment systems.

Organisation for Economic Co-operation and Development;
Banka Slovenije representatives attended sessions of certain committees and working groups of the Organisation for Economic Co-operation and Development (OECD). They participated in virtual meetings of the Committee on Financial Markets, the Working Group on International Investment Statistics, the Working Party on Financial Statistics, and the Working Party on International Trade in Goods and Services, and provided information for the Working Party on SMEs and Entrepreneurship.

Technical assistance;
In 2021 as part of the technical assistance received from the European Commission under the auspices of the programme to support structural reform, work was completed on assistance in setting up an effective system of data management, and work continued in relation to upgrading the tool for analysing bank business models. Under the auspices of the European Commission technical assistance instrument, which replaced the programme to support structural reform, work began on analysing the payments market in Slovenia. Banka Slovenije staff take part in programmes of technical assistance to other central banks and supervisory institutions. In 2021 they provided assistance to the central bank of Montenegro in the area of resolution of credit institutions.

Cooperation with other supervisory bodies in Slovenia

Financial Stability Board;
Slovenia's Financial Stability Board (FSB) again discussed systemic risks in 2021, and was briefed on supervisors' macroprudential measures and actions taken to meet the ESRB's recommendations. There were no new reports issued in 2021, but the implementation of already issued recommendations was regularly monitored. Other topics addressed by the Board were the government initiative to change the arrangements for macroprudential supervision of non-banking providers of credit to households, a review of the issue of voluntary pension insurance and establishing the co-presidency and updating the mandate of the FSB Working Group for fintech and cybersecurity. In scope of the FSB Working Group for fintech and cybersecurity, special attention was devoted to the issue of cybersecurity in the wider financial system, and in the scope of FSB Working Group for climate risk, the transition risk in the banking system and in insurance companies was assessed.

Committee for Cooperation between Supervisory Authorities;
Banka Slovenije representatives took part in four meetings of the Committee for Cooperation between Supervisory Authorities (Banka Slovenije, Ministry of Finance, Securities Market Agency, Insurance Supervision Agency) in 2021. The meetings discussed the following:

- legislative innovations in the financial realm;
- joint inspections and major individual inspections by Supervisory Authorities at supervised entities;
- the main decisions and debates of the EBA's Board of Supervisors and the SSM, the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA);
- the consequences of the Covid-19 crisis on the financial sector and Supervisory Authorities;
- other subjects of relevance to Supervisory Authorities, the financial sector and users of financial services (e.g. the pan-European personal pension plan).

National Payments Council;
In scope of National Payments Council, the project of analyzing the payments market in Slovenia has started in 2021. The aforementioned project is financed with funds in the European Commission call for support for reforms under the instrument for technical support for EU Member States. In relation to combat grey economy in Slovenia, proposed measures in connection with methods of payment that incorporate the experiences of other countries and address current events in the area of payments in the EU are being compiled.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	15	14	14
Branches of foreign credit institutions	2	2	2
Cooperative banks	0	0	0
Banking sector, total:	**17**	**16**	**16**

Total assets of banking sector (at year-end) (in thsd EUR)

Type of financial institution	2019	2020	2021
Commercial banks	39.593.306	42.817.107	46.471.250
Branches of foreign credit institutions	1.619.485	1.833.974	1.780.304
Cooperative banks	0	0	0
Banking sector, total:	**41.212.791**	**44.651.081**	**48.251.554**
y/y change (in %)	**6,3**	**8,3**	**8,1**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	21,9	12,7	12,9
Domestic ownership total	29,9	21,0	21,9
Foreign ownership	70,1	79,0	78,1
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	57,0	71,1	0,1493
Branches of foreign credit institutions	/	/	0,7885
Cooperative banks	/	/	/
Banking sector, total:	**54,9**	**68,4**	**0,1395**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	12,2	9,6	11,3
Cooperative banks	/	/	/
Banking sector, total:	**10,9**	**10,4**	**11,3**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	96,1	95,9	96,3
Branches of foreign credit institutions	3,9	4,1	3,7
Cooperative banks	/	/	/
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables			
Financial sector	12,1	12,0	11,4
Nonfinancial sector	53,1	49,3	48,9
Government sector	19,1	17,3	14,2
Other assets	15,7	21,4	25,5
Liabilites			
Financial sector	6,8	5,3	3,6
Nonfinancial sector	72,9	74,7	75,0
Government sector	2,5	2,1	2,1
Other liabilities	5,7	7,1	8,9
Capital	12,0	10,8	10,5

Capital adequacy ratio of banks

Type of financial institution	2019	2020	2021
Commercial banks	18,5	18,3	18,4
Cooperative banks	/	/	/
Banking sector, total:	**18,5**	**18,3**	**18,4**

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

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

Asset classification	2019	2020	2021
Non-financial sector, including	2,2	1,9	1,2
households	2,1	2,1	2,1
corporate	4,7	4,1	2,2

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	93,8	88,2
Households	65,4	45,5
Corporate	28,4	42,8
Government sector	2,8	6,6
Financial sector (excluding banks)	3,4	5,1
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	789.969	753.991	737.182
Interest expenses	107.256	114.873	112.034
Net interest income	682.708	639.117	625.150
Net fee and commission income	333.821	329.682	377.286
Other (not specified above) operating income (net)	239.574	392.924	205.210
Gross income	1.256.077	1.360.072	1.205.628
Administration costs	639.681	646.494	654.430
Depreciation	69.618	71.953	62.657
Provisions	-4.282	13.778	-12.740
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-41.447	155.811	-60.922
Profit (loss) before tax	592.509	472.033	562.198
Net profit (loss)	530.501	450.343	525.296

Total own funds in 2021 (in thsd EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	5.560.676	5.113.790	5.119.740	440.937	/
Cooperative banks	/	/	/	/	/
Banking sector, total:	**5.560.676**	**5.113.790**	**5.119.740**	**440.937**	**/**

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

Macroeconomic environment in the country

2021 has been a year that our country's economy and financial markets have undergone the influence of global economic problems. First of all, the economic constriction caused by the Covid-19, which started in the first months of 2020, and the supply chain problems that followed, adversely affected our country as well as the whole world. In the following period, the inflationary process triggered by the expansionary policies implemented to reduce the effects of the pandemic caused the global commodity and energy prices to rise excessively. Tight monetary policies implemented by developed countries to combat inflation led to capital movements, especially capital outflows from developing countries. By the end of 2021, no significant improvement has yet been observed regarding the resolution of the aforementioned global economic fluctuations. In addition, the military action initiated by Russia against Ukraine in February 2022 has led to potential negative effects on the economy, as well as the problems in the global supply chain and inflation, and political tensions. All these developments indicate that it is necessary to be cautious and proactive against the risks that may arise in terms of our country's economy and financial markets in 2022.

Economic activity followed a strong course in the first quarter of the year, and GDP grew by an annual 7.3% and a quarterly 2.2%. In this period, the added value of services made a limited contribution to growth due to coronavirus restrictions, while final domestic demand slowed due to private consumption amid tighter financial conditions, and total investments and net exports contributed positively to quarterly growth. In the second quarter of the year, economic activity was somewhat slower due to the restrictive effects of pandemic measures and the tightening in financial conditions. However, due to the strong base effect, annual growth amounted to 21.9%. With the normalization steps that started in June and the strong industrial sector benefiting related items, both final domestic demand and net exports, especially private consumption, contributed to quarterly growth on the expenditures side. Economic activity remained strong in the third quarter on the back of the reopening and buoyant external demand. In this quarter, GDP grew by 7.5% year-on-year and 2.8%[1] quarter-on-quarter. Meanwhile, the increased contribution from domestic demand was driven by private consumption expenditures due to the reopening-induced rapid recovery in sectors that were hit by the pandemic (retail trade, accommodation, catering services, etc.). In the last quarter, the driver of growth was final domestic demand led by private consumption, while net exports continued to contribute to growth, and GDP grew by an annual 9.1% and a quarterly 1.5%. Overall, GDP increased by 11% in 2021 and remained above its long-term trend. Private consumption made a large contribution to growth during 2021, while the contribution of net exports to annual growth was around 5 points thanks to strong external demand conditions throughout the year, but stocks had a limiting effect on annual growth.

Development in the banking sector (including assets total / GDP)

The Turkish financial system is dominated by the banking sector, which represents about 88,1[1] percent of total financial sector assets. As of the end of 2021, 55 banks were operating in Turkey, including 15 investment and development banks, 6 participation (Islamic) banks, and 34 commercial deposit banks, of which 3 were state banks, 8 were private banks, 21 were foreign banks and 2 were Saving Deposit Insurance Fund (SDIF) banks. The asset share of local private banks and foreign banks stood at 30.7% and 25.9%, respectively, as of 2021 year-end, increased by 29.7% and 25.1% YoY, respectively. During that period, the asset share of state banks decreased from 45.3% to 43.4% in 2021. As of year-end 2021, the total assets to GDP ratio for the Turkish Banking Sector (TBS) is at 143,6%.

In 2020, the global COVID-19 pandemic has caused significant market disruptions mainly due to pandemic-driven volatilities in global financial markets and the deterioration in expectations. To remedy pandemic-related

[1] BRSA 2021 Annual Report

disruptions, expansionary monetary policy and government-guaranteed credit schemes (Credit Guarantee Fund) were enacted, mostly led by state banks. In this context, the BRSA took a series of new measures to support the banking sector and accordingly the economy. The aim was to maintain the operationality of credit channels and support SMEs and households in need of working capital and liquidity, respectively, while promoting financial stability. Thanks to these measures, loan growth (particularly led by state banks) accelerated significantly and economic recovery was more evident especially in the 3rd quarter of 2020. Then, CBRT started to tighten monetary stance gradually in that quarter due to inflationary concerns, along with simplified monetary policy framework. In the first three quarters of 2021, the slowdown in loan growth was mainly driven by commercial loans, while retail loans posted a stronger growth performance. Especially in the last quarter of 2021, with the decline in the policy rate, loans started to increase and the total FX adjusted annual loan growth was realized at 13% as of the end of year 2021.

The volume of loans reached to USD 370.9 billion which constitutes 53.2% of banking sector's total assets as of December 2021. The annual decrease in total loans has stemmed from depreciation of TL. Also, the loan growth slowed down mainly due to the increase in interest rates for most of 2021. However, TL-denominated loans increased by 20.4% in 2021.

In terms of asset quality, relatively low level of new NPL inflow compared to previous year because of measures related to restructuring, changes in overdue criteria and loan deferrals, the significant increase in the loan volume and TL depreciation against major currencies helped decline in the NPL ratio from 5.4% in 2019 year-end to 3.2% as of December 2021. Moreover, the improvements in the cash flow of the companies and the debt payment capacity of the households have supported the NPL collection. As of December 2021, the provisioning rate for stage 2 category loans and non-performing loans, realized at 17.7% and 79.7%, respectively, implied 200bps and 480bps rise in provisioning rate in annual terms.

The capital structure of the banking sector remained strong. As of December 2021, the capital adequacy ratio (CAR) is 18.4% and 640 bps higher than 12% target ratio. Moreover, Common Equity Tier 1 ratio is 13.4%, and well above applicable regulatory thresholds. In addition, forbearance measures regarding the calculation of the CAR and capital injection to state banks have positively affected the CAR. Even without forbearance effects (2.9 points), the sector had an adequate CAR of 15.5% as of December 2021.

The resilience of the banking sector against liquidity shocks continues. The current liquidity coverage ratios (LCR) of the sector calculated for total and FX are far above the regulatory limits. Furthermore, a high rollover ratio of external borrowing has been maintained at the current stage. The banks have sufficient liquidity buffers against any liquidity needs. As of December 2021, the FX LCR of the sector was 397.7% while the total LCR level was 181.4%. Besides, the high quality liquid assets to total assets in total was over 20% as of December 2021.

For Turkish banks, the main funding source is deposits (57.6% of total liabilities). Total deposits reached to USD 397.9 billion, and FX deposit constitutes 64.5% of total deposits as of December 2021. Funds from abroad were around USD 80.9 billion and constitutes 11.7% of total liabilities, including repos, deposit, loans and syndication and securitization loans. External borrowing trends of TBS are closely monitored by the BRSA. Even in the most difficult times, Turkish banks have generally maintained a rollover ratio exceeding 80% in syndications. The sector's rollover ratio of the syndications is above 100% as of December 2021.

Although the pandemic caused short-term fluctuations in banks' profits, as of December 2021, the net profit of the TBS increased by 59% annually. Banking sector preserved its high profitability, which helped to build sufficient capital buffers. As of December 2021, NIM was 3.8%, ROA was 1.3% and ROE was 15.5% for the banking sector.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

Banking Regulation and Supervision Agency (BRSA) with the authority given by the Banking Law No. 5411 (The Banking Law) regulates and supervises banks (commercial-deposit banks, investment and development banks and participation banks and the branches in Turkey of such institutions established abroad), financial holding companies, financial leasing companies, factoring companies, consumer financing companies, asset management companies and savings finance companies. Moreover, BRSA authorizes independent audit, rating, valuation and outsourcing firms that give service to supervised institutions.

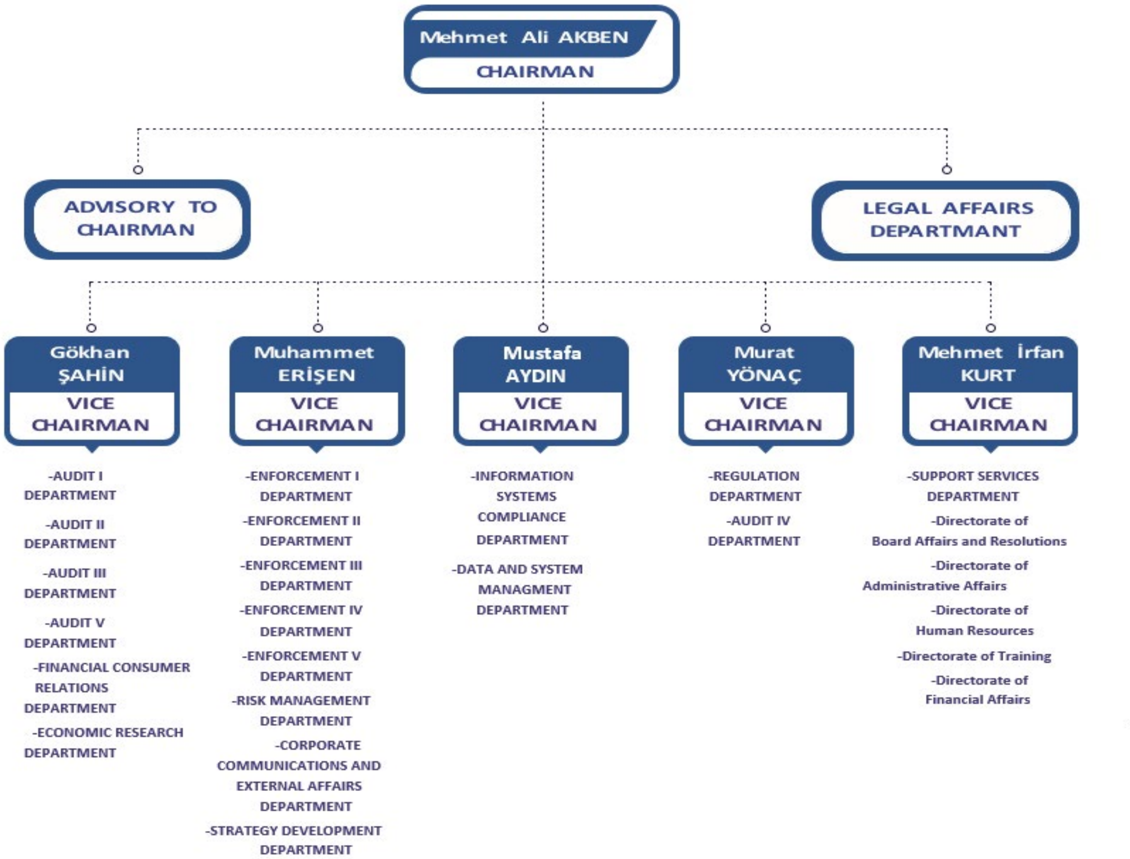
Within the scope of the Law on Bank Cards and Credit Cards, the institutions willing to establish card systems, issue bank cards and credit cards, exchange information on card holders, and engage in clearing and settlement activities are also regulated by BRSA. In addition, BRSA is empowered to authorize and terminate the activities, temporarily or permanently, of institutions that performs the independent audit, valuation, rating and outsourcing activities for banks.

In 2021, a legal arrangement was made that expands the jurisdiction of BRSA. In this context, Law No. 6361 was amended by Law No. 7292 dated 04.03.2021 and renamed as "The Law on Financial Leasing, Factoring, Financing and Savings Financing Companies". With the aforementioned Law, to regulate and supervise savings financing activities and companies; mentioned companies engaged in such activities have been brought under the supervision and surveillance framework of the BRSA. A separate type of license has been created for these companies; persons or institutions other than those who were licensed are prohibited from using the savings financing system and set sanctions so it is aimed to protect customers and collected funds with restrictions on license terms with respect to permitted activities, organizational structures, equity and liquidity of companies. In addition, the "Regulation Governing the Incorporation and Operating Principles of Saving Financing Companies", prepared in line with the amendments made in the Law No. 6361, was published in the Official Gazette dated 07.04.2021 and entered into force. Likewise, amendments have been made in the relevant regulations to regulate the accounting practices, financial statements and uniform charts of accounts of savings financing companies.

Acting as the responsible institution in the field of regulation and supervision of a significant portion of the financial sector the BRSA plays an important role in the Turkish economy in terms of ensuring financial stability, developing the industry, strengthening the framework for practices and regulations, protection of the rights and interests of depositors, and developing an effective financial system and a strong banking industry by increasing the corporate capacity.

On-site audit process carried out by the Agency is established so as to provide a risk-oriented, dynamic, efficient and future-oriented audit approach by taking into account the international best practices including the Core Principles for Effective Banking Supervision of the Basel Committee. Audit process is reviewed and revised regularly in order to ensure it suits the characteristics of Turkish banking industry, and compliant with the latest developments and best practices in banking audits. The most recent study was completed by the end of 2016, and audit guidelines that were updated based on audit approach recommendations set forth in 2016 Financial Sector Assessment Program (FSAP) Report conducted by the IMF and the World Bank were put into force in 2017 upon approval of the Agency Presidency.

Organizational chart of the Banking Supervisory Authority



Main strategic objectives of the Banking Supervisory Authority in 2021

BRSA's main strategic objective is to ensure market efficiency, with aiming full functioning credit system, protecting depositor's rights and improving financial markets.

Major strategic objectives of BRSA can be summarized as;

- Diminishing the effects of Covid-19 Pandemic on economy and financial sector,
  The flexibility provided in the regulations within the scope of the measures taken to reduce the economic and financial effects of the Covid-19, which emerged in 2020, was gradually lifted in 2021, taking into account the course of the pandemic.
- Increasing the solvency of companies,
- Enhancing continuity plans of banks,
- Encouraging banks to keep their credit channels open,
- Improvement of prudent approach based effective management of risks,
- Improving the capacity to analyze systemic fragilities,
  Improving the capacity to analyze systemic fragilities, In line with the digital transformation in the world and in our country, establishing the legislative infrastructure for digital (branch-free) banking and banking as a service model, encouraging financial innovation, increasing financial inclusion and facilitating access to banking services are emerging as priority targets.

- Strengthening corporate structures of factoring companies and investment banks,
- Developing the participation banking and interest-free finance,
- Supporting the ecosystem needed for development of green finance and increase of our country's share in the international green finance,
- Supporting the development of sustainable finance framework
  In 2021, important steps were taken in order to develop sustainable banking in our country and to establish the related risk management infrastructure. With the studies carried out regarding the sustainable banking, it is aimed to contribute to the financing of the green economic transformation in order to achieve the carbon emission reduction targets within the scope of the Paris Agreement and to comply with the conditions created by the EU Green Deal.
  In 2022, within the scope of the Sustainable Banking Strategic Plan, it is aimed to establish a data infrastructure with the required quality and scope for the analysis of financial risks based on climate change and to increase the climate risk management capacity of banks.

The activities of the Banking Supervisory Authority in 2021

The draft Regulation that was prepared in order to encourage financial innovation and competition in the banking sector, to increase financial inclusion and to facilitate access to banking services, the operating principles of branchless banks that only serve through digital channels and determination of the conditions for providing banking services to financial technology companies and other enterprises as a service model, to contribute to the solid development of the financial sector and the national economy, was finalized by taking the opinions and evaluations of all relevant stakeholders and entered into force after being published in the Official Gazette dated 29.12.2021 and numbered 31704. The aforementioned Regulation has enabled digital banks that will only serve through digital channels, without any branches, and numerous innovative business models through banking as a service model. In this context; it is considered that they will be an important milestone for the development of our country's financial sector and fintech ecosystem.

New extensions have been made for enabling citizens to see which banks they have deposit accounts in via e-Government. Internal control processes of the Agency have been strengthened. Infrastructure has been updated and banks have been integrated in order to obtain Safe-Deposit Box data. Services that will enable citizens to inquire about heirs and testators have been added to e-Government, which is planned to be used in 2022.

The Law No. 6361 was amended by Law No. 7292 on 04.03.2021 and its name was changed as "Financial Leasing, Factoring, Financing and Saving Financing Companies Law" and the Agency was authorized to supervise and oversee the savings finance companies. In this context, the audit of 35 savings finance companies that applied for adaptation to the Agency was completed in 2021. 21 of these companies were not found to have sufficient adjustment plans and it was decided to liquidate them compulsorily, 6 companies to be directed to voluntary liquidation, and to continue the adaptation processes of 6 companies, which were formed as a result of the merger of some of the remaining 8 companies.

Works currently in progress related to revision of Regulation on Internal Systems and Internal Capital Adequacy Assesment Process of Banks and Guideline on ICAAP Report came to an end in consideration of the best international practices related to Pillar II and the characteristics of the Turkish Banking Industry. The aim is to make the internal capital adequacy evaluation processes of banks more effective and increase compliance with the best international practices in this regard.

The enforcement activities of the audits regarding the information systems of the institutions within the scope of the Communiqué on the Management and Supervision of Information Systems of Financial Leasing, Factoring and Financing Companies were carried out for the first time in 2021. Enforcement activities were carried out via updating the procedures and sample letter templates for information systems audit reports performed by independent audit institutions and the Agency staff.

Within the scope of the Economy Reform Package, announced on 12.03.2021, the "Guideline on Credit Allocation and Monitoring" for increasing the efficiency of the credit allocation and monitoring processes of the banking sector, and the "Non-Performing Exposures Workout Guidelines" for increasing the asset quality of the banking sector were published on 29.06.2021. With the amendment made in the "Regulation on Loan Operations of Banks", which forms the basis of the " Non-Performing Exposures Workout Guidelines ", banks are obliged to establish resolution units within the framework of the principles determined in the aforementioned Regulation and to prepare the non-performing loans resolution strategy and operational plans.

The BRSA has published the following regulatory studies:

- Regulation on Remote Identification Methods to be Used by Banks and Establishment of Contractual Relationship in the Electronic Environment
- Communiqué on Information Systems Management and Audit of Information Exchange Institutions and Risk Center
- Regulation on Independent Audit of Information Systems and Business Processes

In 2021, important steps were taken in order to develop sustainable banking in our country and to establish the related risk management infrastructure. With the studies carried out regarding the sustainable banking, it is aimed to contribute to the financing of the green economic transformation in order to achieve the carbon emission reduction targets within the scope of the Paris Agreement and to comply with the conditions created by the EU Green Deal. In line with the aforementioned target, within the scope of the "Green Reconciliation Action Plan" put into effect with the Presidential Circular No. 2021/15 published in the Official Gazette dated 16.07.2021, it is foreseen that our Agency creates a roadmap for the development of sustainable banking in order to foster the ecosystem that will enable the development of green finance in our country. In this framework, the "Sustainable Banking Strategic Plan (2022-2025)", which was prepared by taking into account the opinions and suggestions of all relevant parties, was shared with the public on 24.12.2021. In accordance with the EU Green Deal and the "Fit for 55 Package", the Sustainable Banking Strategic Plan is prepared to include the period of 2022-2025 to ensure that our banking sector provides the necessary adaptation before 2026, an important transition date for our country's economic and financial system, when the carbon border adjustment will begin to impose financial obligations. The Plan is built on the strategic objectives of effectively managing climate-related risks, developing the financing needed for the transition to a sustainable economy and increasing cooperation between the relevant parties. In 2022, within the scope of the Sustainable Banking Strategic Plan, it is aimed to establish a data infrastructure with the required quality and scope for the analysis of financial risks based on climate change and to increase the climate risk management capacity of banks.

In 2021, 4 Laws were amended, 8 new regulations and 2 communiqués were put into effect, 14 regulations and 4 communiqués were amended and 19 Board Decisions were taken. Article 93 paragraph four of the Banking Law stipulates that the Agency will use its authorities granted as per this law and other applicable legislation in line with the regulating procedures and special decisions and the Agency is authorized to enact regulations and communiqués regarding the enforcement of this Law. In line with the regulating function, efforts were made to amend the banking legislation to ensure compliance with EU and international banking rules and implementations. Within the scope of the efforts on legislation, draft regulations prepared by the Agency are publicly shared at the Agency's web site.

Supervision activities include all on-site and off-site audits performed by the professional personnel on the relevant institutions using the authority granted to the Agency as per the Banking Law, No. 5411 and other applicable legislation. These activities include review and analysis of various indicators on consolidated or nonconsolidated financial performances of banks and other institutions within the scope of the supervision and regulations and generating periodic reports.

The Agency performs supervision activities with a risk-based and dynamic approach to ensure the effectiveness, continuity and adequacy of audits, and efficient use of resources. An important part of off-site supervision is stress testing and liquidity stress testing. The level of risk and resilience of banks and the banking system are analyzed through these studies. These studies, which are very important tools in testing the resilience of the Turkish Banking Sector against macroeconomic risks that are unlikely to occur but have high impact, also serve as an early warning tool, and the results are one of the most important inputs of audit and oversight activities.

In addition, various impact and scenario analyzes are carried out before both macro and micro precautionary measures and actions are put into practice, so that the possible effects of these measures and actions on banks and the industry could be numerically revealed. In this context, the impact analysis of the extended exceptional regulations and various decisions taken by the Agency due to the pandemic continues to be conducted, and effects on the legal limits of the banks are also monitored.

International activities of the authority

In order to improve the effectiveness of the consolidated supervision, the BRSA collaborates with foreign Supervisory Authorities. Accordingly, the BRSA signs Memorandum of Understanding (MoU) with foreign counterparts pursuant to Article 98 of the Banking Law Nr. 5411. As of the end of 2021, memorandums of understanding were signed with 40 authorities from 36 countries and information regarding existing memorandums of understanding is given in the table below. In addition, negotiations for signing a memorandum of understanding with the audit authorities in Moldova and Austria continued and significant progress was achieved.

As a candidate member country, Turkey has been showing an extensive effort to align national legislation with EU acquis and to improve the administrative capacity for an effective implementation of new regulations.

Within the framework of the Bilateral Technical Cooperation Agreement signed between the Agency and the World Bank in 2013, our relations with the World Bank continue in a positive way. In this regard, contributions were made to the departments that fall under the Agency's scope of duty in the meetings and joint works carried out under the coordination of the Ministry of Treasury and Finance.

Within the framework of studies carried out within the OECD, the Agency participated in the meetings in which it has an interest and the opinion on the issues of the reports prepared by the OECD within the scope of the Agency's areas of responsibility was presented.

The meetings of the Inter-Governmental Commissions on Economic Cooperation and the Joint Economic Commissions were participated and information notes were prepared by participating in the works of preparation of Protocols and Action Plans.

The BRSA is a member of Basel Committee on Banking Supervision (BCBS), Islamic Financial Services Board (IFSB), Supervision and Reconciliation Committee (SRC), which is the standing committee of Financial Stability Board (FSB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

The BRSA has strong ties with multinational institutions such as International Monetary Fund (IMF), World Bank (WB), Organization for Economic Cooperation and Development (OECD), World Trade Organization (WTO), Black Sea Economic Cooperation Organization (BSEC).

In addition, Banking Strategic Plan (2022-2025)", which was prepared by taking into account the opinions and suggestions of all relevant parties, was shared with the public on 24.12.2021. In accordance with the EU Green Deal and the "Fit for 55 Package", the Sustainable Banking Strategic Plan is prepared to include the period of 2022-2025 to ensure that our banking sector provides the necessary adaptation before 2026, an important transition date for our country's economic and financial system, when the carbon border adjustment will begin to impose financial obligations. The Plan is built on the strategic objectives of effectively managing climate-related risks, developing the financing needed for the transition to a sustainable economy and increasing cooperation between the relevant parties.

Cooperation with other supervisory bodies in the country

Based on the Article 98 of Banking Law, the BRSA exchanged views and shared information with the Presidency Strategy and Budget Office, Ministry of Treasury and Finance, the CMB (Capital Markets Board), the SDIF (Savings Deposit Insurance Fund), the FCIB (Financial Crimes Investigation Board) and the CBRT (Central Bank of the Republic of Turkey) in order to ensure coordination and cooperation in executing monetary, credit and banking policies. Additionally, with other public institutions such as the Ministry of Foreign Affairs and the Ministry of Commerce, the BRSA exchanged views on the issues related to the banking sector.

Coordination Committee: The Coordination Committee has been established per the Article 100 of the Banking Law and consists of BRSA's Chairman and Vice Chairmen and, also SDIF's Chairman and Vice Chairmen. The Committee is in charge of ensuring that maximum cooperation is established between the BRSA and the SDIF.

Financial Stability Committee (FSC) consists of the chairmen of the CBRT, the BRSA, the CMB, the SDIF, Borsa Istanbul and the Banks Association (TBB) and chaired by Treasury and Finance Minister. The Committee was established with the aim of managing systemic risks, ensuring harmonization in financial regulations and practices, and increasing coordination with the real sector in order to ensure that the financial system supports economic growth in a healthy way and maintaining confidence in the markets. The working mechanism of the Committee is being regulated and carried out by the Ministry of Treasury and Finance.

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	40	40	40
Branches of foreign credit institutions	5	5	5
Cooperative banks	0	0	0
Banking sector, total:	**53**	**54**	**55**

Total assets of banking sector (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	4188,5	5718,6	8600,1
Branches of foreign credit institutions	16,4	22,7	38,0
Cooperative banks	-	-	-
Banking sector, total:	**4490,8**	**6106,4**	**9215,5**
y/y change (in %)	**16,12**	**36**	**50,9**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	41,03	45,30	43,42
Domestic ownership total	73,53	74,95	74,14
Foreign ownership	26,47	25,05	25,86
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	35.09	53.91	778.01
Branches of foreign credit institutions	0.41	0.41	0.14
Cooperative banks	-	-	-
Banking sector, total:	**35.87**	**53.91**	**792.24**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	11.16	11.14	15.18
Cooperative banks	-	-	-
Banking sector, total:	**11.48**	**11.36**	**15.48**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	93.3	93.6	93.3
Branches of foreign credit institutions	0.4	0.4	0.4
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables			
Financial sector	4,71%	3,45%	5,16%
Nonfinancial sector	69,2%	68,39%	66,75%
Government sector	19,7%	21,66%	22,56%
Other assets	6,40%	6,50%	5,53%
Liabilites			
Financial sector	14,4%	13,4%	13,8%
Nonfinancial sector	64,2%	63,2%	63,8%
Government sector	5,6%	7,9%	9,4%
Other liabilities	4,8%	5,7%	5,2%
Capital	11,0%	9,8%	7,7%

Capital adequacy ratio of banks

Type of financial institution	2019	2020	2021
Commercial banks	18,9	19,1	19,6
Cooperative banks	-	-	-
Banking sector, total:	**18,4**	**18,7**	**18,4**

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

Asset portfolio quality of the banking sector[2] (share of impaired receivables / share of non-performing loans)

Asset classification	2019	2020	2021
Non-financial sector, including			
households	3,3	2,0	2,4
corporate[3]	6,0	4,7	3,3

[2] NPL ratio.

[3] Including SME loans

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:		
Households	61,1	20,1
Corporate	36,4	72,3
Government sector	2,5	7,6
Financial sector (excluding banks)	NA	NA
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	420,5	423,5	641,5
Interest expenses	258,2	208,7	376,0
Net interest income	162,4	214,8	265,5
Net fee and commission income	50,0	40,3	70,0
Other (not specified above) operating income (net)	-24,5	-24,5	-6,3
Gross income	526,9	526,0	801,5
Administration costs	35,0	40,3	48,2
Depreciation	6,8	7,6	8,7
Provisions	21,2	52,7	70,4
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	7,0	17,2	29,9
Profit (loss) before tax	60,6	75,9	118,5
Net profit (loss)	49,0	58,5	93,0

Total own funds in 2021 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	40,8	29,4	31,3	9,5	-
Cooperative banks					-
Banking sector, total:	**64,1**	**46,2**	**51,8**	**12,3**	**-**

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

Macroeconomic environment in the country

In 2021, the Ukrainian economy was recovering from the Covid-crisis at a solid pace, despite sporadic tightening of quarantine restrictions and mounting security risks at the end of the year. Real GDP grew by 3.4% after decreasing by 3.8% in 2020. The economic recovery was driven by sustained consumer demand, supported by a rapid growth in household income, including due to rising salaries, reviving investment activity, and a record harvest of crops. However, the recovery came out slower than expected. This was in part due to a spike in energy prices and shortages, the spillover effects of weaker 2020 harvests, a slower recovery in the services sector adversely affected by a sporadic return to Covid restrictions, the limited production capacity in some manufacturing sectors, and a faster fiscal consolidation. Labor demand and supply increased in 2021, buoyed by the economic recovery. However, unemployment remained high due to the long-term consequences of quarantine measures.

Headline consumer inflation was above its target range of 5% ± 1 pp during 2021 as it was expected by the NBU mainly due to external factors. Thus, the recovery of economic activity in the world led to a rapid increase in the prices of energy resources and raw materials. These factors spurred consumer inflation all over the world, and in the partner countries of Ukraine in particular, which led to an increase in the price of imports. Internal factors also had an impact. The rapid growth of wages in Ukraine stimulated consumer demand and increased production costs. This spurred core inflation further, to 7.9% as of the end of the year. At the same time, having peaked in autumn 2021, headline inflation declined to 10% in December thanks to the record-high harvest and a correction of some global food prices, the vanished low base effect, and a monetary policy tightening. Inflation was also restrained by administrative decisions to fix tariffs on some utility services.

In 2021, the current account, as expected, ran a deficit (USD 3.2 billion) compared to a USD 5.3 billion surplus in 2020, which, however, remained below the pre-crisis level due to favorable terms of trade. In contrast to previous periods, the key factors in the formation of the current account deficit in 2021 were an increase in reinvested earnings and record-high dividend payments amid the improved financial results of enterprises. At the same time, the merchandise trade deficit narrowed slightly (to USD 6.6 billion from USD 6.8 billion in 2020) due to faster growth in merchandise exports compared to imports. On the other hand, the widening of the current account deficit was, as has become usual, held back by remittances, which grew by 17% to USD 14 billion thanks to the opening of the borders and the recovery of economic activity in the recipient countries of Ukrainian labor migrants.

The financial account saw a capital inflow of USD 3.7 billion, generated by both, the public and private sectors. Borrowings by the government sector in Q4 helped maintain capital inflows to the sector for the year as a whole. Meanwhile, the real sector was raising funds through the Eurobond placements by SOEs. However, backed by high reinvested income, unprecedently strong FDIs became the major driver of the capital inflows to the private sector.

Thus, the strong inflows under the financial account resulted in the overall balance of payments surplus (USD 0.5 billion) by exceeding the current account deficit. Along with substantial funds Ukraine received through the IMF's global SDR allocation, this helped significantly increase international reserves to USD 30.9 billion, which was equivalent to around 95% of the minimum required according to IMF reserves adequacy metrics.

Development in the banking sector (including assets total / GDP)

Ukraine had 71 operational banks in Q4. This number did not change from a quarter ago. Net assets of private banks grew the fastest. As a share of the banking system's net assets, they expanded by 0.9 pp in Q4 and by 4.9 pp from the start of the year (to 22.1%). By contrast, the share of state-owned banks shrank by 0.8 pp in Q4 and by 5.8 pp from the beginning of the year (down to 46.7%). The sector's concentration rate continued to decline as smaller financial institutions quickly ramped up their assets.

Assets
The banking sector's net assets increased by 6.3% qoq, driven by the growth in the hryvnia component. Investments in government securities increased, as did client loan portfolios.

The quarterly pace of growth in net hryvnia corporate loans decelerated to 2.3% qoq. In 2021, the net hryvnia loan portfolio grew by 40.2%. State-owned banks were the most active lenders, except for PrivatBank (54.7% yoy). In December, hryvnia loans decreased due to the seasonal repayment of loans by farmers and companies meeting government orders under the Large Construction project. Lending by foreign banks in foreign currency intensified at the end of the year. Net FX loans grew by 7.8% qoq and 9.6% yoy.
Retail lending exceeded its pre-crisis level. The net hryvnia retail loan portfolio grew by 8.0% qoq (up 36.9% yoy). The increase in net hryvnia real estate loans at the end of 2021 was 62.4% yoy – an all-time high.

The NPL ratio continued to shrink, falling by 3.2 pp in Q4 and 11.0 pp for the year, down to 30.0%. The largest contribution to this reduction was made by state-owned banks. They rapidly increased their loan portfolio and wrote off old NPLs in pursuit of their strategies.

Funding
Banks' liabilities grew by 5.7% qoq, primarily driven by customer deposit inflows. They continue to dominate other types of bank funding: at the end of the year, deposits accounted for 84.9% of liabilities. The share of funds due to the NBU remained at 5.3%, flat from Q3.

The volume of hryvnia retail deposits grew by 8.1% qoq (15.3% yoy) in Q4. This increase was led by private and foreign banks: up 41.0% yoy and 22.4% yoy, respectively. At the same time, hryvnia retail term deposits grew more slowly, by 9.6% yoy. The vast majority of new term deposits had a maturity of three months. The total amount of FX retail deposits decreased by 1.8% yoy (in the U.S. dollar equivalent) due to term deposit outflows.

Hryvnia corporate deposits grew by 15.5% qoq (26.4% yoy). Banks with private capital also led the way for this type of deposits, posting growth of 35.1% qoq (63.2% yoy). The U.S. dollar equivalent of FX deposits declined by 4.7% qoq because of deposit outflows from private and foreign banks. On an annual basis, FX corporate deposit rose by 3.9% yoy.

The share of FX deposits shrank by 2.6 pp to 32.9% despite the weakening of the hryvnia. The faster growth in hryvnia deposits compared to FX deposits contributed to dedollarization.

Interest Rates
The NBU started tightening its monetary policy in March 2021 and over the year raised its key policy rate by a total of 3 pp, to 9% in December from 6% in January. During Q4 2021, the NBU continued the cycle of raising the key policy rate, increasing it to 9% per annum, and in January 2022 to 10%. However, only a few banks out of the top 20 raised their rates on hryvnia retail deposits following the key policy rate hike. At the end of Q4, the average rate on 12-month deposits grew to 9.2% per annum. The spread between the rates on quarterly

and annual deposits widened to 1.7 pp. Interest rates on U.S. dollar deposits remained under 1% per annum, although they increased slightly during the quarter.

For the first time in a year and a half, the rates on hryvnia corporate loans exceeded 10% per annum. Ultra-short (up to one month) loans were still the most sensitive to the key policy rate increase. Meanwhile, the rates on FX corporate loans fell to 3% per annum in December. The rates on new consumer loans to households fell by 1.5 pp to 28.7% per annum in December. The rates on new mortgages rose by 0.7 pp in Q4, to 12.6%.

Financial Results and Capital

In 2021, the banking sector earned its maximum historical profit of UAH 77.4 billion (up 94.8% yoy), primarily due to a rapid increase in operating income and a reduction in provisions. In Q4 2021, the banking sector's profit was 12.6 times the level of Q4 2020. Apart from significant income growth, this was driven by the release of provisions for legal risks and a 71.1% reduction in allowances for expected loan losses. The number of loss-making banks fell from seven to five in Q4, and their total loss remained insignificant. Return on equity rose to 35% from 19% last year.

Operating income grew faster than operating expenses, especially in Q4. The cost-to-income ratio (CIR) was 54.8%, down from 65.3% a year ago. The growth in net interest income accelerated during the year. In the last quarter of the year, it surged by 47.7% yoy. Among the main factors in driving this increase were active lending and lower-than-last-year interest rates on short-term retail deposits. Interest income therefore grew rapidly, while interest expenses remained moderate. Further growth in the volume of cashless transactions, including card-based ones, drove an increase in banks' fee and commission income. The growth rates of net fee and commission income were the highest in Q2, after which they began slowing to 16.4% yoy in Q4. This slowdown was driven not only by a high base effect, but also by leading payment systems cutting their interchange commissions and some banks announcing a reduction in acquiring fees.

The legal and institutional framework of the operation and supervision of financial institutions, new developments. Legal competence of the Banking Supervisory Authority in the country

Banking in Ukraine is regulated by the following laws: the Constitution of Ukraine, the Civil Code of Ukraine, the Economic Code of Ukraine, Laws of Ukraine *On the National Bank of Ukraine, On Banks and Banking, On Households Deposit Guarantee System, On Financial Services and State Regulation of Financial Markets, On Joint Stock Companies, On Preventing and Counteracting Legalization (Laundering) of the Proceeds of Crime, Terrorist Financing, and Financing Proliferation of Weapons of Mass Destruction , On Consumer Lending, and On Simplifying Bank Reorganization and Capitalization Procedures.*

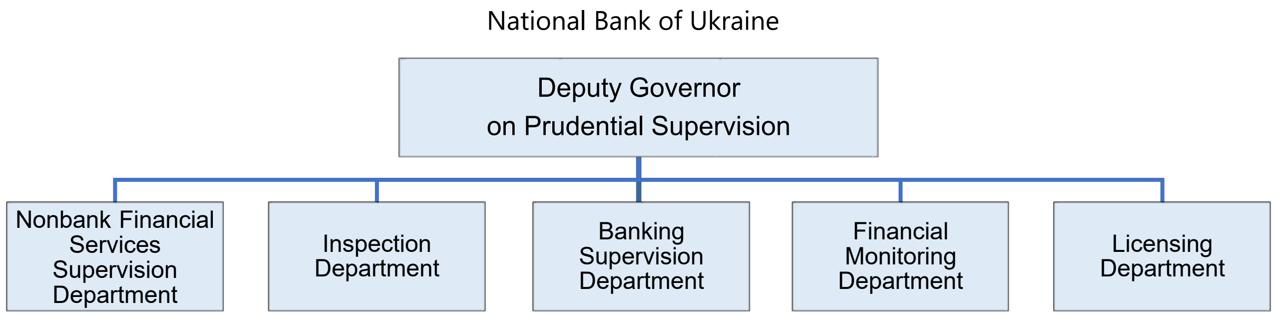
In 2021, the Ukrainian parliament adopted several important laws drawn up with the help of the National Bank of Ukraine. These were:

1) Law No. 1953-IX *On Financial Services and Finance Companies*, which updated requirements for, and the regulation of, financial services provision, while also paving the way for the development and introduction of innovations on the Ukrainian financial market. This law will come into effect on 1 January 2024.
2) Law No. 1909-IX *On Insurance*, which upgrades relations in the field of insurance. This law will come into effect on 1 January 2024.
3) Law No. 1201-IX *On Financial Leasing*, which came into force on 13 June 2021. This law charges the NBU with the state regulation of, and supervision over, the financial leasing market.
4) Law No. 1349-IX *On Amending Certain Laws of Ukraine on Consumer Protection during the Resolution of Past Due Debts*. This law provided a clear legal framework for the operation of collection agencies and lenders during the resolution of past due debts. It also designated the NBU as the regulator supervising the activities of collection agencies.

In 2021, parliament also passed several comprehensive Ukrainian laws that bring national legislation into line with EU legislation. These laws are as follows:

1) Law No. 1591-IX *On Payment Services* (this law came into force on 1 August 2022). This law, which aims to revise payment services legislation, is based on modern requirements, while also factoring in EU regulations, including Directive (EU) 2015/2366 (PSD2) and Directive 2009/110/EU (EMD).
2) Law No. 1587–IX *On Amendments to Certain Laws of Ukraine on Improving Corporate Governance in Banks, and Other Operational Issues of the Banking System.* This law brought national banking laws more closely in line with the relevant EU laws, while also introducing best international practices in banking sector regulation.
3) Law No. 1811-IX *On Amending Certain Laws of Ukraine Concerning Certain Issues Related to the Activities of the National Bank of Ukraine.* This law is based on best international practices in corporate governance and global standards for central bank management.

Organizational chart of the Banking Supervisory Authority



A full organizational chart of the NBU is available at:
https://bank.gov.ua/en/about/structure#orgchart

Main strategic objectives of the Banking Supervisory Authority in 2021

In May 2021 the NBU developed a new institutional Strategy until 2025. This Strategy focuses on creating a maximum value for our clients. The Strategy also meets today's challenges and supports the further evolution of the Ukrainian financial regulator. By presenting its second Strategy, the NBU moved to the next stage in development as a central bank. Within its framework, the NBU continues to implement initiatives that boost economic growth in the country and increase the financial ecosystem's efficiency. The Strategy is being implemented in line with three strategic development directions:

1) Promoting the resumption of economic development;
2) Digital finance as a driver for digitalization of the economy;
3) Institutional Development and Operational Excellence of the NBU.

The activities of the Banking Supervisory Authority in 2021

During 2021, the NBU continued to implement a risk-based approach to banking supervision by following the guidelines of the European Banking Authority on common procedures and methodologies for the Supervisory Review and Evaluation Process (SREP) and recommendations of the Basel Committee on Banking Supervision, while taking a proportionality approach to supervision.

In conducting risk-based banking supervision, the NBU conducted offsite banking supervision on an individual and consolidated basis, taking into account its own requirements for banking regulation. These requirements aim to help banks recover from the negative impact of the restrictions that were imposed to stop the spread of COVID-19, and to adapt to the new conditions.

Among other things, the NBU:

- assessed 71 banks on the basis of the SREP framework and designed a banking supervision strategy for 2022 based on the assessments' results
- assessed the resilience of the banks and the banking system through:
  a. stress testing the 30 largest banks, which together account for 93% of the banking system's assets
  b. engaging independent auditors to conduct an asset quality review of all Ukrainian banks
  c. verifying credit risk assessments based on the banks' assets
- monitoring the current financial standings of banks and banking groups
- supervising the banks' transactions with their related parties, and analyzing the terms and conditions of the banks' transactions with their customers to identify terms and conditions that are not market-driven
- monitoring the banks' compliance with Ukrainian law, including NBU regulations that set the rules on how audit firms should conduct annual audits of banks' financial statements and consolidated financial statements.
- monitoring to ensure banks conduct independent external quality assessments of their internal audit functions in line with international standards, and to ascertain whether or not the banks are implementing external evaluators' recommendations on how to enhance the quality of their internal audits.

In addition, in complying with the Law of Ukraine No. 1587-IX, dated 30 June 2021, *On Amendments to Certain Laws of Ukraine on Improving Corporate Governance in Banks and Other Operational Issues of the Banking System*, which was drafted by the NBU, the central bank adopted several regulations amending, among other things: the Bank Licensing Regulation, the Regulation on the Requirements for the Rules, Procedures and Reports on the Remuneration of a Bank's Supervisory Board and Management Board Members, the Methodological Recommendations for Organizing Corporate Governance in Banks, the Regulation on Business Recovery Plans of Ukrainian Banks and Banking Groups, and the Instruction on the Procedure for the Regulation of Bank Activities in Ukraine.

With a view to boosting the effectiveness and ensuring the stability of the Ukrainian banking system, and pursuant to the provisions of European legislation, the recommendations of the Basel Committee on Banking Supervision, and documents of the European Banking Authority, and while taking into account global best practices, the NBU set:

- the requirements for organizing internal capital adequacy assessment processes (ICAAP) in Ukrainian banks and banking groups and
- the requirements on how the banks should measure their minimum market risk with a view to using this measure when calculating capital adequacy ratios.

International activities of the authority

In 2021 the NBU continued to develop its relations with its foreign partners and international organizations.

The NBU proceeded to implement the 18-month Stand-By Arrangement (SBA) with the International Monetary Fund which started in June 2020. In particular, measures aimed at further strengthening the Ukrainian banking sector and further developing the financial markets were realized and in November 2021 the first review of the SBA was completed. Under the program the NBU was strongly committed to continuing a prudent monetary policy to anchor inflation expectations and build stronger reforming of the financial sector.

The NBU was also engaged in activity within the IBRD project "Economic Recovery Development Policy Loan - ER DPL" under which Ukraine received two tranches under the ER DPL, which were used to finance the general fund of the State Budget in a total amount of USD 700 million.

The NBU was very active in technical cooperation with IFIs, central banks and financial sector regulators from other countries. There was an increase in technical assistance received and provided by the NBU during 2021. The key TA partners of the NBU were the EU, IMF, organizations of the WB Group, EBRD, USAID, the Deutsche Bundesbank, the National Bank of Poland, the Sveriges Riksbank, and the Bank of Lithuania. These institutions exchanged their experiences and practices on green finances, financial innovations, emergency liquidity assistance, EWS and cyclic risk measurement indicators etc. The NBU held 15 bilateral and multilateral international events for the key recipient-central banks. The main topics were: the use of large data groups for macroeconomic analysis, CBDC, Developing Green Finances in the NBU, management of gold and foreign exchange reserves, inflation targeting, international relations, modelling of banknotes and currencies in circulation.

In 2021 the NBU continued to fulfill its obligations on the EU-Ukraine Association Agreement implementation, focusing on the harmonization of national laws with EU acquis in the areas of banking regulation and supervision, AML/CFT, liberalization of capital movements, insurance and the operation of payment systems.

Fruitful activities were continued by the NBU within the Twinning project "Strengthening the NBU's Institutional and Regulatory Capacity to Implement the EU-Ukraine Association Agreement" with the Central Banks of Poland and Lithuania. The project enabled the NBU to obtain expert assistance in developing approaches to banking supervision in the framework of the SREP, implementing an instant payment system, and strengthening strategic planning and cooperation with international institutions.

Additionally, in 2021 the NBU signed memorandums of understanding and exchange of information in the field of insurance supervision with the Central Bank of Armenia, Komisija Nadzoru Finansovego and the Bank of Lithuania.

Cooperation with other supervisory bodies in the country

As a banking supervisor, the NBU cooperated with the Deposit Guarantee Fund and the Audit Chamber of Ukraine, as well as with the other financial regulators under the Financial Stability Council.

Other relevant information and developments in 2021

For further information on the NBU's supervisory activities and regulations, please visit the NBU's website at www.bank.gov.ua

Questionnaire tables for the 2021 BSCEE Review

Number of financial institutions (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	75	73	71
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**75**	**73**	**71**

Total assets of banking sector (at year-end)

Type of financial institution	2019	2020	2021
Commercial banks	1 981 594	2 205 915	2 358 324
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**1 981 594**	**2 205 915**	**2 358 324**
y/y change (in %)	**3.7**	**11.3**	**6.9**

Ownership structure of banks on the basis of assets total

Item	2019	2020	2021
Public sector ownership	60.39	55.88	49.75
Domestic ownership total	27.19	28.88	29.63
Foreign ownership	12.42	15.24	20.62
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions, 2021

Type of financial institution	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	44.22	55.41	0.087
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**44.22**	**55.41**	**0.087**

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2019	2020	2021
Commercial banks	33.45	19.22	35.09
Cooperative banks	-	-	-
Banking sector, total:	**33.45**	**19.22**	**35.09**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2019	2020	2021
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

	2019	2020	2021
Receivables	100	100	100
Financial sector	21.42	19.08	20.59
Nonfinancial sector	38.35	32.99	31.88
Government sector	19.31	28.18	27.27
Other assets	20.92	19.75	20.26
Liabilites	100	100	100
Financial sector	28.99	24.88	21.76
Nonfinancial sector	22.43	25.05	26.97
Government sector	1.28	0.94	0.86
Other liabilities	35.71	38.35	38.46
Capital	11.59	10.78	11.95

Capital adequacy ratio of banks

Type of financial institution	2019	2020	2021
Commercial banks	19.66**	21.98**	18.01**
Cooperative banks	-	-	-
Banking sector, total:	**19.66****	**21.98****	**18.01****

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

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

Asset classification	2019	2020	2021
Non-financial sector, including	37.9	37.7	29.0
households	9.8	8.8	7.8
corporate	28.1	28.9	21.2

The structure of deposits and loans of the banking sector in 2021 (%) (at year-end)

	Deposits	Loans
Non-financial sector, including:	95.9	96.5
Households	53.8	24.4
Corporate	42.1	72.1
Government sector	1.0	2.6
Financial sector (excluding banks)	3.1	0.9
Total	**100.0**	**100.0**

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

P&L account	2019	2020	2021
Interest income	152 954	147 743	168 746
Interest expenses	74 062	62 895	51 097
Net interest income	78 892	84 848	117 648
Net fee and commission income	43 961	46 508	57 977
Other (not specified above) operating income (net)	8 147	6 813	7 488
Gross income	243 102	250 171	273 863
Administration costs	62 936	69 437	78 293
Depreciation	6 149	7 553	8 477
Provisions	10 714	31 037	3 448
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-	-	-
Profit (loss) before tax	63 125	43 537	83 740
Net profit (loss)	58 356	39 727	77 376

Total own funds in 2021 (in EUR)

Type of financial institution	Total own funds	Core Tier 1	Tier 1	Tier 2	Tier 3
Commercial banks	6 847	-	4 558	2 302	-
Cooperative banks	-	-	-	-	-
Banking sector, total:	**6 847**	**-**	**4 558**	**2 302**	**-**

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