BSCEE

Review

2007

INTRODUCTION

The Group of Banking Supervisors from Central and Eastern Europe (the BSCEE Group) was established in 1991. The Agreement of the BSCEE Group was signed during the Stockholm International Conference of Banking Supervisors (ICBS) in 1996. The BSCEE Group is operating according to its Agreement that determines its organizational structure and the rules governing its operations. As of today it is signed by twenty-one member countries: Albania, Austria (signing of the Agreement at the XXI Conference in Belgrade, 2008), Republic of Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia and Ukraine. The Chairmanship of the BSCEE Group rotates on annual basis. In 2007 Dr Peter Schiffer, Deputy Director General of the Hungarian Financial Supervision Authority chaired the Group.

In 1996 the BSCEE Group entered into an agreement setting out a framework for cooperation and coordination in organizing common events. The primary role of the BSCEE Group Secretariat is to provide technical assistance in organizing conferences, leader's meetings, workshops and training seminars. The Secretariat also facilitates cooperation among the member countries, the Basel Committee on Banking Supervision (BCBS) and other international institutions and organizations in the sphere of banking supervision. The permanent Secretariat of the Group until 2005 was located at the premises of the Hungarian Financial Supervision Authority(HFSA) and as of January 2006 is located in Poland, at the Polish Financial Supervision Authority (PFSA).

According to the previous years practice the Annual Review of the BSCEE Group summarizes the developments of the member countries in 2007. This publication gives an overview of the macroeconomic circumstances in the twenty-one member states, and it describes the banking sector as well as the supervisory activities. It was prepared on the basis of the information given by the member countries. The Annual Review also summarizes the main events of the BSCEE Group, including the workshops co-organized by the Financial Stability Institute (FSI) and the Training Initiative for Banking Supervisors (TIBS). The 20th Annual Members Conference was organized by the Hungarian Financial Supervision Authority in Budapest, Hungary on May 29 – June 1, 2007.

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

I hope that you will find this publication informative and useful. I am sure that this will help you become acquainted with our supervisory job in the Central and Eastern European region, the cooperation among the supervisory authorities of the member countries and with the Basel Committee.

Secretariat BSCEE

CONTENTS

2007 DEVELOPMENTS IN THE BANKING SYSTEM
OF THE MEMBER COUNTRIES

2007 DEVELOPMENTS IN THE ALBANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The Albanian economy is estimated to have grown by about 6% in 2007. The growth of gross domestic product was provided by the performance of services, industry, transportation and telecommunications. Year 2007 recorded a high figure in foreign direct investments which account for 6% of the GDP.

The positive exports' performance which resulted 28% higher in 2007 than the previous year is another factor to have affected the economic growth. Domestic demand remained high throughout 2007, reflecting to a large extent the growth of consumer credit and of imports.

Significant structural reforms were undertaken in 2007, notably the establishment of Credit Registry, the re-organization and strengthening of financial sector's supervision, the improved tax and public spending management, the privatization of Albtelecom, the establishment of the National Business Registration Centre and the further reduced customs duties.

In addition, our economy went through one of the hardest times with respect to production and consumption of energy. For a considerable part of the year Albania was challenged with a difficult situation which had at its core the drastic fall in domestic production while the alternative sources of energy, such as oil and its by-products, hit record prices in the international markets. in light of these developments, the import of energy was deemed as the sole alternative to put the energy deficit to an end.

The year 2007 was not a good year for the construction sector as well. According to the available data, the construction sector has almost recorded no growth; hence its contribution to the economic growth has been inexistent. However, house prices continued to go upward in the last months of 2007, although at slower rates.

The entire economic activity in Albania was supported by an encouraging environment in terms of inflation which was kept under check despite the unfavorable global economic developments. However, the increasing inflationary pressures in economy were confirmed by the upward trend of core inflation. In 2007 average inflation rate marked 2.6% or 0.8% higher than the previous year. The inflationary pressures increased in the second half of 2007. During this period the average annual core inflation rate marked 3.4%, reaching the highest rate of this indicator for the last five years.

In order to meet the price stability objective successfully, the Bank of Albania has estimated risks stemming from the developments in demand and supply and responded accordingly three times by tightening the monetary policy. Hence, starting from November 2007, the repurchase agreement rate of one-week maturity reached 6.25%.

To the other side, the exchange rate was stable during 2007 although with a slight appreciating tendency of the lek, mainly in the last quarter. In annual nominal effective terms, the lek has appreciated to foreign currencies by an average of 1.4%.

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

Year 2007 continued to present stabel and positive developments in the banking system. During the year, banking system underwent important changes in the shareholders structure. Some of the well known banks in the international arena, are now present in Albania raising the prospective for a more competitive and efficient development of the banking system, as well as higher and safetier support with capital. This panorama, associated with the phenomen of consolidation through the absorbation proccess of two banks, which happened for the first time in Albania, is considered as a step forward to the optimization of the synergies in the system. These developments seem to have raised and strengthen also the dependece of the albanian banking system to the dynamics of the global markets. As a consequence, we deem that there is a tendency to minor frequencies but with higher impact of potential financial crisis, rajonal or global, in our banking system. In this context, the financial crise derived from subprime mortgage, which consequenses haven't yet disappeard, didn't affect our banking system. Banks operating in Albania are considered as institutions that had no direct exposure to the USA mortgage market, while impact from potential indirect exposures seems to be unsignificant or inexistent.

The financial situation of the banking system is assessed to be healthy and it reflects these characteristics:

- satisfactory levels and generally stabel growth of the profitability indicators. Return on Assets Ratio (RoAA), is estimated at 1.57 per cent from 1.36 per cent by the end of 2006, while NIM is measured at 4.35 per cent from 4.22 per cent;
- stability of "nonperforming loans to credit outstanding" ratio on net basis, which estimates the quality of the loan portfolio (1.8 per cent from 1.7 per cent by the end of the previous year) and a slight deterioration of this ratio on gross basis influenced by higher growth rate of nonperforming loans against credit outstanding growth (3.4 per cent against 3.1 per cent);
- stability of credit portfolio weight when mismatches between the currency in which the loan is denominated and the currency in which clients get their income occur. However, there aren't yet any signs for concern levels of nonperforming loans in this portfolio, especially when exchange rate has been stable;
- a decline in the banking ability to cover the potential loss loans with capital measured by the "nonperforming loans (net) to regulatory capital" ratio which increased from 6.8 per cent up to 11.1 per cent. Despite the deterioration of this indicator, it still stands at satisfactory levels;
- capital adequancy ratio over the minimum level established by Bank of Albania and a downward trend of this ratio as consequence of a

higher oriented to risk weighted assets system (from 18 per cent down to 17.1 per cent);
- a lower level of liabilities to shareholders capital and as consequence a lower financial leverage ratio from 10.8 per cent down to 13.2 per cent;
- limited levels of market risk;
- higher activity in foreign currency reflected in higher levels of deposits and loans denominated in foreign currency;
- a growth in the banking intermedation reflected in the growth of loans portfolio to total assets ratio and total assets to GDP ratio; total assets to GDP ratio is measured at 75.9 per cent;
- a countinuing extension of the banking activity reflected in the continuing growth of assets, activity expenditures, operational income, banking network, etc.
- enlargement of the number and the variety of banking products to attract more "lethargic" sources and to grow up the intensity of the lending activity;
- a satisfactory liquidity situation reflected in satisfactory levels of the liquidity indicators and in the upward trend of deposits attracted by the system;
- a gradual reduction of the concentration of assets and deposits, although their levels continue to stand far from the optimal level measured by the Herfindahl Index;
- an improvement in the banking sector's efficiency compared to other sectors of the economy reflected in higher net result weight to GDP from 0.8 per cent up to 1.1 per cent.

These developments, associated with the upward trend of the paid-up capital level and higher net result levels have balanced the growing of risk weighted assets and have created the frame to enhance the stability in the banking system during year 2007.

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.

Bank of Albania is the supervisory authority of banks, branches of banks and non-bank financial institutions. It carries out its supervisory role, pursuant to the Law "On banks in the Republic of Albania", through licensing, issuing of by-laws, financial analyses of financial data received periodically, on-site inspections, corrective action and cooperation agreements with other supervisory authorities abroad.
During the 2007, as per the new Law "On Banks in the Republic of Albania" some changes on regulatory framework have been made and some others are planned to be completed during 2008, aiming a stable and sound banking system in the country.

Bank of Albania**,** in the process of convergence to the EU standards on the banking field, is taking into consideration the EU directives, standards and recommendations of the Basle Committee and the best practices of the countries in the region, while enacting and strengthening the regulatory framework (regulations/guidelines) governing the banking system.

The process of revising the regulatory framework consisted on approval of the two new draft regulations respectively on "Licensing, organization, activity and supervision of foreign exchange bureaus" and "Risk administration at foreign bank branches" as well on some amendments to the regulation "On Capital Adequacy Ratio" concerning the risk weight of 150 percent to be considered on risk weighted assets for the purpose of the CAR calculation. Also, Bank of Albania issued the necessary regulatory framework for the functioning and organization of the Credit Bureau, which was set up pursuant to the provisions of the Law "On Banks in the Republic of Albania".

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2007

Main strategic objectives of the Supervision Department during 2007 have been as following:

- Making sure of a safe and sound banking system in compliance with laws and by-laws with the final aim of protecting depositors and preventing financial crises.
- Safeguarding the banking system stability through the monitoring of the market developments and taking appropriate and timely measures to address weaknesses and adverse trends.
- Promoting the market discipline by demanding a higher transparency of the banks activity as well as a higher transparency of the banks relative to their clients. But not only that. The other side has been very important, which means increasing transparency of the credit exposure of the borrowers to the banking industry, in order to penalize bed ones and rendering a safe and efficient credit process through the set up of the Credit Registry.
- Promoting a fair competition and providing equal treatment of market operators as well as holding close contacts and open lines of communications with the banking industry and other stakeholders in order to contribute to a better functioning of the banking system and to precede to adverse developments.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2007

The developments in the banking industry have been followed intensively pursuant with rapid credit growth, market competition and structural changes. Several challenges were faced during 2007 with these events and relative consequences.

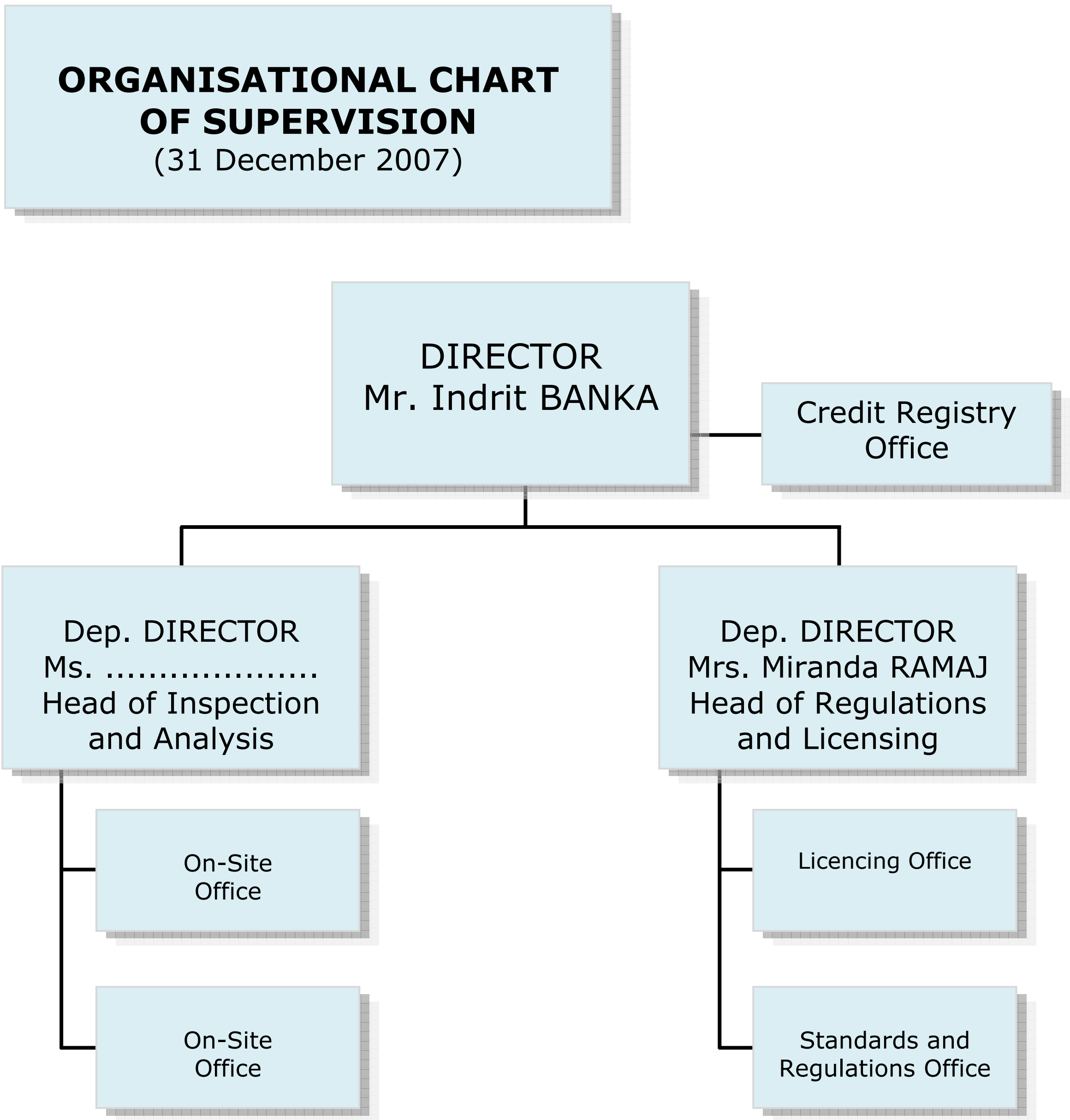
As a routine practice, on-site inspections were carried out to assess the overall performance to individual banks. Special attention was given to the managerial behavior as per the strong competitive developments in the banking industry such as strong quantitative targets, network expansion and traditional prudential requirements for capital adequacy. In more specific terms credit procedures were carefully revised in order to guarantee proper analysis and reduce eventually lax standards. In addition, special focus was provided to the risk management structures establishment or consolidation.

As a distinctive topic during 2007, a special focus was dedicated to the transparency of banks toward customers, which concern is still being addressed. Parallel focused examinations were carried out to assess the issue and a standard procedure during full-scope examinations was added.

Bank of Albania established the Credit Registry Office, which event was undertook major engagement during 2007. Its functioning is successfully supporting the credit activity of banks after the presentation on January 1st 2008.

In overall, 20 examinations took place for supervisory purposes in banks and 56 examinations in other licensed institutions such non-bank financial institutions, savings and credit unions and foreign exchange bureaus. Some 17 examinations took place with the purpose to estimate banks' data recorded in the credit registry. Other 27 examinations were performed in collaboration with other supervisory bodies in the country.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF YOUR AUTHORITY AND COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

Taking into consideration the developments in the financial markets, the increased importance of banking presence in different regional countries as well as challenges presented to supervisors there is an incremented collaboration with other supervisory bodies. The collaboration has been intensified with supervisors of the country of banking capital origin.

Last year, six countries of the region, signed a multilateral agreement of collaboration with the purpose of promoting a structured coordination for banking activity. A joint on-site inspection with one of these supervisory activities has been carried out. Strong collaborative links have also been established with supervisory authorities from two EU countries with the final scope of signing a memorandum of understanding.

Internally, based on legal obligations and a memorandum of understanding sign with other home supervisors, joint inspection have been undertaken with bodies in the field of anti-money laundering and insurance companies relations with the banks.

STATISTICAL TABLES

Number of financial institutions
(at year-ends)

Type of financial institution	2005	2006	2007
Commercial Banks	17	17	16[1]
Non-bank Financial Institutions	7	6	6
Exchange bureaux	58	60	110
Saving&Credit Associations (SCAs)	131	125	130
Unions of SCAs	2	2	2
Representative Offices of Foreign Banks	1	1	1
Financial institutions, total	**216**	**211**	**265**

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

Item	2005	2006	2007[2]
Public sector ownership			1.26
Other domestic ownership			7.41
Domestic ownership total			**8.67**
Foreign ownership			91.33
Financial institutions, total	**100.0**	**100.0**	**100.0**

[1] In December 2007 the merger and acquisition of Italian – Albanian Bank S.A. (IAB) by American Bank of Albania S.A. (ABA) is approved by the Supervisory Council of the BoA. In march 2008 the licence of IAB has been revoked.

[2] The capital of banks is expressed in ALL, USD and EUR. Assessment of the ownership structure of the register capital is done based on the domestic currency ALL. The exchange rate of the Bank of Albania in December 31, 2007 is 1 USD = 82.89 ALL and 1 EUR = 121.80 ALL.

Ownership structure of the financial institutions (Banks) on the basis of assets total

Item	2005	2006	2007
Public sector ownership			0.28
Other domestic ownership			5.86
Domestic ownership total			**6.14**
Foreign ownership			93.86
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of institutions	The first three largest (%)	The first five largest (%)
Bank	55.95 %	72.12 %
Credit Cooperatives		
Financial Institutions		
Savings Cooperatives		
Specialized Credit Institutions		

Return on Asset (ROA) by type of financial institutions

Type of financial institution	2005	2006	2007
Bank	1.40	1.36	1.57
Credit Cooperatives			
Financial Institutions[3]			5.50
Savings Cooperatives[4]			2.35
Specialized Credit[5] Institutions			4.00

[3] Nonbank Financial Institutions, other from Savings and Loans Associations, that report to Bank of Albania and do not provide loans
[4] Savings and Loans Associations including their Unions
[5] Nonbank Financial Institutions that report to Bank of Albania and provide loans

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2005	2006	2007
Bank	22.24	20.17	20.74
Credit Cooperatives			
Financial Institutions[6]			5.50
Savings Cooperatives[7]			12.00
Specialized Credit[8] Institutions			4.00

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

Type of financial institution	2005	2006	2007
Banks			
G1 (< than 2% of total banks assets)	7.15 %	4.84 %	3.4 %
G2 (2% - 7% of total banks assets)	20.40 %	25.86 %	31.6 %
G3 (> 7% of total banks assets)	72.46 %	69.30 %	65 %
Financial institutions, total	**100.0**	**100.0**	**100.0**

[6] Nonbank Financial Institutions, other from Savings and Loans Associations, that report to Bank of Albania and do not provide loans
[7] Savings and Loans Associations including their Unions
[8] Nonbank Financial Institutions that report to Bank of Albania and provide loans

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

Type of financial institution	2005	2006	2007
Treasury operations and interbank transactions	58.85	50.63	39.45
Operations with costumers	25.59	31.53	39.11
Securities transactions	12.16	14.73	17.95
Other assets	0.7	0.86	1.30
Fixed assets	1.46	1.52	1.49
Total accrued interest	1.60	1.27	1.32
Liabilities	**2005**	**2006**	**2007**
Treasury operations and interbank transactions	58.85	50.63	39.45
Operations with costumers	25.59	31.53	39.11
Securities transactions	12.16	14.73	17.95
Other assets	0.7	0.86	1.30
Fixed assets	1.46	1.52	1.49
Total accrued interest	1.60	1.27	1.32

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

Type of financial institution	2005	2006	2007
Banks	36.92 %	42.28 %	54.84 %

Solvency ratio of financial institutions

Type of financial institution	2005	2006	2007
Banks	18.57 %	18.02 %	17.08 %

Asset portfolio quality of the banking system

Type of financial institution	2005	2006	2007
Standard	94.09	93.63	91.90
Special mentioned	3.64	3.34	4.80
Substandard	0.85	1.10	1.68
Doubtful	0.52	0.89	0.79
Loss	0.92	1.03	0.82
Overdue loans/Total loans	2.33	3.05	3.36
Classified total	**100**	**100**	**100**
Specific reserves	**1.39**	**1.72**	**1.58**

The structure of deposits and loans in 2007 (%)
(at year-end)

	Deposits	Loans
Households	81.62	35.5
Government sector	4.03	1.34
Corporate	14.35	63.16
Total	**100.0**	**100.0**
Foreign	42.85	72.53

The structure of deposits and loans in 2007 (%)
(at year-end)

Maturity of deposits		Loans	
At sight	26	Long term loans	22.01
Within one year	70	Medium-term loans	25.14
Over one year	4	Short-term loans	25.40
		Real estate	21.60
		Other loans	5.85
Total	**100.0**	**Total**	**100.0**

Proportion of foreign exchange assets and liabilities (at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Banks	41.10	44.23	46.75	41.00	44.03	46.92

Structure of revenues and expenditures of financial institutions (at year-ends)

Item	2005	2006	2007
Total Interest Income	29,960.53	35,988.82	48,642.55
Treasury and Interbank Transactions	2,962.25	4,446.6	6,334.47
Interest Received from Customers	9,228.22	15,049.07	23,415.69
Interest Received from Securities	17,560.66	16,327.32	18,791.08
Other Interest Received	209.41	165.83	101.31
Total Interest Expense	13,548.60	14,452.06	21,222.44
Interest Expense on Treasury and Interbank Transactions	244.62	520.17	1,266.95
Interest Paid to Customers	13,069.69	13,341.90	19,057.11
Interest Expense on Securities	126.77	528.19	842.87
Other Interest Expense	107.52	61.79	55.51
Net Interest Income (Total Int. Inc. minus Total Int. Exp.)	16,411.93	21,536.77	27,420.11
Other Income	8,057.72	6,110.68	6,704.55
Other Expense	4,055.81	1,771.45	1,068.75
Net Result - Other Income and Expense	4,001.91	4,339.23	5,635.80
Provisioning Expenses	869.33	2,615.18	3,466.10
Gross Income	19,544.50	23,260.81	29,589.82
Gross Expenses	10,864.37	13,504.80	16,244.42
of which: Personnel Expenses	3,995.85	5,072.73	6,264.79
Net Income	8,680.13	9,756.01	13,345.39
Net Extraordinary Income (Loss)	80.61	-75.58	209.56
Taxes Other Than Income Taxes	40.18	34.23	47.75
Income Before Taxes	8,720.56	9,646.20	13,507.21
Income Tax	2,122.67	2,195.63	2,940.54
Net Income after taxes	**6,597.89**	**7,450.58**	**10,566.67**

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	EUR	%	EUR	%
Banks	271,376,131			
Financial institutions, average				

2007 DEVELOPMENTS IN THE AUSTRIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The Austrian economy again benefited in 2007 from its strong positioning in Central and Eastern Europe, so that its growth rate corresponded more to the average of the new EU Member States than to that of the old ones. The real GDP growth rate rose slightly from 3.3% to 3.4% during the previous year. Domestic demand was slightly up by 2.4%, compared with 2006, primarily boosted by gross fixed capital formation, which grew at a rate of 5.7% - the highest rate since 2003. At a rate of 1.7% (2006: 2.1%) private consumption grew less quickly, and the situation is similar with regard to public consumption (2007: +1.9%). Net exports dropped slightly. Although exports, at a rate of 7.2%, increased almost as strongly as in 2006, when the rate was 7.5%, the volume of imports was up even more, at 6.1% (2006: 5.6%). The growth also had a positive effect on the labour market: the unemployment rate (according to the Eurostat definition) fell from 4.7% to 4.4% in 2007, while the number of vacancies climbed by roughly 16% to more than 38,000 – the highest figure since 2000.

Accelerated inflation could be observed in Austria in 2007. The rate of increase in the HICP (Harmonised Index of Consumer Prices) rose from 1.7% in 2006 to 2.2% in 2007, also with higher rates towards the year-end – the price rise between November and December was 3.5%. From September, wholesale prices in particular grew at high rates. Excluding energy prices and unprocessed foods, the rate of inflation in December, compared with the previous year, was 2.4%.

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

The direct impact of financial market turbulence on Austrian banks has been comparatively limited. By the end of 2007, Austrian banks had to write off EUR 1.1 billion invested in structured credit products, which is a relatively small amount compared with other countries. This can largely be explained by the fact that their foreign business activities focus mainly on Central, Eastern and Southeastern Europe (CESEE). Moreover, Austrian banks' "originate and hold" strategy and the relatively high significance of customer deposits were contributing factors. Yet, Austrian banks were affected by the turmoil indirectly: Refinancing on the interbank market became more difficult for them, and they incurred trading losses caused by fluctuations in value on capital markets.

Despite these difficult conditions, the Austrian banking sector developed favorably in 2007. The ongoing dynamic activities of Austrian banks in CESEE contributed substantially to this positive development.

In 2007, Austrian banks' CESEE business already accounted for 26% of total assets and 43% of consolidated profits before taxes. Especially the banks' subsidiaries in non-EU countries have been growing at a dynamic pace. Austrian banks have been able to step up their lending and income not only abroad but also at home. On a consolidated basis, i.e. including the data of subsidiaries in CESEE, total assets augmented by 15.7% or EUR 145.5 billion to EUR 1,073 billion year on year at the end of 2007. The share of the five largest Austrian banks rose slightly to 62.5% owing to their strong external business operation. As per end-2007 total consolidated assets as a percentage of GDP amounted to 393%. Consolidated operating profits went up by EUR 1.8 billion or 19.7% to EUR 11.1 billion in 2007 compared with EUR 9.2 billion in the same period of the proceeding year. Reflecting a further improvement in efficiency, banks' consolidated cost-to-income ratio came down from 61.5% at the end of 2006 to 60.7% in December 2007. Consolidated operating income went up by 17.1% – thus more markedly than consolidated operating costs (+15.5%). Driven by credit expansion in CESEE, consolidated interest income advanced by EUR 3.1 billion or 20.7% to EUR 18.0 billion year on year in 2007, thus already making up about two-thirds of the total growth of consolidated operating income. Consolidated fee income, which rose by even 21.1% year on year, accounted for the remainder. International financial market turmoil reduced the consolidated trading income by almost one-quarter to about EUR 0.8 billion in 2007 compared to the previous year.

Given the uncertainty regarding further repercussions of financial market turmoil, there is still the risk that banks might perform less well in future as a result of declining fee and commission income and increasing value adjustments.

Overall, Austrian banks' risk-bearing capacity remains high. Both stable capital ratios and stress tests confirm the Austrian banking sector's good shock resilience. This ties in with a favourable report by the IMF on Austria's financial sector under the 2007 FSAP update.

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

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY.

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 the supervision of credit institutions, insurance undertakings, pension funds, staff provision funds, investment funds, investment service providers, companies listed on the stock exchange as well as stock exchanges themselves.

In accordance with its statutory mandate, the banking supervisory authority is responsible for monitoring the credit institutions' compliance with the statutory framework provisions pertaining to the banking business, ascertaining facts in cases involving the endangering of creditors' interests and taking appropriate remedial measures. In order to carry out these tasks, the FMA is obliged and authorised to take a number of supervisory measures [see answer to Question 5]. These include exercising the right to inspect supervised credit institutions, to demand information from them, to prevent them from taking certain actions or to intervene in their affairs as well as carrying out additional on-site inspections. In case the violation of the BWG results in an inadequate coverage of the risks faced by the (group of) credit institution(s), the FMA shall – irrespective of other measures – oblige the respective institution to hold own funds in excess of the minimum level (up to a maximum of 150%) with regard to specific exposures.

In 2007, the Austrian system of banking supervision was dominated by the debate on the structural reform of its work. The Court of Audit submitted its Audit Report, the Parliamentary Enquiry Committee on Banking investigated cases involving supervision that had been the subject of much public debate, and the International Monetary Fund (IMF) undertook a comprehensive update of its 2003 assessment of Austria as part of its Financial Sector Assessment Programme (FSAP).

Building on these detailed evaluations of the Austrian system of supervision and the experiences gathered during the first five years of operational activity of the FMA, the Austrian Parliament adopted a series of reforms of the country's financial market supervisory system in the late autumn of 2007 (entering into force on January 1, 2008). The core points of the reform encompass the following: (1) The legislators have reaffirmed their clear commitment to an independent, autonomous, integrated financial supervisory authority in the FMA. A clear demarcation between the FMA and OeNB in the area of banking supervision was effected – with the FMA remaining the sole authority and responsibility for inspection whereas analysis being concentrated at the OeNB (including reporting and on-site model inspections) – see.

Chart 1 below; (2) To reinforce the layered structure of supervision, the rights and obligations of the instances upstream of state supervision – such as internal audit, auditors and supervisory boards – were expanded in a corporate governance package; and (3) The fundamentals were put in place for a significant increase in resources in the areas of banking supervision and securities supervision with a particular focus on intensifying and stepping up analysis activities and on on-site presence.

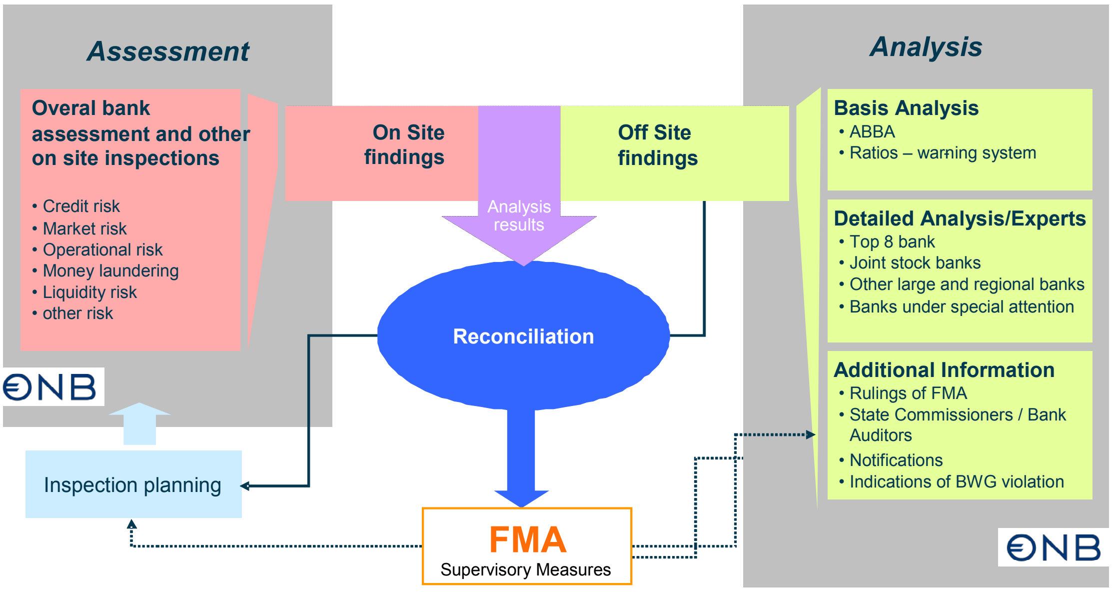


Chart 1: Scheme of Division of Tasks (FMA/OeNB) in the field of banking supervision

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2007

- Orderly execution of the new legal framework deriving from the capital requirements directive (CRD, Dir. 2006/48/EC) and the capital adequacy directive (CAD, Dir. 2006/49/EC);
- Efficient handling of the first (cross-border) IRB- and AMA-approval processes;
- Strengthening the supervision by increasing the number and intensity of on-site inspections;
- Intensifying the collaboration with the Oesterreichische Nationalbank;
- Strengthening the involvement of the external auditor and the state commissioner in the supervisory process;
- Further improvement of analytical tools and systems;
- Further intensifying of the concept of consolidating supervision and contributing to the Lamfalussy Process.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2007, the banking supervisory authority made use of its right to demand information in about 150 cases, usually with the involvement of bank auditors. Apart from these ad hoc information requests, the FMA also held standardised meetings with the management of numerous credit institutions. The so called management talks, representing an important facet of routine analysis, take place on a regular basis with major banks. The main purpose of these meetings is to maintain contact with the management of credit institutions and to examine in greater detail their risk assessment and strategy.

On-site analysis in 2007 was dominated by inspections that were related to individual events and issues as well as by a comprehensive FMA project on the subject of AMA (systematic workflow of AMA model approvals and related inspection activities). In the light of the prospective redistribution of competencies in the field of on- and off-site analysis in the second half of 2007, the FMA started the phase-out of its on-site activities in the fourth quarter of the year.

The focus of OeNB on-site inspections was mainly on the adequate limitation of market and credit risks. In addition, the OeNB was mandated to write expert opinions on the fulfilment of the requirements to receive approval for an internal ratings based (IRB) approach. Inspections related to individual developments that were carried out in 2007 were conducted jointly by the FMA and the OeNB.

In two cases during the period under review the FMA ordered credit institutions, under threat of a coercive penalty, to establish compliance with statutory provisions within an appropriate period of time. These cases concerned violations of regulatory provisions, such as capital requirements or inadequate risk management, but also violations of the provisions pertaining to the prevention of money laundering and terrorist financing. With regard to the need to impose official measures in individual cases, the FMA did not have to take any measures in 2007 to prevent potential danger that obligations of a credit institution vis-à-vis its creditors would not be fulfilled. Furthermore, a total of 15 company visits focusing on money laundering took place during the period under review.

BANKWESENGESETZ (BWG; AUSTRIAN BANKING ACT)	2006	2007
Granting of a licence (new licence) pursuant to section 4 ff. BWG.	8	6
Extensions of a licence pursuant to section 4 ff. BWG	7	5
Expiries of the licence pursuant to section 7 para 2 BWG	14	8
Notification procedures under the freedom to provide services and the freedom of establishment pursuant to section 9 ff. BWG	44	99
Permit for mergers pursuant to section 21 para 1 no. 1 BWG	8	12
Permit for the participation in credit institutions pursuant to section 21 para 1 no. 2 BWG	28	25
Permit for changes in the legal form pursuant to section 21 para 1 no. 3 BWG	4	5
Permit for de-mergers pursuant to section 21 para 1 no. 6 BWG	5	1
Reporting of personnel changes concerning managers pursuant to section 73 para 1 no. 3 BWG	129	112
Reporting of changes in the person responsible for internal audits pursuant to section 73 para 1 no. 11 BWG	63	79
Interest charged pursuant to section 97 BWG (up until the reporting date September 2007)	26	34
BAUSPARKASSENGESETZ (BSPG; BUILDING SOCIETY LAW)	**2006**	**2007**
Permit for changes in the general terms and conditions for the home-purchase savings business pursuant to section 7 para 1 BSpG	6	7

In 19 cases, the FMA's Enforcement Task Force performed preparatory investigations for the purpose of combating unlawful banking activities. Furthermore, 2007 witnessed a significant increase in legal enquiries concerned with the assessment of business models in relation to the licensing provisions as laid down in the BWG.

In 2007, in its role as consolidating supervisor, the FMA concluded one cross-border approval procedure for the internal ratings-based approach in the area of credit risk. To this end, a joint decision was reached between six European supervisors and subsequently signed, and the relevant national administrative decision for implementation in Austria was issued. More than 50 credit institutions thus received approval or preliminary approval, pursuant to section 103e no. 2 BWG, to apply the IRB approach. Further cross border procedures of internationally active groups of credit institutions were initiated by the FMA in its capacity as home supervisor and are expected to be completed in 2008. Finally, in its role as host supervisor, the FMA was actively involved in a cross-border approval procedure and signed a joint decision.

In the area of operational risk, in 2007 the FMA carried out in its role as host supervisor, upon a structured request of the respective home supervisor, initial examinations on the current preparatory status of AMA implementation. The approval procedure is expected to be completed during 2008.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

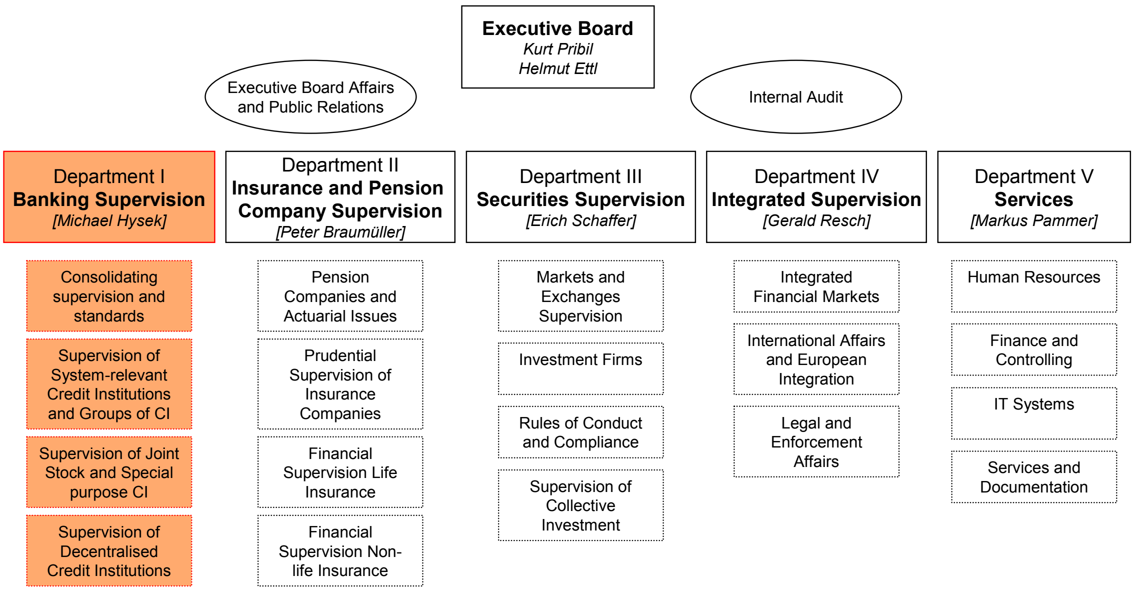


Chart 2: Organizational chart of the FMA

INTERNATIONAL ACTIVITIES OF THE AUTHORITY

Promoting international cooperation and the exchange of information between supervisory authorities is one of the central aims of the FMA. Alongside its involvement in international bodies (IAIS, IOPS, IOSCO, CEBS, BSC, CEIOPS, CESR, CESR-POL), the FMA works particularly hard to intensify contact with those sister authorities that are of particular importance to the Austrian financial market, with particular emphasis in this regard being placed on strategic partnerships with the supervisory authorities in Central and Eastern Europe. 25 MoUs (Memoranda of Understanding) were signed between 1994 and 2007 with 17 countries in the field of banking, insurance and securities supervision. In essence, they set out the details applicable to the respective tasks and the obligations to establish contact with and inform the other supervisory authority in a practice-oriented manner, and they form the basis for regular meetings of the authorities involved. Two new bilateral MoUs in the banking sector were concluded in 2007, with the Malta Financial Services Authority (MFSA) and with the Central Bank of Cyprus.

One focus of the bilateral meetings was the exchange of information on supervised institutions and groups engaging in cross-border activities (cooperation meetings in the banking sector as well as coordination committees in the insurance sector). In 2007, meetings were held with the supervisory authorities of Bulgaria, Bosnia and Herzegovina, Croatia, the Czech Republic, Hungary, Malta, Romania, Russia, Serbia, Slovakia, Slovenia and the USA (Securities and Exchange Commission [SEC], Public Company Accounting Oversight Board [PCAOB], Federal Reserve System [FED]; Office of the Comptroller of the Currency [OCC]; Commodity Futures

Trading Commission [CFTC], New York State Banking Department, and the National Association of Insurance Supervisors [NAIC]). Meetings were also held with the International Monetary Fund (IMF) and the World Bank.

In May 2007, the FMA took part in the Round Table Crisis Mangement (organised by the Austrian Ministry of Finance) with the supervisory authorities of the Czech Republic, Hungary and Slovakia, organised to exchange views on crisis management issues. In June 2007, the FMA also attended the 9th Integrated Financial Supervisors Conference, the annual event for exchange of information and experience among integrated supervisory authorities, in Tokyo and held a joint conference with the World Bank on „Cross border cooperation in Central, Eastern and South Eastern Europe". The traditional annual four-country meeting of the supervisory authorities of Germany, Switzerland, Liechtenstein and Austria was held in Liechtenstein in September.

FMA staff members also visited sister authorities abroad for the purpose of training and exchange of experience, while the FMA hosted similar visits.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

In order to develop a platform for the institutions responsible for the Austrian financial market, the Financial Market Committee was established. It consists of one representative of each of the three bodies (FMA, MoF, OeNB) and meets at least on a quarterly basis at the Federal Ministry of Finance. The committee was designed to encourage cooperation as well as giving feedback on the economic situation and challenges of the Austrian financial sector. Some of the topics discussed can be domestic legal issues, political aspects concerning the financial market or upcoming EU directives and their impact on Austria.

Aside from this tripartite committee, there are two additional forums for information exchange between FMA and OeNB that meet on a regular basis and act as a supporting base for banking supervision in Austria. The first is the Heads of Divisions Forum (Abteilungsleiterforum). As the name indicates, the heads of the departments responsible for banking supervision of the OeNB and the FMA, along with selected (internal) experts meet generally every two months to discuss current issues and problems arisen in the respective divisions. The second forum is the Coordination Forum (Koordinationsforum) which takes place after the Heads of Divisions Forum. Here, the executive board of the FMA meets with the executive director of the economics and financial markets department and the head of the section for financial stability and bank inspections of the OeNB.

[Note, as a result of the structural reform of the Austrian supervisory system, two additional platforms of information exchange between FMA and OeNB were created in spring 2008 to further enhance cooperation between these two institutions (Einzelbankforen).]

STATISTICAL TABLES

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

Type of financial institution	2005	2006	2007
Joint stock banks and private banks	44	48	51
Savings banks	57	56	56
State mortgage banks	10	10	11
Raiffeisen credit cooperatives	576	567	558
Volksbank credit cooperatives	68	70	69
Building and loan associations	4	4	4
Special purpose banks	121	116	121
Financial institutions, total	**880**	**871**	**870**

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

Type of financial institution	2005	2006	2007
Public sector ownership	2,8	2,4	2,4
Other domestic ownership	70,1	71,7	62,2
Domestic ownership total	**72,9**	**74,1**	**64,6**
Foreign ownership	27,1	25,9	35,4
Financial institutions, total	**100.0**	**100.0**	**100.0**

Source: OeNB. Only stakes above 50% are included. Ownership shares are weighted with 100%.

Ownership structure of the financial institutions on the basis of assets total (%)

Type of financial institution	2005	2006	2007
Public sector ownership	5,4	5,1	5,2
Other domestic ownership	73,1	73,0	68,1
Domestic ownership total	**78,5**	**78,1**	**73,3**
Foreign ownership	21,5	21,9	26,7
Financial institutions, total	**100.0**	**100.0**	**100.0**

Source: OeNB. Only stakes above 50% are included. Ownership shares are weighted with 100%.

Concentration of asset by the type of financial institutions (within type of institution)

Type of institutions	The first three largest (%)	The first five largest (%)
Joint stock banks and private banks	79.50	85.03
Savings banks	74.82	80.53
State mortgage banks	57.15	74.35
Raiffeisen credit cooperatives	49.86	59.18
Volksbank credit cooperatives	61.02	66.70
Building and loan associations	90.45	100
Special purpose banks	62.76	69.95

Source: OeNB. Unconsolidated data.

Return on Asset (ROA) by type of financial institutions[9](%)

Type of financial institution	2005	2006	2007
Joint stock banks and private banks	0.57	1.45	0.81
Savings banks	0.60	0.65	0.77
State mortgage banks	0.57	0.55	0.44
Raiffeisen credit cooperatives	0.93	1.09	0.99
Volksbank credit cooperatives	0.41	0.41	0.46
Building and loan associations	0.25	0.28	0.31
Special purpose banks	0.32	0.34	0.29

Source: OeNB. Consolidated data.

[9] ROA = Profits before taxes/Sum of total assets

Return on Equity (ROE) by type of financial institutions[10] (%)

Type of financial institution	2005	2006	2007
Joint stock banks and private banks	14.16	34.05	16.71
Savings banks	18.90	19.69	21.84
State mortgage banks	16.93	16.35	9.5
Raiffeisen credit cooperatives	17.26	20.49	17.25
Volksbank credit cooperatives	9.94	9.05	10.55
Building and loan associations	5.91	6.14	6.20
Special purpose banks	20.10	18.02	18.68

Source: OeNB. Consolidated data.

Distribution of market shares in balance sheet total (%)

Type of financial institution	2005	2006	2007
Joint stock banks and private banks	31.61	30.06	28.32
Savings banks	18.06	17.54	17.24
State mortgage banks	8.45	9.13	9.94
Raiffeisen credit cooperatives	23.22	24.11	23.95
Volksbank credit cooperatives	5.37	6.47	7.59
Building and loan associations	2.90	2.68	2.40
Special purpose banks	10.40	10.02	10.56
Financial institutions, total	**100.0**	**100.0**	**100.0**

Source: OeNB. Unconsolidated data.

[10] ROE = Profits before taxes/Core capital

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

Assets	2005	2006	2007
Cash Reserve	1.88	2.22	2.46
Claims against Credit Institutions	19.94	19.90	19.67
Claims against Customers	49.67	49.14	51.29
Bonds, Stocks, debt instrument	9.57	8.48	6.77
Shares in affiliated enterprises	11.85	12.19	11.32
Other Assets	5.47	6.02	6.27
Total Assets	**100**	**100**	**100**
Liabilities	**2005**	**2006**	**2007**
Amounts owed to credit institutions	24.23	23.43	22.57
Amounts owed to customers (nonbanks)	40.38	40.63	41.48
Debt evidenced by certificates	21.31	20.52	20.40
Provisions	2.32	2.32	1.32
Supplementary capital	2.90	2.67	3.27
Equity	4.26	5.06	5.22
Other Liabilities	4.59	5.37	5.09
Total Liabilities	**100**	**100**	**100**

Source: OeNB. Consolidated data.

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

Type of financial institution	2005	2006	2007
Joint stock banks and private banks	339.40	340.00	426.29
Savings banks	207.29	252.55	257.54
State mortgage banks	104.24	96.69	84.40
Raiffeisen credit cooperatives	146.38	143.56	142.61
Volksbank credit cooperatives	218.71	178.38	182.6
Building and loan associations	18.66	19.03	23.19
Special purpose banks	100.56	85.22	77.53
Financial institutions, total	**207.53**	**208.13**	**228.56**

Source: OeNB. Unconsolidated data. Off-balance sheet items including derivatives.

Solvency ratio of financial institutions (%)

Type of financial institution	2005	2006	2007
Joint stock banks and private banks	12.07	11.93	11.68
Savings banks	10.06	10.02	10.60
State mortgage banks	11.99	11.90	12.34
Raiffeisen credit cooperatives	11.26	12.01	11.92
Volksbank credit cooperatives	11.53	11.64	11.97
Building and loan associations	23.49	22.39	23.52
Special purpose banks	9.36	10.00	11.70
Financial institutions, total	**11.70**	**11.60**	**12.10**

Source: OeNB. Consolidated data.

Asset portfolio quality of the banking system[11]

Asset classification	2005	2006	2007
Non performing loans	2.6	2.1	**n.a.**
Specific loan loss provisions	3.1	2.9	2.4

Source: OeNB.

The structure of deposits and loans in 2007 (%)
(at year-end)

	Deposits	Loans
Households	71.08	40.03
Government sector	4.23	9.15
Corporate	22.29	49.95
Other	2.4	0.87
Total	**100.0**	**100.0**

Source: OeNB. Unconsolidated data. All sectors include domestic and foreign deposits/loans.

[11] All data are in percent of total claims.

The structure of deposits and loans in 2007 (%)
(at year-end)

Maturity of deposits		Loans	
At sight	15.76		
Within one year	34.98	Within one year	37.31
Over one year	37.44	Over one year	54.43
Undefined[12]	11.82	Undefined	8.26
Total	**100.0**	**Total**	**100.0**

Source: OeNB. Unconsolidated data.

Proportion of foreign exchange assets and liabilities (%): (at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Joint stock banks and private banks	18.65	18.38	17.93	16.90	16.28	13.52
Savings banks	25.88	25.73	23.69	22.97	24.44	21.87
Raiffeisen credit cooperatives	22.69	20.71	19.61	21.29	19.46	17.36
Volksbank credit cooperatives	23.03	19.92	16.71	10.22	13.29	9.42
Building and loan associations	-	-	-	-	-	-
Special purpose banks	10.13	8.01	10.75	35.47	32.27	31.64
State mortgage banks	16.78	16.77	15.63	20.67	21.09	18.81
Financial Institutions, total	**19.54**	**18.67**	**11.79**	**20.52**	**19.91**	**17.73**

Source: OeNB. Unconsolidated data.

[12] Undefined: No time to maturity is reported.

Structure of revenues and expenditures of financial institutions (at year-ends) (in Mio EUR)

Revenues	2005	2006	2007
Interest and similar income	23,925	29,366	37,656
Income from securities and participations	2,699	2,878	3,521
Fee-based income	5,446	6,126	6,658
Net profit or loss on financial operations	642	688	289
Other operating income	1,333	1,580	1,592
Interest and similar income	23,925	29,366	37,656
Expenditures	**2005**	**2006**	**2007**
Interest payable and similar charges	16,831	22,196	30,256
Total fees payable	1,506	1,837	1,948
General administrative expenses	8,368	8,960	9,171
Depreciation and amortization	705	647	614
Other Operating expenses	989	1,580	1,592

Source: OeNB. Unconsolidated data.

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	in 1000 EUR	in %	in 1000 EUR	in %
Joint stock banks and private banks	4,038,026	1.28	20,754,790	6.57
Savings banks	645,578	0.32	11,540,296	5.65
State mortgage banks	146,346	0.18	5,885,848	7.16
Raiffeisen credit cooperatives	796,261	0.28	22,973,696	7.96
Volksbank credit cooperatives	508,531	0.51	6,507,500	6.51
Building and loan associations	72,163	0.46	918,706	5.84
Special purpose banks	329,160	0.74	977,953	2.19
Financial institutions, average	**6,536,065**	**0.62**	**69,558,789**	**6.55**

Source: OeNB. Consolidated data.

2007 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF BELARUS

MACROECONOMIC ENVIRONMENT

Macroeconomic situation in the Republic of Belarus in 2007 was characterized by positive dynamics of the main macroeconomic indicators.
In 2007, GDP increased by 8.2% on the previous year. For the most part, such increase was due to the growing domestic consumer and investment demand.

Inflation in the consumer market was 12.1% or 1% per month on average, compared with 6.6% and 0.5% per month, respectively, in 2006.
Real volumes of proceeds and profits from the sale of products by enterprises of the real sector of the economy continued to grow, the number of loss-making enterprises dropped, their paying capacity increased, and the status of settlements in the economy improved. Profitability of sold products throughout the economy amounted in 2007 to 12% (in 2006 to 13.2%). The share of loss-making enterprises dropped from 8.3% to 6.3%.

In the year under review, households' money incomes grew by 24.4% compared with 2006. In 2007, their share accounted for 61.4% of GDP versus 59.8% in 2006. On the whole, in 2007, the households' propensity to save decreased and amounted to 7.9%, compared with 10.1% in 2006.
In the previous year, gold and foreign exchange reserves of the Republic of Belarus increased 3 times amounting to USD4.2 billion as at January 1, 2008, or 1.65 month of goods and services imports (compared with 0.7 month as at January 1, 2007). This was conducive to strengthening of the country's financial stability.

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

As at January 1, 2008, the banking sector of the Republic of Belarus included 27 operating banks and 365 branches. Eight representative offices of foreign banks were operating in the Republic of Belarus (Latvian, German, Lithuanian, Ukraine, Russian banks, and the Interstate Bank).

Foreign capital participated in the authorized capital of 23 out of 27 operating banks, including seven wholly-foreign owned banks. As at January 1, 2008, the share of non-residents in the aggregate authorized capital of the Belarusian banks amounted to 9.8%. In four banks the share of the state (the State Committee on Property of the Republic of Belarus) exceeded 50% of the authorized capital.

In 2007, the banks' aggregate authorized capital grew by 21%, amounting to BYR4,521.5 billion as at January 1, 2008 (USD2.1 billion in equivalent).

In the year under review, the assets (liabilities) of the banking sector increased by 43.8%, amounting to BYR41,690.2 billion (USD19.4 billion in equivalent), and "assets/GDP ratio" rose from 36.6 to 43.4%.

The banks' profits in 2007 amounted to BYR602.1 billion, exceeding 1.5 times the profit obtained in 2006. Profitability indicators13 of the banking sector were as follows:

- "profit/assets ratio" – 1.7% (compared with 1.7% as at January 1, 2007); and
- "profit/own capital ratio" – 10.7% (compared with 9.55% as at January 1, 2007).

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

In 2007, the entire complex of prudential requirements to mitigating risks of the banks' activity was improving, including approaches to calculating capital adequacy in order to ensure a fuller coverage of risks taken by the banks in the course of operation and to make provision for potential losses, and consolidated supervision was in the process of establishment.

The requirements to the business plan of a bank to be established as well as the criteria of its assessment (the adequacy, consistency, reliability, and relevance of the information contained in it) were improved. The information in the business plan should make it possible to reveal potential opportunities and risks of a bank.

The procedures for a bank's temporary administration appointing and functioning were improved: the functions of the temporary administration in case of restriction and suspension of the powers of a bank's executive bodies, the procedures for taking decisions by the temporary administration, and the procedures for coordination of transactions with the temporary administration and a bank's governing bodies were determined.

With a view to improving the management of credit risk the banks were required to use the Basel Committee's on Banking Supervision methodological basis of organization of the credit risk management. Implementation of the above-mentioned principles will enable the banks to increase the efficiency of the credit risk management system with account of the scale, character, and specifics of their activity; to create the information database required to carry out the adequate assessment of the debtor's financial position when issuing and carrying out further monitoring of credit; and to start creation of the own internal system of the debtors assessment on the basis of their internal ratings.

In 2007, the National Bank of the Republic of Belarus made a self-assessment of a compliance of legislation of the Republic of Belarus and practice of its application with the revised Core Principles for Effective Banking Supervision published by the Basel Committee on Banking Supervision in 2006. The National Bank considers it necessary to note a

[13] Profit after taxation is used in the calculation of the indicator.

significant progress of the banking supervision in the Republic of Belarus since the assessment which has been made under FSAP in autumn 2004. It is planned that the assessment by the external experts under FSAP will be made at the end of 2008.

LEGAL COMPETENCE OF THE BANKING SUPERVISION AUTHORITY

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

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

- state registration of banks and licensing of banking activity;
- development of the corresponding economic standards with a view to maintaining stability and soundness of the banking system;
- development of rules and procedures for banking operations;
- on-site inspection of a bank and evaluation of risks related to its functioning;
- revealing infringements of banking legislation and application of corresponding sanctions;
- execution of foreign exchange control;
- specification of the rules of publication and contents of information which is published to assess the degree of reliability of banks and non-bank financial institutions;
- analyses of banks' reports;
- regulation of the foreign capital access to the banking system of the country; and
- regulation of banks' reorganization and liquidation.

Besides, the system of guaranteeing the repayment of funds attracted by banks from natural persons is used in the Republic of Belarus. It is governed by the regulations of the National Bank of the Republic of Belarus and is formed at the expense of the monthly irrevocable payments of banks licensed to accept deposits from natural persons that are accumulated with the National Bank on a free basis.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2007

In 2007, the primary objective of the National Bank was to ensure stability of the banking system of the Republic of Belarus and protection of the banks' creditors and depositors. The above-mentioned objective was achieved by:

- setting up prudential limits with respect to banking risks, capital and reserves adequacy requirements which are in conformity with international practice and take into account the economic situation in the country;
- execution of the efficient day-to-day supervision over banks by analyzing their official reports and inspecting them;
- timely application of remedial measures which ensure the banks' paying capacity, liquidity, and soundness;
- assuring adequate professional skills and reputation of the banks' top managers; and
- removal of banks whose financial condition cannot be improved from the market in a timely fashion and minimization of the after-effects of banks' bankruptcies for the banking system and creditors.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2007

The National Bank carries out a three-way supervision of banks: off-site supervision, inspections of banks and macroprudential supervision.

Off-site supervision is a component part of the ongoing supervision over a bank and is based on the analyses of balance sheet and prudential reports, inspection materials, and other relevant information provided by banks.

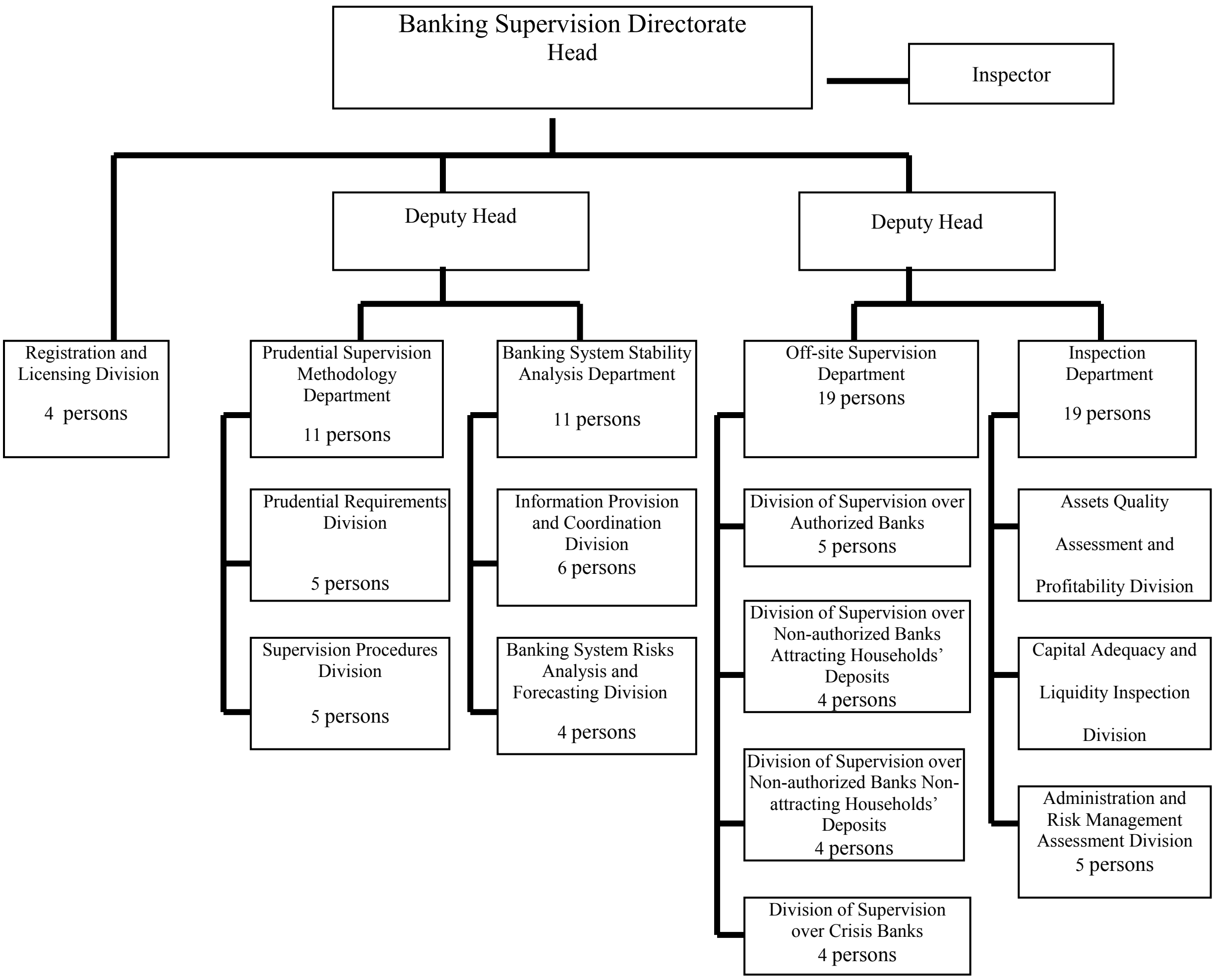
The banks' compliance with the secure functioning requirements was constantly followed throughout the year. Efforts directed towards discontinuation of granting preferences regarding banks' compliance with the prescribed prudential regulations and limitations continued. The National Bank was engaged in strengthening supervision in the area of an in-depth analysis of performance indicators, early identification of negative trends and crisis situations, and implementation of the entire range of supervisory response measures.

The National Bank inspects banks in order to reveal on-site their real financial situation and to assess the risks assumed by the bank, the state of the internal control system, organization of management, compliance with the prescribed prudential requirements, accuracy of transactions in book-keeping, and validity of reports.

In 2007, the National Bank conducted four comprehensive and eight topical inspections in the banks.

In 2007, development of macroprudential supervision aimed at facilitating stable functioning of the banking sector as a whole by means of the comprehensive assessment of the systemic banking risks continued at the National Bank of the Republic of Belarus. Alongside with the monitoring and analysis of the tendencies in the dynamics of the financial stability indicators the key instruments of the macroprudential analysis are the analysis of scenarios, stress-tests and systems of early warning of problem situations.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

The National Bank is endeavoring to establish and develop contacts and exchange of information with foreign banking supervision agencies. Of particular interest is cooperation with those countries in which the representative offices of Belarusian banks are located and whose banks have set up subsidiaries and representative offices in the Republic of Belarus. By end-2007, eleven bilateral agreements with foreign banking supervision agencies were in force, chiefly from the CIS member-states and Baltic countries.

In January and April-May 2007, the IMF missions worked at the National Bank for the purpose of carrying out consultations on the issues related to the efficient use of the instruments of supervision of the banks' activities.

Two IMF missions visited the National Bank in March and July 2007 with a view to providing technical assistance on the financial stability issues. In the course of the above-mentioned missions were considered: the problem of selecting threshold values for the financial stability indicators; technical issues of the macroeconomic stress testing development at the National Bank; current progress of the National Bank in the creation of the macroeconomic model of credit risk for the banking sector; and approaches to stress testing the liquidity risk. The IMF's experts held a number of training seminars.

COOPERATION WITH THE OTHER SUPERVISORY BODIES IN THE COUNTRY

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

Other relevant information and developments in the course of 2007

More detailed information about the development of the banking system and the banking supervision in the Republic of Belarus may be obtained at the official site of the National Bank of the Republic of Belarus (www.nbrnb.by/engl/publications/regulrep/).

STATISTICAL TABLES

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

Type of financial institution	2005	2006	2007
Commercial banks	30	30	27

*) Number of acting financial institutions

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

Type of financial institution	2005	2006	2007
Public sector ownership	85,30	87,92	86,27
Other domestic ownership	5,40	4,24	3,89
Domestic ownership total	**90,70**	**92,16**	**90,16**
Foreign ownership	9,30	7,84	9,84
Financial institutions, total	**100.0**	**100.0**	**100.0**

Ownership structure of the financial institutions on the basis of assets total (%)

Type of financial institution	2005	2006	2007
Public sector ownership	77,55	79,03	76,50
Other domestic ownership	6,28	6,32	3,84
Domestic ownership total	**83,83**	**85,35**	**80,34**
Foreign ownership	16,17	14,65	19,66
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Bank	68,25	71,20	69,79	83,63	86,71	85,95

Return on Asset (ROA) by type of financial institutions (%)

Type of financial institution	2005	2006	2007
Bank	1,25	1,70	1,70

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

Type of financial institution	2005	2006	2007
Bank	6,75	9,55	10,70

Distribution of market shares in balance sheet total (%)
(groupage of acting banks according to capital)

Type of financial institution	2005		2006		2007	
	Quantity of banks	market share	Quantity of banks	market share	Quantity of banks	market share
Bank's capital	30	100,00%	29	100,00%	27	100,00%
incl.						
negativ capital	0	0,00%	1	0,28%	0	0,00%
to 10 bln. roubles	6	0,62%	4	0,10%	0	0,00%
from 10 to 30 bln. roubles	11	3,77%	7	1,34%	8	1,01%
from 30 to 70 bln. roubles	7	8,10%	10	7,60%	8	3,80%
from 70 to 500 bln. roubles	4	28,47%	5	27,69%	9	35,34%
from 500 to 1000 bln. roubles	0	0,00%	0	0,00%	0	0,00%
more than 1000 bln. roubles	2	59,04%	2	62,99%	2	59,85%

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

Assets	2005	2006	2007
Cash assets, gold, precious metals	2,5%	2,5%	2,6%
Assets in the National Bank of the Republic of Belarus	3,4%	1,8%	1,9%
Accounts in other banks	9,3%	5,2%	7,7%
Required reserves	3,9%	4,5%	2,4%
Securities	10,0%	8,7%	7,1%
Credit to individuals and enterprises	64,7%	72,0%	73,4%
Permanent assets and intangibles	4,6%	3,6%	3,4%
Other assets	1,6%	1,7%	1,5%
Total Assets	**100**	**100**	**100**
Liabilities	**2005**	**2006**	**2007**
Own capital	19,7%	17,8%	15,8%
Settlement and current accounts	15,5%	12,8%	12,5%
Correspondent accounts of other banks	0,7%	0,5%	0,8%
Deposits and credit resources of other banks	7,7%	11,8%	14,0%
Deposits of individuals and enterprises	45,1%	47,6%	48,1%
Credit resources of the National Bank of the Republic of Belarus	3,5%	5,3%	3,8%
Other liabilities	7,8%	4,2%	5,0%
Total Liabilities	**100**	**100**	**100**

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

Type of financial institution	2005	2006	2007
Commercial banks	147,45%	150,89%	154,07%

Solvency ratio of financial institutions

Type of financial institution	2005	2006	2007
Commercial banks	26,7%	24,4%	19,3%

Asset portfolio quality of the banking system

Asset classification	2005	2006	2007
Loans, total	14 516,7	22 271,5	32 304,1
Extended loans	22,4	32,3	39,0
Past due loans	52,8	225,1	171,4
Doubtful loans	197,6	-	-
Past due interest			
up to 30 days	18,3	9,4	8,5
more than 30 days	154,8	147,1	131,2
Special reserves	236,9	330,7	398,8

The structure of deposits and loans in 2007 (%)
(at year-end)

	Deposits	Loans
Commercial organizations	15,5%	23,4%
Households	52,6%	27,5%
Noncommercial organizations	30,2%	48,7%
Nonbank financial institutions	1,7%	0,4%
Total	**100.0**	**100.0**

The structure of deposits and loans in 2007 (%)
(at year-end)

Types of deposits		Types of loans	
Demand deposits	41,29%	Long-term lending	75,75%
Time deposits	58,71%	Short-term lending	24,25%
Total	**100,00%**	**Total**	**100,00%**

Proportion of foreign exchange assets and liabilities
(at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Commercial banks	35,34%	30,89%	33,86%	35,29%	30,88%	34,45%

Structure of revenues and expenditures of financial institutions (at year-ends)

Revenues	2005	2006	2007
Interest revenues	1 564,0	2 082,4	3 215,1
Commission	684,0	878,3	1 060,7
Other revenues	219,4	313,0	422,3
Other operational revenues	137,1	92,6	140,5
Reserve settlement	96,2	109,7	178,2
Unanticipated revenues	0,1	-	-
Total revenues	**2 700,8**	**3 476,0**	**5 016,8**
Expenditures	**2005**	**2006**	**2007**
Interest expenses	869,6	1 195,6	1 980,9
Commission	55,3	102,7	162,2
Other expenses	16,8	33,5	63,8
Other operational expenses	1 337,3	1 515,8	1 914,3
Allocation to reserve	211,2	208,4	311,0
Total expenses	**2 490,2**	**3 056,0**	**4 432,2**
Economic revenue	**210,6**	**420,0**	**584,6**

Excluding banks under liqiudation

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	EUR mln	%	EUR mln	%
Banks	2103,0	10,52%	3 035,7	15,19%

2007 DEVELOPMENTS IN THE BANKING SYSTEM OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

MACROECONOMIC ENVIRONMENT

During the year 2007, investments registered a sudden growth, as a result of the inflow of foreign investment (KM 2.89 bn, equal to 13,8% of GDP) and intensified construction activity. The contribution of external consumption to GDP was reduced by approximately 24%, compared to 2006. The nominal value of the GDP in 2007 was KM 21,641 bn, which is a nominal growth of 13,18%, compared to 2006; the growth rate of the real GDP was 6,84%, which indicates that the growth trend from previous years continued, GDP in 2006 was 6.7%. GDP per capita in 2007 was $ 3,940, 23% higher than GDP in 2006 ($ 3,188). GDP per capita (PPP) is $ 7,000. B&H has a large informal sector, which could also be as much as 50% of official GDP.

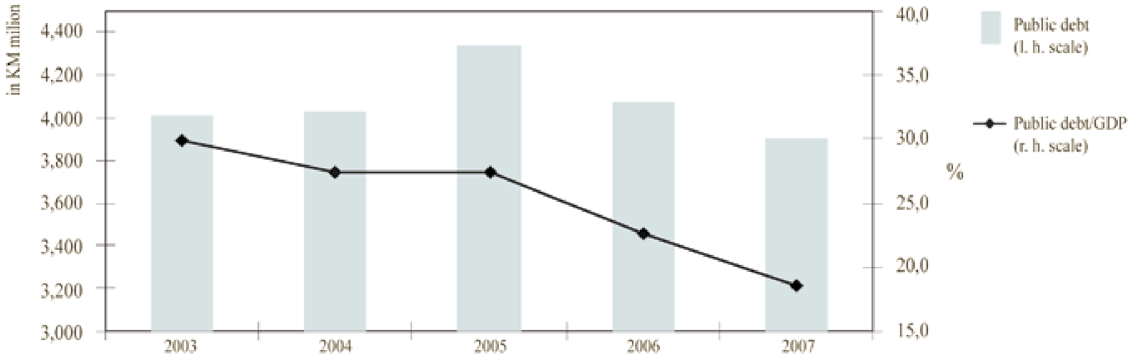
Over the past five years, the average registered growth rate of the volume of industrial production was 8.0% in Federation of Bosnia and Herzegovina (FB&H) and 10.9% in Republic Srpska (RS). In comparison with the previous year, the growth of the volume of industrial production in FB&H was 8.6%, and in RS 1.4%.

During 2007, B&H achieved mild progress in the transition process (privatization of large enterprises and competitiveness), while reforms of non-banking financial institutions proceeded very slowly; in addition, EBRD studies show that B&H needs to accelerate activities in the area of enterprise restructuring, competitiveness and infrastructural reforms. The average annual inflation was 1.3%, which was much lower than in 2006 (in 2006 average annual inflation was 6.1%). Since 2005, inflation has been monitored on the basis of the index of consumer prices, and not on the basis of the retail price index, as was the case previously. Namely, in September 2007 the B&H Statistics Agency published the data on the movement of the consumer price index (CPI) from January 2005. This index, as a measure of inflation, is fully aligned with international standards.

43.9% of total working age population in B&H comprises the labor force (employed and unemployed persons). During 2007, the share of inactive population was reduced, compared to the year 2006: employment trend resulted in the increase of the employment rate by 0.5% and in 2007 it was 31.2%; the unemployment rate was 29% during 2007, lower by 2.1% relative to the previous years.

In 2007, average net wage was KM 681, and it exceeded the average net wage in 2006, by 7.5% (real growth of the average net wage was 5.9%).

The tax incomes grew by 12% in 2007, while in 2006 they grew more than 23%. The concerning fact is that the public consumption, including the procurement of regular assets, grew also in the last year and it amounted 45% of GDP. Fiscal Surplus in 2007 amounts to 1.5% of the GDP. The export/import ratio for the year 2007 is 42.71%.



The total balance of external public debt at the end of 2007 was KM 3.9 bn; the total amount of foreign debt was reduced by KM 167.2 m or 4.1% in comparison with the end of the previous year. The main reasons for the reduction of the external public debt were a reduction of drawing of new credits (KM 179 m of new credits were drawn in 2006, and KM 144.6 m in 2007) and appreciation of KM exchange rate against the US dollar.

At the end of 2007, the external public debt was 18.6% of GDP; the relative size of the debt to GDP has significantly decreased over the last five years (the Figure).

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

At the end of 2007, there were 22 banks operating in the system, out of which 3 banks are majority state-owned and 19 banks are majority privately-owned; seven banks are majority owned by domestic private and legal entities, while 12 banks are majority foreign owned. Four largest banks in the system hold 67.7% of the FB&H market.

There were 7,361 employees in 22 banks in FB&H, representing an increase of 11%, compared to 2006.

In 2007, the banking system of the FB&H has shown a successful performance, continuing with ongoing growth and development, followed by strengthening its stability and safety. During 2007, the banking system of FB&H remained the largest part of the overall financial system in the country, and the most regulated one.

The growth trend of main indicators continued, as follows:

- business indicators improved:
  - the assets of banks grew 24%, comparing to the previous year (KM 14.2 bn),
  - total capital of banks amounted KM 1.5 bn, an increase of 24%,
- capital base of the whole system became stronger;
- new foreign investments were attracted;

- increased deposits (especially savings deposits);
- credit portfolios enlarged;
- risks were monitored and under control;
- stability of the whole sector was improved;
- banking network was expanded;
- new products were introduced/wider diversification of products and services offered, as well as new technologies;
- competition was fortified/higher level of working quality was achieved;
- international operational and examinational standards were applied.

In 2007, the most significant changes could be summarized as further growth and development of the system, strengthening of capital base, inflow of FDI in credit and deposit funds and additional capitalizations/changes in the ownership structure.

Integration process has been directed toward better market positioning, resulted by the largest banks becoming larger, consequently having direct impact on decreasing number of banks and intensifying competition. As of 31.07.2007, integration process of the bank-members of the Intesa SanPaolo Group was finalized (previous LT Gospodarska Bank d.d. Sarajevo acquired to UPI Bank d.d. Sarajevo); integration of the members of the UniCredit Group (UniCredit Zagrebačka Bank d.d. Mostar acquiring HVB Central Profit Bank) was planned for the end of 2007, but it was postponed to 01.03.2008.

As the consequence of the enrolment of domestic banks in international financial markets, the banks will be required to strengthen their capital base, primarily because of the larger exposure to market risks. Banks performed additional capitalization through public subscription of shares and use various instruments, such as: interest rate policy, improvement of organization and staff strengthening, use of financial support, provided by parent bank or group member bank, to occupy better market position and realize higher network expansion.

A result of encouraging the use of credit- and debit-cards, performed by FB&H banks, resulted in FB&H economy as not any more a heavy cash-based one, the process which is caused by present massive use of credit and debit cards in payment processes. The process of using card-based operations in every day transactions was a contribution of the increased profitability of banks in FB&H.

FBA, according to the Law on Micro-credit Organizations (MCOs), is responsible for the supervision of the micro-credit institutions - an entirely new responsibility; during 2007, the FBA has completed development of the overall regulation that has been adopted, within the anticipated timeframe.

Also, since 01.07.2008, all banks and MCOs are obliged to present effective interest rate in all elements.

Total balance sheet sum amounted KM 14.4 bn, representing an increase of 24%, comparing the year 2006. During the last five years (2003-2007), the balance sheet sum has increased 2.5 times.

Commonly used indicator of banks' strength and of the development of banking system is ratio between assets and GDP. In developed countries bank assets are twice or more times larger then GDP; in countries in transition the results are more modest: the indicator is less than 100%. By these criteria, banking sector in the Federation of B&H continued to show constant growth in the last two years, 2006 and 2007: the assets/GDP ratio in FB&H reached 95% and 108%, respectively. The growth of balance sheet resulted from growth of deposits by KM 1.8 bn or 22%, borrowings of KM 435 m which represents increase of 31% in comparison to the previous year and growth of capital by KM 291 m or 24%, compared to 2006.

During 2007, total deposits, as the essential source of financial potential of banks in FB&H, has reached the amount of KM 10.2 bn, which represents, approximately, 49% of estimated GDP. Total capital of banks is amounting to KM 1.5 bn.

Total net income amounted to KM 807 m in 2007, which represents growth of 18%, compared to 2006. The income structure has been improved from qualitative aspect, based on faster growth and higher participation of interest income, in comparison to 2006. The previous has significantly influenced the growth of total profit. At the end of 2007, participation of net interest income was 63.7% and operating income 36.8%.

Previously stated represents a positive indicator of improvement in quality and stability of earnings, as part of the overall positive movements and trends in the banking system of the FB&H.

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) LAWS:

1. Law on Banking Agency of the Federation of B&H ("Official Gazette of the F B&H", No. 9/96, 27/98, 20/00, 45/00, 58/02, 13/03, 19/03, 47/06 and 59/06),
2. Law on Central Bank of B&H ("Official Gazette of B&H", No. 1/97, 29/02, 13/03, 14/03, 9/05, 76/06 and 32/07),
3. Law on Banks ("Official Gazette of the F B&H", No. 39/98, 32/00, 48/01, 27/02, 41/02, 58/02, 13/03, 19/03 and 28/03),
4. Law on Micro credit organizations ("Official Gazette of the F B&H", No. 59/06),
5. Law on Financial Operations ("Official Gazette of the F B&H", No. 2/95, 13/00 and 29/00),
6. Law on Foreign Exchange Operations ("Official Gazette of the F B&H", No. 35/98),
7. Law on Securities ("Official Gazette of the F B&H", No. 39/98 and 36/99),
8. Law on Securities Registry ("Official Gazette of the F B&H", No. 39/98 and 36/99),
9. Law on Securities Commission ("Official Gazette of the F B&H", No. 39/98 and 36/99),

10. Law on Prevention of Money Laundering ("Official Gazette of the B&H", No. 29/04),
11. Law on Bill of Exchange ("Official Gazette of the F B&H", No. 32/00 and 28/03),
12. Law on Check ("Official Gazette of the F B&H", No. 32/00),
13. Law on Payment Transactions ("Official Gazette of the F B&H", No. 32/00 and 28/03),
14. Law on Obligations ("Official Gazette of the F B&H", No. 29/03),
15. Law on Enterprises ("Official Gazette of the F B&H", No. 23/99, 45/00, 2/02, 6/02-correction, 29/03 and 68/05),
16. Law on Bankruptcy ("Official Gazette of the F B&H", No. 29/03, 32/04 and 42/06)
17. Law on Liquidation Process ("Official Gazette of the F B&H", No. 29/03),
18. Labor Law ("Official Gazette of the F B&H", No. 43/99, 32/00 and 29/03),
19. Law on Executive Procedure ("Official Gazette of the F B&H", No. 32/03, 33/06 and 39/06),
20. Law of Civil Procedure ("Official Gazette of the F B&H", No. 53/03 and 19/06),
21. Law on Opening Balance Sheet of Enterprises and Banks ("Official Gazette of the F B&H", No. 12/98, 40/99 and 47/06),
22. Law on Registration of Legal Entities into Court Registry ("Official Gazette of the F B&H", No. 4/00, 19/00, 49/00, 58/01, 32/02, 13/03, 19/03 and 50/03),
23. Law on Administrative Procedure ("Official Gazette of the F B&H", No. 2/98 and 48/99),
24. Law on Violations Subject to the F B&H ("Official Gazette of the F B&H", No. 31/06),
25. Law on Treasury in the F B&H ("Official Gazette of the F B&H", No. 19/03),
26. Law on Bank Privatization ("Official Gazette of the F B&H", No. 12/98, 29/00, 37/01 and 33/02),
27. Law on Accounting and Audit of the F B&H ("Official Gazette of the F B&H", No. 32/05),
28. Law on Competition ("Official Gazette of the F B&H", No. 48/05),
29. Law on Assumption of Share Holder Companies ("Official Gazette of the F B&H", No. 7/06),
30. Law on Criminal Procedures of Bosnia and Herzegovina ("Official Gazette of the B&H", No. 36/03, 26/04 and 76/06),
31. Roof Law on Pledges ("Official Gazette of the B&H", No. 27/04 and 54/04),
32. Law on Deposit Insurance in B&H ("Official Gazette of the B&H", No. 20/02 and 18/05).

B) PRUDENTIAL REGULATIONS ISSUED BY FBA:

1. Decision on Bank Supervision and Actions by the Banking Agency of the Federation of B&H ("Official Gazette of the F B&H", No. 3/03),

2. Decision on Minimum Standards for Capital Management in Banks ("Official Gazette of the F B&H", No. 3/03, 18/03, 53/06, 55/07, 81/07 and 6/08),
3. Decision on Minimum Standards for Loan Risk and Assets Classification Management in Banks ("Official Gazette of the F B&H", No. 3/03, 54/04 and 68/05),
4. Decision on Minimum Standards for Risk Concentration Management in Banks ("Official Gazette of the F B&H", No. 3/03, correction 6/03, 18/03, 64/03 and 1/06),
5. Decision on Minimum Standards for Internal and External Audit in Banks ("Official Gazette of the F B&H", No. 3/03),
6. Decision on Minimum Standards for Internal Control System in Banks ("Official Gazette of the F B&H", No. 3/03),
7. Decision on Minimum Standards for Liquidity Risk Management in Banks ("Official Gazette of the F B&H", No. 3/03, 12/04, 88/07 and 6/08),
8. Decision on Minimum Standards for Foreign Exchange Risk Management in Banks ("Official Gazette of the F B&H", No. 3/03, 31/03, 64/03 and 54/04),
9. Decision on Minimum Standards for Operations with Related Entities in Banks ("Official Gazette of the F B&H", No. 3/03),
10. Decision on Minimum Standards for Documenting Loan Activities in Banks ("Official Gazette of the F B&H", No. 3/03),
11. Decision on Reporting about Non-performing Customers Considered a Special Loan Risk ("Official Gazette of the F B&H", No. 3/03),
12. Decision on Minimum Scope in Form and Content of Program and Reporting about Economic-Financial Audit in Banks ("Official Gazette of the F B&H", No. 3/03 and 64/03),
13. Decision on Reporting Forms Submitted by Banks to the Banking Agency of the Federation of B&H ("Official Gazette of the F B&H", No. 3/03, 18/03, 52/03, 64/03, 6/04, 14/04, 54/04, 5/05, 43/07, 55/07, 81/07, 88/07 and 6/08),
14. Decision on Conditions when Bank is Considered Insolvent ("Official Gazette of the F B&H", No. 3/03),
15. Decision on Procedure for Determination of Claims and Distribution of Assets and Liabilities in Liquidation of Banks ("Official Gazette of the F B&H", No. 3/03),
16. Criteria for Internal Rating of Banks by the Banking Agency of the Federation of F B&H ("Official Gazette of the F B&H", No. 3/03, correction 6/03),
17. Decision on Minimum Standards for Activities of Banks in Prevention of Money Laundering and Terrorism Financing ("Official Gazette of the F B&H", No. 3/03, 18/04, 5/05 and 13/05),
18. Decision on Financial Disclaimer ("Official Gazette of the F B&H", No. 3/03),
19. Decision on Interest and Fee Accrual for Dormant Accounts ("Official Gazette of the F B&H", No. 7/03),
20. Decision on Amount and Conditions for Origination of Loans to Bank Employees ("Official Gazette of the F B&H", No. 7/03),

21. Guidelines for Licensing and Other Approvals Issued by the Banking Agency of the F B&H ("Official Gazette of the F B&H", No. 46/02, 18/03, 27/04 and 6/08 changes and cleaned text)
22. Decision On Minimum Standards For Bank Market Risks Management ("Official Gazette of the F B&H", No. 55/07, 81/07 and 6/08),
23. Decision on Unified Accrual and Declaration of Effective Interest Rate on Loans and Deposits ("Official Gazette of the F B&H", No. 27/07),
24. Decision on Minimum Standards for Operational Risk Management in Banks ("Official Gazette of the F B&H", No. 6/08),
25. Decision on Requirements and Procedure for Issuance of License to Micro-credit Foundations, Created as a Result of Changed Form of Micro-credit Organizations ("Official Gazette of the F B&H", No. 27/07),
26. Decision on Requirements and Procedure for Issuance and Revoking of License and Other Approvals to Micro-credit Organizations ("Official Gazette of the F B&H", No. 27/07),
27. Decision on Requirements and Procedure for Issuance of Licenses and Consent to Acquirer Ownership Share by Investing and Transferring Property of Micro-credit Foundation ("Official Gazette of the F B&H", No. 27/07),
28. Decision On The Supervision Of Micro-credit Organizations ("Official Gazette of the F B&H", No. 27/07),
29. Decision On The Form And Content Of Reports Micro-credit Organizations Submit To The Banking Agency Of The Federation Of B&H And Reporting Deadlines ("Official Gazette of the F B&H", No. 27/07),
30. Decision on Level and Method of Establishing and Maintaining Loan Loss Reserves of Micro-credit Organizations ("Official Gazette of the F B&H", No. 27/07),
31. Decision on Other General Requirements for Micro-credit Organizations ("Official Gazette of the F B&H", No. 27/07),
32. Decision on Fees Micro-credit Organizations Paid to Banking Agency of the Federation of B&H ("Official Gazette of the F B&H", No. 27/07),
33. Decision on Unified Method of Accrual and Declaration of Effective Interest Rate on Loans and Deposits ("Official Gazette of the F B&H", No. 27/07),

Legal Competences of FBA:

1. Issuance of license for establishment and work of banks and micro-credit organizations, issuance of license for changes of organizational system of banks and micro-credit organizations, type of activity and approvals for appointment of their managing staff;
2. Supervision of banks and micro-credit organizations, undertaking of measures in accordance with law;
3. Revoking work license from banks and micro-credit organizations in accordance with law;
4. Administration or supervision of bank rehabilitation and liquidation process and initiation of bank bankruptcy procedure;
5. Adoption of sub-legislation regulating work of banks;

6. Evaluation of conditions and issuance of approval to banks for the next issue of shares;
7. Implementation of actions in the support of anti-terrorist activities related to banks;
8. Taking all such actions as may be appropriate, which may include the blocking of customer accounts in any bank or banks within the jurisdiction of the Federation Banking Agency, in order to prevent the funding of activities which are, or which threaten to be, obstructive of the peace implementation process as pursued under the aegis of the General Framework Agreement for Peace in Bosnia and Herzegovina and requiring the Central Bank of Bosnia and Herzegovina to open a special reserve account; requiring the banks in which accounts are blocked under item h) aforesaid and transfer criminal funds to the safe keeping of the Central Bank of Bosnia and Herzegovina, or one of its main units and undertake numerous actions related to above mentioned issues including revocation of banking licenses and other kinds of authorizations.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2007

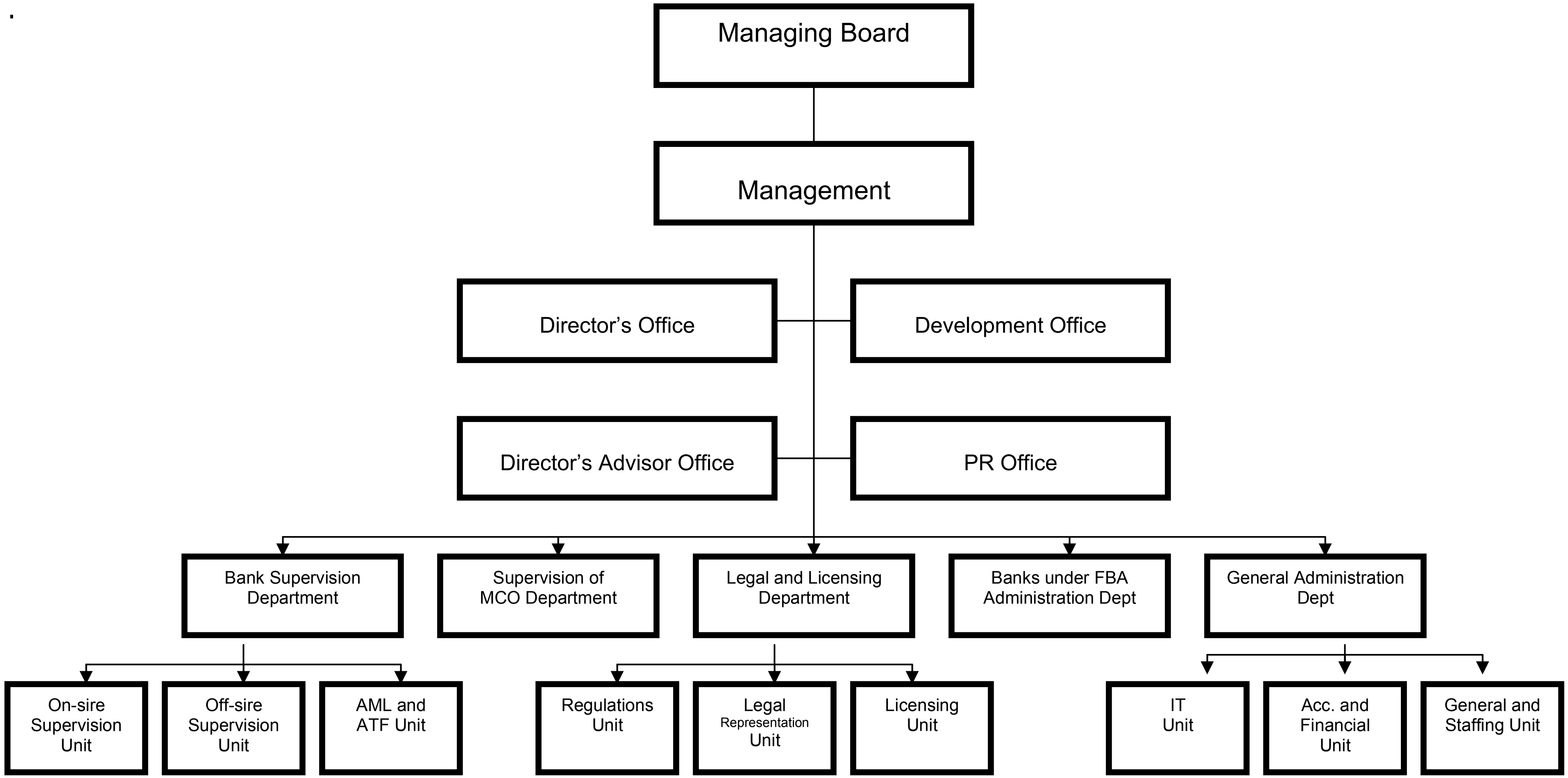
1. To continue process to amend and develop the Laws, regulations and procedures in accordance with the Core Basel principles and the EU directives;
2. To further enhance and strengthen supervision process, with special emphasis on trends of capital strengthening, increased quality of credit policies and their harmonized implementation in practice, increased prudence and strengthen quality of bank management, especially of credit risk as a dominant risk in the banking system of the Federation of B&H, followed by liquidity risk and foreign exchange position, providing incentive for large banks to become larger and strengthening of their financial potential;
3. To pass a sub-legislation aimed to regulation and supervision of micro-credit organizations;
4. To further develop and adjust the FBA's IT system from the aspect of some new requirements concerning capital, new risks and new products;
5. To add value to the finalization of the privatization process of banks;
6. To expand cooperation with the authorized supervisory institutions, domestically and internationally;
7. To continue working on permanent education of the Agency's staff.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2007

1. Adoption of some new and changes to the present regulation;
2. Self-assessment of compliance with the Basel Core Principles Effective Banking Supervision;
3. Activities aimed to implement the recommendations issued by the IMF for banking supervision (the IMF document „National Report‟ for B&H, number 07/268 dated of July, 2007);
4. Regular activities related to examination of banks (full-scope and targeted on-site examinations, examinations conducted by the Prevention of Money Laundering and Terrorism Financing in Banks Unit);
5. Administration of previously initiated provisional or liquidation administrations in banks;
6. Collection and analysis of prudential reports submitted by banks (at quarterly, monthly or daily basis);
7. Preparation of reports (annually and quarterly based) about the banking system of the Federation of B&H, and any other information for internal and external purposes;
8. Adoption of legislation and sub-legislation for regulation and supervision of micro-credit organizations;
9. Participation in the work of the Group of Banking Supervisors of the Central and Eastern Europe (BSCEE);
10. Participation in preparations to establish a special „Group of Banking Supervisors of Host Countries‟ in the Southeast Europe countries with purpose of cooperation and strengthening of the host country supervisors' position that share the same supervisory interests and prevention of problems in banks with the same foreign banks owners;
11. Continued education of the FBA's staff, domestically and internationally, and providing assistance in form of a specialized education of the staff of other supervisory bodies and institutions of the Federation of B&H, etc.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

.



INTERNATIONAL ACTIVITIES OF YOUR AUTHORITY

The FBA has already signed the memorandums of understanding with supervisory authorities of 4 countries (Bank of Slovenia, National Bank of Croatia, National Bank of Serbia and Central Bank of Montenegro), while negotiations related to signing of the memorandums with the supervisory authorities of Italy (Bank of Italy), Turkey (Banking Regulation and Supervision Agency) and Austria (Financial Market Supervisory Authority) are underway.

At the beginning of 2008, in Greece was signed a Memorandum of Understanding, among the representatives of Bosnia and Herzegovina (Central Bank of B&H, Banking Agency of the Federation of B&H and Banking Agency of Republic Srpska) and central banks of the Southeast Europe countries (Albania, Greece, FYR of Macedonia, Romania, Bulgaria, Serbia, Montenegro and Cyprus), with the aim to further advance international cooperation in the area of banking supervision.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The FBA has established cooperation with the Central Bank of Bosnia and Herzegovina (MoU); Deposit Insurance Agency of B&H (MoU); Insurance Companies Supervision Agency (MoU); Intelligence-Security Agency of B&H (MoU), and other domestic institutions.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN THE COURSE OF 2007

During the past year, activities have been intensified to sign the new expanded „Memorandum on Principles of Coordination in Bank Supervision and Cooperation and Exchange of Data and Information" (which was realized at the beginning of June 2008) among the Central Bank of B&H, Banking Agency of the Federation of B&H and Banking Agency of Republic Srpska, as realization of the CARDS Program recommendations (proposed measures for coordination of bank supervision), prepared by the experts of the European Central Banks. The purpose of this new Memorandum is to significantly strengthen coordination of bank supervision by the Central Bank of B&H and it represents a transitional phase with its ultimate goal to have an institutional establishment of a consolidated banking supervision at state level.

The FBA offers a strong support to consolidation of bank supervision at state level, since it is the only acceptable way to get a stronger and more effective supervision of financial sector of the country.

STATISTICAL TABLES

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

Type of financial institution	2005	2006	2007
BANKS	24	23	22

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

Type of financial institution	2005	2006	2007
Public sector ownership	16,9	15,2	12,8
Other domestic ownership	12,9	9,3	13,0
Domestic ownership total	**29,8**	**24,5**	**25,8**
Foreign ownership	70,2	75,5	74,2
Financial institutions, total	**100.0**	**100.0**	**100.0**

Ownership structure of the financial institutions on the basis of assets total (%)

Type of financial institution	2005	2006	2007
Public sector ownership	4,5	4,1	2,7
Other domestic ownership	6,5	2,9	4,9
Domestic ownership total	**11,0**	**7,0**	**7,6**
Foreign ownership	89,0	93,0	92,4
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Bank			57,8			74,4

Return on Asset (ROA) by type of financial institutions (%)

Type of financial institution	2005	2006	2007
Bank	0,72	0,86	0,86

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

Type of financial institution	2005	2006	2007
Bank	7,81	10,64	11,68

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

Assets	2005	2006	2007
CASH AND SECURITIES	37,9	37,7	34,8
PLACEMENTS TO OTHER BANKS	0,7	0,9	0,5
LOANS - NET VALUE	56,3	56,8	60,2
PREMISES AND OTH. FIXED ASS.	3,3	3,0	2,9
OTHER ASSETS	1,8	1,6	1,6
Liabilities	**2005**	**2006**	**2007**
DEPOSITS	73,2	72,9	71,8
BORROW. FROM BANKS	0,0	0,0	0,0
LOANS PAYABLES	12,3	12,3	13,1
OTHER LIABILITIES	3,7	4,1	4,5
CAPITAL	**10,8**	**10,7**	**10,6**

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

Type of financial institution	2005	2006	2007
Banks	16,96	17,52	19,54

Solvency ratio of financial institutions

Type of financial institution	2005	2006	2007
Banks	89,2	89,3	89,4

Asset portfolio quality of the banking system

Asset classification	2005	2006	2007
A	89,6	90,0	89,8
B	7,5	7,9	8,7
C	1,4	1,1	0,8
D	1,5	1,0	**0,7**
E	-	-	-
Classified total	**100,0**	**100,0**	**100**
Specific reserves*	**17,0**	**14,2**	**11,9**

*Specific reserves/ asset classif.B+C+D

The structure of deposits and loans in 2007 (%)
(at year-end)

	Deposits	Loans
Households	41,2	50,3
Government sector	12,8	0,4
Corporate	25,1	47,4
Foreign	-	-
Other	20,9	1,9
Total	**100.0**	**100.0**

The structure of deposits and loans in 2007 (%)
(at year-end)

Types of deposits		Types of loans	
At sight	46,6	Long term loans	78,2
Within one year	14,5	Medium-term loans	-
Over one year	38,9	Short-term loans	21,8
Total	**100.0**	**Total**	**100.0**

Proportion of foreign exchange assets and liabilities
(at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Banks	26,5	20,8	15,6	62,5	59,9	60,3

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	000 EUR	%	000 EUR	%
Banks	534.421	7,3	237.899	3,3

2007 DEVELOPMENTS IN THE BULGARIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

GDP growth rate in 2007 was 6.2%, preserving the trend of relatively strong growth performance despite the sharp contraction of real agricultural output of about 30%. Fixed capital formation growth was strong at 21.7%. Thus the contribution of investment was well above that of consumption expenditure. In 2007 a marked improvement of the labour market was observed. Unemployment dropped down markedly by two percentage points to 6.9% for 2007. Annual average HICP inflation in 2007 was 7.6%, while end of period inflation reached 11.6% with major contribution of food and hotel and restaurants (7.1 pp). The combined current and capital account balance deteriorated in 2007 to a deficit of 20.3% of GDP from 17.1% in 2006. The high investment activity in the country (the gross capital formation reached 36.8% as a share of GDP in 2007, up by 5.1 p.p. compared to 2006) continued to be spurred by large capital inflows from abroad. The inflow of foreign direct investment in 2007 (21.1% of GDP) covered the net borrowing position of the country at 104%. Overall, the balance of payments was on surplus in 2007 and the central bank's reserves expanded by 10.1% of GDP. The steady growth of the imported investment goods (machines and equipment, vehicles and electrical machinery) was driven by the substantial inflows of FDI.

Monetary aggregates have preserved their relatively high growth rates supported by the strong economic activity and large capital inflows. Broad money increased by 31.2% in the year to February 2008, with monetary aggregate M1 and quasimoney growing by 28.9% and 33.7% respectively. 3-month SOFIBOR increased from 4.53% in June 2007 to 6.56% in December 2007 Its average spread against 3-month EURIBOR widened from 0.38 percentage points in June 2007 to 1.71 percentage points in December 2007. The yield on the long-term government securities moved up as well increasing from 4.57% in June 2007 to 5.08% in December 2007.

DEVELOPMENT IN THE BANKING SYSTEM

At the end of 2007 the total assets of the Bulgarian banking sector amounted EUR 30.2 billion. As a result of the increase during last few years for the first time at the end of 2007 the sectors' assets are bigger than the country GDP. The ratio of banking sector assets to the GDP moved up from 77% in 2005, 86% in 2006 to 104% in 2007. In total there are 29 credit institutions, including 5 branches of foreign banks. The public sector ownership (state or municipal) is insignificant - below 2%. Top five banks hold 57% of the market in terms of total assets and their development is a significant determinant of the processes in the banking system as a whole. Three credit institutions are listed at the Bulgarian stock exchange.

During 2007 the number of domestically controlled institution decreased from 10 to 8 as well as their market share in terms of total assets from 19.92% to 17.3%. Foreign ownership accounted for 82.10% of total assets. The market share of total assets of the EU institutions operating in Bulgaria rises from 77.3% to 79.4%. As of end-2007, the biggest market share is held by banks and branches under the control of Greek shareholders, – over ¼ of system assets, followed by those with Italian, Hungarian, and Austrian owners. Credit institutions with shareholders from France, Germany, and Belgium hold a more modest stake (below 5%). During the first year of the membership in EU 89 notifications were submitted to Bulgarian National Bank by EU licensed credit institutions with intentions to provide cross border services in Bulgaria.

The banks in Bulgaria are licensed as universal credit institutions, offering a broad range of products and services both to the corporate and the household sectors. There is no narrow specialization of banks into investment banks, savings institutions, etc. The penetration ratio indicates a growing intensity of banking intermediation and expanding branch network. The number of devices for non-cash services in this country has grown. At the end of 2007 there were 76 points of sale (branches, offices, representative offices and remote workstations), 52 ATMs and 525 POS terminals per 100 000 population. The banks have been increasingly using the alternative distribution channels like debit and credit card issuers, leasing companies registered as banking subsidiaries, asset management companies, pension and insurance companies, etc. New saving and investment products have been offered to the growing number of clients.

The assets quality remains good. The ratio NPL to total gross loans is 2.1%. The level of provisioning is adequate to the risk profile of the banks operating in Bulgaria. Bulgarian national bank follows very tight level of impairment – loans, past due more than 90- days are considered NPL and should be provisioned 100%. Similarly, supervisory requirements for provisioning of loans in less riskier categories are higher than those under IRFS.

By a stress testing model, the BNB has analyzed the institutions' capabilities of absorbing future shocks in terms of different types of risks – credit, liquidity and market - typical for bank portfolios. The effect of applied shocks indicates that the banking system has the capacity to absorb negative impact.

The system generated more than 588 Million EURO profit for 2007 - 46.3% higher than the previous year. The 2007 performance is strong with stable and good profitability, driven by core activities. ROA is 2.4% (2.2% as of Dec. 2006), ROE is 23.9% (23.7% Dec.2006). Those are sustainable trends and the levels are above the average for the EU member states. The key driver is considered the growth of the interest bearing assets. On the other hand the level of operating cost had been sustained despite the investments in expanding branch network - cost–to–income ratio is 51.5% for 2007 compared with 60.2% for 2006 and is considered a positive indicator for overall banks' performance. The positive trend is to continue through 2008 providing that the quality of assets is preserved.

Banks report their own fund, capital requirements, exposures and solvency ratio using the COREP reporting framework Current level of own funds is good and adequate to the risk profiles. The overall solvency ratio is

13.9%, Tier 1 ratio is 10.8% at the end of 2007 (The regulatory minimum in Bulgaria is 12%). Against 2005 and 2006 the adequacy ratios declined as the banking business grew and the capital expenditures were optimized. Most banks have increased their own funds throughout 2007 – some trough paid-in capital by their shareholders, others trough the capital market. Additional own funds were allocated trough instruments of subordinated debt, which estimate of more than half of Tier 2 capital. The capital surplus is unevenly distributed - the considerable part is concentrated in the five largest banks. Credit risk remained as the dominating risk in the banking system, as the capital requirements for covering it amounted to 89.5% of total capital requirements for covering all risks in the system.

Current level of liquidity is estimated as good and adequate. Loans-to-deposit ratio is 79.7%, Liquid assets ratio is 28.24%. The level of parent funding is relatively low, mainly due to the fact that banks finance their activities relying on the funds, provided by residents (households and corporate).

The outlook for 2008 is stable and positive. Certain deteriorations in loans' quality are not excluded, but we expect this to be covered by resources, generated by core activities of the banks.

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

The legal framework for establishment and operation of banks is stipulated in the Law on Credit Institutions (in force since 1 January, 2007) and many ordinances for its application, settling the basic bank supervisory regulators (capital adequacy, large exposures, provisions set aside for risk of losses on exposures, liquidity, internal control, consolidated supervision, etc.). With adoption of the Law on Credit institutions, which is in full accordance with the legislation of the European Union, the ordinances regulating the basic requirements to the activity of the banks since the beginning of 2007 were amended, or new ordinances were accepted.

The institutional framework of the bank supervision and the payment systems supervision (which are performed by the Bulgarian National Bank) is stipulated in the Law on the Bulgarian National Bank, Law on Credit Institutions, and Law on Funds Transfers, Electronic Payment Instruments and Payment Systems. BNB licenses, performs current supervision, applies different corrective supervisory measures and sanctions, and is in its right to revoke the licenses of the banks. Licensing and the grievous measures (putting under special supervision, revoking the license) are in the power of the Governing Council of the BNB, and the remaining supervisory measures and sanctions – of the Deputy Governor, in charge of the Bank Supervision Department.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2007

In 2007 the focus was given to the development of the Pillar 2 requirements related to the application of the Capital adequacy regime. The process was build around the CEBS Pillar 2 guidelines for ICAAP/SREP process, concentration risk, liquidity risk and interest rate risk in the banking book. In response to the ongoing activities for increasing convergence of the supervisory practices in the EU, we've also introduced a Supervisory Disclosure section on the BNB's official web site, containing relevant information about the transposition of the CRD requirements. Another strategic objective for 2007 was passing through the final stage of implementation of FINREP and COREP frameworks, including the organizations of seminars for banks' experts involved in regulatory and financial reporting.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In the field of supervisory methodology 2007 was a very intensive year. The scope of activities covers the implementation of a legal framework comprising the latest European directives introducing Basel II requirements, adoption of Law on Credit Institutions, introducing compliance between Bulgarian legislation and European directives on credit institutions.

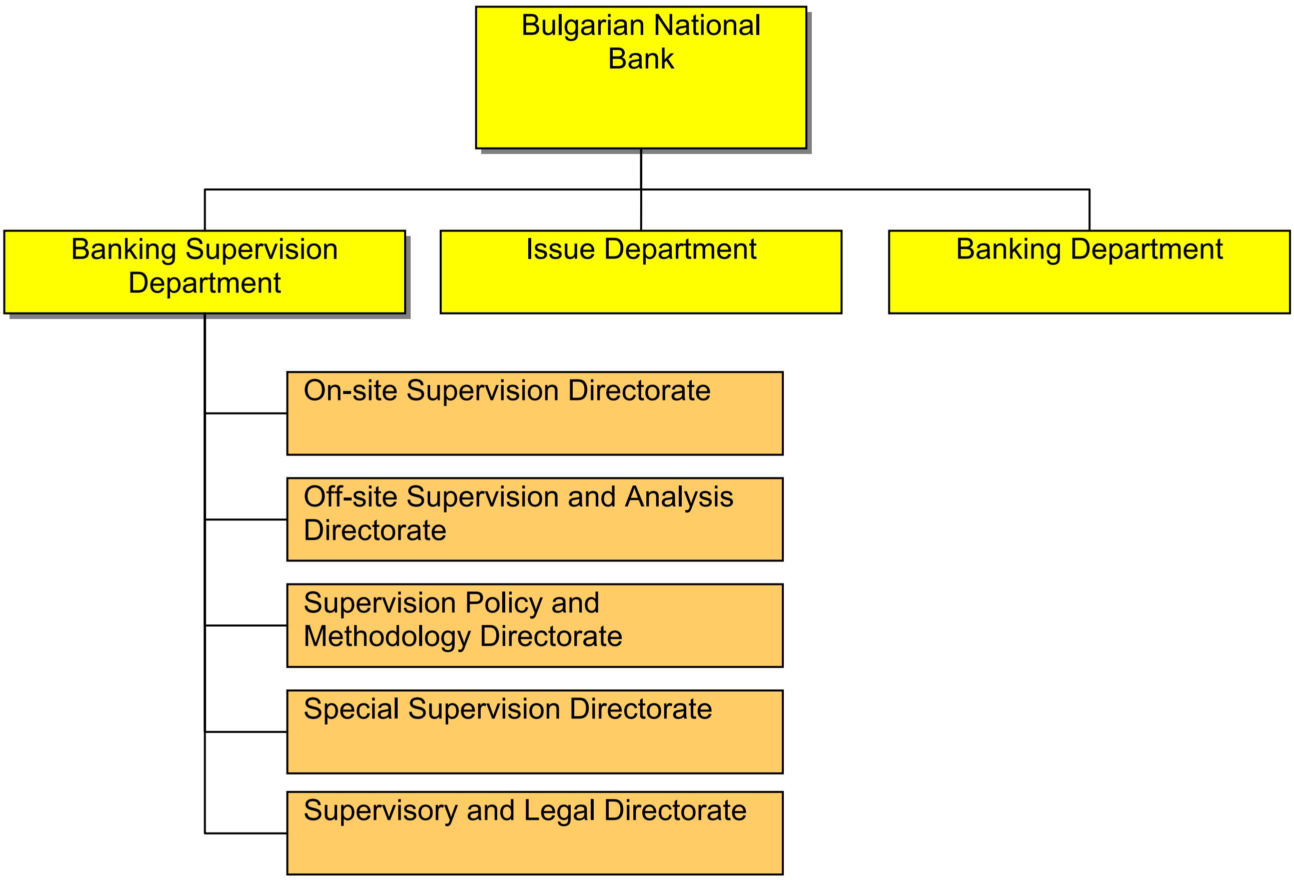
- Several changes in secondary regulations had been undertaken:
  - on Capital Adequacy of Credit Institutions; on Large Exposures of Banks;
  - on Liquidity Management and Supervision of Banks;
- on the Evaluation and Classification of Risk Exposures of Banks and the Allocation of Provisions to Cover Credit Risk;
- on Establishing the Amount of Bank Investment in respect to connected lending and
- on the Supervision on a Consolidated Basis.
- In the beginning of 2007 new reporting forms, compliant with the common reporting standards (COREP) and New balance sheet and income statements based on CEBS FINREP consolidated financial reports were introduced.
- In July 2007 BNB published The Major Principles of BNB Licensing Policy stating the essential considerations of prudent and conservative licensing for new entrants into the banking market.

The 2007 on-site supervision program increased the intensity of full-scope and theme inspections (monitoring particular risks or products). One such inspection of the operational risk management of all banks found that banks were highly aware of operational risk and managed it adequately. Most of the recommendations resulting from the full-scope examinations addressed credit risk monitoring and management, including loan classification and provisioning, credit concentration, and on the other hand improving and updating banks' internal rules and procedures and strict adherence to them.

Off-site supervision focused on early identification of risks and monitoring banking system risk dynamics. An important accent in off-site supervision work was the updating and improvement of methodology for monitoring credit institutions' performance. The off site review was adapted to reflect the new regulatory framework. The improvements in the off site analytical tools (Early Warning System and stess-testing) aimed at better reflection of the growing level of sophistication in credit institutions' operations and diversification of risks.

In 2007 the Special Supervision focused on improving transparency of shareholders' contributions to banks' capital. Consistent measures were initiated to prevent the illegal use of banking, money laundering and terrorist financing. Intensive cooperation with institutions responsible for preventing illegality in the financial sector continued. Coordinated action under memoranda of understanding with the Chief Prosecutor, the Financial Investigation Agency, and the Financial Supervision Commission aimed at financial sector crime prevention. Under established good practice for assistance between institutions fighting financial fraud and money laundering expert help was provided to law enforcement bodies.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES

In relation with the supervision over the international banking groups presented on the Bulgarian market, experts from the Banking Supervision Department took part in a number of supervisory colleges, organized by the Greek, Italian, Austrian, Hungarian and French Banking Supervision Authorities.

Representatives from the Banking Supervision Department of BNB regularly take part in the work of several European committees and their related sub-structures in charge of the development of the financial systems, regulatory framework and supervision in the EU.. In connection to the work in these committees our experts also took part in different studies of the supervisory practices harmonization and the implementation of Basel II in EU.

COOPERATION WITH OTHER SUPERVISORY BODIES IN BULGARIA

BNB has signed MoUs with the Deposit Insurance Fund (DIF) and the Financial Supervisory Commission (FSC) in 1999 and 2003 respectively. Also in 2003 joint Instructions of the BNB and the State Agency for National Security (former Financial Intelligence Agency) have been issued. In 2006 a joint instruction has been concluded between the BNB and the Prosecutor's Office General. All these documents formally arrange the information sharing, cooperation and joint actions to be undertaken by the domestic supervisors.

BNB participates in two other structures: Domestic Standing Group on Financial Stability and Financial Stability Council in which the Financial Supervisory Commission (FSC) and the Ministry of Finance also take part.

2007 FINANCIAL TURBULENCES AND THE BULGARIAN BANKING SYSTEM

The Bulgarian banking system is dominated by traditional banking operations and products. Banking business is based on the classical banking model – traditional maturity transformation-based intermediation. Credit risk remains on the balance sheets of the lending banks, thus allowing for a reliable evaluation of credit quality, timely depreciation, and allocation of provisions where necessary. Banks' exposures to structured products and participation in the securitization of assets is insignificant, hence the recent mishaps in the markets of such instruments have not impacted the banking sector's performance. The problems facing some large foreign banking groups did not affect the behavior of their Bulgarian subsidiary banks in terms of their credit activities. The BNB continues to closely monitor the growth of bank lending and is ready to enforce additional measures to limit growth rates to more sustainable levels, that would pose no threat to financial stability.

STATISTICAL TABLES

Number of financial institutions
(at year-ends)

Type of financial institution	2005	2006	2007
Commercial Banks	**34**	**32**	**29**
of which:			
Large banks*	10	10	5
Small and medium-sized banks	18	18	19
Foreign bank branches	6	4	5
Financial Institutions (**Financial houses)**	**87**	**86**	**82**
Leasing companies	**50**	**54**	**63**

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

Item	2005	2006	2007
Public sector ownership	2.44	1.97	1.71
Other domestic ownership	22.68	25.28	25.48
Domestic ownership total	25.12	27.25	27.19
Foreign ownership	74.88	72.75	72.81
Banks, total	**100.0**	**100.0**	**100.0**

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

Item	2005	2006	2007
Public sector ownership	0.29	0.26	0.39
Other domestic ownership	23.11	19.64	17.31
Domestic ownership total	23.40	19.90	17.70
Foreign ownership	76.60	80.10	82.10
Banks, total	**100.0**	**100.0**	**100.0**

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

Item	2006	2007
Public sector ownership	0	0
Other domestic ownership	93.74	94.3
Domestic ownership total	93.74	94.30
Foreign ownership	6.26	5.70
Financial houses, total	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	FOREX assets / Total assets	FOREX liabilities / Total liab.
Banks	39.00	56.55
Financial Institutions (Financial houses)	73.24	83.50

Return on Average Asset (ROAA) by type of financial institutions

Type of financial institution	2005	2006	2007
Banks	2.01	2.15	2.37
Financial Institutions (Financial houses)	1.85	1.01	2.9

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

Type of financial institution	2005	2006	2007
Banks	21.64	23.70	23.89
Financial Institutions (Financial houses)	7.81	23.70	59.31

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

Item	2005	2006	2007
Banks	94.3%	90.4%	87.2%
Financial Institutions (Financial houses)	1.8%	4.2%	5.9%
Leasing companies	4.0%	5.4%	6.8%
Financial institutions, total	**100**	**100**	**100**

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

Assets	2005	2006	2007
Cash in hand, balances with central banks	9.85	10.83	12.16
Loans and advances to credit institutions	17.83	20.52	13.41
Loans and advances to customers	54.38	52.86	62.55
Financial assets at fair value through profit or loss, held-to-maturity investments, available-for sale assets and investments in associates, subsidiaries and joint ventures	14.52	12.81	9.36
Tangible assets and Intangible assets	2.86	2.44	2.16
Residual assets	0.55	0.53	0.36
Total assets	**100.00**	**100.00**	**100.00**
Liabilities	**2005**	**2006**	**2007**
Amounts owed to credit institutions	17.33	14.40	18.25
Amounts owed to customers	69.15	72.38	66.00
Debts evidenced by certificates	0.00	0.00	1.98
Residual liabilities	1.62	1.37	0.98
Provisions	0.16	0.11	0.17
Subordinated liabilities	1.20	1.34	2.10
Equity (including valuation adjustments)	8.79	8.53	8.57
Profit or loss for the financial year	1.74	1.86	1.95
Total liabilities and equity	**100.00**	**100.00**	**100.00**

The structure of assets and liabilities of the financial houses (%)
(at year-end)

Assets	2006	2007
Cash and cash equivalent	4.75	5.92
Clients' portfolio - shares	88.02	89.74
Clients' portfolio - other securities	1.13	0.62
Financial instruments held by clients	3.01	1.19
Trading portfolio	1.48	1.44
Non-current assets	0.81	0.36
Other receivables	0.80	0.73
Liabilities	**2006**	**2007**
Amounts owed t ocustomers - securities contracts	92.06	91.47
Amounts owed to customers - other contracts	2.47	2.27
Equity	3.75	4.84
Current payables	1.43	1.23
Other liabilities	0.28	0.20

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

Type of financial institution	2005	2006	2007
Large banks	12.8	18.6	19.3
Small and medium-sized banks	14.0	16.2	16.4
Foreign bank branches	30.5	57.0	85.3
Banks, total	**14.0**	**19.3**	**21.4**

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

Type of financial institution	2005	2006	2007
Financial houses, total		9.42	14.93

Solvency ratio of financial institutions

Type of financial institution	2005	2006	2007
Large banks	14.7	14.14	13.32
Small and medium-sized banks	17.6	15.83	14.75
Banks, average	**15.3**	**14.51**	**13.86**

Asset portfolio quality of the banking system

Asset classification	2005	2006	2007
Amount in **EURO'000**	12 385	16 056	23 464
Standard %	94.2	95.58	96.40
Watch %	3.0	2.19	1.57
Substandard %	1.1	0.65	0.36
Non-performing %	1.7	1.59	1.67
Classified total	**100.0**	**100**	**100**
Specific reserves %	**2.7**	**2.20**	**2.16**

The structure of deposits and loans in 2007 (%)
(at year-end)

	Deposits	Loans
Households	37.4	36.6
Government sector	5.0	0.4
Corporate	26.7	60.5
Foreign	23.4	1.3
Other	7.5	1.2
Total	**100.0**	**100.0**

The structure of deposits and loans in 2007 (%) (at year-end)
Monetary statistic data

Types of deposits		Types of loans	
At sight	35.1	Long term loans	45.8
Within one year	52.7	Medium-term loans	25.1
Over one year	12.2	Short-term loans	29.1
Total	**100.0**	**Total**	**100.0**

Proportion of foreign exchange assets and liabilities (at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Large banks	52.7	53.4	50.8	56.3	55.4	55.2
Small and medium-sized banks	53.9	51.4	59.3	53.9	50.9	61.5
Foreign bank branches	52.9	42.6	74.0	52.9	56.8	72.8
Banks, average	**53.0**	**52.6**	**55.2**	**54.9**	**54.5**	**58.6**

* Currency composition of the liabilities only – equity, reserves and current year results are not included as those are always in local currency

Structure of revenues and expenditures of the banking sector (at year-ends) EUR'000

Assets	2005	2006	2007
Net interest income	695 638	817 438	1 111 439
Dividends and other income from variable yield securities	860	2 354	1 308
Commissions (net)	221 808	290 244	345 235
Trading and foreign exchange results	69 609	50 468	70 193
Other operating income	17 791	39 413	51 601
Total operating income	**1 005 706**	**1 199 916**	**1 579 775**
Expenditures	**2005**	**2006**	**2007**
Staff costs	198 413	222 514	276 439
General administrative expenses and Value adjustments in respectof tangible and intangible assets	364 006	438 627	473 252
Total operating expenses	**562 420**	**661 141**	**749 691**
Impairment losses (net) on financial assets and provisioning	122 207	67 865	179 527
Profit or loss from discontinued operations and from consolidated entities	23 341	2 430	1 698
Profits before taxes	344 421	473 340	652 255
Tax charges	51 447	71 486	63 815
Profits after taxes	292 974	401 853	588 440

Structure of revenues and expenditures of financial institutions (financial houses) (at year-ends) EUR'000

Assets	2006	2007
Trading and foreign exchange **net** results	8 023	7 528
Income from operations with financial assets and instruments	25 960	130 540
Other financial operations	45 203	25 659
Interest income	2 092	3 598
Income on share capital	177	483
Operating income	2 639	6 764
Expenditures	**2006**	**2007**
Expenses for operations with financial assets and instruments	17 199	30 168
Other financial operations	33 228	5 665
Interest expenses	1 090	1 078
Operating expenses	15 920	20 258
Extraordinary expenses	1	218

Structure of registered capital and own funds of the banking sector in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	EUR mln	%	EUR mln	%
Large banks	524 307	3.1	1 782 735	11.8
Small and medium-sized banks	546 094	4.7	1 177 390	11.2
Banks, average	1 070 401	3.5	2 960 125	10.9

* Own funds within the meaning of Capital Requirement Directive

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	EUR mln	%	EUR mln	%
Financial houses, **average**	30 069	1.46	100 363	4.89

2007 DEVELOPMENTS IN THE CROATIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The characteristics which marked the Croatian economy in 2007 were high real GDP growth, slowdown in external borrowing growth, acceleration in the rate of inflation and current account deficit widening. Acceleration in the nominal growth of household disposable income and strong corporate borrowing abroad led to an acceleration in the real growth of domestic demand and real GDP growth, from 4.8% in 2006 to 5.6% in 2007. The CNB took measures to slow down bank placements growth, reducing the banks' external debt and achieving a slower growth of external debt of the economy as a whole. Though slower, credit activities of banks were still significant, boosting domestic demand and imports growth and resulting in a current account deficit of 8.6% of GDP. External debt of the Republic of Croatia rose by 12.5% in 2007. Its faster growth compared with the nominal growth of GDP caused the external debt to GDP ratio to increase from 85.5% at the end of 2006 to 87.8% at the end of 2007.

Against the backdrop of faster inflation growth, the Croatian National Bank ensured stability of the nominal exchange rate of the kuna against the euro, a crucial precondition for the stability of domestic prices. The exchange rate of the kuna appreciated by a slight 0.3% against the euro in 2007.

The Croatian capital market in 2007 was marked by dynamics which enabled its further fast growth and development. The year was characterised by so far the largest annual turnovers in stock and bond markets. Positive developments were also seen on the labour market in 2007, where registered unemployment fell by 13.2% and which saw a moderate increase in average real gross (3.4%) and net wages (2.3%).

In an effort to contribute to the reduction in international trade in goods and services imbalances in the Croatian economy, the central bank expanded its monetary policy instruments in 2007 Thus, in addition to marginal reserve requirements (55%) and minimum foreign currency liquidity (32%), to slow down bank placements growth, the central bank issued a Decision on the purchase of compulsory CNB bills.

DEVELOPMENTS IN THE BANKING SYSTEM

The banking sector in the Republic of Croatia consisted of 33 banks and 5 housing savings banks in 2007. Total banking system assets was HRK 351.6bn and accounted for 127.8% of GDP. In total banking system assets, banks' assets accounted for 98.1% and housing savings banks accounted for 1.9% of the total.

At the end of 2007, 20 institutions were in majority foreign ownership. The assets of these institutions accounted for 90.6% of total banking system assets. The remaining 9.4% of banking system assets went to assets of 15 institutions in majority domestic ownership and 3 state-owned institutions.

The banking sector of the Republic of Croatia employed 20,991 persons at the end of 2007, an increase of 8.2% compared with the end of the previous year. Steadily growing, asset per employee rose by 4.5% at the end of 2007, compared with the end of 2006.

Changes in banks' balance sheets in 2007 were influenced by CNB's monetary and prudential measures, while the effects of these measures were reflected in decelerated placements growth, substitution of a part of foreign sources of financing by supplementary capital and currency restructuring of the entire balance sheet. CNB's measures proved successful in slowing down bank placements growth with the annual rate of change in total placements and contingent liabilities falling from 25.5% in 2006 to 13.4% at the end of 2007. The quality of bank placements continues to improve. Slower growth in partly recoverable and irrecoverable placements (7.9%) was in line with the downward trend in the previous years of their share in total placements and contingent liabilities of banks which stood at 3.1% at the end of 2007.

Although CNB's monetary policy measures are aimed at reducing household spending financed by borrowing, credit activities of banks in 2007 were again largely focused on the household sector. Loans to households were up 18.2% compared with the end of 2006, with household loans accounting for 50.7% of total bank loans granted in that year. Of total household loans granted, housing loans rose the most. They accounted for 41.0% of total loans granted to households and 20.7% of total bank loans. Banks' adjustment to CNB's monetary measures was seen in more moderate corporate lending, with loans to companies growing by 11% and companies meeting their financing needs through other sources of finance.

Despite a slowdown in bank placements growth and slower credit activities, after tax income of banks rose by 19.9% in 2007 as the banks turned to a broader range of products and to services which carry non-interest income to increase their income. ROAA rose from 1.5% to 1.6%, while ROAE fell from 12.4% to 10.9% as a result of significant bank recapitalisation amounts in 2007.

Prudential measures relating to increased capital requirements for credit risk prompted banks to increase bank capital as a permanent source of financing. The CNB has prescribed to the banks the obligation of monitoring, analysing and assessing their clients' exposures to currency risk with a view to reducing bank placements' exposure to currency-induced credit risk (CICR). CICR is recognised as a constituent part of credit risk, inherent in those financial systems which are largely linked to a currency other than domestic one. With over one half of total banking system assets linked to foreign currencies, most notably the euro, the Croatian Banking System is one of such systems. Greater risk weight allocation for placements to debtors whose expected foreign currency inflows cover less than 80% of their foreign liabilities and liabilities with a currency clause, led to a fall in the capital adequacy ratio in 2006. This prompted recapitalisation of over one third of total banks in 2007 and increased total share capital by 51.8%. Banks' own funds rose by 31% while capital adequacy ratio rose from 13.98% at end-2006 to 16.36% at the end of 2007, achieving a comfortable margin well above the minimum capital adequacy ratio of 10%.

Banking system liquidity in 2007 was satisfactory. Bank deposits received rose by 14.9% and banks' liabilities under loans received fell by 4.7%. As majority foreign owners of banks in the RoC, foreign banks took an important part in domestic banks liquidity creation as a result of which deposits and loans received from such owners accounted for 13.9% of total deposits and loans of banks.

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

LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY

The Croatian National Bank is responsible for the supervision of banks, savings banks, housing savings banks and credit unions with a view to safeguarding depositors and ensuring stability and safety of the banking system. Supervisory tasks of the CNB include issuing authorisations to and withdrawing authorisations from these institutions and other approvals as prescribed by law, enacting relevant subordinate legislation and supervision of the operations of these institutions. The Croatian National Bank conducts supervision of the operation of banks in accordance with the provisions of the Act on the Croatian National Bank and the Banking Act. Development of the banking industry, entry of foreign banks in the domestic market, domestic banks' exit to the foreign markets and association in the context of European integration prompted changes in the legislative framework and the adoption of the Banking Act in 2002 which is still in force.

Verification of legality of banks' operations and banks' risks management is carried out by means of on-site examinations, specialised on-site supervision and off-site supervision. On site-examinations are conducted in accordance with a previously determined schedule. In case of indications of deviations from standards or in case of banks more prone to risks, examinations are carried out more often.

Other supervisory bodies operating in the area of financial system supervision are the Ministry of Finance and the Croatian Financial Services Supervisory Agency (HANFA). Their competencies include the regulation and supervision of non-banking financial services.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2007

Intense supervisory activities in 2007 were related to the drafting of the new regulatory framework for the operations of banks and other financial institutions supervised by the CNB, as a result of adjustment of the legislation of the Republic of Croatia with EU requirements. The Republic of Croatia is undergoing the process of alignment of domestic legislation with the EU acquis communautaire, a requirement that has to be met if the country is to achieve full membership in the EU. To this end, activities were launched on the drafting of the basic Credit Institutions Act which is to replace the currently applicable Banking Act. In the drafting of the Credit Institutions Act, account was taken of the relevant EU directives, changes in domestic legislative framework and the manner of bank operations. The adoption of the Credit Institutions Act is expected until end-2008 and its implementation is planned for 2009.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2007

In addition to regular supervisory tasks and intense activities on the alignment of legislation of the Republic of Croatia with the EU acquis communautaire, a number of activities were undertaken in 2007 to transform the existing 104 savings and loan cooperatives into institutions subject to CNB supervision. This included amendments to the Banking Act and adoption of the Credit Unions Act, which created the preconditions for the transformation of savings and loan cooperatives into new financial institutions and for their inclusion in the banking system of the Republic of Croatia as savings banks or credit unions.

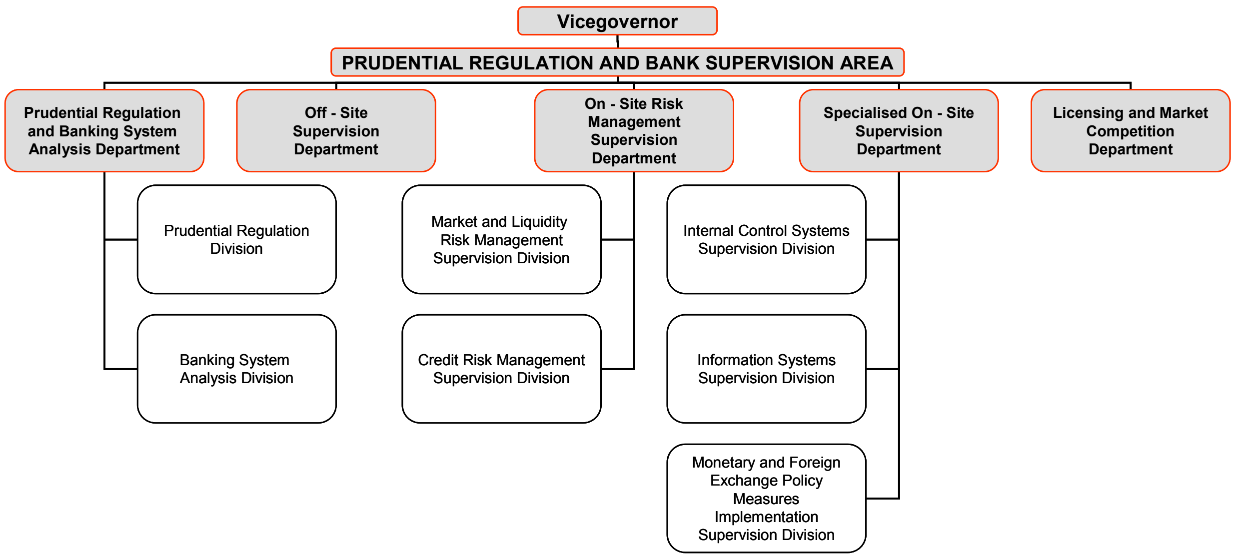
Changes in the manner of banks' operations have prompted adoption of a number of documents, positions, guidelines and decisions by the CNB for the management of individual segments of their operations, of which we state here only those most important. They include the Guidelines for information system management with a view to reducing operating risk and the Decision on adequate information system management and currently being prepared is a guideline on corporate management in banks.

Under amendments to the Decision on Amendments to the Decision on the Capital Adequacy of Banks, the use of unstable (secondary) sources of financing has been linked with the permissible growth of placements. For faster placements growth, banks with above-average dependence on secondary sources have to have a larger amount of primary sources (capital and long-term household deposits). With a view to reducing exposure of placements to currency induced credit risk, these amendments have also provided for greater weights for placements to clients with unhedged currency position.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

At the end of 2007, the Prudential Regulation and Bank Supervision Area had a staff of 100.

Organisational scheme of the Prudential Regulation and Bank Supervision Area



INTERNATIONAL ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

Based on the provisions of the Act on the Croatian National Bank and the Banking Act, the Croatian National Bank has concluded memoranda on cooperation in the area of supervision with foreign institutions. The basic principles and the contents of these memoranda are based on relevant documents of the Basel Committee on Banking Supervision.

In the past several years, the following memoranda of understanding and co-operation were concluded:

- Memorandum of Understanding between the Croatian National Bank and the Austrian Federal Ministry of Finance and the

Austrian Financial Market Authority concerning their Co-operation in the Field of Banking Supervision,
- Memorandum of Understanding and Co-operation in Banking Supervision between the Croatian National Bank and the Central Bank of Bosnia and Herzegovina, Banking Agency of the Federation of Bosnia and Herzegovina and Banking Agency of Republika Srpska,
- Memorandum of Understanding between the Banca d'Italia and the Croatian National Bank in the Field of Banking Supervision,
- Memorandum of Understanding between the Hungarian Financial Supervisory Authority and the Croatian National Bank in the Field of Banking Supervision.

Activities are underway on the preparation of a memorandum on cooperation with supervisory bodies in Germany and France.

The bulk of international supervisory activities of the CNB in 2007 included cooperation with EU bodies in connection with the process of alignment of domestic legislation with EU requirements.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The CNB has concluded the following agreements with other supervisory bodies in the Republic of Croatia:

- Agreement on cooperation with the Croatian Financial Supervisory Agency,
- Agreement on cooperation with the Office for the Prevention of Money Laundering,
- Agreement on cooperation in the area of protection of market competition in banking and financial services market with the Croatian Competition Agency,
- Agreement on co-operation and exchange of information in the area of anti-money laundering and combating of terrorism financing with the Ministry of Finance.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN THE COURSE OF 2007

Significant engagement of the Prudential Regulation and Bank Supervision Area in the field of legislative alignment with EU requirements has led to a somewhat narrower scope of on-site examinations of banks and savings banks, compared with 2006. However, off-site supervision efforts increased, as evidenced in higher frequency contacts with the management boards and senior management of banks and housing savings banks so that the efforts that went into the adoption of new legislation in 2007 did not lead to a deterioration in overall supervision quality.

For further information on supervisory activities of the CNB, the legislative framework used as a basis for its supervisory activities, as well as draft legislation that is currently being prepared, please visit CNB's web pages at (www.hnb.hr).

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2005	2006	2007
Banks	34	33	33
Housing savings banks	4	5	5
Financial Institutions, total	**38**	**38**	**38**

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

Item	2005	2006	2007
Public sector ownership	6,7	4,9	3,2
Other domestic ownership	11,5	8,6	6,0
Domestic ownership total	18,3	13,4	9,2
Foreign ownership	81,7	86,6	90,8
Financial Institutions, total	**100,0**	**100,0**	**100,0**

Ownership Structure of the Financial Institutions on the basis of assets total (%) (at year-ends)

Item	2005	2006	2007
Public sector ownership	3,3	4,1	4,6
Other domestic ownership	5,2	4,9	4,8
Domestic ownership total	8,5	9,0	9,4
Foreign ownership	91,5	91,0	90,6
Financial Institutions, total	**100,0**	**100,0**	**100,0**

* share capital

Concentration of asset by the type of financial institutions

Type of the financial institutions	FOREX assets / Total assets	FOREX liabilities / Total liab.
Banks	52,7	71,6
Housing savings banks	52,4	100,0

Return on Asset (ROA) by type of financial institutions (%)

Type of financial institution	2005	2006	2007
Banks	1,65	1,50	1,57
Housing savings banks	0,87	-0,94	-0,68

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

Type of financial institution	2005	2006	2007
Banks	15,11	12,41	10,93
Housing savings banks	27,88	-26,34	-20,51

Distribution of market shares in balance sheet total (%)

Type of financial institution	2005	2006	2007
Banks	97,7	98,0	98,1
Housing savings banks	2,3	2,0	1,9
Financial institutions, total	**100,0**	**100,0**	**100,0**

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

Assets	2005	2006	2007
Money assets and deposits with the CNB	16,5	16,3	14,9
Money assets and deposits with the CNB	1,3	1,3	1,3
Deposits with the CNB	15,2	15,0	13,6
Deposits with banking institutions	8,9	8,5	10,2
MoF treasury bills and CNB bills	2,7	2,7	2,5
Securities and other financial insturments held for trading	3,2	2,5	2,5
Securities and other financial instruments available for sale	4,5	4,2	3,3
Securities and other financial instruments held to maturity	2,0	1,1	1,0
Securities and other financial instruments not traded in active markets but carried at fair value	0,4	0,2	0,2
Derivative financial assets	0,1	0,1	0,1
Loans to financial institutions	1,5	1,3	2,0
Loans to other clients	56,9	60,3	60,7
Investments in subsidiaries and associates	0,6	0,6	0,5
Foreclosed and repossessed assets	0,1	0,1	0,1
Tangible assets (net of depreciation)	1,6	1,5	1,3
Interest, fees and other assets	1,9	1,6	1,6
Less: Specific reserves for unidentified losses	0,9	0,9	0,8
Total Assets	**100**	**100**	**100**
Liabilities	**2005**	**2006**	**2007**
Loans from financial institutions	5,3	5,0	6,0
Short-term loans	2,8	2,4	3,3
Long-term loans	2,5	2,6	2,7
Deposits	66,0	66,6	67,6
Giro account and current account deposits	11,2	12,4	13,1
Savings deposits	10,0	8,7	7,8
Time deposits	44,7	45,5	46,6
Other loans	13,9	13,1	9,2
Short-term loans	3,2	3,3	1,6
Long-term loans	10,7	9,8	7,6
Derivative financial liabilities and other financial liabilities held for trading	0,1	0,1	0,1
Debt securities issued	1,3	1,2	1,0
Short-term debt securities issued	0,0	0,0	0,0
Long-term debt securities issued	1,3	1,2	1,0
Subordinate instruments issued	0,3	0,2	0,1
Hybrid instruments issued	0,3	0,2	0,2
Interest, fees and other liabilities	3,8	3,4	3,4
TOTAL LIABILITIES	**91,0**	**89,7**	**87,4**
TOTAL CAPITAL	**9,0**	**10,3**	**12,5**
Total Liabilities	**100**	**100**	**100**

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

Type of financial institution	2005	2006	2007
Banks	18,0	20,1	20,0
Savings banks	0,9	1,4	1,8
Financial institutions, total	**17,7**	**19,7**	**19,6**

Solvency ratio of financial institutions

Type of financial institution	2005	2006	2007
Banks	14,62	13,98	16,36
Savings banks	23,78	18,66	14,51
Financial institutions, total	**14,67**	**14,01**	**16,34**

* Capital adequacy ratio

Asset portfolio quality of the banking system

Asset classification	2005	2006	2007
1. Fully recoverable placements (category A)	96,0	96,8	96,9
2. Partly recoverable placements (category B)	2,4	2,0	2,0
3. Irrecoverable placements (category C)	1,5	1,2	1,1
Classified total	**100,0**	**100,0**	**100,0**
Specific Reserves*	3,2	2,6	2,5

*specific reserves / classified total

The structure of deposits and loans in 2007 (%) (at year-end)

	Deposits	Loans
Households	52,2	50,6
Government sector	2,3	6,5
Corporate	23,1	38,8
Foreign	12,9	0,8
Other*	9,5	3,4
Total	**100,0**	**100,0**

* Financial sector is included

The structure of deposits and loans in 2007 (%)
(at year-end)

Types of deposits		Types of loans	
At sight	19,4	Long term loans	68,1
Within one year*	54,5	Medium-term loans	10,7
Over one year	26,1	Short-term loans	21,2
Total	**100,0**	**Total**	**100,0**

* Total savings deposits are included

Proportion of foreign exchange assets and liabilities*
(at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Banks	71,2	65,0	57,5	67,8	60,1	51,2
Housing savings banks	90,0	91,8	93,0	90,1	91,7	92,4
Financial Institutions, average	**71,6**	**65,5**	**58,2**	**68,3**	**60,7**	**51,9**

Type of the financial institutions	FOREX off balance sheet items / total liabilities		
	2005	2006	2007
Banks	34,7	38,8	35,5
Housing savings banks	0,0	15,5	28,6
Financial Institutions, average	**34,6**	**38,8**	**35,5**

* include items denominated in foreign currency and items with a currency clause

Structure of revenues and expenditures of financial institutions
(at year-ends)

Revenues	2005	2006	2007
Interest income	71,7	73,0	74,4
Income from fees and commissions	18,5	17,7	17,2
Other non-interest income	9,8	9,3	8,5
Expenditures	**2005**	**2006**	**2007**
Interest expenses	42,3	44,6	49,9
Expenses on fees and commissions	9,9	8,5	7,0
Other non-interest expensses	5,2	5,6	4,1
General administrative expenses and depreciation	38,9	37,1	34,0
Loss provision expenses	3,8	4,2	5,0

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	EUR mln	%	EUR mln	%
Banks	3 437	7,3	41 215	87,5
Housing savings banks	49	5,5	860	96,3
Financial Institutions, average	**3 486**	**7,3**	**42 076**	**87,7**

* share capital
** in millions of EUR

2007 DEVELOPMENTS IN THE CZECH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT IN THE CZECH REPUBLIC

2007 was a very good year from the macroeconomic point of view in the Czech Republic. As in previous years, economic growth in the Czech Republic was faster than that in the EU economy as a whole as well as that in the original, pre-enlargement EU Member States. Real GDP growth was also markedly lower in Germany, which has long been the Czech Republic's biggest trading partner. Gross domestic product in the Czech Republic was CZK 3,557.7 billion at current prices. At 6.5%, annual GDP growth remained high.

The GDP growth continued to be driven mostly by domestic demand, which was affected in particular by still high household consumption. The contribution of gross capital formation was also significant, in line with the phase of the business cycle in terms of both fixed capital formation and change in inventories. The contribution of foreign trade to GDP growth is still low, despite having risen slightly year on year in 2007. The export activity of the Czech economy was mostly related to export and investment activities in EU countries. Production facilities created by foreign direct investment had a positive effect.

Inflation gradually increased in 2007 compared to the previous year. The average figure in 2007 was 2.8%, up by 0.3 percentage point compared to a year earlier. Over the entire period (except for the last quarter) it converged towards the CNB's inflation target of 3%. Consumer price inflation picked up in 4Q2007 rising above the upper boundary of the inflation target tolerance band. During 2007, inflation was affected primarily by food prices and regulated prices (in particular rises in regulated rents and prices of electricity) and by increases in excise duties.

The koruna's appreciation trend against the euro and the dollar continued throughout 2007. The bulk of exports and imports are traded in these two currencies. The strengthening koruna reduced the prices of most imported commodities, thereby contributing to the low inflation level for most of the year. From an annual average of CZK 28.34 to the euro in 2006, the koruna firmed to CZK 27.76 in 2007. The koruna's annual average exchange rate against the dollar appreciated even more substantially – from CZK 22.61 to CZK 20.31.

The balance of payments saw a gradual improvement in 2007. The favourable macroeconomic trend caused the current account deficit to fall by 0.6 percentage point to 2.5% of GDP, or CZK 89.0 billion. The persisting deficit was due to a widening of the income deficit, reflecting a rapid increase in non-residents' FDI profits in the form of reinvested earnings and dividends. Another reason for the current account deficit is an increasing volume of compensation of foreign employees. As in previous years, the financial account showed a surplus of CZK 104.5 billion in 2007, which is roughly the same as the 2006 level. Growth in net direct investment inflow remained its principal component.

The labour market situation continued improving in 2007. The economic growth was accompanied by job creation. The favourable employment conditions were taken advantage of, and the rising employment and high job creation led to a decline in the unemployment rate. Long-term unemployment decreased to 2.8% on average. The labour market was affected by seasonal factors in individual months of 2007. The registered unemployment rate declined again under the existing methodology, averaging 6.6%. The positive trends also affected average gross monthly nominal wages, which increased by 7.3% year on year, up by 0.9 percentage point on the previous year. Average real wages increased by 4.4% year on year, a rise of 0.6 percentage point compared to 2006. Aggregate labour productivity grew by 4.6% year on year, outpacing real wage growth by 0.2 percentage point.

Despite the persisting robust economic growth, the state budget yet again ended the year in a deficit. The absolute deficit declined compared to the previous year, to CZK 66.4 billion, or 1.9% of GDP. The economic growth greatly helped to stabilise the public debt-to-GDP ratio, which was little changed in 2007, standing at 30.4% at the end of the year.

The CNB raised its key interest rates four times during 2007 (in June, July, September and November), each time by 0.25 percentage point. The monetary policy decisions were based on forecasts for the Czech economy and inflation and the external economic outlook. A gradual rise in interest rates was consistent with these predictions. The domestic two-week repo rate went up from 2.5% to 3.5%, the discount rate from 1.5% to 2.5% and the Lombard rate from 3.5% to 4.5%.

DEVELOPMENT IN THE BANKING SYSTEM

As of 31 December 2007, the Czech banking sector consisted of 37 banks and foreign bank branches. Compared to the end of 2006, the number of banks was unchanged and the same number of entities were offering banking services in the domestic banking sector.

As of 31 December 2007, a total of 23 banks (4 large banks, 5 medium-sized banks, 8 small banks and 6 building societies) and 14 foreign bank branches were offering banking services to clients in the Czech Republic. The group of four large banks is still the main component of the domestic banking market. The share of their assets in total banking sector assets slightly exceeded the 61% level in 2007.

A total of 198 banks from EU Member States were ready to provide banking services under the freedom to provide services as of the end of 2007. These banks had notified the CNB of their activities. They can offer banking services without establishing a branch in the Czech Republic pursuant to Article 21 of Directive 2000/12/EC of the European Parliament and of the Council.

Banking services were also offered in other EU Member States by banks having their head offices in the Czech Republic. As in 2006, only two banks notified the CNB providing cross-border services, both in respect of Slovakia. In 2007, no other bank gave notification of the provision of such activities. Until the end of 2007, two banks based in the Czech Republic were also offering services through foreign branches in EU countries.

The shareholder structure of the Czech banking sector is stable. At the end of 2007, as in the previous year, foreign capital dominated the sector's capital, with a direct share of 82.6% (this refers to cases where a legal entity registered outside the Czech Republic holds a direct share in a bank). A total of 97.6% of the sector's total assets were controlled by foreign owners at the end of 2007. Owners from EU countries dominate.

A total of 41,207 people were employed in the Czech banking sector at the end of 2007, a rise of 2,975 on the previous year. The annual rate of growth of the sector's workforce at the end of 2007 (7.8%) was less than half that of its total assets in the same period. Unlike the number of employees, the number of banking units in the Czech Republic fell by 12 to 1,865.

The assets of the banking sector rose by 18.9% to CZK 3,746.6 billion in 2007. The rate of growth picked up significantly compared to 2006 (annual growth 6.6% had been recorded). The banking sector's activities are very dynamic, mainly thanks to high rates of growth of lending activities.

Private individuals' debt with domestic banks continued rising in 2007. As in previous years, mortgage loans for housing, which increased by 40.0% during the year to account for 49.9% of all the loans provided to individuals. This significant increase was due mainly to the favourable environment of low interest rates, strong demand and the still high volumes of liquid assets held by banks.

Bank loans to non-financial corporations rose by 17.1% in 2007.

The ratio of total assets to GDP at current prices was 105.3% at 2007 year end.

The total value of loans in default fell by 4.2% to CZK 51.9 billion in 2007. Ratio of loans in default remains low as a result of the strong growth in the total loan portfolio. The coverage of classified loans by created provisions and high quality collateral is sufficient.

The banking sector has adequate liquidity at its disposal. The liquidity crisis resulting from insufficient liquidity in some European countries was not observed in the Czech Republic.

Despite rising capital requirements, the capital ratio of the banking sector edged up by 0.09 percentage point to 11.50% in 2007, mainly due to faster growth in regulatory capital. In 2007, banks also made capital savings as a result of the implementation of Basel II. At the end of 2007, six banks – representing around 50% of the banking sector's total assets – were applying the new approach to calculating capital requirements, while all other banks were using the Basel I methodology. Compared to the previous period, the banking sector's capital increased more in the retained profit item. Tier 2 capital was affected by an increase in subordinated debt. Tier 1 still has a dominant position in the sector's capital, accounting for roughly 85% of total regulatory capital.

The banking sector recorded a net profit of CZK 47.2 billion in 2007, up by CZK 9.2 billion on 2006 (24% year on year).

Return on Tier 1 (RoE) was 24.5% at the end of 2007, up by 2.0 percentage points on 2006. The very good results of the banking sector were reflected in a rise of 0.11 percentage point in return on assets (RoA). As of 31 December 2007, the RoA was 1.34%.

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

The Czech National Bank is responsible for performing supervision: banking sector and credit unions, the capital market and collective investment and insurance companies and private pension schemes.

As an integrated regulator, the CNB is responsible for the financial regulation and supervision of the business activities of regulated financial institutions. The first mentioned competency (regulation) consists mainly in the CNB, under the relevant laws, issuing subordinate legal rules and thereby setting detailed prudential rules for regulated financial institutions, and the latter competency (supervision) involves licensing, off-site supervision, on-site supervision and imposition of remedial measures. Primary legislation falls within the field of competence of the Finance Ministry.

The changes made to the financial market legislation in 2007 mostly related to the transposition of European directives regulating the new capital adequacy framework (Basel II). The Act on Banks, the Act on Credit Unions, the Capital Market Undertakings Act and the Payment System Act were all amended. More legislative changes are expected in 2008 in connection with the transposition of the Markets in Financial Instruments Directive (MiFID) and with the new Insurance Act and the new Act on Certain Measures Against Money Laundering and Terrorist Financing.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2007

The major financial market supervisory activities during 2007 – linked with the ongoing integration of supervisory work into the CNB – included intensive alignment of the procedures for supervision of financial market participants, rationalisation of information duties and the preparation for the changeover to the new supervisory set-up. Since 1 January 2008, the CNB has been applying a functional model in its supervisory activities as the next step in the integration of the supervisory departments of the CNB. On this date, the newly established Financial Market Regulation and Analyses Department, Licensing and Enforcement Department and Financial Market Supervision Department began work. Financial market supervisory activities in the new organisational set-up are governed by a single supervisory concept. The CNB, as the integrated regulatory and supervisory authority, focused on unifying its licensing, authorisation and supervisory procedures. When implementing the single supervisory concept and conducting supervision, the CNB takes into account the individual risk profiles of the supervised entities.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2007

In the second half of 2007, the CNB's official information focused mostly on issues relating to Basel II. A total of 21 official information documents were issued, containing the explanatory opinions and expectations of the CNB relating to provisions of Decree No. 123/2007 Coll., on prudential rules for banks, credit unions and investment firms, and certain provisions of the Act on Banks, the Act on Credit Unions and the Capital Market Undertakings Act.

The CNB worked closely with the Ministry of Finance on the preparation of other amendments to laws implementing Basel II, namely amendments to the Act on Banks, the Credit Unions Act, the Payment System Act and the Capital Market Undertakings Act, and prepared a draft implementing nine decree for Act No. 120/2007 Coll., on the amendment of some laws in connection with the setting of capital requirements for banks, credit unions, investment firms and electronic money institutions. The transposition of the directives into the Member States' national legislation should have been completed by 31 December 2006. However, owing to general delays in legislative processes caused by the political discussions following the June elections, the new rules took effect in the Czech Republic on 1 July 2007. Until that time, regulated entities were subject to the original rules, which could be applied on an optional basis until 31 December 2007.

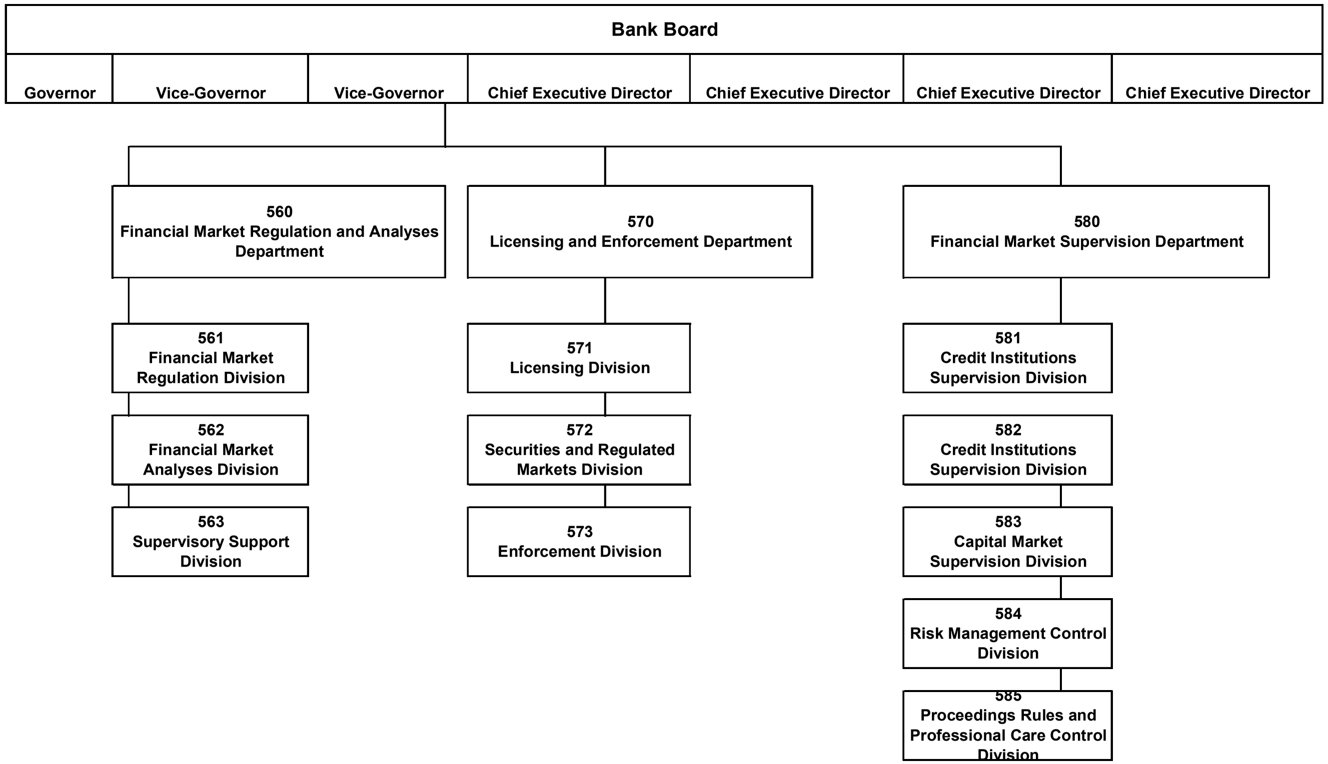
In 2007, off-site surveillance focused more on the potential impacts of the global market turbulence caused by the problems in the US subprime mortgage segment on the performance of domestic financial institutions. In this context, the portfolios of individual institutions were inspected and their exposure to the US mortgage market, for example through direct holdings of CDOs or other securities backed by these mortgages, was determined. These instruments were held only exceptionally, their volumes were relatively low and so their impacts on institutions' financial results were only limited. Exposures to such instruments should in this sense have no major impact on financial institutions' solvency, capital adequacy or liquidity. Nevertheless, significant attention continues to be devoted to the evolution of the value of these securities. Related aspects, such as the method of valuing such securities given the currently lower liquidity in the markets for these instruments, are also being monitored. In this context, a number of information-gathering visits were made to the supervised institutions.

As part of the supervision of banks and credit unions, 14 on-site examinations were carried out in 2007, of which 7 at banks and 7 at credit unions. These examinations focused on the management of credit risk, market risks and operational risks, including information systems risks, as well as on the prevention of money laundering and on overall assessment of the internal control systems of banks and credit unions. All these areas or a selected set thereof were examined. One specialized extraordinary on-site examination was conducted in 2007.

ORGANIZATIONAL CHART OF BANKING AUTHORITY

Organisational structure of CNB Financial Market Supervision

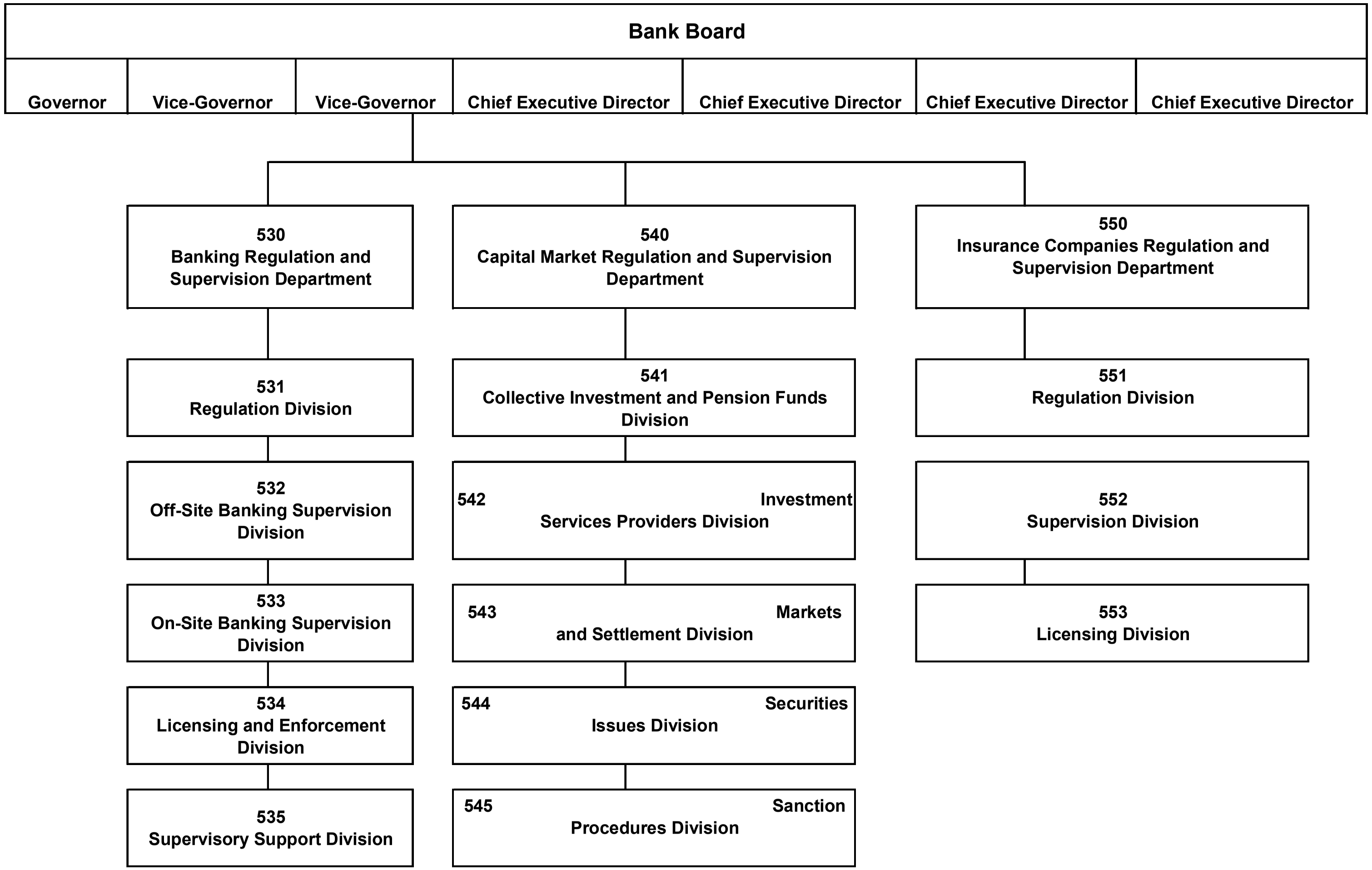
as of 1 January 2008



Vice-Governor Luděk Niedermayer's term of office ended on 26 February 2008. Effective 1 March 2008, the Czech President appointed Mojmír Hampl as Vice-Governor of the CNB and Eva Zamrazilová as Chief Executive Director and Member of the Bank Board of the CNB.

Organisational structure of CNB Financial Market Supervision

as of 31 December 2007



INTERNATIONAL ACTIVITIES OF THE CZECH NATIONAL BANK

In the field of financial market supervision, the CNB is involved in the work of international – in particular European – institutions via 14 committees and 28 working groups. In terms of numbers of representatives, the CNB is most involved in the areas of banking and the capital market.

The Czech Republic is represented in Interim Working Committee on Financial Conglomerates (IWCFC). Working in this Committee is beneficial for the Czech Republic, as there is one financial conglomerate active on the Czech market and it is supervised by the CNB. The CNB also acts as coordinator vis-à-vis foreign supervisors and cooperates with them in the supervision of five other conglomerates from EU countries.

The aims of the Committee of European Banking Supervisors (CEBS), in which the CNB has a representative, are to achieve better regulation, to promote convergence in approaches to regulation and supervisory practices, and to enhance cooperation between supervisors. CEBS works to achieve these aims through three standing expert groups, in which the CNB is actively involved (the Groupe de Contact, the Expert Group on Capital Requirements and the Expert Group on Financial Information).

The Committee of European Securities Regulators (CESR) aims to improve the coordination and cooperation among regulators and ensure consistent and timely implementation of EU legislation in the Member States. The CNB is represented in all its major working groups (CESR-Fin, CESR-Pol, CESR-Tech, MiFID Level 3, the Prospectus Expert Group, the Investment Management Expert Group and recently also the Post-Trading Expert Group). In 2007, CESR focused on activities relating to the implementation of the Markets in Financial Instruments Directive (MiFID) and its two implementing measures.

The CNB took part in Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), it continued working on the new Solvency II prudential framework. At the beginning of 2007, representatives of the CNB and the Ministry of Finance attended a meeting of the Commission's working group on solvency of insurance companies, which was preparing the draft framework directive. In 2007, CEIOPS also focused on the preparation, implementation and assessment of the third round of the quantitative impact study (QIS3). Last year saw continued cooperation between the Lamfalussy Level 3 committees (CEBS, CESR and CEIOPS), which started in 2005 under a joint protocol on cooperation.

The CNB was active in cooperation within the structures of the European Central Bank. The CNB is represented in the Banking Supervision Committee (BSC) and its Working Group on Macroprudential Analysis (WGMA), Working Group on Developments in Banking (WGBD) and Working Group on Credit Registers (WGCR). In the second half of 2007, the CNB also sent representatives to two working sub-groups of the WGBD, namely the sub-group on the structure of banks' income and the sub-group on liquidity. In addition to supervisory issues, the Banking Supervision Committee and its working groups and sub-groups also devote much attention to the area of financial stability. The CNB's experts on supervision and financial stability, who are jointly represented in these structures, work together very closely in this field of activity.

The CNB is represented in the International Liaison Group (ILG), established by the BCBS as a successor to the Core Principles Liaison Group (CPLG), which achieved much in creating the revised Core Principles for Effective Banking Supervision. The Core Principles have become an internationally acknowledged standard for banking supervision.

The CNB is a member of the Group of Banking Supervisors from Central and Eastern Europe (BSCEE), which now has 20 members. Its main activity consists in organising seminars and an annual conference. In May 2007, the annual conference was held in Budapest. It focused on the following topics: social responsibility and the principles of correct corporate governance in banking and the principles and regulatory rules for assessing the integrity of a bank's management and owners.

In March 2007, the CNB became a signatory to the Multilateral Memorandum of Understanding within the International Organization of Securities Commissions (IOSCO). It has already started cooperating actively with specific countries under the Memorandum, which has replaced the existing bilateral MoUs.

The CNB was also involved in the International Association of Insurance Supervisors (IAIS) in 2007, actively monitoring work on individual standards and guidelines and participating in various surveys conducted by the IAIS.

Since 1 January 2007, the CNB has also been a member of the International Organisation of Pension Supervisors (IOPS). In 2007, it was actively involved in the meetings of the Technical Committee and the Annual General Meeting.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE CZECH REPUBLIC

The domestic financial market is supervised by two authorities in the Czech Republic. There are Czech National Bank and Ministry of Finance of the Czech Republic. Ministry of Finance is primarily responsible for legislation process and CNB is responsible for regulation and supervision particularly. Both CNB and MF cooperate very close. In 2006, the CNB and the Czech Ministry of Finance signed an agreement on cooperation in the field of preparation of new legislation and other legal documents concerning financial market. In 2007, the CNB and the Czech Ministry of Finance signed an agreement on cooperation in the exchange of information relating to the financial market. Under this agreement, the two institutions regularly exchange aggregated data on the financial market.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN THE COURSE OF LAST YEAR

Integration of financial market supervision was the most important topic of last period. Following the integration of supervisory activities into the CNB the previous year, 2007 saw intensive convergence of procedures for the supervision of the various different financial market entities, further rationalisation of the system of reporting duties of market participants, and above all the preparation of a new organisational set-up for financial market supervision, changing from a sectoral model to a functional model (see: Enclosure 1).

The application of the functional model represents a further step forward in the integration of the supervisory units, following on logically from the earlier dissolution of the Czech Securities Commission, the Ministry of Finance's Office of State Inspection in the Insurance and Pension Scheme Industry and the Office for Supervision of Credit Unions and their integration into the CNB and the simultaneous take-over of their responsibilities as of 1 April 2006. Since 1 January 2008, integration has also been going on from the procedural perspective. The new organisational structure allows for better unification and harmonisation of procedures and approaches in the area of licensing, administrative proceedings and regulation and also for the use of synergies in the area of control and analytical procedures and individual support activities relating to data output preparation and information system management.

Starting from 2008, the original Banking Regulation and Supervision Department, Capital Market Regulation Department and Insurance Companies Regulation and Supervision Department were replaced by a Financial Market Regulation and Analyses Department, a Licensing and Enforcement Department and a Financial Market Supervision Department.

Under the new organisational set-up, financial market supervisory activities will be governed by a single supervisory concept for all segments of the financial services sector and will be based on the principle that the same kinds of financial risks and other facts relevant to regulation are subject to the same rules across all segments of the financial services sector, in order to limit the scope for regulatory arbitrage.

The CNB will focus on unifying the rules for granting licences and authorisations to carry on business in the financial market and on ensuring that the same business risks are regulated in the same way across the various sectors of the financial market. Regulation will become one of the instruments for promoting a level playing field for competition in financial market. The CNB will also focus on the maximum possible unification of procedures for the supervision of the individual financial market sectors previously supervised separately. An integral part of this process is the revision and unification of methods and internal procedures. The CNB will respect the specific features of individual sectors of the financial market wherever it is appropriate to do so.

When implementing the single supervisory concept and in the actual exercise of supervision the CNB will rigorously take account of the individual risk profiles of supervised entities.

STATISTICAL TABLES

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

Type of financial institution	2005	2006	2007
Banks	36	37	37
Credit unions	20	20	19
Financial institutions, total	**56**	**57**	**56**

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

Type of financial institution	2005	2006	2007
State ownership	4.6	4.3	4.2
Other domestic ownership	13.3	13.1	13.2
Domestic ownership total	17.9	17.4	17.4
Foreign ownership	82.1	82.6	82.6
Financial institutions, total	**100.0**	**100.0**	**100.0**

Ownership structure of the financial institutions on the basis of assets total (%)

Type of financial institution	2005	2006	2007
State ownership	2.5	2.2	2.4
Other domestic ownership	1.3	0.8	0
Domestic ownership total	3.8	3.0	2.4
Foreign ownership	96.2	97.0	97.6
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	FOREX assets / Total assets	FOREX liabilities / Total liab.
Banks	54,6	69,9
Credit unions	61,5	75,2

Return on Asset (ROA) by type of financial institutions

Type of financial institution	2005	2006	2007
Banks	1.39	1.23	1.34
Credit unions	0.96	1.20	0.92

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2005	2006	2007
Banks	25.2	22.5	24.5
Credit unions	5.2	6.3	5.5

Distribution of market shares in balance sheet total (%)

Type of banks	2005	2006	2007
Banks	99.9	99.8	99.8
Credit unions	0.1	0.2	0.2
Banks, total	**100.0**	**100.0**	**100.0**

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

Assets	2005	2006	2007
Cash	1,1	1,1	1,0
Deposits with central banks	16,4	11,6	8,2
Financial assets held for trading	5,3	7,1	9,8
Financial assets designated at fair value through profit or loss	n/a	n/a	1,8
Available-for-sale financial assets	6,1	7,4	7,6
Loans and receivables	55,7	58,5	59,1
Held to maturity investments	11,3	10,2	8,7
Derivatives - hedge accounting (positive fair value	0,4	0,4	0,3
Fair value changes of the hedged items in portfolio hedge of interest rate risk	0,0	0,1	0,0
Tangible assets and intangible assets	1,7	1,5	1,2
Investments in associates, subsidiaries and joint ventures	1,2	1,4	1,8
Other assets	0,8	0,7	0,6
Liabilities	**2005**	**2006**	**2007**
Deposits, loans and other fin. liabilities vis-à-vis central banks	1,0	0,0	0,0
Financial liabilities held for trading	2,0	2,4	2,7
Financial liabilities designated at fair value through profit or loss	0,0	0,0	4,0
Financial liabilities measured at amortised cost	87,2	87,6	84,1
Derivatives - hedge accounting (negative fair value)	0,1	0,2	0,2
Fair value changes of the hedged items in portfolio hedge of interest rate risk	0,0	0,0	0,0
Provisions	0,4	0,3	0,3
Other liabilities	1,8	2,0	1,7
Equity, tota	**7,4**	**7,4**	**6,8**

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

Type of banks	2005	2006	2007
Banks	198.4	248.9	290.2
Credit unions	64.6	40.3	45.1

Solvency ratio of financial institutions

Type of banks	2005	2006	2007
Banks	198.4	248.9	290.2
Credit unions	n/a	22.3	25.0

Asset portfolio quality of the banking system

Asset classification	2005	2006	2007
Without default	1204.7	1457.5	1846.6
Standard	1157.6	1404.0	1795.4
Watch	1079.8	1302.7	1734.3
With default	77.9	101.3	61.0
Substandard	47.1	53.5	51.3
Doubtful	18.0	20.4	15.7
Loss	7.6	9.0	8.7
Reserves and provisions	21.5	24.1	26.8

The structure of deposits and loans in 2007 (%)
(at year-end)

	Deposits	Loans
Households	50.2	37.5
Government sector	9.0	3.2
Corporate	25.9	41.7
Foreign	3.7	6.5
Other	11.2	11.2
Total	**100.0**	**100.0**

The structure of deposits and loans in 2007 (%)
(at year-end)

Types of deposits		Types of loans	
At sight	53.6	Long term loans	57.4
Within one year	35.4	Medium-term loans	18.1
Over one year	11.0	Short-term loans	24.4
Total	**100.0**	**Total**	**100.0**

Proportion of foreign exchange assets and liabilities
(at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Banks – volume – ratio	22.6 (29.7)	20.9 (31.9)	21.1 (32.4)	18.6 (28.7)	16.9 (29.8)	18.0 (29.9)
Credit unions	n/a	n/a	n/a	n/a	n/a	n/a
Financial institutions, average	**22.6 (29.7)**	**20.9 (31.9)**	**21.1 (32.4)**	**18.6 (28.7)**	**16.9 (29.8)**	**18.0 (29.9)**

Structure of revenues and expenditures of financial institutions
(at year-ends)

Revenues	2005	2006	2007
Interest income	107 144	124 114	156 436
Fees and commissions income	38 899	41 093	44 830
Dividend income	2 189	1 675	5 886
Other operating income	5 006	2 507	2 201
Exchange differences, net	841	4 212	7 759
Expenditures	**2005**	**2006**	**2007**
Interest expenses	43 100	52 567	71 738
Fees and commissions expenses	7 068	8 174	8 989
Other operating expenses	2 478	3 835	3 770
Administrative costs	51 786	55 652	59 713
Impairment	2 871	5 163	6 525
Tax expenses	10 133	11 132	12105

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	EUR mln	%	EUR mln	%
Banks	2 775	2.25	8 312	6.7
Credit unions	50	14.6	57	16.8

* Exchange rate as of 31 December 2007: CZK/EUR = 26.62

2007 DEVELOPMENTS IN THE ESTONIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2007, risks related to the general economic environment increased. Economic growth in Estonia slowed down, though it was still one of the fastest in the European Union: 7.1%. According to the Ministry of Finance economic growth in the European Union reached 2.6% in 2007. Economic growth slowed down due to the respective slowdown of the growth in domestic demand and in the exports and imports of goods and services, especially in the second half of the year. Growth of domestic demand slowed down to 9.3%, in comparison with 16.1% in 2006. Export grew only by 1.5% and import by 2.8% in comparison with the previous year. According to the forecast of the Ministry of Finance, the slowdown of the economic growth in 2008 will probably be 3.7%. Deterioration in business conditions of various industries and loss of consumer confidence will probably continue. In 2007, the rate of inflation increased: the average increase in consumer prices was 6.6% (4.4% in 2006). The growth in consumer prices was mainly affected by increasing housing expenditure and increased prices for food. The number of employed persons increased by 9,000 in comparison with the previous year. At the end of 2007, the unemployment rate decreased to 4.7%; this is the lowest level reached during the past 15 years. The growth in wages continued in 2007: the average growth in wages was 20.4%. In 2008, the growth in wages will probably slow down, the growth in employment rate will come to standstill and the unemployment rate will somewhat increase due to the slowdown of economic growth.

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

As at 31 December 2007, there were seven locally authorized credit institutions and eight branches of foreign credit institutions operating in Estonia. The ratio of banking sector's total assets to GDP was 132%.

Competition in the loan market was still very intense in 2007. Lending policy of major banks has become more conservative, in particular when financing the real estate sector. In the light of presumably increasing competition, branches of foreign banks will continue to expand and act aggressively in gaining the market share.

Total assets of banks increased by 34% and their volume totalled 320.6 billion kroons as at 31 December 2007. This increase in assets was primarily caused by the growth in the client loan portfolio by a total of 35% (42% in 2006). At the end of 2007, the gross loan portfolio for banks was 239.2 billion kroons, i.e. 75% of total assets. In 2007, the growth in financing of both private persons and companies as well as housing loans and financing of business premises slowed down. Whereas loans to private persons increased 69% in 2005 and 63% in 2006, the growth in financing private persons slowed down to 33% by the end of 2007. This is true also for the growth in financing companies, which was 63% in 2005 and 60% in 2006, and which slowed down to 31% by the end of 2007. The growth slowed down mostly due to the slowdown in the growth of housing loans and financing of business premises.

The quality of the combined loan portfolio of the banking sector remained sound. Still, due to the changing economic environment also loans overdue have started to grow both in absolute values and as a share of loan portfolio. At the end of 2007, the percentage of loans overdue more than 60 days was 0.7% of loans given to the non-financial sector (0.3% in 2006). As a result of the strong growth in the number of loans overdue also their coverage with discounts has significantly declined. Whereas the coverage of loans overdue more than 60 days was 152% at the end of 2006, it had declined to 77% by the end of December 2007. 87% of combined loan portfolio was classified as non-problem14 loans. Loans described as doubtful, risky or unlikely formed 3% of the entire loan portfolio (2% in 2006).

By the end of 2007, the total volume of resources in the banking sector had reached 233 billion kroons, growing by 29% in 2007. Client deposits accounted still for slightly more than a half of resources of the banking sector, though their share has significantly decreased in 2007. Funds provided by parent banks picked up, primarily in the form of loans, term deposits and subordinated liabilities. The growth in deposits was still considerably smaller that the growth in loans. The loan-deposit ratio had significantly increased in favour of loans by the end of 2007, reaching the level of 168% (145% in 2006). As the liquidity risk of Estonian banks is managed on the level of parent bank group, the realization of risk is directly depending on the ability of the parent bank to refinance its liabilities on money markets and to involve additional funds.

Profitability of the banking sector remained at the high level in 2007 both on solo and consolidated bases. In 2007, banks earned 7.4 billion kroons in net profit on a solo basis, which is twice as high as in the previous year. Net profits in 2006 totalled almost 3.6 billion kroons on a solo basis.

The most important efficiency ratios remained also high, e.g. the aggregated ROE reached 28.3% by the end of 2007 (25.5% in 2006).

On 31 December 2007, the composite capital adequacy of banks on a solo basis was 14.78% (13.14% in 2006). Banks increased their share capital and included profits and subordinated liability in their own funds in order to keep capital adequacy at a good level. Consolidated capital adequacy of banking groups was 10.84% at the end of 2007 (10.79% in 2006). Credit risk weighted assets still formed more than 90% of total risk weighted assets.

[14] Classification pursuant to Decree No 9 of the Governor of the Bank of Estonia of 27 June 2000

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 task of the Estonian Financial Supervision Authority (EFSA) in the development of legal environment is first of all to make proposals for adopting and changing legal acts and other legislation related to the financial sector and its supervision and to participate in the preparation of relevant draft legislation. Furthermore, EFSA must provide evaluations of the amendments to legislation in force as well as to new regulations that are being drafted. Pursuant to the Estonian Financial Supervision Authority Act, draft legislation regulating a supervised entity or the activities of EFSA or having in some other way an effect on the achievement of supervisory objectives must be approved by EFSA.

The following Eesti Pank Governor's Decrees that entered into force in 2007 and at the beginning of 2008 were prepared in cooperation with the Bank of Estonia:

- Eesti Pank Governor's Decree No 4, Reports on prudential requirements of credit institutions and consolidation groups of credit institutions;
- Eesti Pank Governor's Decree No 9, Establishment of supplementary reports on credit institutions' balance sheet;
- Eesti Pank Governor's Decree No 16, Establishment of off-balance-sheet reporting of credit institutions;
- Eesti Pank Governor's Decree No 20, Disclosure of information on credit institutions' risk management, own funds and capital adequacy and establishment of supplementary reporting.

The Act Amending the Insurance Activities Act, the Estonian Financial Supervision Authority Act and the Personal Data Protection Act came into force on 1 January 2008. The Insurance Activities Act was renewed due to the transposition of the Directive 2005/68/EC of the European Parliament and of the Council. Amendments concerned the activities of a reinsurer and prudential norms, but the underlying principle formerly in force remained generally unchanged, i.e. provisions on insurers specified in the Insurance Activities Act are applied also to reinsurers, unless otherwise provided in the law.

The Act Amending the Motor Third Party Liability Insurance Act, the Insurance Activities Act and the Traffic Act entered into force on 2 November 2007. Amendments were made due to the new Directive 2005/14/EC of the European Parliament and of the Council amending Council Directives 72/166/EEC, 84/5/EEC, 88/357/EEC and 90/232/EEC and Directive 2000/26/EC of the European Parliament and of the Council relating to insurance against civil liability in respect of the use of motor vehicles (so-called the Fifth Motor Insurance Directive).

EFSA has an important role in issuing regulations on insurers' activities. In 2007, the following regulations were amended in cooperation with the Ministry of Finance: Minister of Finance Regulation No 33 of 13.04.2005, Establishment of insurer's supervisory reporting and requirements to preparation and disclosure of interim reports; and Minister of Finance Regulation No 34 of 13.04.2005, Establishment of insurers' reporting forms, their content and submission deadlines. Also the following regulation was drafted: Minister of Finance Regulation No 20, Preparation and submission of reports by Estonian branches of insurers from contracting countries.

These regulations govern the content, form and preparation of reports of insurers and branches of foreign insurers, as well as procedures for their submission and disclosure and also deadlines

The Act Amending the Securities Market Act, the Estonian Financial Supervision Authority Act, the Authorized Public Accountants Act, the Investment Funds Act, the Credit Institutions Act and the Commercial Code entered into force on 19 November 2007. Preparation of the Draft Act to amend these acts commenced in 2006 in order to harmonize the Directive 2004/39/EC of the European Parliament and of the Council (Markets in Financial Instruments Directive – MiFID), its implementing Directives 2006/73/EC and 2004/109/EC (Transparency Directive – TD), its implementing Directive 2007/14/EC and to transpose European Parliament and Council Directives 2006/48/EC and 2006/49/EC (new Capital Requirements Directive) and Directive 2004/25/EC of the European Parliament and of the council on takeover bids (Takeover Bids Directive).

In connection with the enforcement of amendments to the Securities Market Act, the following regulations were adopted on 14 November 2007: Minister of Finance Regulation No 52, Procedures for notifying the Estonian Financial Supervision Authority of transactions in securities; and Minister of Finance Regulation No 51, Requirements for presenting information and reports to customers in connection with the provision of investment services.

The new Money Laundering and Terrorist Financing Prevention Act was drafted in 2007, in order to transpose into the Estonian law the Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing and the Commission Directive 2006/70/EC laying down implementing measures for Directive 2005/60/EC as regards the definition of "politically exposed person" and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2007

The EFSA strategy 2007-2010 which was approved by the Supervisory Board at the end of 2006 sets the following main objectives for the EFSA activities: raising cross-border supervisory capabilities; growth in the proportion of preventive supervisory methods; raising the awareness of customers of financial services; an open communication and working culture; and the efficiency of activities and minimal bureaucracy through ensuring the competitiveness of the Estonian financial sector at the international level.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN2007

In 2007, EFSA issued permits for the commencement of activities to four new market participants. In addition, two market participants expanded the range of financial services.

The risk analysis of credit institutions was based on usual monthly and quarterly cycles and it covered all credit institutions authorized in Estonia and partly also branches of foreign credit institutions.

In 2007, EFSA conducted on-site inspections in two banks. The following issues were examined during on-site inspections:

- Implementation of anti-money laundering procedures;
- Procedures for creating relations with non-resident customers;
- Handling of personal data;
- Management of problems and incidents;
- Ensuring functional consistency.

In the insurance sector, on-site inspections of the three insurance companies were conducted. The following issues were examined:

- Handling of insurance losses;
- Processing of personal data;
- Organization of IT area;
- Internal control environment and the operation of internal audit function.

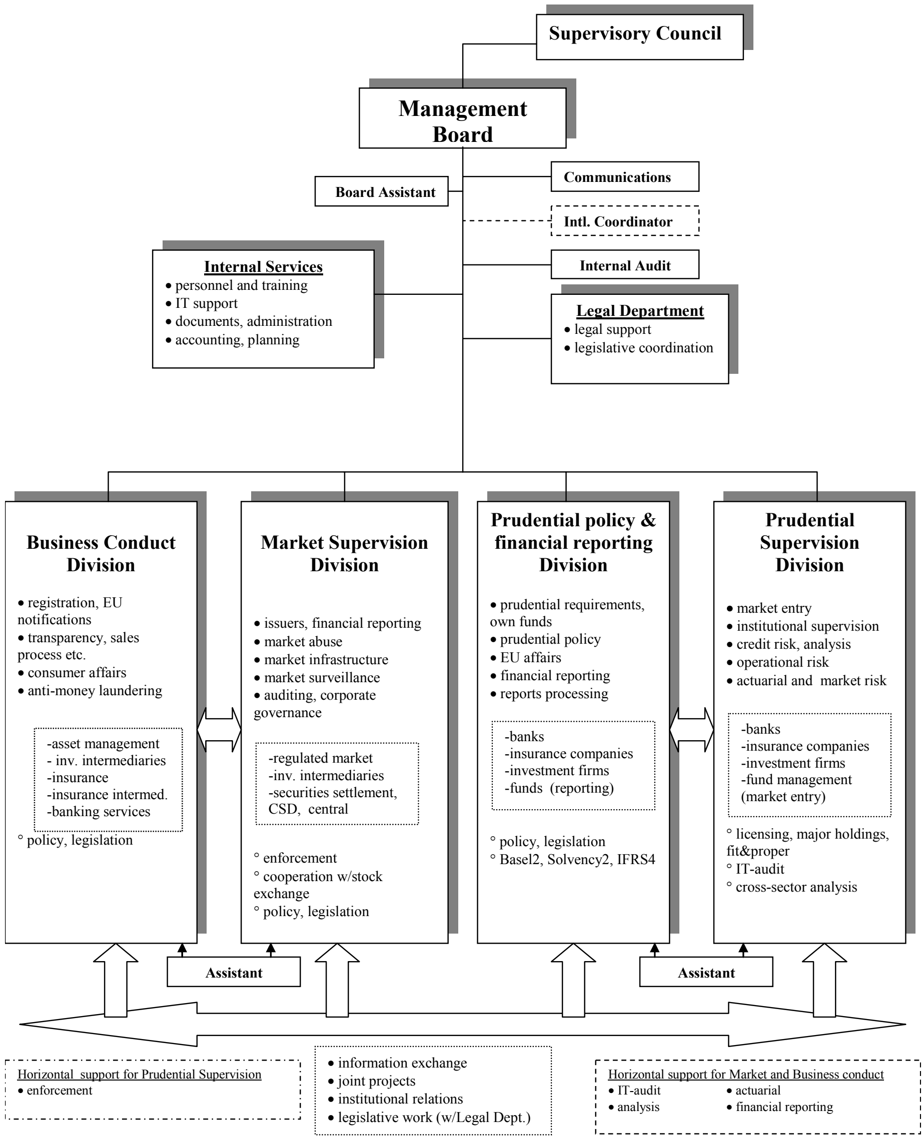
Taking into account that the implementation of internal risk assessment methods is allowed only when approved by the EFSA, EFSA commenced with examining applications that were submitted by credit institutions in 2007 in order to switch over to internal assessment systems for credit risk and operational risk. Several on-site inspections were conducted where also supervisory agencies of Sweden and other Baltic countries participated. Inspections were aimed at evaluating the credibility of the design of internal risk assessment methods (models) intended for use by credit institutions, the adequacy of underlying time-series and forecasting abilities of such models.

One of the strategic goals of the EFSA is to raise the awareness of consumers. In 2007, EFSA developed further the on-line environment www.minuraha.ee by improving its practicality. It opened also the Russian version of www.minuraha.ee. The number of consultations in www.minuraha.ee increased in 2007 approximately threefold in comparison with the beginning of the year, whereas users of the portal were mostly interested in credit, investment and travel insurance services.

In 2007, EFSA started to publish the report on financial services, in order to provide an overview of the volumes and market shares of financial services provided in Estonia. This semi-annual report on financial services is published on the website of the EFSA.

ORGANISATIONAL STRUCTURE OF THE ESTONIAN FINANCIAL SUPERVISION AUTHORITY

The activities of the EFSA are managed and organized by the Management Board, which consists of four members (Mr. Raul Malmstein, Mr. Andres Kurgpõld, Mr. Kaido Tropp and Mr. Kilvar Kessler) and is simultaneously the management body and the administrative body. The Management Board has competence over the organization of all activities of the EFSA and making decisions related to the financial supervision.



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

EFSA is able to influence the shaping of international supervision practices and policies that have an impact on the Estonian financial market by participating in the work of the EU financial sector supervisory committees. Thus, the main emphasis is on participation on Level 3 committees: Committee of European Securities Regulators (CESR), Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and Committee of European Banking Supervisors (CEBS). A large share of decision-making was and is being transferred to the level of these committees in accordance with the European Commission initiative. In 2007, the Financial Supervision Authority signed MoU's on banking supervision with the Central Bank of the Netherlands and with the Central Bank of Cyprus.

STATISTICAL TABLES

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

Type of financial institution	2005	2006	2007
Banks	7	7	7
Branches of foreign credit institutions	6	7	8
Financial institutions, total	**13**	**14**	**15**

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

Item	2005	2006	2007
Public sector ownership	0.0	0.0	0.0
Other domestic ownership	6.9	5.6	4.3
Domestic ownership total	6.9	5.6	4.3
Foreign ownership	93.1	94.4	95.7
Financial institutions, total	**100.0**	**100.0**	**100.0**

Ownership structure of the financial institutions on the basis of assets total (%)

Item	2005	2006	2007
Public sector ownership	0.0	0.0	0.0
Other domestic ownership	0.7	0.9	1.3
Domestic ownership total	0.7	0.9	1.3
Foreign ownership	99.3	99.1	98.7
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	FOREX assets / Total assets	FOREX liabilities / Total liab.
Bank	86.0	95.9

Return on Asset (ROA) by type of financial institutions

Type of financial institution	2005	2006	2007
Bank	2.0	1.7	2.6

Return on Equity (ROE) by type of financial institutions

Type of financial institution	2005	2006	2007
Bank	21.1	19.8	30.0

Distribution of market shares in balance sheet total (%)

Type of financial institution	2005	2006	2007
Bank	100.0	100.0	100.0

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

Assets	2005	2006	2007
Cash	0.94	0.89	0.75
Claims on central bank	6.47	7.13	5.47
Claims on credit institutions	16.56	9.24	11.29
Claims on customers	67.79	74.18	74.60
Allowance for uncollectible claims	-0.25	-0.31	-0.39
Securities	6.87	7.38	6.36
Intangible assets	0.22	0.18	0.13
Tangible assets	0.42	0.26	0.19
Other assets	0.98	1.05	1.60
Total assets	**100.00**	**100.00**	**100.00**
Liabilities	**2005**	**2006**	**2007**
Amounts owed to credit institutions and central bank	24.82	27.25	34.88
Amounts owed to customers	51.53	51.47	44.70
Government lending funds and counterpart funds	0.05	0.03	0.02
Issued debt securities	12.16	7.34	5.31
Other liabilities	1.94	2.35	2.69
Subordinated liabilities	0.79	3.08	3.70
Provisions	0.06	0.06	0.06
Equity capital	8.65	8.42	8.64
Total liabilities and capital	**100.00**	**100.00**	**100.00**

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

Type of financial institution	2005	2006	2007
Banks	38.08	40.59	26.87

Solvency ratio of financial institutions

Type of financial institution	2005	2006	2007
Banks	11.72	13.14	14.78

Asset portfolio quality of the banking system

Asset classification %	2005	2006	2007
Standard loans	88.71	90.35	87.37
Watch loans	9.18	7.48.	9.61
Doubtful loans	1.62	1.78	2.36
Insecure loans	0.24	0.22	**0.36**
Uncollectible loans	0.25	0.17	0.30
Classified total	**100.00**	**100.00**	**100.00**
Specific reserves	**0.30**	**0.28**	**0.36**

The structure of deposits and loans in 2007 (%)
(at year-end)

	Deposits	Loans
Households	35.44	44.94
Government sector	6.12	1.35
Corporate	36.42	44.49
Foreign	17.44	3.72
Other	4.58	5.50
Total	**100.0**	**100.0**

The structure of deposits and loans in 2007 (%)
(at year-end)

Types of deposits		Types of loans	
At sight	59.23	Long term loans	67.96
Within one year	35.53	Medium-term loans	24.01
Over one year	5.24	Short-term loans	8.03
Total	**100.0**	**Total**	**100.0**

Proportion of foreign exchange assets and liabilities
(at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Banks (balance sheet items only)	73.2	70.3	72.7	59.9	59.8	68.1

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

Structure of revenues and expenditures of financial institutions (at year-ends)

Revenues (mln EUR)	2005	2006	2007
Interest income	379.04	596.95	987.62
Net interest profit/loss (+/-)	190.88	287.30	388.93
Income from financial investments	56.86	7.66	154.00
Commission income	135.02	163.29	201.02
Profit on financial operations	76.97	94.97	153.19
Value adjustments of claims and off-balance sheet commitments (income)	8.65	5.17	2.98
Value adjustments of financial fixed assets (income)	0.01	1.05	0.00
Other operating income	15.49	22.25	66.55
Extraordinary income	0.00	0.00	0.00
Expenditures	**2005**	**2006**	**2007**
Interest expenses	188.17	309.65	598.69
Commission expenses	33.70	42.25	52.41
Loss on financial operations	49.41	54.64	92.85
Administrative expenses	161.20	204.18	266.60
Value adjustments of tangible and intangible fixed assets (expenses)	9.98	9.91	9.90
Value adjustments of claims and off-balance sheet commitments (+/-)	14.24	18.88	38.45
Value adjustments of financial fixed assets (expenses)	0.03	0.56	0.00
Other operating expenses	16.90	19.03	31.51
Extraordinary expenses	0.00	0.00	0.00
Profit/loss for the reporting period	197.36	230.63	472.47

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	EUR mln	%	EUR mln	%
Banks	367,215,433.3	1.8	2,258,682,461.0	12.1

2007 DEVELOPMENTS IN THE HUNGARIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The correction program launched in the middle of 2006 led to the fast and powerful decrease of budgetary imbalance: In 2007, the public finance deficit was reduced by an extent that corresponds with 3.5% of the GDP, way in excess of the planned level, while the government debt rate measured against total income was stabilised. Parallel to that, the net external financing requirement of the Hungarian economy decreased by 3% of the GDP. In a global market environment characterised by increasing risks and risk aversion by investors, both of these changes can be regarded as fundamental factors that improve the stability of the forint currency and bond market. From this respect, it is a remarkable circumstance that the net external financing of the Hungarian economy actually relies, on a fifty-fifty basis, on portfolio investments and foreign borrowing by the Hungarian banking system.

The improvement of the budget balance, however, was accompanied by the major deceleration of economic growth: in Q4 2007, annual GDP increase failed to reach even 1%. All this happened despite the fact that the total exports of goods and services rose by 15.6% during the year. The success in exporting, however, was overshadowed by the significant setback in domestic consumer and construction industry demand, the lower performance of certain government services and the supply shock caused by dry weather which restrained the crop production sector of agriculture. Economic deceleration generated a modest increase of unemployment, mainly as a consequence of dismissals in the government sector which underwent expenditure cuts.

Another unfavourable symptom that has burdened macroeconomic processes in the past year is the inflationary pressure which remains high despite decelerating economic growth. Since its peak in March 2007, the annual consumer inflation rate has been decreasing slightly and averaged at 8%. Although the pace of price stabilisation was lower than suggested by former Central Bank forecasts and market expectations, this was mainly a result of the jump of food and energy prices worldwide. These views on the Hungarian economy clearly leave their footprint on the market evaluation of the forint and instruments denominated in forint. Since the middle of 2007, the forint exchange rate took on a moderately weakening trend after three quarters of revaluation. Parallel to that, the return premium of forint sovereign bonds and the premium of credit risk swaps began to rise considerably again.

DEVELOPMENTS IN THE BANKING SYSTEM

Despite the decelerating national economy, the banking sector boasted dynamic business growth in 2007, thanks to the quick growth of household borrowings and the expansion of lending to foreigners. Although the dynamics of corporate lending was lower than that, it still greatly exceeded nominal GDP growth which was principally a result of the fast increase of lending to small and medium enterprises and of the boom of project lending. As a result of the above outlined process, total assets to GDP rose to 96% by end-2007 representing further deepening of financial intermediation by banks, from a 87% ratio in 2006.

Customer deposits, however, grew at a lower rate than loans in 2007 again, further augmenting the exposure of banks to financial and capital markets. The resulting financing gap was covered in part from parent bank resources, in part from the dynamic growth of deposits placed by domestic money market funds and third from other wholesale deposit, loan and bond financing.

The relatively fast-paced expansion of loans was accompanied by a perceivable deterioration of portfolio quality, deriving mainly from increased impairment loss on loans to household and foreigners. This trend reflects the growing indebtedness of Hungarian households and, in relation to impairment loss on the foreign loan portfolio, the increased exposure to the risks of the Central-Eastern European region.

An important trend for Hungarian banks in 2007 was the significant decrease of ROE in the sector, albeit from a rather high level. Average return on equity fell by 5.6 percentage points to 17.4% in 2007. This setback was the aggregate effect of various factors which typically related to increasingly fierce competition in services, the impacts of ongoing fiscal correction and the growing cost of global liquidity. Despite the worsening profitability, the capital position of banks remained stable. The average solvency ratio was significantly above the regulatory minimum requirement reaching 11.6% at end-2007, with none of the banks breaching the regulatory solvency criterion.

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

As a rule, the regulations of financial institutions are stipulated in the Acts of the Parliament and the implementing decrees issued by the Government or the Finance Minister. The most important laws concerning the banking sector are

- Act CXII of 1996 on Credit Institutions and Financial Enterprises
- Act CXIII of 1996 on Home Savings and Loan Associations;
- Act XXX of 1997 on Mortgage Loan Companies and Mortgage Bonds;

- Act XXXV of 2004 on Specialized Credit Institutions Issuing Electronic Money Instruments;
- Act CXX of 2001 on the Capital Market
- Act CXXXVIII of 2007 on Investment Firms and Commodity Dealers, and on the Regulations Governing their Activities; and
- Act CXXXVI of 2007 on the Prevention and Combating of Money Laundering and Terrorist Financing ;

As far as the new developments are concerned, in 2007 Hungary has transposed into its national legislation different directives of the European Union, the most important of which are the Capital Requirement Directive (CRD) and the Markets in Financial Instruments Directive (MiFID).

Financial institutions in Hungary are supervised by the Hungarian Financial Supervisory Authority (HFSA), which is a government body. The HFSA was established on 1 April 2000, as an integrated financial supervisory agency, responsible for the supervision of the whole financial sector, including banks, cooperative credit institutions, leasing and factoring companies, insurers, brokerage companies, fund managers, investment funds, pension and health care associations and stock exchanges, etc. Thus HFSA is the sole financial supervisory authority in Hungary. The legal status, responsibilities and tasks of the HFSA are defined in a separate Act, which was reviewed in 2007 and as a result of the revision a new act – Act CXXXVII of 2007 on the Hungarian Financial Supervisory Authority - was passed by the Parliament which came into force on 1 December 2007.

Within the framework of its vested responsibilities, the Authority – among others - shall:

- evaluate the applications submitted for authorization and other petitions (licensing);
- maintain the records and registers prescribed in the acts;
- monitor the systems of information supply and oversee the data provision of the supervised entities;
- supervise the operations and activities of the supervised entities in order to ensure the compliance with the regulations and supervisory resolutions;
- unless otherwise prescribed by law, open proceedings in the case of any violating of the provisions referred to in the previous point, including the taking of supervisory measures (including imposing fines);
- open market surveillance procedures where there is reasonable suspicion of insider dealing or market manipulation, in connection with operations conducted without proper authorization or notification, and with the enforcement of regulations relating to company takeovers;
- collaborate with foreign financial supervisory authorities, in particular with the competent authorities of Member States of the European Economic Area exercising financial supervision;
- discharge disclosure requirements within its sphere of competence and the obligation of reporting to the European Commission;
- discharge notification and information requirements in connection with the formation of branches and cross-border activities;

- cooperate in discovering and eliminating obstacles that hamper the development of voluntary mutual insurance funds and private pension funds, and their guarantee funds, and in coordinating the cooperation of the above with the competent social security offices and agencies;
- monitor and examine compliance with and enforcement of the regulations and principles relating to the acquisition of participating interests in public limited companies;

MAIN STRATEGIC OBJECTIVES OF THE HFSA IN 2007

The HFSA has a mid-term strategic plan: Efficient supervision – Strategy of the Hungarian Financial Supervisory Authority up to 2010. The primary aim of the HFSA's strategy is to catch up with the international development of financial activities and supervisory methodology. This requires a more target oriented and more efficient utilization of the available resources. The strategy for the period up to 2010 is based on the basic tasks of the HFSA as set out in the legislation, primarily to ensure the lawful, reliable, continuous and transparent operation of the financial markets. The strategy's key directions of action include elements which are indispensable for adaptation to the changing conditions: responsiveness, ongoing and substantive supervision, analysis of professional relationships, strengthening of the international aspects of supervision, implementation of EU regulation, active influence to improve market transparency and, adequate utilization of resources. The fulfilment of the strategy is aided by various actions: creation of a new, up-to-date human resource policy, creation of effective resource allocation, development of the methodology, establishment of IT awareness in supervision, transformation of organization and management conditions and of the working culture.

In order to meet its goals, the HFSA determined its supervisory (examination) priorities for 2007, which were: the capital position of the financial institutions, data provisioning by the supervised entities, asset quality, systemic risk, compliance, prevention of money laundering and the protection of consumers. The general priorities are supported by institution specific priorities. In case of banks these were the examination of the practical implementation of the new capital requirements stemming from the CRD.

ACTIVITIES OF THE HFSA IN 2007

The supervisory activities of the HFSA may be divided into two major parts: prudential supervision and market supervision.

The priorities of the prudential supervision are mentioned in the previous point. Prudential supervision encompasses the quarterly prepared risk assessments based on which the financial institutions are categorized in different groups. The rating of financial institutions defines the timing, excess and priorities of the examinations. In 2007 the HFSA conducted a series of (pre-)validation examinations to check the implementation of the

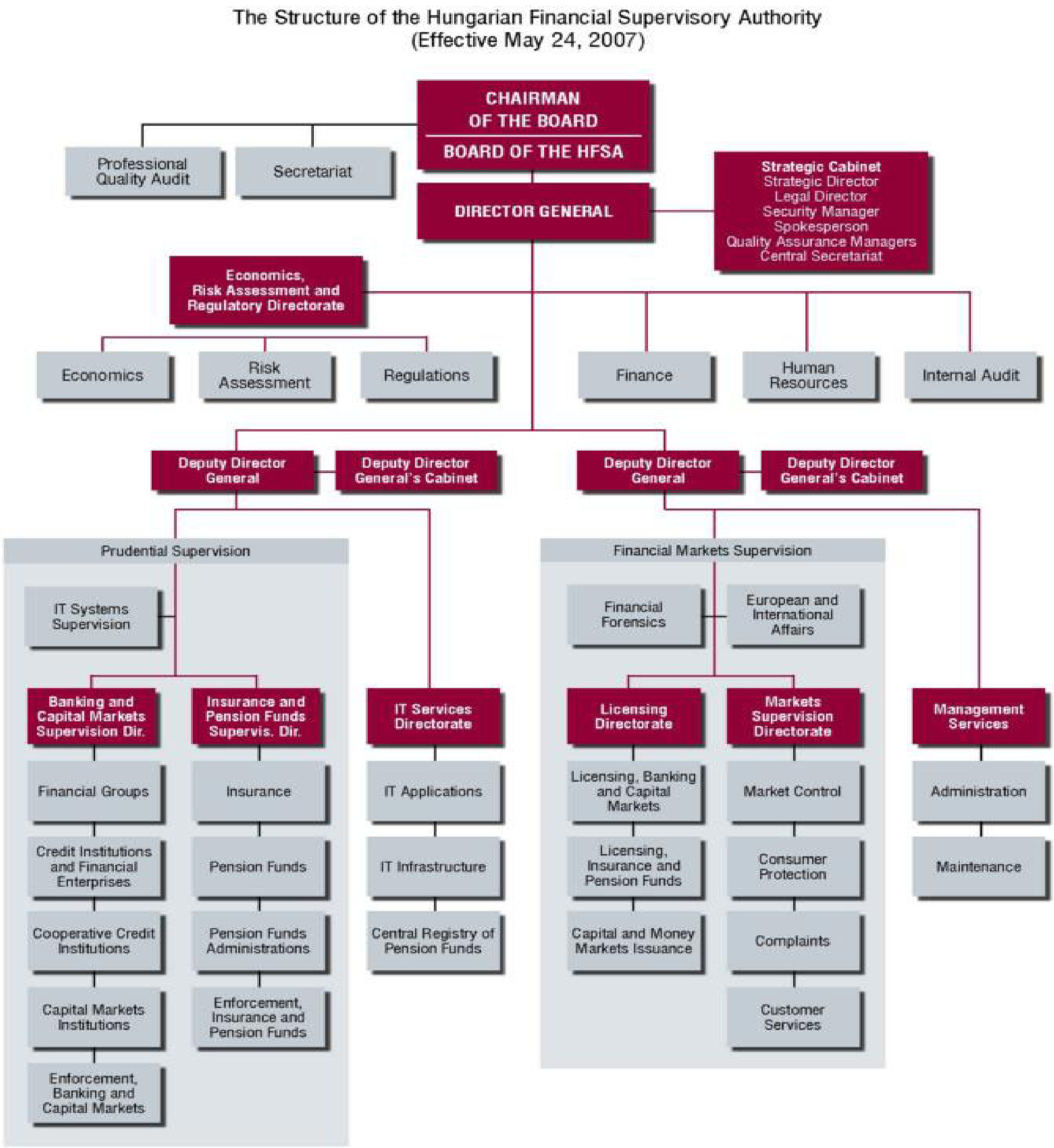
CRD in the credit institutions and co-operated with its foreign counterparts in the Joint Decision procedure. The HFSA is an active partner in the home-host co-operation, being home and host supervisor at the same time. The HFSA monitored carefully the activities of the 13 financial groups operating in Hungary.

In the field of market supervision the licensing activity, the monitoring and examination of conduct of the players, the consumer protection and complaint handling, and the activity against financial abuses should be mentioned as key areas.

Resolutions are the most important documents of the supervisory activity. In 2007 the HFSA issued 4014 resolutions, of which 25% stemmed from the prudential supervision, 70% from the market supervision and 5% from other areas. The HFSA issued 117 resolutions imposing fines on supervised institutions. In accordance with the general priorities, 2/3 of the fining resolutions was because of breaching the data provisioning obligations, and 10% because of insider dealing and market manipulation.

As additional activity, the HFSA participated in the preparation of new pieces of legislation and developed its own methodology in order to foster the implementation of the new rules. The most important of the latter was the preparation of the Validation Guidelines.

ORGANIZATIONAL CHART OF THE HFSA



The Prime Minister of the Republic of Hungary approved the Organisational and Operational Rules of the HFSA which was promulgated by the Finance Minister. The new rules came into force on 24 May, 2007.

INTERNATIONAL ACTIVITY OF THE HFSA

HFSA's international activities were centred around cooperation within the European Union's institutional structure in 2007. The HFSA continued to actively participate in the work of third-level committees under the Lámfalussy-process (CEBS, CEIOPS, CESR), with special interest in stepping up cooperation between supervisory authorities within the EU. HFSA also participated in the activities of other European committees, of which an especially important area was the work on the preparation and national implementation on the EU directive to fight money laundering and the financing of terrorism.

2007 brought about the intensification of cooperation with the financial supervisory authorities of other EU Member States and non-EU countries, regarding the joint supervision of multinational and regional banks, investment service providers and insurance companies. HFSA was an active initiator, organiser and participant of meetings, conferences and work in this area, both on the home country and the host country side. HFSA also took part in the activities of various other international organisations, including OECD, IAIS, IOSCO, IOPS.

The HFSA concluded bilateral Memoranda of Understanding with the Central Bank of Montenegro, la Commission Bancaire and le Comité des Établissements de Crédit et des Entreprises d'Investissement, and Hrvatska Agencija za Zador Financijskih Usluga.

COOPERATION WITH OTHER SUPERVISORY BODIES

The national payment and settlement system's oversight is provided by the Magyar Nemzeti Bank, the central bank. The HFSA shares responsibility for financial stability with the Finance Ministry and the Magyar Nemzeti Bank. These authorities cooperate on financial stability issues within the framework of a tripartite Financial Stability Committee.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN THE COURSE OF 2007

The Board of the HFSA issued 4 recommendations in 2007. These are:

- Recommendation No. 1 of 2007 (8 February) of the Board of the Hungarian Financial Supervisory Authority on proper real estate fund management
- Recommendation No. 2 of 2007 (8 March) of the Board of the Hungarian Financial Supervisory Authority on custody operations
- Recommendation No. 3/2007 (19 July) of the Board of the Hungarian Financial Supervisory Authority on the Request for Proposals Procedure for Asset Management Functions

- Recommendation No. 4 of 2007 of the Board of the Hungarian Financial Supervisory Authority on the assessment of the fitness and propriety of managers, directors and owners of financial organisations

- Management letters or "Dear CEO letters" are communication from the Director General of the HFSA. They assist in complying with the requirements of the regulation and inform about the supervisory practice of the HFSA. In 2007, the HFSA issued 11 letters:
- Dear CEO Letter No. 1/2007 for the chief executives of the financial institutions dealing with motor vehicle loans and leasing
- Dear CEO Letter No. 2/2007 for the Chief Executive Officers of independent insurance intermediaries dealing with motor third party liability insurance
- Dear CEO Letter No. 3/2007 for the Chief Executive Officers of insurance companies selling savings type life insurance and for Chief Executive Officers of independent insurance intermediaries
- Dear CEO Letter No. 4/2007 for the senior managers of organizations involved in trade financing
- Dear CEO Letter No. 5/2007 on the portfolio composition of index-linked investment funds
- Dear CEO Letter No. 6/2007 for the Chief Executive Officers of insurance companies selling motor third party liability insurance products
- Dear CEO Letter No. 7/2007 for the Chief Executive Officers of credit institutions and investment enterprises applying the standard method for determining the credit risk capital requirement
- Dear CEO Letter No. 8/2007 for the Chief Executive Officers of credit institutions and financial enterprises providing Japanese Yen-based loans, as well as forex loans with currency options
- Dear CEO Letter No. 9/2007 for the Chief Executive Officers of insurance companies dealing with the preparation of the institutional investment policies (internal investment regulations) of insurance companies
- Dear CEO Letter No. 10/2007 to the Chief Executive Officers of insurers selling unit linked life insurance products
- Dear CEO Letter No. 11/2007 about the contents and certain formal requirements of the insured person's consent that provides a legal basis for the insurer's handling their health-related data

In 2007 a new supervisory fee structure was introduced: all the market participants are obliged to pay a fix amount of annual fee once a year. This fix amount is calculated as a multiplication of HUF 50.000 (approximately EUR 200) by a multiplication factor defined by law. The multiplication factors are different for different type of institutions from one to forty units, i.e. credit institutions pay fix annual fee of HUF 2 million (HUF 50.000*40) while an insurance agent pays HUF 50.000 (HUF 50.000*1) fix annual fee.

In addition, market participants such as credit institutions, financial enterprises, investment firms, investment funds, insurance companies, mutual and pension funds shall pay variable supervisory fees on quarterly basis, too. The quarterly payable supervisory fee in case of credit institutions and investment firms is calculated as a sum of supervisory fee depending on the capital requirement (in the lack of capital requirement the balance sheet total, e.g. in cases of branches and financial enterprises) plus the supervisory fee calculated for the portfolio management activity carried out by the institution. The annual amount of the variable supervisory fee depending on the capital requirement is calculated as 3.8‰ of capital requirement defined by the general rules for prudential purposes. After portfolio management activity the annual amount of this kind of supervisory fee is calculated as 0.25‰ of total assets managed by the institution. The 3.8.‰ or 0.25‰ multiplication factors are applicable for all types of institutions apart from the sector in which they carry out activities:

	3.8‰	0.25‰
banks	capital requirement	market value of total assets managed by the institution within the frame of its portfolio management activity
insurance companies	capital requirement	book value of insurance technical reserves
investment firms	capital requirement	market value of total assets managed by the institution within the frame of its portfolio management activity
pension funds		market value of the assets

The Hungarian Supervisory Authority has the right to make reserves – up to 15% of its annual revenue - in order to cover unexpected costs and to smooth unforeseeable changes in the total volume of fees and charges paid by the market participants.

STATISTICAL TABLES

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

Type of financial institution	2005	2006	2007
Credit institutions	210	203	194
Commercial banks	29	32	32
Specialized banks	5	5	5
Savings and credit cooperatives	176	166	157
Financial enterprises	219	235	250
Investment companies	18	17	17
Asset managers	24	27	31
Insurance companies and associations	62	62	65
Pension, health & mutual self-assistance associations	178	176	158
Total	**711**	**720**	**715**

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

Type of financial institution	2005	2006	2007
Domestic ownership	13,0	14,5	12,3
Public sector	0,9	0,8	0,1
Private sector	12,1	13,7	12,2
Foreign ownership	80,9	79,5	82,0
Other/*	6,1	6,0	5,7
Total	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	Top 3 institutions			Top 5 institutions		
	2005	2006	2007	2005	2006	2007
Banks	40,6%	40,6%	40,7%	57,2%	58,0%	58,4%
Savings and credit cooperatives	8,2%	8,4%	8,8%	12,3%	12,7%	13,4%
Financial enterprises	22,5%	22,7%	22,4%	33,0%	32,7%	31,4%
Investment companies	73,6%	79,0%	78,2%	84,2%	87,8%	88,6%
Asset managers	55,6%	50,7%	53,1%	73,1%	67,8%	67,3%
Insurance companies and associations	57,7%	53,4%	49,8%	80,3%	76,6%	72,6%
Pension, health & mutual self-assistance associations	47,2%	49,1%	50,4%	65,1%	66,8%	68,1%

Return on Asset (ROA) by type of financial institutions (%)

Type of financial institution	2005	2006	2007
Banks	2,00	1,86	1,48
Savings and credit cooperatives	0,92	0,72	0,75
Financial enterprises	2,08	1,53	2,04

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

Type of financial institution	2005	2006	2007
Banks	22,7	23,0	17,4
Investment companies	-1,1	28,8	28,9
Insurance companies	33,9	24,6	23,0
Financial enterprises	24,4	20,4	22,6
Savings and credit cooperatives	13,9	10,7	10,8
Total	**22,7**	**22,7**	**18,5**

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

	2005	2006	2007	2005	2006	2007
	HUF bn	HUF bn	HUF bn	Percent	Percent	Percent
Credit institutions	18830	22428	25875	70,0%	69,4%	68,4%
Commercial banks	15840	19128	22094	58,8%	59,2%	58,4%
Specialized banks	1726	1940	2262	6,4%	6,0%	6,0%
Savings and credit cooperatives	1264	1360	1519	4,7%	4,2%	4,0%
Financial enterprises	2013	2200	2675	7,5%	6,8%	7,1%
Investment companies	489	689	856	1,8%	2,1%	2,3%
Asset managers	1985	2681	3353	7,4%	8,3%	8,9%
Insurance companies and associations	1701	1956	2259	6,3%	6,1%	6,0%
Pension, health & mutual self-assistance associations	1899	2350	2797	7,1%	7,3%	7,4%
Total	**26917**	**32304**	**37815**	**100,0%**	**100,0%**	**100,0%**

Structure of bank assets (at year end)

	Stock data (HUF billion)				Year-on-year change (%)			Structure (% of total)			
	Dec 04	Dec 05	Dec 06	Dec 07	2005	2006	2007	2004	2005	2006	2007
Cash & deposits at banks	2340	2876	3068	2447	22,9	6,7	-20,3	13,6	15,7	14,8	10,0
Cash & current accounts	726	697	689	812	-4,0	-1,1	17,9	3,6	4,9	3,3	3,3
Deposits at central bank	541	1291	1205	446	138,6	-6,6	-63,0	3,3	3,6	5,8	1,8
Interbank deposits	1073	889	1174	1188	-17,2	32,1	1,2	6,7	7,2	5,7	4,9
Securities	2100	2189	2485	3390	4,2	13,5	36,4	16,8	14,1	12,0	13,9
Loans	9483	11369	13462	16439	19,9	18,4	22,1	63,2	63,6	64,8	67,4
Non-financial companies	4579	5209	5915	6650	13,8	11,5	12,4	31,2	30,7	28,5	27,3
Households	2494	3250	4237	5366	30,3	28,4	26,7	14,9	16,7	20,4	22,0
Government	278	290	401	428	4,3	35,0	6,8	2,1	1,9	1,9	1,8
Domestic MFIs	443	566	630	841	27,9	11,4	33,4	3,0	3,0	3,0	3,5
Other domestic FIs	1208	1423	1610	1870	17,7	9,8	16,2	7,4	8,1	7,8	7,7
Nonresidents	421	573	854	1514	36,2	45,4	77,3	4,1	2,8	4,1	6,2
Others	60	59	18	21	-2,2	10,2	16,5	0,5	0,4	0,1	0,1
Investments	241	283	488	542	17,6	71,1	11,2	2,0	1,6	2,3	2,2
Total assets	**14912**	**17566**	**20763**	**24376**	**17,8**	**18,2**	**17,4**	**100,0**	**100,0**	**100,0**	**100,0**
Loans / GDP	**46,5%**	**52,2%**	**56,7%**	**64,8%**							
Assets / GDP	**73,1%**	**80,6%**	**87,4%**	**96,1%**							

Structure of bank liabilities (at year end)

	Stock data (HUF billion)				Year-on-year change (%)			Structure (% of total)			
	Dec 04	Dec 05	Dec 06	Dec 07	2005	2006	2007	2004	2005	2006	2007
Domestic interbank deposits	1235	1476	1796	2771	19,5	21,7	54,3	7,6	8,3	8,6	11,4
Debt securities	1483	1765	2030	2441	19,1	15,0	20,3	8,5	9,9	9,8	10,0
Domestic customer deposits	7407	8230	9371	10089	11,1	13,8	7,7	52,3	49,7	45,1	41,4
Non-financial companies	2399	2686	3391	3445	12,0	23,2	1,6	17,8	16,1	16,3	14,1
Households	4279	4666	4800	5103	9,0	4,3	6,3	30,1	28,7	23,1	20,9
Government	265	273	289	447	2,7	5,7	54,9	1,8	1,8	1,4	1,8
Other domestic FIs	321	454	736	905	41,2	57,1	23,0	1,6	2,2	3,5	3,7
Others	142	152	156	188	7,0	13,8	20,9	1,1	1,0	0,8	0,8
Deposits from nonresidents	2502	3431	3985	5047	37,2	16,1	26,7	17,1	16,8	19,2	20,7
Other liabilities	1024	1138	1867	2024	11,2	52,7	8,4	6,1	6,9	9,0	8,3
Own capital	1262	1525	1715	2004	20,8	19,7	16,8	8,3	8,5	8,3	8,2
Total liabilities	**14912**	**17566**	**20763**	**24376**	**17,8**	**18,2**	**17,4**	**100,0**	**100,0**	**100,0**	**100,0**
Customer deposits / GDP	**36,3%**	**37,8%**	**39,4%**	**39,8%**							
Nonresident deposits / GDP	**12,3%**	**15,8%**	**16,8%**	**19,9%**							

Off-balance sheet positions of banks (at year-end)

	Items	Items	Items	Items	Change	Change	Change
	HUF bn	HUF bn	HUF bn	HUF bn	%	%	%
	2004	2005	2006	2007	05/04	06/05	07/06
Off-balance sheet items, total	**8566**	**11454**	**8566**	**11454**	**33,7**	**17,1**	**45,2**
Future and contingent liabilities	4369	5252	4369	5252	20,2	7,1	7,2
- credit facilities	2598	3116	2598	3116	19,9	11,0	8,6
- guarantees	905	1118	905	1118	23,5	12,5	7,2
- other	866	1019	866	1019	17,6	-11,0	2,0
Spot and derivative transactions	4197	6202	4197	6202	47,8	25,6	72,6
- due to spot transactions	1064	858	1064	858	-19,3	42,9	-14,5
- due to forward transactions	556	1081	556	1081	94,5	9,0	345,3
- due to swap transactions	1782	2849	1782	2849	59,9	17,8	53,8
- other	795	1414	795	1414	77,7	43,5	-2,2
Ratio of off-balance sheet items to total assets	**57,4%**	**65,2%**	**57,4%**	**65,2%**			

Average solvency ratio (at year-end, %)

Type of financial institution	2005	2006	2007
Banks	11,88	11,54	11,60
Savings and credit cooperatives	14,24	15,26	15,82
Insurance companies /*	195,4	216,3	205,9

Portfolio quality at banks (at year-ends, as % of total)

	Problem-free				Substandard		
	2005	2006	2007		2005	2006	2007
Balance sheet items, total	88,4	89,8	91,9	Balance sheet items, total	1,1	0,8	0,7
Corporate loans	83,1	82,9	86,3	Corporate loans	1,4	1,2	0,8
Retail loans	92,3	91,5	90,4	Retail loans	0,6	0,7	0,8
Off-balance sheet items, total	95,9	96,1	97,8	Off-balance sheet items, total	0,2	0,2	0,1
All items	**91,8**	**92,7**	**94,9**	Balance sheet items, total	1,1	0,8	0,7
	Watchlisted				**Doubtful**		
	2005	**2006**	**2007**		**2005**	**2006**	**2007**
Balance sheet items, total	8,9	7,7	5,6	Balance sheet items, total	0,6	0,6	0,7
Corporate loans	13,5	13,5	10,1	Corporate loans	0,7	1,0	1,1
Retail loans	5,2	5,9	6,7	Retail loans	0,8	0,8	0,9
Off-balance sheet items, total	3,7	3,5	1,9	Off-balance sheet items, total	0,1	0,1	0,1
All items	**6,6**	**5,8**	**3,7**	**All items**	**0,3**	**0,4**	**0,4**
	Problem				**Bad**		
	2005	**2006**	**2007**		**2005**	**2006**	**2007**
Balance sheet items, total	2,7	2,5	2,5	Balance sheet items, total	1,0	1,1	1,1
Corporate loans	3,4	3,6	3,6	Corporate loans	1,3	1,4	1,7
Retail loans	2,5	2,6	2,9	Retail loans	1,1	1,1	1,2
Off-balance sheet items, total	0,4	0,4	0,3	Off-balance sheet items, total	0,1	0,1	0,1
All items	**1,6**	**1,5**	**1,4**	**All items**	**0,6**	**0,6**	**0,6**

Problem = substandard, doubtful and bad, total

Structure of bank loans and deposits by sector (at year-end)

	2005	2006	2007
Loans	**100,0%**	**100,0%**	**100,0%**
Non-financial companies	45,8%	43,9%	40,5%
Households	28,6%	31,5%	32,6%
Domestic FIs	17,5%	16,6%	16,5%
Government	2,6%	3,0%	2,6%
Nonresidents	5,0%	6,3%	9,2%
Others	0,5%	0,1%	0,1%
Deposits	**100,0%**	**100,0%**	**100,0%**
Non-financial companies	20,4%	22,4%	19,2%
Households	35,5%	31,7%	28,5%
Nonresidents	26,1%	26,3%	28,2%
Domestic FIs	14,7%	16,7%	20,5%
Government	2,1%	1,9%	2,5%
Others	1,2%	1,0%	1,1%

Term structure of loans from credit institutions (at year-end)

	2005	2006	2007
Loans to domestic non-banks, total	**100,0%**	**100,0%**	**100,0%**
Maturity up to 1 year	26,1%	26,1%	24,0%
Maturity between 1 and 5 years	27,3%	23,8%	21,8%
Maturity over 5 years	46,7%	50,1%	54,2%
- Loans to non-financial enterprises	**100,0%**	**100,0%**	**100,0%**
Maturity up to 1 year	37,6%	38,9%	37,1%
Maturity between 1 and 5 years	28,1%	27,8%	26,7%
Maturity over 5 years	34,3%	33,4%	36,2%
- Loans to financial enterprises	**100,0%**	**100,0%**	**100,0%**
Maturity up to 1 year	37,0%	35,3%	30,0%
Maturity between 1 and 5 years	43,0%	41,8%	44,1%
Maturity over 5 years	20,1%	22,9%	25,9%
- Loans to households	**100,0%**	**100,0%**	**100,0%**
Maturity up to 1 year	6,3%	6,7%	7,0%
Maturity between 1 and 5 years	16,2%	12,9%	9,0%
Maturity over 5 years	77,6%	80,4%	84,0%

Term structure of deposits at credit institutions (at year-end)

	2005	2006	2007
Deposits by domestic non-banks, total	**100,0%**	**100,0%**	**100,0%**
At sight	36,9%	36,7%	36,4%
Maturity up to 1 year	58,4%	55,1%	54,7%
Maturity between 1 and 2 years	1,0%	2,6%	2,2%
Maturity over 2 years	3,7%	5,6%	6,7%
- Deposits by non-financial enterprises	**100,0%**	**100,0%**	**100,0%**
At sight	58,7%	53,4%	57,0%
Maturity up to 1 year	40,0%	45,4%	41,4%
Maturity between 1 and 2 years	0,2%	0,3%	0,4%
Maturity over 2 years	1,0%	0,9%	1,2%
- Deposits by financial enterprises	**100,0%**	**100,0%**	**100,0%**
At sight	26,6%	31,9%	18,0%
Maturity up to 1 year	56,2%	40,8%	49,6%
Maturity between 1 and 2 years	5,7%	1,0%	2,2%
Maturity over 2 years	11,5%	26,3%	30,2%
- Deposits by households	**100,0%**	**100,0%**	**100,0%**
At sight	27,8%	27,3%	27,3%
Maturity up to 1 year	66,9%	62,5%	62,7%
Maturity between 1 and 2 years	1,1%	4,2%	3,2%
Maturity over 2 years	4,2%	6,0%	6,8%

Foreign currency shares in banks' balance sheet

	Dec 05	Dec 06	Dec 07
Total assets	**38,4%**	**43,0%**	**49,4%**
Loans to customers & MFIs	**50,5%**	**54,5%**	**63,2%**
- Companies	47,5%	47,1%	52,6%
- Households	32,6%	47,1%	59,5%
Other assets	13,7%	21,9%	20,6%
Total liabilities	**31,6%**	**36,0%**	**38,8%**
Deposits from customers	**20,9%**	**25,8%**	**24,1%**
- Companies	25,0%	34,9%	29,4%
- Households	13,7%	17,2%	18,0%
Deposits from MFIs	61,4%	62,3%	65,9%

Revenues and expenditures of banks

	2005 HUFbn	2006 HUFbn	2007 HUFbn	2005 ROA%	2006 ROA%	2007 ROA%
Net interest income	**622,8**	**697,8**	**717,4**	**3,89%**	**3,59%**	**3,27%**
- Interest revenue	1387,9	1514,9	1846,2	8,67%	7,79%	8,43%
- Interest expenditure	765,1	817,1	1128,8	4,78%	4,20%	5,15%
Net non-interest income	**260,8**	**300,6**	**368,5**	**1,63%**	**1,55%**	**1,68%**
- Fees and commissions, net	207,2	229,9	244,3	1,29%	1,18%	1,11%
- Trading and valuations, net	122,9	116,0	178,1	0,77%	0,60%	0,81%
- Other net income	-69,2	-45,3	-53,9	-0,43%	-0,23%	-0,25%
Operating expenses	-469,0	-525,5	-587,1	-2,93%	-2,70%	-2,68%
Operating profit	**414,6**	**472,9**	**498,8**	**2,59%**	**2,43%**	**2,28%**
Write-offs and provisioning	-35,0	-76,7	-105,8	-0,22%	-0,39%	-0,48%
Extraordinary income, net	1,3	29,7	-2,8	0,01%	0,15%	-0,01%
Corporate tax	-66,7	-69,1	-65,6	-0,42%	-0,36%	-0,30%
After-tax profit (ROA)	**314,2**	**356,8**	**324,7**	**1,96%**	**1,84%**	**1,48%**

Structure of registered capital and own funds of financial institutions (at year-end)

2005	Registered Capital (EUR)	/Total assets	Own funds (EUR)	/Total assets
Banks	1 552 233 609	2,2%	5 671 811 815	8,2%
Savings and credit cooperatives	65 342 919	1,3%	324 726 890	6,5%
Financial enterprises	44 240 573	0,9%	200 455 031	4,1%
Financial ititutions, average	**1 661 817 101**	**2,1%**	6 196 993 736	**7,8%**
2006	**Registered Capital (EUR)**	**/Total assets**	**Own funds (EUR)**	**/Total assets**
Banks	1 710 150 614	2,1%	6 798 882 283	8,3%
Savings and credit cooperatives	75 022 842	1,4%	362 418 728	6,7%
Financial enterprises	45 788 823	0,9%	235 621 577	4,5%
Financial ititutions, average	**1 830 962 279**	**2,0%**	7 396 922 588	**8,0%**
2007	**Registered Capital (EUR)**	**/Total assets**	**Own funds (EUR)**	**/Total assets**
Banks	1 827 965 265	1,9%	7 908 975 725	8,2%
Savings and credit cooperatives	82 582 917	1,4%	395 156 325	6,6%
Financial enterprises	49 131 754	0,9%	244 547 701	4,3%
Financial ititutions, average	**1 959 679 937**	**1,8%**	8 548 679 751	**7,9%**

2007 DEVELOPMENTS IN THE LATVIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The gross domestic product (GDP) growth of late years (in 2007 it was 10.3%) indicated an upward phase of economic development and that Latvia's economy was among the most rapidly developing global economies in last eight years. An essential impetus to the above growth, of course, was an increase in mortgage lending that, in turn, was boosted by the increasing resident purchasing power and demand for higher living standard.

The year 2007 was a turning point in the macroeconomic development. As a result of measures under the inflation curbing plan adopted by the government, the growth that in the past few years was strong was gradually moving towards more sustainable levels. The already steep and increasing inflation was mostly supported by excessive inflows of a variety of financing: credit resources from parent banks, foreign direct investment, EU funding, workers' remittances from labour income abroad.

Most believably, in the future there will be no such steep economic growth as up to now – an average 10-percent increase in GDP over a three-year period. The current economic phase compels people to think over their savings, as the users of the Latvian financial services take out numerous loans but make insignificant savings for the time being.

DEVELOPMENT IN BANKING SYSTEM

Although the economic development slowed somewhat in the second half of 2007, it was still robust, contributing to the Latvian banking sector's record high profit in 2007. However, the annual growth of profit was slower than previously, as well as ROA and ROE were slightly lower than in 2006 (2% and 24%, respectively).

The cost efficiency remained high and cost to income ratio (based on ECB methodology) was 46% at the end of 2007.

The banking credit risk has been constantly growing in Latvia since 2000, when loans comprised just 25% of bank assets, but at the end of 2007 loans amounted to 68% of total bank assets. Lending has developed in Latvia starting from a very low baseline; thus the rapid year-on-year growth rate (in 2007 - 37%, in 2006 - 56%) was also due to the very low initial position. In 2007, there were 153 000 households (more that 10% of households have a mortgage) which had taken housing loans.

With mortgage lending decelerating, the growth in industrial credit was becoming more pronounced.

Due to significant increase in banking sector own funds and slower credit growth, banking sector solvency and liquidity position improved. At the end of 2007 the total capital adequacy ratio reached 11.1% (10.2% at the end of 2006); liquidity ratio increased to 55.7% (51.1% at the end of 2006).

During the year 2007, the classification of banking loan portfolio did not change materially and at the end of the year banks still assessed 99.2% of the loan portfolio as standard, 0.4% as close-watched, 0.2% as substandard, 0.1% as doubtful and 0.1% as lost.

The amount of specific provisions for claims on non-MFI grew almost by 30% in 2007; the ratio of specific provisions to total loans still was 0.5%, while their ratio to non-performing loans reached 129.8%.

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

Implementation of Basel II
(EU directives 2006/48/EC and 2006/49/EC - CRD)

To implement the CRD, the EU version of the Basel II in Latvia, in 2007 amendments to the **Credit Institution Law** and **Law on Financial Instruments Market** were passed, as well as a number of regulations: **Regulations on the Calculation of Minimum Capital Requirements, Regulations on the Compliance with Restrictions on Exposures, Regulations for Establishing an Internal Control System, Regulations on the Information Disclosure, Regulations on the Recognition of External Credit Assessment Institution** and **Regulations on Obtaining Permits for Using Internal Ratings Based Approach, Advanced Measurement Approach, Internal Model Approach and Internal Value-at-Risk Model** and internal procedures. To provide methodological assistance for proper application of regulations and compilation of relevant reports, the FCMC made a presentation of the new regulations and provided training for market participants. The trial calculation of minimum capital requirements under the CRD rules has been made and impact assessment has been discussed at the FCMC Board and with the banks. The results were not surprising: the impact on capital requirements for credit risk on banks using the standartised approach varied depending on asset structure (increased in 7 banks and decreased in 12 banks), capital requirements for credit risk for IRB banks decreased dramatically. This was to a great extent mitigated by the capital requirements for operational risk and a 90% floor for IRB banks. Overall, capital adequacy ratio under Basel II was only slightly higher than under Basel I rules.

The banks used the option provided in CRD and did not switch to Basel II rules in 2007. As of 1 January 2008 CRD is mandatory for all banks and investment firms. All Latvian banks but 1 will apply standartised approach for calculation of capital requirements for credit risk and basic indicator approach for operational risk. One bank was granted permission to use IRB approach to calculate capital requirements for credit risk and AMA for operational risk, application of 1 more bank for the use of IRB is under consideration.

Reporting requirements

Reporting templates for the calculation of minimum capital requirements and own funds are based on the guidelines developed by the Committee of European Banking Supervisors (CEBS) regarding common reporting framework (COREP). COREP is implemented in full, both for solo and consolidated reporting. Regulations on the Consolidated Supervision were amended to bring financial reporting templates for consolidated banking groups in line with guidelines developed by the CEBS (FINREP), as well as reporting frequency was reduced from quarterly to semi-annual. Banks must report all core information and 1 template from the non-core FINREP package on a consolidated basis.

To reduce administrative burden as of 1 July 2008, an annual report would be submitted only to the State Revenue Service which would forward it in an electronic format to the Registry of Enterprises and the Registry of Enterprises in turn would publish a notification in the newspaper Latvijas Vēstnesis (Official Gazette) that information of annual report has been entered into the registration file of relevant authority. The annual report should be placed also on the Internet website to ensure free access for the public.

MAIN STRATEGIC OBJECTIVES OF FCMC IN 2007

The supervision of the Latvian financial and capital market by off-site analysis and by conducting on-site examinations of market participants.

Improvements to Latvian legislative enactments and their harmonization with EU requirements, with the recommendations of international financial supervisory authorities and with the best international practises in this field.

Preparing analytical information and providing explanation on a regular basis will boost a dialogue between the local market participants and international financial market as well as provide instructions and information for the Latvian residents about key tendencies and service reliability.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In the reporting year, 21 banks and four branches of foreign banks operated in Latvia. During the reporting year, the FCMC conducted 23 bank inspections, in particular focusing on lending as well as risk management, namely - operational risk, interest rate risk, foreign exchange risk, liquidity risk.

The underlying document for carrying out bank inspections is the FCMC's Bank Risk Assessment Manual which sets out the core principles for identifying risks incurred by activities of institutions subject to supervision as well as for analysis and assessment of quality, adequacy and compliance of approaches used to the size and complexity of activities.

Taking into account the principles laid down in the Bank Risk Assessment Manual, planning bank inspections and using information available from financial reporting and internal control management information, assessment of banks is carried out with a purpose to determine material business units/areas and business activities in each material business group's company where attention should be paid during the inspection. A decision on whether business units/areas and business activities in each business group company are regarded as material is made using qualitative and quantitative criteria in accordance with methodology. The FCMC identifies the risks and the aspects of risk management for each unit, which is to be assessed. At the end of 2007, overall 10 banks had undergone the assessment pursuant to the above methodology. Results of assessment allow the FCMC to compare assessments of bank activities and use them in planning further inspections.

Upon the significant growth in the amount of loans issued by banks, 16 inspections were conducted in the reporting year during which time the FCMC's specialists examined the quality of credit portfolio and the banks' credit risk management systems (identification, measuring, supervision and control of credit risk) in order to timely identify any weaknesses and possible credit repayment problems. The strategies, policies and procedures for granting credits and their implementation were evaluated. Overall, the housing credit portfolio quality and credit risk management were assed as satisfactory and no additional provisions were required.

In view of the specific weight of credit portfolio in the banking assets and considerable increase in the banking assets, special attention was paid to management of concentration risk in credit portfolios of banks and procedures for stress testing. In 2007, the FCMC issued a fine of 1 000 lats to one bank for violation of regulatory requirements regarding credit risk management.

When performing nine bank inspections in 2007, the FCMC paid greater attention to the quality of operational risk, interest rate risk, foreign exchange risk, liquidity risk and strategic risk management. In particular, the FCMC analyzed whether the banks had used results of various scenarios and stress testing procedures in risk management.

In assessing the compliance function, the FCMC evaluated efficiency of bank internal control system and corporate management overall. An emphasis was laid to make certain whether the internal control systems developed by the banks ensured compliance with law provisions and allowed for duly compliance with the changes in legal norms regarding the spheres linked to the banking activities, incl. foreign countries where the banks performed their activities.

Compliance function covers also the risk of laundering of proceeds derived from criminal activity and terrorism financing, namely, compliance function may be insufficient to ensure observance of the provisions of the anti-money laundering and terrorism financing laws, incl. the risk that the bank could be involved in laundering of proceeds derived from criminal activity and financing of terrorism.

Assessing the above risk, in 2007 the FCMC continued paying attention to activities of the market participants so that they would observe the Know Your Client (KYC) principle and be able to ensure the timely identification of unusual and suspicious transactions and report to the Office for the Prevention of the Legalization of Proceeds Derived from Criminal

Activity of them as well as the market participants be able to refrain from execution of such transactions.

In 2007, the FCMC conducted 15 inspections to probe the banks' compliance with the provisions of the Law on the Prevention of the Laundering of Proceeds Derived from Criminal Activity and to evaluate the quality and effectiveness of the banks' internal control systems. The FCMC fined five banks in the amount of 40 000 lats for drawbacks in the internal control system due to which inadequate monitoring of the clients' economic activities was detected.

Within anti-money laundering framework, in 2007 the FCMC's specialists took part in work of Committee on the Prevention of Money Laundering and Terrorist Financing of the European FCMC, as well as in the joint 3L3 Task Force on AML/CTF including the members of three European Union committees (Committee of European Banking Supervisors (CEBS), Committee of European Insurance and Occupational Pensions Supervisors (CEOPS) and Committee of European Securities Regulators (CESR)).

INTERNATIONAL ACTIVITIES OF FCMC

Involvement in the EU institutions is a main direction of the FCMC's international cooperation, aimed at observation of Latvia's commitments arising from the accession treaty and falling within the FCMC's competence as well as protection of the Latvian financial sector. Participation of the FCMC in the EU institutions has remained unchanged in the reporting year. The FCMC's experts continued actively taking part in work of the EU institutions: in the meetings of the Financial Services Committee (FSC) under Lamfalussy framework, Level 1, as well as in the committees set up by the European Central Bank (ECB) and their working groups in the area of financial services.

The FCMC's experts, representing the Ministry of Finance, participated in the following committees and their working groups: the European Banking Committee (EBC) Level 2, European Insurance and Occupational Pensions Committee (EIOPC)), European Securities Committee (ESC). The FCMC actively participated in the committees of Lamfalussy Level 3: Committee of European Securities Regulators (CESR), Committee of European Banking Supervisors (CEBS) and Committee of European Insurance and Occupational Pension Supervisors (CEIOPS). All the Level 3 committees make every effort to ensure convergence of supervision practice in the EU, as well as review issues specific to the respective sector.

The FCMC within its competence reviewed and expressed its opinion also on 60 draft positions and instructions prepared by other institutions. All efforts were made to implement the EU Lisbon strategy, as well as enhancement of draft directive aiming to harmonise consumer credit contracts and draft directive regarding portability of supplementary pension rights and finalizing the draft regulation on the law applicable to contractual obligations.

In the reporting year, the FCMC efficiently cooperated also with foreign supervisory authorities and taking account of cross-border activities by market participants expanded cooperation with partners and entered into one new agreement – the Memorandum of Understanding between the

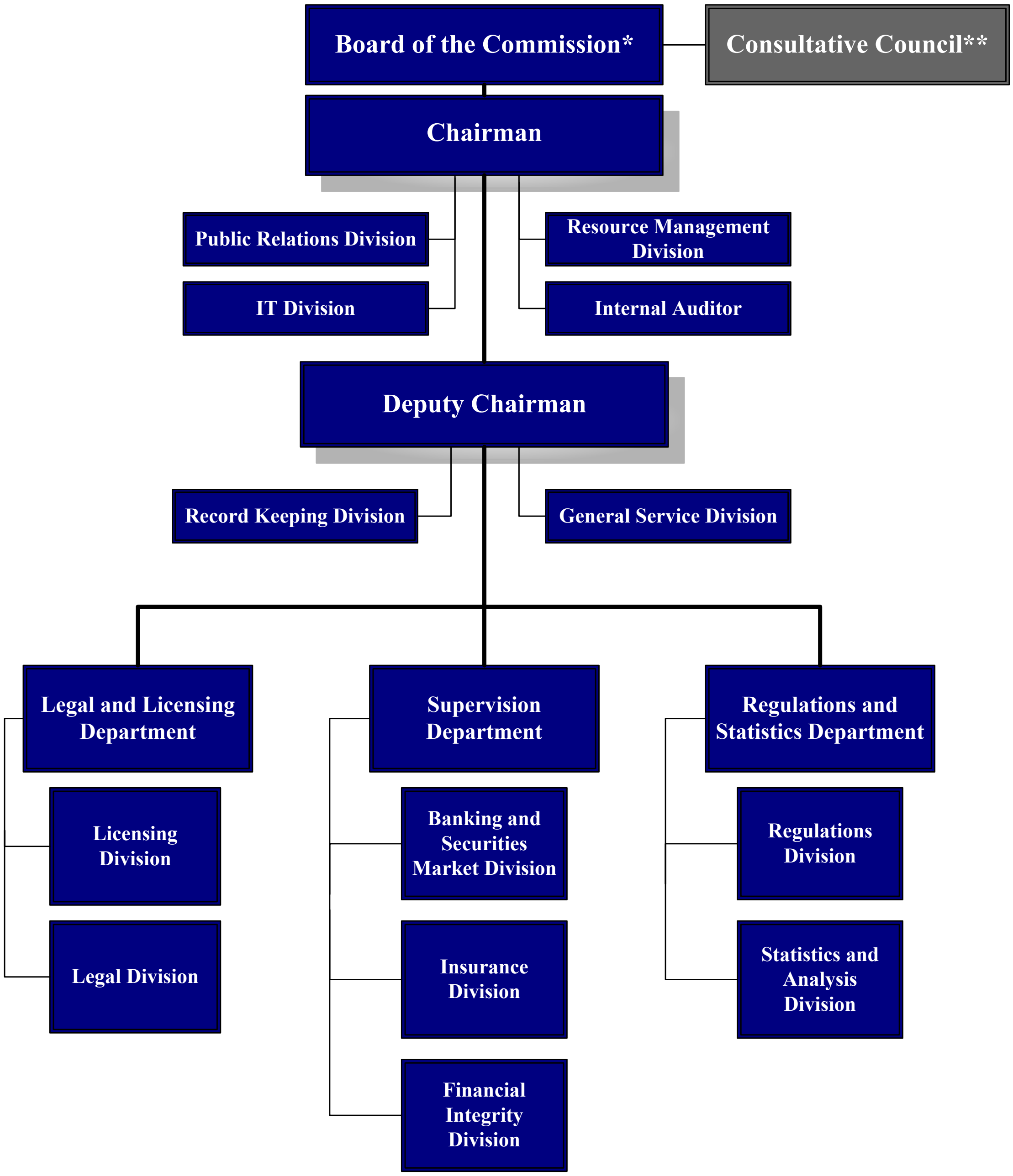
New York State Banking Department and the FCMC concerning their cooperation and exchange of information in the field of supervision of banks and their cross-border establishments.

In total, the FCMC has signed 24 bilateral cooperation agreements up to now of which 13 agreements are concluded with foreign credit institution supervisory authorities. The FCMC has entered into Memorandum of Understanding with the Finnish Financial Supervision Authority regarding cooperation in the supervision of Nordea Bank Finland Plc. Two agreements on sharing information without signing a cooperation agreement in writing have been already reached: the Office of the Comptroller of the Currency (the U.S. federal banking supervision agency under the United States Department of the State Treasury) and the Swiss Federal Banking FCMC. Moreover, the FCMC has signed also three multilateral cooperation: Memorandum of Understanding on Co-operation between the Banking Supervisors, Central Banks and Finance Ministries of the European Union in Financial Crisis Situation, Memorandum of Understanding on Co-operation between Payment Systems Overseers and Banking Supervisors in Stage Three of EMU; Memorandum of Understanding on High-Level Principles of Co-operation between Banking Supervisors and Central Banks of the EU in Crisis Management Situations.

COOPERATION WITH OTHER SUPERVISORY BODIES IN LATVIA

The FCMC is a unified supervisory authority for the financial sector in Latvia.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



***The Board consists of five Board members: Chairman of the Commission, Deputy Chairman of the Commission and three Board members, who are simultaneously directors of the departments of the Commission.**

****The Consultative Council of the Financial and Capital Market is formed on a parity basis from representatives of the Commission and heads of professional organizations of financial and capital market participants.**

STATISTICAL TABLES

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

Type of financial institution	2005	2006	2007
Banks	22	21	21
Credit Unions	34	35	35
Foreign bank branches	1	3	4
Financial institutions, total	**57**	**59**	**60**

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

Item	2005	2006	2007
Public sector ownership	10.6	8.2	5.5
Other domestic ownership	30.8	23.0	16.5
Domestic ownership total	41.4	31.2	21.8
Foreign ownership	58.6	68.8	78.2
Financial institutions, total	**100.0**	**100.0**	**100.0**

Ownership structure of the financial institutions on the basis of assets total (%)

Item	2005	2006	2007
Public sector ownership	4.3	4.3	4.2
Other domestic ownership	37.8	30.4	29.2
Domestic ownership total	42.1	34.7	33.4
Foreign ownership	57.9	65.3	66.6
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions (within type of institution)

Type of institutions	The first three largest (%)	The first five largest (%)
Banks	50.4	66.6

Return on Asset (ROA) by type of financial institutions (%)

Type of financial institution	2005	2006	2007
Banks	2.1	2.1	2.0

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

Type of financial institution	2005	2006	2007
Banks	27.1	25.6	24.2

Distribution of market shares in balance sheet total (%)

Type of financial institution	2005	2006	2007
Banks	94.7	93.9	92.1
Foreign bank branches	5.3	6.1	7.9
Financial institutions, total	**100.0**	**100.0**	**100.0**

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

Assets	2005	2006	2007
Cash and balances with the Bank of Latvia	6.0	8.7	7.5
Claims on credit institutions	17.6	12.9	16.0
Loans	63.6	68.4	68.1
Bonds and other fixed interest securities	9.6	7.2	5.6
Shares and other variable yield securities	0.3	0.4	0.3
Participating interest and other financial investments	0.5	0.5	0.5
Other assets	2.4	1.9	2.0
Liabilities	**2005**	**2006**	**2007**
Amounts owed to the Bank of Latvia	0.2	0.0	0.0
Amounts owed to credit institutions	29.9	37.3	40.1
Deposits	56.7	48.8	46.5
Other liabilities	4.8	5.7	4.9
Provisions	0.8	0.6	0.6
Total equity	7.6	7.6	7.9

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

Type of financial institution	2005	2006	2007
Banks (incl.foreign bank branches)	14.5	13.8	13.2

Solvency ratio of financial institutions (%)

Type of financial institution	2005	2006	2007
Banks	10.1	10.2	11.1

Asset portfolio quality of the banking system

Asset classification	2005	2006	2007
Standart	98.8	99.3	99.2
Watch	0.5	0.3	0.4
Substandart	0.3	0.2	0.2
Doubtful	0.2	0.1	0.1
Lost	0.2	0.1	0.1
Classified total	**100.0**	**100.0**	**100.0**
Specific provisions	**0.7**	**0.5**	**0.5**

The structure of deposits and loans in 2007 (%)
(at year-end)

	Deposits	Loans
Households	29.8	40.0
Government sector	2.3	0.5
Corporate	21.2	47.4
Foreign	46.0	12.0
Other	0.7	0.1
Total	**100.0**	**100.0**

The structure of deposits and loans in 2007 (%)
(at year-end)

Maturity of deposits		Loans	
At sight	60.9	Long term loans	56.5
Within one year	34.1	Medium-term loans	30.8
Over one year	5.0	Short-term loans	12.7
Total	**100.0**	**Total**	**100.0**

Proportion of foreign exchange assets and liabilities * (at year-ends) (%)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Banks (incl. foreign bank branches)	71.8	72.9	79.7	70.5	71.2	75.2

Structure of revenues and expenditures of financial institutions (at year-ends) (in Mio EUR)

Revenues	2005	2006	2007
Interest income, incl.:	59.6	65.8	72.5
interest on loans	44.9	50.9	57.6
interest on deposits with credit institutions	7.8	8.8	9.1
interest on bonds and other fixed income securities	6.4	5.6	4.4
Dividends	3.1	1.2	1.1
Commission received	21.7	17.8	13.9
Profit/loss from securities and currencies trading	8.2	8.8	7.3
Other	7.4	6.4	5.2
Expenditures	**2005**	**2006**	**2007**
Interest expense	32.9	42.9	52.4
Commission paid	6.7	5.9	4.9
Operating expenses	42.0	36.0	30.0
Depreciation	5.4	3.7	2.5
Loans loss provision expenses	6.3	3.9	3.9
Other	6.7	7.6	6.3

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	in 1000 EUR	in %	in 1000 EUR	in %
Banks	1,264,776	4.1	2,362,699	7.6

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

2007 DEVELOPMENTS IN THE LITHUANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2007, the economy in Lithuania continued to grow. The growth rate of real GDP accelerated, compared to 2006, and amounted to 8.8 per cent. The economic development was pushed up by a buoyant growth of investment at the start of the year, a better absorption of EU funds, rapidly soaring income and increasing consumption supported by still intensive borrowing. The growth rate of investment over the second half of the year was more moderate than within the first half of the year. However, a favourable development of net exports entailed a stimulating effect on the economy. The main features characteristic to the year 2007 were the further buoyant rise in the compensation of employees, supported by a more intensive growth rate of corporate profit.

Domestic demand remains the main driver of the economic growth. In 2007, the composition of investment changed significantly – the share of investment into vehicles expanded. A buoyant investment growth in the first half of the year spurred the growth rate of all investments. A more effective usage of the EU funds and a good financial stance of enterprises determined the expansion of investment into engineering and commercial buildings.

The analysis of the Lithuanian economic development in 2007 in terms of supply discloses that the most important driver of the value added growth was a buoyant increase in activity of trade enterprises: the value added created by retail and wholesale trade enterprises accounted for a quarter of the growth of GDP in 2007. The growth rate of sales of the manufacturing (excluding oil products) production also remained intensive.

In 2007, the average annual inflation soared significantly. Over the year, it grew by 2 percentage points and accounted for 5.8 per cent in December. The strongest contributor to the inflation increase was a buoyant growth of prices of processed food products. The increase in these prices reflects the global trends of food becoming more expensive. These trends are largely driven by robustly expanding economies in less developed countries, thus pushing up the demand for agricultural products and processed food.

DEVELOPMENT OF THE BANKING SYSTEM

There are 9 commercial banks and 5 foreign bank branches that hold banking licences operating in Lithuania. As of 1 January 2008, the Bank of Lithuania had received 176 notifications from the supervisory authorities of the EU Member States on intentions of the banks licensed by supervisory institutions of the said countries to provide services in Lithuania without establishing a branch.

The year 2007 was profitable for banks and marked by a rapid development. The growth of GDP was accompanied by the growth of the domestic banking sector, both in relative and in absolute terms, which was faster than in 2006 according to many key indicators. Market increase of the ratio of assets managed by banks to GDP from 71.9 per cent to 83.7 per cent proves the significantly increasing role of banks. The loans to customers increased 46.8 per cent, compared to 2006. Over the year, the amount of deposits with domestic banks soared by 21.5 per cent. Of these, the deposits of residents went up by 26.8 per cent.

On 1 January 2008, the share of loans to customers in bank assets was 70.1 per cent, a year-on-year increase of 4.5 percentage points. Along with the loans to financial institutions, they accounted for 74.1 per cent of the banking sector assets. This big share of loans has a positive impact on the profitability of banks; however, it also shows the growth of assumed credit risk. Investing in the domestic market has remained among the priorities of banks.

In 2007 the performance of the absolute majority of banks was profitable. In 2007 the total profit of the domestic banking system was EUR 334 million, and was 73 per cent higher than in 2006. Bank profit grew mostly because fast growing loan portfolio and the real interest margin pushed up interest income.

The year 2007 saw an increase in return on assets of the banking system. Over the year, it went up from 1.3 per cent to 1.7 per cent, while return on equity grew from 20.3 per cent to 25.9 per cent.

The ratio of fixed expenses and the profit from the principal activity, which serves as the banking system efficiency indicator, declined (improved) over the year by 4.9 percentage points to 40 per cent on 1 January 2008, showing the share of net income earned by banks from the principal activity, that was used to cover operating and amortisation expenses.

On 1 January 2008, the capital adequacy ratio of the banking system was 10.9 per cent (the required minimum set by the bank of Lithuania is 8%), up by 0.16 percentage point, compared to the previous year. This was mostly influenced by the capital base, which grew faster than the risk-weighted assets. All commercial banks complied with the established capital adequacy requirement.

According to the data of 1 January 2008, the liquidity ratio of the banking system was 43.5 per cent, exceeding the Bank of Lithuania's established minimum by 13.5 percentage points. The liquid assets accounted for 21.9 per cent of the total assets of the banking system. All banks complied with the liquidity ratio set by the Bank of Lithuania.

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

Financial market supervision in Lithuania is performed by three separate authorities: the Bank of Lithuania (Credit Institutions Supervision Department) is responsible for the supervision of credit institutions (banks and credit unions) on solo basis, also it is carrying out consolidating supervision of financial group, to which belong credit institutions; Securities Commission supervises securities market participants (financial brokerage firms, banks' specialized financial brokerage subdivisions, investment funds, pension funds); Insurance Supervisory Commission is responsible for insurance market participants (insurance undertakings, insurance broker companies).

Furthermore, the Commission for Co-ordination of Regulation and Supervision of the Activities of Financial Institutions and Insurance Undertakings was established and it deals with the issues arising in cooperation field among local supervisory authorities, when supervising financial and insurance undertakings.

As stated in the Law on the Bank of Lithuania, the Bank of Lithuania supervises the activities of credit institutions holding a licence of the Bank of Lithuania. The supervision of the activities of credit institutions consists of:

1. licensing – consideration of applications for issuing licences, permissions and consents established by laws, and adoption of decisions, as well as other activities related thereto;
2. collection and analysis of information obtained for the purposes of supervision in the form of reports, as well as assessment of activities of credit institutions and their financial situation on the basis of the said information, taking into account prudential and other requirements of the activities of credit institutions established by legal acts (off-site supervision);
3. inspection of the activities of credit institutions — verification of the correctness of the compilation of financial reports presented to the Bank of Lithuania and assessments of the activities and financial situation (capital, quality of assets, profitability) of credit institutions, as well as assessment of the efficiency of the management of risks (credit, liquidity, market, operational, others) and of the management of a credit institution (on-site supervision);
4. application of enforcement measures prescribed by laws to credit institutions.

In performing supervision of the activities of credit institutions, the Bank of Lithuania has the right to:

1. receive information necessary for the performance of the supervisory function from state institutions, credit institutions, their subsidiaries, as well as from other enterprises, institutions and organisations;
2. inspect (examine) credit institutions holding a licence issued by the Bank of Lithuania, and, in the cases established by laws, other persons as well;
3. in the cases and manner established by laws, apply enforcement measures against credit institutions and other persons holding a licence issued by the Bank of Lithuania; and
4. take measures in order to ensure efficient operation of the credit system.

Ongoing supervisory functions are performed by the Credit Institutions Supervision Department, a structural unit of the Bank of Lithuania. The Board of the Bank of Lithuania is empowered to resolve issues pertaining to the issuance and revocation of licenses, permissions, consents to credit institutions, to apply enforcement measures established by laws to credit institutions, to decide on issues regarding initiation of bankruptcy proceedings against credit institutions, etc.

MAIN STRATEGIC OBJECTIVES OF THE BANKINGSUPERVISORY AUTHORITY IN 2007

The goal of credit institution supervision is to monitor the compliance of credit institutions with the standards of safe and reliable banking as set by the laws and legislation of the Bank of Lithuania, International Financial Reporting Standards and recommended by the Basel Committee on Banking Supervision.

The main objectives of the banking supervisory authority in 2007 were:

- Seek to ensure the reliability, transparency and competitiveness of the national credit institutions system.
- Even in the course of licensing process try to prevent unreliable market participants with bad reputation from entering the banking market.
- To supervise how banks observe prudential requirements and implement the requirements set forth by legal acts regulating the operation of banks.
- Try to ensure an effective prevention of emerging risks in credit institutions and assure maximum early identification of potential problems.
- To further improve the regulation of banking accounting and reporting taking into account the latest EU directives, TFAS provisions and developments in financial markets.
- To ensure consistent implementation of the European Union directives: 2006/48/EC relating to the taking up and pursuit of the business of credit institutions and 2006/49/EC on the capital adequacy of investment firms and credit institutions.
- In the course of the implementation of the aforementioned directives to maintain constant relations with the industry and interested supervisory authorities of other EU member states.
- To ensure proper preparation for the implementation of new supervisory inspection and assessment process.
- To guarantee proper representation of the national credit institutions supervision at relevant structures of the European Union, to expand and develop contacts with credit institutions supervision authorities of foreign countries.

THE ACTIVITIES OF BANKING SUPERVISORY AUTHORITY IN 2007

In 2007, continuing the implementation of the new capital directives, the Bank of Lithuania adopted several new legal acts and made supplements and amendments to legal acts.

The new recommendations of the Committee of European Banking Supervisors (CEBS) and clarifications of the working group on the implementation of the new capital adequacy directives formed by the European Commission were taken into account in making adjustments to the General Regulations for the Calculation of Capital Adequacy. The said adjustments deal with the establishment of risk coefficients by applying the standardised credit risk assessment method, the establishment of credit risk parameters by applying the internal ratings-based method, the classification of activities as business lines to determine capital requirements for covering operational risks, etc. Furthermore, some capital structure elements have been changed for calculating capital adequacy. Banks were allowed to include retained profit for the current year into its Tier I capital only after making assessment of operational results, the nature of risk management and asset concentration level in the bank.

The General Provisions on Undated Debt Securities and Their Inclusion into Bank Capital were prepared to create conditions for banks to issue undated debt securities and include them into capital. This document sets requirements to be met for undated debt securities.

Since subordinated loans are an important component in a bank‘s capital, the General Provisions of Subordinated Loans and Their Inclusion into Bank Capital were revised.

A series of individual meetings with bank managers and experts were held to assess preparedness of banks to apply the requirements provided for in the legal acts on the calculation of capital adequacy from 1 January 2008 and in particular the introduction of the internal capital adequacy assessment process (ICAAP). Banks made presentations regarding their ICAAP during the meetings and recommendations for the content of ICAAP report prepared by the Bank of Lithuania were discussed. The Bank of Lithuania is making preparations for performing the provided Supervisory Review and Evaluation Process (SREP).

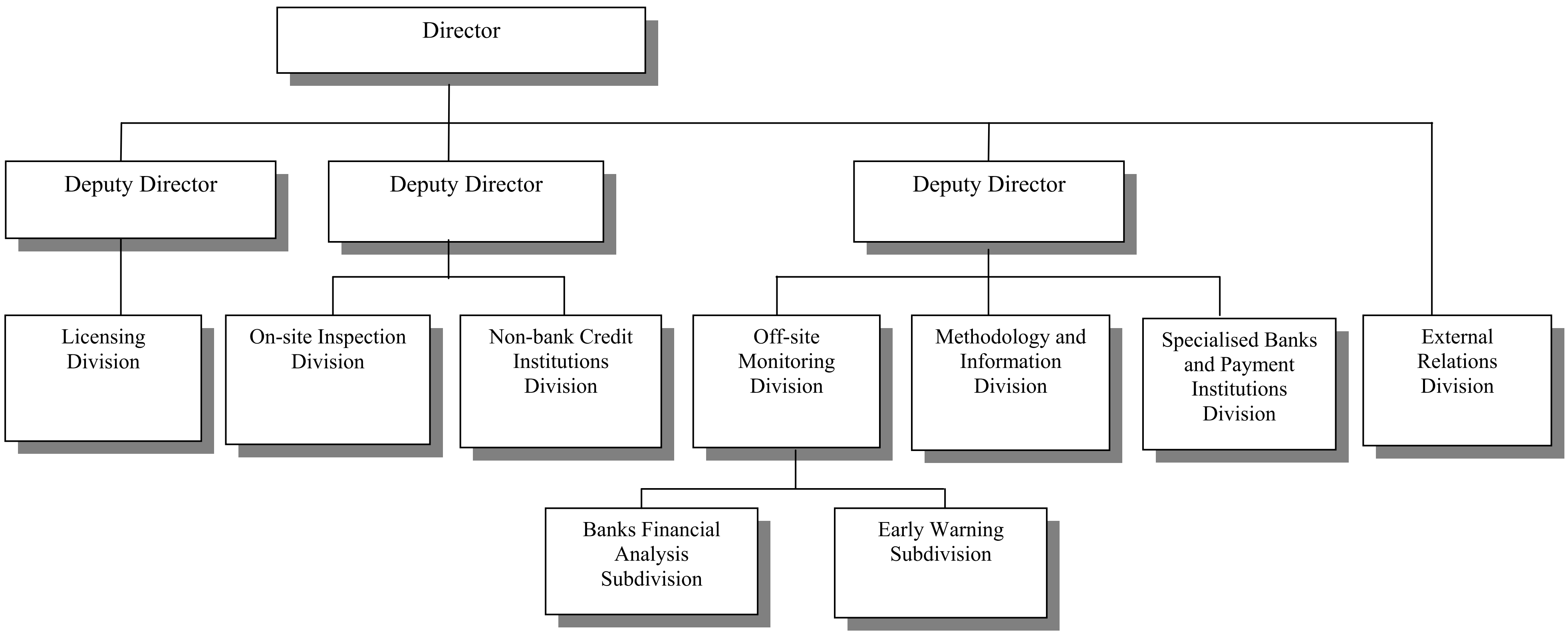
In implementing the new capital adequacy requirements, the Bank of Lithuania made an assessment of the preparation of one of the banks to apply the internal ratings-based credit risk assessment method and the advanced operational risk measurement approach for the calculation of capital requirements. The Board of the Bank of Lithuania allowed this bank to start the application of both methods from 1 January 2008.

The General Provisions on Stress Testing were updated and revised. In conducting the credit institutions supervision, a supervisory review and assessment process was started by the Bank of Lithuania with regard to each of them, therefore every credit institution shall have to create and implement an effective and functional mechanism for determining internal capital requirements, depending on the scope and nature of its activities, the risks assumed and the operations performed. An obligatory stress testing of the bank’s activities is one of the conditions for the capital distribution and adequate assessment of the risks related to the bank’s activities. The document sets out key aspects of the organisation and performance of stress testing in credit institutions.

Taking into account the fact that the Basle Committee on Banking Supervision updated the Core Principles for Effective Banking Supervision and considering a rapid development of the banking supervision and the international practice gained, the Core Principles for Effective Banking Supervision were supplemented with new requirements and approved by the Board of the Bank of Lithuania. The key innovations paid particular attention to risk management processes in banks. Supervisory institutions must make sure that both individual risks and the overall risk faced by the bank are properly identified, assessed and managed. At the same time, the Bank of Lithuania made an assessment of how the Core Principles for Effective Banking Supervision have been implemented in the Lithuanian banking system.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

THE STRUCTURE OF CREDIT INSTITUTIONS SUPERVISION DEPARTMENT OF THE BANK OF LITHUANIA AT THE END OF 2007



INTERNATIONAL ACTIVITIES

The Bank of Lithuania has signed the cooperation agreements with supervisory authorities of almost all countries (excluding only Denmark and Norway) having the establishments of their banking groups in Lithuania and other countries. At the end of 2006 central banks of Lithuania, Latvia, Estonia and Sweden signed the memorandum for the management of financial crisis at banks having branches or subsidiaries in other countries. In current years crisis management issue is solved globally EU-wide. The Bank of Lithuania also actively participates in this process and closely collaborates with central banks of other countries and with other institutions as regards crisis management issues. The Bank of Lithuania together with the Ministry of Finance has signed multilateral agreement on cooperation for crisis management, which has also been signed by central banks, Ministries of Finance and supervisory institutions of other EU countries.

It is very important to maintain close relations with financial sector supervisory authorities of foreign countries, where banks within their jurisdiction have subsidiary (controlled) banks or branches in Lithuania. The harmonisation of actions by supervisory authorities of individual countries and national requirements has become especially important after starting the validation of more complex credit and operational risk assessment methods based on internal models. To this end, particularly close cooperation has been maintained with supervisory authorities of Estonia, Latvia and Sweden.

The Bank of Lithuania takes part in a project that aims to render technical assistance to central banks of other countries, with priority given to Belarus and Ukraine. Experts of the Bank of Lithuania consult representatives of those banks and organise their visits to the Bank of Lithuania.

CO-OPERATION WITH OTHER SUPERVISORY BODIES

In view of the strengthening relations between the financial sector and the insurance sector and their influence on the business of credit institutions, the Bank of Lithuania continued close co-operation with other financial and insurance supervisory authorities of Lithuania. This co-operation is coordinated by the Commission for Co-ordination of Regulation and Supervision of the Activities of Financial Institutions and Insurance Undertakings. The Commission includes representatives of all the three financial and insurance supervisory authorities of Lithuania. The Commission, in consultation with the representatives of banks, other financial institutions and insurance undertakings, seeks to ensure a more efficient coordination and improvement of the supervisory processes in individual sectors of the Lithuanian financial market, development of a supervisory strategy and identification of its priorities; it submits proposals to the Seimas (Parliament) on the amendments to the laws and other legal acts regulating the provision of financial and insurance services, the business and the supervision of financial institutions and insurance undertakings. The Commission also analyses potential threats for the national financial system: influence of the global financial market turmoil on commercial banks in Lithuania and their possible relations with the EU member states banks posing problems; impact of current situation in financial market on the stability of the national financial system, etc.

STATISTICAL TABLES

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

Type of financial institution	2005	2006	2007
Commercial banks	10	9	9
Foreign bank branches	2	2	5
Credit unions	65	67	68
Financial institutions, total	**77**	**78**	**82**

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

Type of financial institution	2005	2006	2007
Public sector ownership	0,15	0,05	-
Other domestic ownership	15,55	11,59	14,25
Domestic ownership total	15,7	11,64	14,25
Foreign ownership	84,3	88,36	85,75
Financial institutions, total	**100,0**	**100,0**	**100.0**

Ownership structure of the financial institutions on the basis of assets total (%)

Type of financial institution	2005	2006	2007
Public sector ownership	N/a	-	-
Other domestic ownership	N/a	-	-
Domestic ownership total	84,0	83,6	85,3
Foreign ownership	16,0	16,4	14,7
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	FOREX assets / Total assets	FOREX liabilities / Total liab.
Bank	67,6	81,6
Credit unions	22,4	30,6
Financial Institutions		
Savings Cooperatives		
Specialized Credit Institutions		

Return on Asset (ROA) by type of financial institutions (%)

Type of financial institution	2005	2006	2007
Bank	1,04	1,32	1,71
Credit unions	0,61	0,62	0,5
Financial Institutions			
Savings Cooperatives			
Specialized Credit Institutions			

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

Type of financial institution	2005	2006	2007
Bank	13,58	20,29	25,93
Credit unions	6,2	5,3	4,3
Financial Institutions			
Savings Cooperatives			
Specialized Credit Institutions			

Distribution of market shares in balance sheet total (%)
(groupage of acting banks according to capital)

Type of financial institution	2005	2006	2007
Commercial banks	89,9	91,8	90,9
Foreign bank branches	9,3	7,2	8,1
Credit unions	0,8	1,0	1,0
Financial institutions, total	**100.0**	**100.0**	**100.0**

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

Assets	2005	2006	2007
Cash in hand	1,9	1,9	1,7
Claims on banks and other financial institutions	25,6	18,2	16,4
Securities	12,4	12,4	9,8
Loans granted	57,9	65,6	70,1
Other assets	2,2	1,9	2,0
Liabilities	**2005**	**2006**	**2007**
Liabilities to banks and other financial institutions	29,7	31,5	36,1
Deposits and L/C	58,3	51,4	45,9
Other liabilities	4,7	10,4	10,7
Bank capital	7,3	7,0	7,3

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

Type of financial institution	2005	2006	2007
Commercial banks	16,7	20,6	18,9
Foreign bank branches	21,9	31,9	32,9
Credit unions	-	1,8	1,4
Financial institutions, total	**17,1**	**21,3**	**19,8**

Solvency ratio of financial institutions

Type of financial institution	2005	2006	2007
Commercial banks	10,31	10,75	10,90
Credit unions	17,4	16,66	16,22
Financial institutions, average	**10,4**	**11,12**	**11,22**

Asset portfolio quality of the banking system

Asset classification	2005	2006	2007
Commercial banks	53,29	117,30	180,43
Classified total	**53,29**	**117,30**	**180,43**
Specific reserves	**78,24**	**108,40**	**130,22**

Since, 2005 there are no formal definition of the non-performing loans. Data presented on the table are loans with 60 days overdue periodical payments.

The structure of deposits and loans in 2007 (%)
(at year-end)

	Deposits	Loans
Households	58,2	39,6
Government sector	7,5	0,3
Corporate	30,8	51,0
Foreign	8,7	2,0
Other	3,5	9,1
Total	**100.0**	**100.0**

The structure of deposits and loans in 2007 (%)
(at year-end)

Types of deposits		Types of loans	
At sight	54,4	Long term loans	47,7
Within one year	43,3	Medium-term loans	24,2
Over one year	2,3	Short-term loans	28,1
Total	**100.0**	**Total**	**100.0**

Proportion of foreign exchange assets and liabilities (at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Commercial banks	59,3	54,5	55,8	44,4	**46,2**	49,4
Foreign bank branches	85,4	74,4	74,3	82,4	74,1	82,5
Credit unions	0,39	1,3	0,83	0,46	1,5	2,2
Financial Institutions, average	**61,7**	**55,4**	**47,8**	**47,9**	**56,8**	**51,6**

Structure of revenues and expenditures of financial institutions (at year-ends)

Revenues	2005	2006	2007
Interest income	65,8	68,9	73,3
Profit from operations in foreign exchange	5,6	4,1	3,3
Income from services and commissions	26,3	21,1	17,5
Other bank income	2,3	5,9	5,9
Total	**100,0**	**100,0**	**100,0**
Expenditures	**2005**	**2006**	**2007**
Interest expenses	32.0	41,6	50,4
Operational expenses	39.9	34,0	30,5
Expenses for specific provisions	6.3	4,3	2,6
Other expenses	21.8	20,1	16,5
Total	**100,0**	**100,0**	**100,0**

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	EUR mln	%	EUR mln	%
Commercial banks	897,3	4,2	897,1	4,2
Credit unions	21,2	9,6	3,4	1,5
Financial institutions, average	**10,2**	**4,97**	**11,2**	**4,2**

2007 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF MACEDONIA

MACROECONOMIC ENVIRONMENT IN THE REPUBLIC OF MACEDONIA

Macroeconomic environment in the Republic of Macedonia in 2007 generally created positive climate for maintenance of the financial stability. The positive trend of the economic growth and low average inflation from the previous years continued during this year. Macedonian economy was not directly affected from turbulences at the international financial markets.

The Central Bank continued to implement the strategy of foreign exchange rate targeting in 2007 as well, in order to maintain price stability as an ultimate monetary objective. The average inflation in 2007 was 2.3%, being within the perceptions of a low and stable inflation. However, the annual inflation of 6.1% in December was a clear indicator of the price increase trend in the last months of the year that derived mostly from the increase in the prices of food and energy. But, the moderate rise in the basic inflation during the year, which was 0.7% on average in 2007, was an indicator of the partial influence of the demand on the inflation.

The economic growth in 2007 was within the expectations. From this viewpoint, last year was especially successful because the real GDP growth of 5.1% has been the highest performance of the Macedonian economy so far. Such growth rate, undoubtedly contributes to a faster real convergence to the EU, and the combination of successful structural reforms and macroeconomic stability is a key to the increase in the productivity of the economy and, consequently, increase in the potential growth. The service sector, that is, trade and telecommunications, accounted for the largest portion (more than 70%) of the growth in 2007. Thus, the Macedonian economy started to pursue the same development stages as the other emerging economies.

The sustainable external developments are a key pillar of the macroeconomic stability for a small and open economy such as the Macedonian. In the first half of the 2007, the maintenance of a favourable conjuncture at the world metal market (in conditions when metal industry is the dominant export sector) contributed to further increase in the positive balance of this category that neutralized to a great extent the negative shifts in the other segments, including energy exchange. Therefore, despite the increase in the world prices of energy sources, food prices, as well as the growth in the import of consumption goods, and especially import of food, in a part due to the price increase, supported by the rapid growth in crediting, trade deficit in 2007 deepened by one percentage point and reached 21% of GDP. However, the expansion of the current account deficit was more emphasized, going up from 0.9% to 3.1% of GDP, reflecting the effect of the decelerated growth in the private transfers, mainly conditioned by the negative growth dynamics in the last quarter of the year. Namely, in 2007, private transfer inflows registered growth of 6.8%, what is considerable deceleration, compared to growth rates of 15.4% in 2006 and 39.7% in 2005. What is typical of last year is an increased inflow of direct investments, 4.5% of GDP, which, together with portfolio investments, contributed to an increase in the foreign exchange reserves, that reached Euro 1,524 million, or coverage of 3.8 months of the import of goods and services planned for the following year. The allocation of these investments to the sector of exchangeable goods is important for the improvement of the foreign trade exchange and for a positive trend in the current transactions with abroad, in the medium run.

Taking into consideration that in the major part of 2007, the foreign exchange inflows on the basis of private transfers, portfolio investments and foreign investments were continuously growing, NBRM purchased foreign exchange at the foreign exchange market in the amount of 6.4% of GDP, as opposed to 4.8% of GDP in the previous year. So, the interventions at the foreign exchange market neutralized the effect on the foreign exchange reserves from the large early repayments of the public debt to the Paris Club of Creditors, World Bank, IMF and EIB. Although during the first three quarters, a significant part of the need for sterilization of the liquidity effects was supported through the accumulation of funds at the government account with NBRM, still, the concentration of the major part of the fiscal expenditures in the last quarter imposed in this period a complete assumption of the burden for sterilization by means of monetary instruments. In 2007, excess liquidity of 3.4% of GDP was withdrawn through the Central Bank bills, as opposed to 1.7% of GDP in the previous year.

The need for sterilization of foreign exchange inflows usually leads also to an increase in the interest rates in order to raise the interest in investment of the excess liquidity with the central bank. In the particular case, in 2007 as well, the higher demand for NBRM securities compared to the supply led to a trend of reduction in interest rate on the Central Bank bills, being reduced to 4.77% in 2007, as opposed to 5.74% in December 2006. This speaks of a relatively poor range of investment opportunities and high attractiveness of the Central Bank bills, in spite of the decreased yield. Such changes in the reference interest rate spilled over into the inter-bank money market, as well, where the average interest rate registered an annual decrease of 1.8 percentage points thus amounting to 3.1% in December.

At the end of 2007, the gross foreign debt[15] equaled Euro 2,711.5 million, which on annual basis represented increase of 8.7%. On institutional aspect, such development of the foreign debt was determined by the continuous growth in the foreign debt, primarily in the category "other sectors" (non-banking financial intermediates, non-financial trade associations, households and non-profitable institutions), than by the banking sector and the debt among enterprises, which fully neutralized the decrease in the gross foreign debt of the Government sector and the monetary Government. The decrease in the foreign public debt was performed through the early repayment to individual foreign creditors, as follows: Paris Club of Creditors, International Bank for Reconstruction and Development (IBRD), International Monetary Fund (IMF) and the European Investment Bank (EIB). The indicators of the relative foreign indebtedness of the country indicated improvement, relative to 2006. Namely, from the indicators on gross basis, the foreign debt relative to GDP (48.9%), showed

[15] In 2007, NBRM started preparing and issuing data on the gross foreign debt. The data pertains to the period 2004-2007.

small decrease, which was mainly due to the more intensive growth rate of GDP relative to the foreign debt. This includes our country in the group of moderate indebted countries.

In 2007, the fiscal policy acted towards creating possibilities for higher economic growth. The changes in the law on the personal income tax and in the law concerning the gain tax[16], acted towards improvement of the economic activity in the country through decreasing of the tax burdening of the economic agents. In final extent, the expected results from these measures are to initiate the domestic supply (output) through decrease in the cost of the producing factors (working force and capital) and initiating employment. Furthermore, positive effects are expected in form of decreasing of the grey economy and improvement of the tax revenues collection. On the other side, in conditions of intensified public consumption, especially in the last quarter of 2007 and increased investment consumption (which was significantly supported by the Government in 2007) the fiscal policy stimulated the domestic demand, which positively influenced the economic activity in the country.

In 2007 the budget surplus of 0.6% of the realized GDP was registered, which was significantly differing from the annual projection for surplus of 1% of GDP. In the Republic of Macedonia, for a longer period, a prudent policy with low budget deficits (or surpluses) which are lower than the Maastricht criterion for the budget deficit (by 3% of GDP) was conducted.

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

As of December 31, 2007, the banking system of the Republic of Macedonia comprised of eighteen banks and twelve savings houses. Relative to the end of 2006, the number of banks reduced by one and the number of the savings houses is unchanged.

Banks maintained their dominant position in the banking system, as opposed to the further marginalization of the role of the savings houses. At the end of 2007, the share of the savings houses in the total gross-credits extended to non-financial entities and in the total households' deposits at the level of the banking system equaled 1.9% and 0.7%, respectively, which is a decline of 0.1 percentage point relative to the end of 2006. The share of savings houses in the total assets of the banking system remained unchanged compared with 2006, and equaled 1.3%. Having in mind the insignificant role of the savings houses in the overall activities of the banking system, further analyses (below) are focused solely on the banks' operations.

Concentration in the banking system of the Republic of Macedonia remains relatively high and registers further increase in certain segments of

[16] In December 2006, there been made changes to the law on the personal income tax, i.e. the current rates of 15%, 18% and 24%, were replaced with single tax rate of 12% in 2007 (and 10% since 2008). Simultaneously, the changes in the law concerning the gain tax, by which the tax rate of 15% decreased to 12% in 2007 (and to 10% since 2008) and which introduced the tax release equaling the amount of the reinvested gain.

banks' operations. The group of large banks[17] strengthened the dominant position on the banking market in the Republic of Macedonia, Their market share in the total assets, the total activities (on-balance and off-balance sheet), the total gross-credits and the total deposits of non-financial entities at the level of the banking system, ranges between 67.1% in the total assets and 72.2% in the total deposits at the end of 2007.The group of medium banks also continued to strengthen its market share, registering an increase in all segments. Relatively larger portion of the growth in the share of this group of banks in the total assets and total gross credits was due to the transfer of one bank from the group of small banks. As for the deposit activity, most of the increase in the share was caused by the strengthening of the role of the medium banks in real terms, within the deposit activity at the level of the banking system. On the other end, there was a significant further marginalization of the role of the group of small banks, according to all analyzed segments of banking operations.

According to the Herfindahl index the level of concentration for all analyzed domains of banks' operations, except total assets and corporate deposits, is above the level which is generally considered acceptable. As of December 31, 2007, the level of the Herfindahl index for the total assets was 1,625 (1,595 as of December 31, 2006). At the same time, the Herfindahl index for household deposits equaled high 2,084, which, in spite of the decline by 88 index points relative to 2006, is beyond the generally acceptable level of concentration. In the credit activity with the households, despite the relatively high level of the Herfindahl index of 2,001 points, at the end of 2007 the upward trend of concentration in this area, which started in the second half of 2006, was interrupted. Herfindahl index for the gross corporate credits continued its upward trend and on December 31, 2007 it reached the level of 1,819. This index, measured for the corporate deposits equaled 1,778 (11 index points lower relative to 2006), which is within the generally acceptable concentration level.

The share of the foreign capital in the ownership structure of the banking system of the Republic of Macedonia significantly increased in 2007. The main driving force of the increase in the share of foreign capital in the capital of banks were the acquisitions of the existing banks by foreign investors, but also the continuous inflow of foreign portfolio investments during 2007. As of December 31, 2007 the share of foreign capital in the total shareholders' capital equaled 69.1%, which is by 13.0 percentage points more compared with end 2006. During 2007, the number of banks which are dominantly owned by foreign shareholders increased from eight to eleven. At the end of 2007, eight banks were owned by foreign financial groups. The increase in the number of banks which are in dominant ownership of foreign shareholders caused their share in the total assets and in the total capital at the level of the banking system to reach 85.9% and 73.3% as of December 31, 2007, which is an annual increment of significant 32.7 and 23.3 percentage points, respectively. The increased presence of foreign capital in the banks should create additional preconditions for increasing the banks' activities, increasing the range of

[17] The principle of grouping the banks according to the size of their assets has been maintained, where large are considered those banks the assets of which exceed Denar 15 billion, the group of medium banks comprises the banks with assets ranging between Denar 4.5 and 15 billion, while the banks with assets lower than Denar 4.5 billion are included in the group of small banks.

services, improving the corporate image, modernization of the risk management processes and additional increment of the banking system efficiency.

As to the country of origin of the dominant bank owners, at the end of 2007, the largest part of the assets of the banking system was concentrated with the banks with dominant owners from the EU countries. Almost half of the assets of the banking system of the Republic of Macedonia are the assets of the banks dominantly owned by shareholders from two countries, Greece 27.6% and Slovenia 19%. On the other hand, only 14.1% of the total banks' assets belong to banks dominantly owned by shareholders from the Republic of Macedonia.

Degree of financial intermediation

Given the continuation of the economic growth, as a trend from the previous years, the continuous strengthening of the trust in the banking system and the increased propensity to save, in 2007 the role of the banking system as a financial intermediary strengthened. At the end of 2007, the level of financial intermediation in the banking system, measured as a ratio of the total assets, gross credits and total deposits to GDP reached 66.2% (56.4% as of December 31, 2006), 37% (29.1% as of December 31, 2006) and 47.4% (39.9% as of December 31, 2006), respectively[18].

The balance sheet structure

In 2007, banks' total assets registered a significant annual growth rate of 28.5%. As a result of such a dynamics, on December 31, 2007, it reached a level of Denar 223,659 million.

Banks' deposits are the main driving force of the growth of assets, and at the same time the most important source for financing banks' activities, taking account their share of 71.7% in the liabilities structure. On annual level, deposits went up by Denar 37,255 million or by 30.3%. Household deposits (with their share of 58.7% in total deposit base) are the main component of the banks' overall sources of financing, and they had the fastest growth during 2007. The positive trend of gradual increase of the maturity of total deposits with banks continued also during 2007. However, the relatively unfavourable maturity is one of the main features of the bank deposits. Dominant portion (94.6%) of the deposit base is with maturity of up to one year, with 51% of them being short-term deposits, while the rest are sight deposits[19]. Long-term deposits participated with 5.4% in the total deposits. According to the currency of denomination structure, at the end of 2007, 48.5% of the banks' deposit base are Denar

[18] In the calculation of the financial intermediation indicators, the data on the GDP for 2006 is a preliminary data, while for 2007 it is estimated data.

[19] For the needs of these analyses sight deposits include also transaction accounts of natural persons and legal entities.

deposits, 44.5% are foreign currency deposits, and 7% are Denar deposits with FX clause.

In 2007, the accelerated growth of the total sources of funds reflected in further acceleration of the credit activity of the banks. In 2007, gross-credits went up by Denar 35,098 million, or by significant 39.1% As a result of that, net-credits to non-financial entities with a share of 50.9%, strengthened the dominant position on the part of the banks' assets and caused the largest portion (69.2%) of its growth. The increased credit activity was a result of the higher households' and enterprises' demand for credits and the easing of the lending terms, due to the increased competition. Despite the intensive lending activity of banks with the households, corporate credits remained to be dominant in the structure of the credits from the viewpoint of the various sectors. Thus, as of December 31, 2007, the share of the corporate credits in the total gross-credits equaled 60.8% (64.9% as of December 31,2006), while the household credits participated with 38.6% (34.3% as of December 31, 2006), besides their (households credits) highest annual growth of 56.2%[20]. As for the currency structure, 45.3% of the loans to non-financial entities are in denars, 30.1% are indexed denar loans and 24.6% are foreign currency loans. From a viewpoint of maturity, long-term lending is still dominant (61.6%), as opposed to the short-term lending (29.8%) and due and non-performing loans (8.5%).

Simultaneously with the intensive lending activity, banks continued to be increasingly interested in investing in domestic short-term debt securities (CB bills and Treasury bills), which was manly a result of the positive assessment of the banks about the risk and return on these financial instruments. As a result of that, the securities portfolio registered an annual increase of Denar 11,233 million, or 46.3%, and caused 22.7% of the total growth of the assets of the banking sector. Thus, this segment of banking operations increased its share and as of December 31, 2007 it forms 15.9% of the banks' total assets.

The income statement structure and profitability ratios

Profitability and efficiency of the banking system of the Republic of Macedonia was improving continually during recent years. The key drivers for the improved profitability of the banking system was growth of the volume of banking activities, particularly lending, accompanied with favourable macroeconomic environment and reduced risk profile of the credit portfolio. Thus, on December 31, 2007, the banks registered an operating profit of Denar 3,650 million, which is significant increase of 30.4% compared to the previous year.

The profit generated in 2007, was mostly a result of the regular operating income (93.4% of total banks' income). Major driver of the positive developments related to the banks' profitability, same as in the

[20] During 2007, credits on the basis of issued credit cards registered the highest growth rate of 121.5%, and relatively high annual growth was registered also in the overdrafts on current accounts (76.6%) and in the credits for purchasing and refurbishing of homes and business premises (64%).

recent years was the interest income (59.7% of the regular operating income), which registered an annual growth of 21.2% and contributed with 60.2% of the annual growth of the regular operating income.

All profitability and efficiency indicators at the level of the entire banking system register an improvement compared to the previous year. As of December 31, 2007 ROAA and ROAE equalled 1.8% (1.8% as of December 31, 2006) and 15.2% (12.3% as of December 31, 2006), respectively. The growth of banks' income was accompanied with improvement of the banks' operating efficiency. Thus, cost-to-income ratio was 58.4% (62% as of December 31, 2006) and the ratio of non-interest expenses relative to total regular income equaled 60.3% (63.6% as of December 31, 2006). Staff costs were dominant component (41.5%) of the operating costs and their annual growth was 7.4%. Their share in total regular operating income equaled 23.2% (26.2% as of December 31, 2006).

Credit risk

Banks' credit risk remained dominant in their operations. The strengthened credit activity of banks over the recent years did not cause serious deterioration of their risk profile. On the contrary, the credit risk, measured through a series of indicators, mitigates. The pick up of the credit quality was result of improved banks' credit policies and procedures, as well as due to the fact that the credit portfolio is relatively "young" and does not shows serious signs of deterioration, yet. Namely, the total credit exposure registered annual growth of 32.6%, which was a highest rate during last four years and was primarily a result of the newly approved credit exposures mainly classified in A risk category. The share of credit exposure classified in risk categories C, D and E in the total credit exposure amounted to 5.7% (7.6% as of December 31, 2006). On December 31, 2007, the average risk level of the credit exposure at the level of the banking system amounted to 5.3%, which is by 1.3 percentage points less compared with December 31, 2006.

The improved quality of banks' credit exposure is evident also from the reduced share of the non-provisioned amount of credit exposure classified in risk categories "C", "D", and "E" (credit exposure reduced by the respective amount of allocated special reserve) in the own funds from 19.4% (as of December 31, 2006) to 17.9% (as of December 31, 2007). This means that, under the assumption for complete non-collectibility of the credit exposure classified in risk categories "C", "D", and "E", it would take 18% of the banks' own funds to cover the losses. In accordance with this, capital adequacy ratio would reduce from 17% to 14%, which indicates that the solvency of the banking system of the Republic of Macedonia remains stable even under such an extreme scenario. Also, in 2007 the coverage of the credit exposure classified in risk categories "C", "D", and "E" with allocated loan loss provisions registered an improvement of 7.3 percentage points relative to December 31, 2006.

During 2007, the indirect credit risk, which arises from the exposure of the borrowers to an exchange rate risk and interest rate risk, becomes increasingly important, having in mind the accelerated dynamics of lending in foreign currency and in Denars with foreign exchange clause as well as of considerable apply of credit agreements with adjustable interest rates (which depends on the decision of the bank's competent bodies).

Capital adequacy ratio

Banks maintained a relatively high solvent position. Their capital adequacy ratio was still significantly higher than the prescribed minimum of 8%, registering further downward trend, which reflected the accelerated credit activity. The existing level of banks' capital position fully covers the identified risks. At the end of 2007, the capital adequacy ratio of the banking system equaled 17%, which is a drop of 1.3 percentage points compared to December 31, 2006. The lower capital adequacy ratio of the banks resulted from the faster annual growth in the risk- weighted assets (by 37.6%), relative to the growth in the banks' own funds, which in 2007 equaled 17.4%. In spite of the decrease in the capital adequacy ratio, the solvent position of the banking system remained stable, illustrated by the results of the stress-test analyses of the banks' resilience to insulated shocks and combination of hypothetical shocks.

Liquidity risk

The banks in the Republic of Macedonia have preserved satisfactory liquidity level. Banks, traditionally, maintain high amount of liquid assets[21]. Even the tendency of reducing the share of liquid assets in the total assets, due to the accelerated credit activity of the banks, the average share during 2007 is still high (35.2%). Such level of highly liquid assets in the total assets provides 41% coverage of the total average banks' liabilities[22], i.e. they were 2.7 times higher then the total banks' liabilities that would mature within 30 days according banks' expectations and historical analysis. More then half (54.3%) of the liquid assets was characterized as highly liquid assets[23]. This level of highly liquid assets provides 60.2% coverage of the sight deposits and full coverage of the total banks' liabilities that would mature within 30 days according banks' expectations. During 2007, the continuing upward trend of the deposits to non-financial entities kept them dominant source of funds (72.5% from the total average sources of banks' funds and 84.5% from the total average banks' liabilities). The average monthly share of secondary sources of financing (banks' deposits and short-term and long-term borrowings) of 11.3% and 13.2% from the total sources of financing and from the total average banks' liabilities, respectively, addresses to relatively low level of banks' "reliance" of these funds compared to deposits. During 2007, the parent funding was increased

[21] Liquid assets, in broader terms, include highly liquid assets, short-term placed assets with foreign banks and placements in other short-term debt securities.
[22] Total liabilities refers to all banks' liabilities deducted for own funds, income and provisions for off-balance sheet liabilities. For liquidity analysis, "average monthly amount" denotes a balance average at the end of each month over the period under observation.
[23] Highly liquid assets includes cash and balances with NBRM; securities with NBRM rediscount; short-term placements in securities issued by the government and correspondent accounts with foreign banks.

by 40.2% relative to 2006. At the end of December 31, 2007 only 5 foreign-owned banks were using parent fund (subordinated debt, deposits and borrowings). Their share in the total secondary sources of financing amounted to 37.1% (33.9% as of December 31, 2006). As of December 31, 2007 banks registered contractual residual maturity mismatch between the assets and the liabilities of the banks, primarily due to the longer maturity of the credits, as opposed to the shorter maturity of the deposit potential. On the other hand, the residual maturity of the expected banks' cash flows shows high degree of compliance, primarily resulting from the high stability of the sight deposits, determined on the basis of the experience of the banks from previous years. On December 31, 2007, the average level of stable sight deposits up to 7 days equaled 86.2% (81.8% - 2006), across the banking sector. The stress-test analysis of the banking system of the Republic of Macedonia, as of December 31, 2007, that rely upon two stress-test scenarios[24], indicates a relatively high level of resilience of the banking system to liquidity risk.

Foreign exchange rate risk

There is high presence of the f/x component in the balance sheet of the banking system. However, the downward trend in the last two years was registered. As of December 31, 2007, the share of foreign exchange assets (including the f/x indexed assets) and foreign exchange liabilities (including the f/x indexed liabilities) in the total assets of the banking system equal 52% (56.7 as of December 31, 2006) i.e. 47.4% (50.6% as of December 31, 2006), respectively.

The Euro is the dominant currency in the banking system aggregate foreign open exchange position. Namely, 82.8% of the foreign open exchange position was in euros. In circumstances of a relatively high level of currency substitution in the balance sheets of banks in the Republic of Macedonia, they satisfactorily managed the exchange rate risk, within the framework of the prudential limits. Despite the significant growth of the capital market and the increasingly active involvement of the banks in the trading in securities, primarily the government securities, the other types of market risks still play marginal role in the spectrum of risks they are facing with.

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

The National Bank of the Republic of Macedonia (NBRM) is a sole banking supervisory body in the Republic of Macedonia. The National Bank is an independent institution in conducting its functions, including the supervisory function. Within the NBRM the Supervision, Banking Regulations and Financial Stability Division conducts the supervisory and regulatory function. According to the organizational chart of the NBRM the General Manager of this Division is directly liable to the Governor of the NBRM.

[24] First simulation is hypothetical one-time withdrawal of 20% of the total households' deposits from the banking system and the second simulation is potential withdrawal of deposits of the 20 largest depositors of each bank.

This organizational structure is a result of the changes made under the Supervisory Development Plan (SDP), developed and implemented in 2006 and 2007 (the implementation period shall finish at end-2009). The new structure consists of one division with three Departments: 1) Off-site Supervision and Licensing, 2) On-site Supervision, and 3) Financial Stability, Banking Regulations and Methodology. Following the new organizational structure, a Supervisory Committee was established. The Committee is chaired by the Division's General Manager, while the Department's managers are its members.

The Off-site Supervision and Licensing Department is responsible for licensing of banks and savings houses, off-site supervision of their operations and undertaking corrective measures against institutions suffering problems, irregularities and non-compliance with the legal framework. On-site Supervision Department is responsible for direct implementation of the on-site supervisory function. The Financial Stability, Banking Regulations and Methodology Department is responsible for the activities related to establishment and improvement of the banking regulatory framework, promotion of the supervisory practices and following of the international standards in banking and supervision. Also, this Department is responsible for financial stability analysis and the trainings of the employees in the Sector.

The competence of the NBRM is regulated with the Law on the National Bank of the Republic of Macedonia and the (new) Banking Law adopted by the Parliament of the Republic of Macedonia in May, 2007. The (new) Banking Law follows the provisions and standards prescribed with Directive 2006/48/EC of the European Parliament and of the Council relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC of the European Parliament and of the Council on the capital adequacy of investment firms and credit institutions. The most important changes and improvements of the (new) Banking Law are as follows:

1. strengthening of the "fit and proper" criteria for bank shareholders with qualified holding in a bank and members of Supervisory Board and Board of Directors,
2. enhancement of the corporate governance in banks, with clear and precise definition of the role and responsibilities of different bank bodies,
3. introduction of provisions for implementation of the New Capital Accord (BASEL II),
4. enhancement of the banks' risk management systems, with special attention to the credit risk, liquidity risk, currency risk, market risk and the information technology risk, as well as all other material risks,
5. improvement of the NBRM's supervisory methods and procedures,
6. introduction of a new accounting framework for banks in line with the International Financial Reporting Standards (IFRS),
7. more detailed provisions related with role and responsibilities of the banks' external auditor,
8. enhanced efficiency of the rehabilitation and receivership of troubled banks i.e. more efficient procedures for dealing with troubled banks, and

9. definition of the criteria for establishment and operation of a foreign bank branch in the Republic of Macedonia.

In accordance with the new Banking Law, in the period of June 2007 - February 2008, the NBRM Council adopted 23 by-laws (secondary regulation) which enable an adequate implementation of the new law and enhance the efficiency of the NBRM's banking supervision.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2007

In 2007, the main strategic objectives of the supervisory authority can be summarized as follows:

a) *Changes in the accounting framework in line with the requirement of IFRS that will enable better financial reporting and disclosure and enhanced bank transparency;*

The NBRM, through an international public tender selected a provider of advisory services for the implementation of the International Financial Reporting Standards (IFRS) in the banking sector of the Republic of Macedonia. In 2006, KPMG Business Advisory Services B.V., Netherlands, (in cooperation with KPMG Prague, Czech Republic and KPMG Skopje, Republic of Macedonia) was selected as the most successful bidder on the tender. The consultants, together with the NBRM produced several reports that represent a base for the issuance of the accounting regulation by the NBRM. This accounting regulation consists of: Chart of accounts for banks, Methodology for accounting and valuation of items and Format of the financial statements. The consultants also conducted training on IFRS for the NBRM and banks. The overall accounting regulation was adopted by the NBRM Council in September, 2007, and shall start being applied as of January 01, 2009. Before adoption the documents were distributed to the industry, which gave the industry a chance to comment on the proposed accounting and financial disclosure regulation.

b) *Transition from compliance focused supervision to risk-based supervision;*

The Supervisory Development Plan (SDP), aimed at facilitating the transition to risk-based supervision, was adopted by the NBRM Council in January, 2006. During the first quarter of 2006, an advisor was selected to help the NBRM in the process of transitioning to risk based supervision. For the purpose of successful implementation of the plan, the Governor of the NBRM established:

- A Working Group that together with the advisor worked on technical issues and recommendations detailed in the plan;

- A Steering Committee in charge of monitoring the Working Group and the advisor's activities, and of adopting the documents produced by the Working Group and the advisor.

As a final result, a Policy Manual (Manual) that covers the Supervisory Framework (Supervisory approach) and the Risk Assessment System (assessment of seven risk categories identified as inherent in the Macedonian banking system), was developed. During 2007, the On-site Supervision Department tested the developed Manual. The results enabled an adequate revision of the risk-based procedures. The Governor officially adopted the new methodology and Supervisory procedures in January, 2008.

c) Changes in the legal framework that will enable its harmonization with the New Capital Accord for Banks (Basel II).

The New Capital Accord (Basel II) represents one of the biggest challenges that lay ahead the banking supervision performed by the NBRM, having in mind the complexity of the framework that would further strengthen the soundness and stability of the banking system.

The main activities and efforts of the NBRM for the implementation of the Basel II could be summarized as follows:

- Development and implementation of adequate legal framework, procedures and rules for minimum capital requirements, adequate supervisory review process and efficient market discipline,
- Training of the supervisory staff on the Basel II components (pillars), especially the supervisory role in the assessment of the banks' risk management systems.

The implementation of the New Capital Accord (Basel II) is a long-term process that was initiated in previous years with the development of a Road Map to Basel II. It officially started in November, 2007, when the NBRM Council adopted a Decision on reports and data disclosure by the bank. In the beginning of 2008, the new by-laws were adopted that enable convergence with the Basel standards: Decision on risk management and Decision on the methodology for determining the capital adequacy. The former Decision enables the development and implementation of an efficient and modern risk management system and development an internal process for capital adequacy assessment, as a part of the Pillar 2. The later Decision prescribes the minimum capital requirements. Although this Decision mainly follows the Basel I requirements (capital for covering credit risk, FX risk and market risk), still it enables inclusion of all other risks which are deemed as material for the banks' operation.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2007

The supervisory function of the NBRM is carried out through 3 main activities: licensing (issuing licenses and approvals to banks and savings houses), supervision of the operations of the banks and the savings houses and undertaking corrective measures. During 2007, NBRM performed these activities as follows:

- Within the licensing framework, the NBRM issues 13 different types of licenses and approvals among which the main activities in 2007 were related to issuing approvals for changes in the Statute of the banks, approvals for shareholders with qualified holding in a bank and approvals for members of the Supervisory Board and Board of Directors of banks. During 2007, 102 consents/licenses were issued by the NBRM.

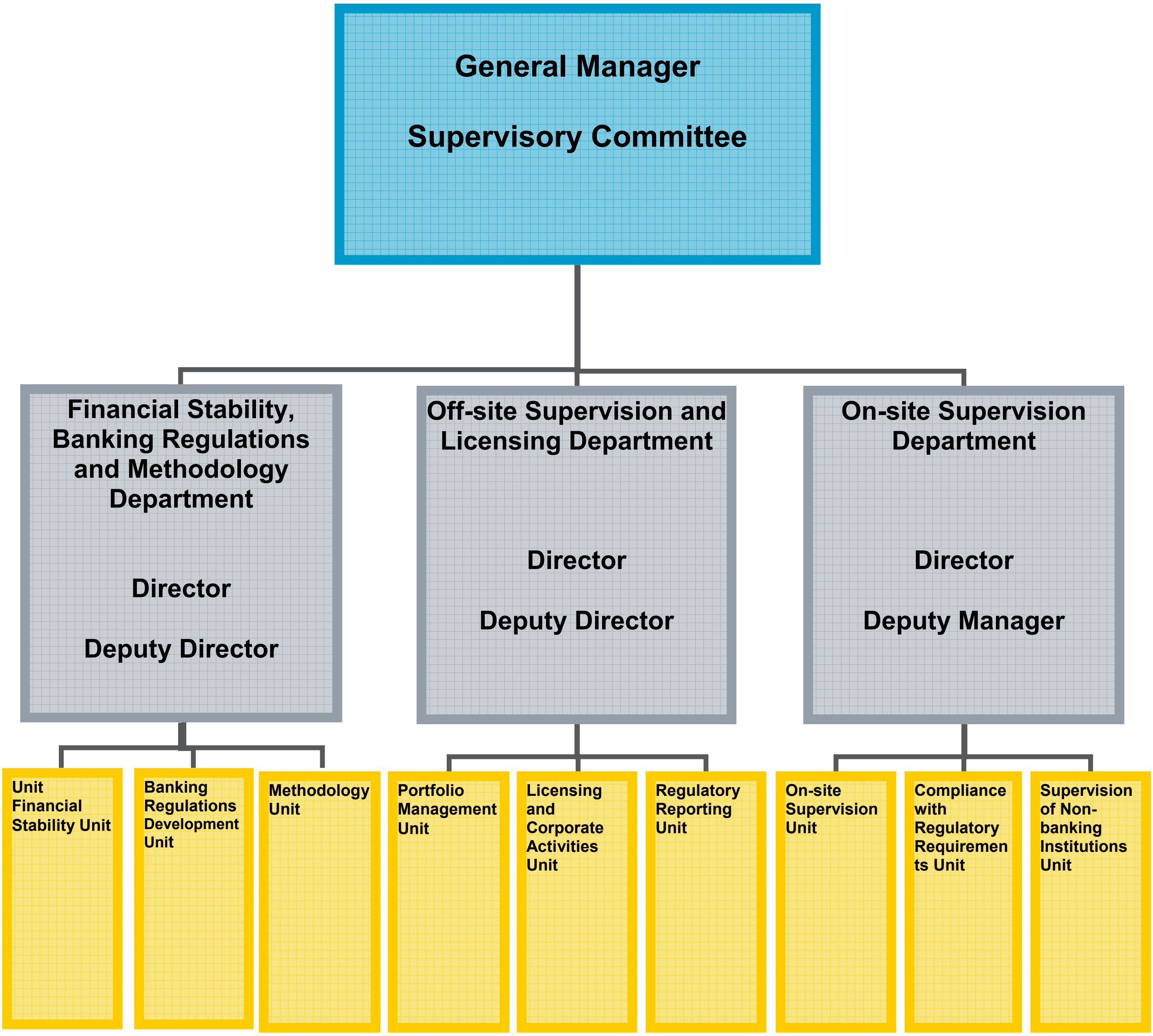
- In 2007, NBRM carried out 12 examinations of the operations of the banks and the savings houses. Eight of them were full-scope examinations of three banks and five savings houses, and four were targeted examinations.
- The assets quality analysis, i.e. the credit risk assessment and quantification, as a dominant risk the banks and the savings houses are exposed to, remained the most important component of the NBRM supervisory process. Also, an important part of the examinations was the evaluation of the design and functioning of the internal control and audit systems, the anti-money laundering systems and the design and the functioning of the corporate governance. Besides the credit risk, the risk-based supervision particularly covered the assessment of the liquidity risk and the so-called indirect credit risk that arises from the exposure of the borrowers to foreign exchange risk. The positive developments in the banking system, identified during the on-site supervisory examinations were confirmed with the permanent off-site supervision. Those positive trends mainly relate with the improved banks' risk profile and the enhanced corporate governance systems.

- Within its legal authorizations, NBRM undertakes corrective measures against banks and saving houses in which violations and irregularities were identified in order to preserve the stability and the safety of the banks and the saving houses and the stability and the safety of the overall banking system. During 2007, the founding and operating license of 1 bank was revoked, identifying that the requirements for introducing liquidation were met. NBRM also adopted 12 decisions with corrective measures against 5 banks and sent 1 written letter with recommendations to 1 bank. In addition, NBRM filed 5 requests for initiation of misdemeanor procedure and initiated 3 criminal charges.

- The most common corrective measures undertaken against banks and saving houses were: ban on performing certain banking operations within a certain period of time; ban on disposing the banks' assets; measure for recapitalization; reducing the share of shareholders below 10% of the voting shares in a bank; measure for reducing the credit exposure within the prudential limits; ban on lending to clients classified in risk categories C, D and E; etc.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

Supervision, Banking Regulations and Financial Stability Division



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

According to existing legal framework, the NBRM may exchange information with foreign supervisory bodies with relations to supervision of internationally active banks. Furthermore, NBRM may approve an on-site examination of a foreign bank subsidiary and a foreign bank branch in the Republic of Macedonia conducted by the home supervisory body. In order to assert this right, NBRM requires from the supervisory bodies of other countries to provide legal and operational capability to ensure confidentiality of the data. The new Banking Law provides for more comprehensive framework for consolidated supervision and co-operation with the foreign supervisory bodies.

Based on this legal framework, NBRM has signed Memorandums of Understanding (MoU's) with several foreign supervisory agencies. These bilateral agreements define the principal areas of co-operation, exchange of information and common procedures for supervision of foreign banks' subsidiaries. Thus, besides the MoU's that were concluded in the previous years with the Central Bank of the Russian Federation (March 1998), the Bank of Slovenia (June 2001), the Bulgarian National Bank (October 2003) and the Bank of Albania (March 2005), in 2007 NBRM has signed MoU's with the Central Bank of Montenegro (January) and the Bank of Greece (February).

As part of the regional efforts for enhanced supervision, in July 2007, NBRM, together with the Bank of Albania, Bank of Greece, Bulgarian National Bank, Central Bank of Cyprus, National Bank of Romania, National Bank of Serbia, the Banking Agency of the Federation Bosnia and Herzegovina, the Banking Agency of the Republic of Srpska and the Central Bank of Montenegro, has signed a multilateral Memorandum of Understanding on High-level Principles of Co-operation and Co-ordination among the Banking Supervisors of South Eastern Europe. The purpose of this MoU is to promote a more structured co-operation in the field of banking supervision in order to enhance financial stability in South Eastern Europe and to improve the effectiveness and efficiency of supervisory measures. Furthermore, the MoU formulates the list of information which is exchange on a semi-annual basis, as well as on ad hoc basis, when deemed necessary. The exchange of information includes data on supervisory methods and practices, monitoring of banking groups' systems and controls, financial stability - macro prudential issues, crisis management and co-operation in the field of AML/CFT. Besides the exchange of information, the co-operation involves regular meetings where current supervisory issues are discussed.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

Currently four domestic financial supervisory agencies exist in the Republic of Macedonia:

- National Bank of the Republic of Macedonia, as a banking supervisory authority,
- Ministry of Finance, as a supervisor of the insurance companies and leasing companies,
- Securities and Exchange Commission, as an authorized body for supervision of the issuance and operation with securities, and
- Agency for Supervision of Fully Funded Pension Insurance.

Despite the fact that there is a limited inter-sector capital holdings, the cooperation between the domestic financial supervisory authorities is regulated with the existing legal framework, which enables NBRM to exchange information with other domestic supervisory bodies. In addition, NBRM has signed MoU's with the Security Exchange Commission (December 2004) and the Agency for Supervision of Fully Funded Pension Insurance (February 2007). According to this MoU's, contractual parties exchange information and data related with the licensing process, examination reports and findings, uncovered irregularities and non-compliances and other relevant issues.

NBRM has also signed MoU's with the Central Registry of the Republic of Macedonia, Macedonian Stock Exchange, Central Securities Depositary and the Anti-Money Laundering Agency.

Also, for the purpose of improved co-operation between supervisory and regulatory authorities in the country, in the beginning of 2007 the Inter-institutional Body was created (on an informal basis), where experts from all supervisory and regulatory bodies in the country participate. The main purpose of the meetings of this Body is to: discuss problems and issues related to different segments of financial system and the overall financial stability, initiate changes in the important regulation, provide consistency in the laws and regulations relevant for the different segments of the financial system, discuss relevant supervisory issues etc.

OTHER RELEVANT INFORMATION AND DEVELOPMENT IN THE COURSE OF 2007

Publication of a Financial Stability Report

In 2007, NBRM published its first Financial Stability Report (for 2006), based on the IMF Compilation Guide on Financial Soundness Indicators and the international best practice. This Report embodies the efforts to identify the potential risks in the individual segments of the financial system which encompasses a growing part of the national economy.

The Report contains data related to the monitoring of the system, individual important events, as well as part of the analyses and the research intended for improved market disclosure. In this context, the main objective of the Financial Stability Report is to assess the level of resilience of the financial system, with an accent on the banking system, identifying the main systemic risks, whose materialization could cause serious disturbances in the functioning of the financial system.

NBRM will publish the Financial Stability report on an annual basis.

Promotion of the new Credit Registry

During the second half of 2007, NBRM performed a series of preparatory activities for establishment of an improved Credit Registry that has been established by the NBRM in 1998. The improved Registry encompasses modern technical features, containing a wide range of data and ensuring more frequent updating. Thus, the Project ensures expansion of the sight and scope of the data contained in the Credit Registry, reduction of the individual exposure threshold that is reported, shortens the deadlines for processing and delivering the data, increases the frequency for informing and updating of the reporting forms of the Registry. This project should be finalized until the end of August 2008.

STATISTICAL TABLES

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

Type of financial institution	2005	2006	2007
Banks	20	19	18
Savings houses	14	12	12
Brokerage firms	9	11	16
Deposit insurance fund	1	1	1
Insurance companies	10	10	12
Stock Exchange	1	1	1
Money Market	1	0	0
Leasing companies	8	4	4
Pension funds	0	2	2
Pension fund management companies	2	2	2
Investment funds	0	0	3
Investment fund management companies	0	0	2
Private fund management companies	0	0	4
Clearing House KIBS AD Skopje	1	1	1
Central Securities Depository	1	1	1
Financial Institutions, total	**68**	**64**	**79**

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

Type of financial institution	2005	2006	2007
State ownership	4,5	4,7	5,8
Other domestic ownership	46,4	45,3	20,9
Domestic ownership total	50,9	50,0	26,7
Foreign ownership*	49,1	50,0	73,3
Financial institutions, total	**100,0**	**100,0**	**100,0**

Note: Savings Houses are not included due to their marginal share (3.7%) in the total registered banks and savings house capital
'* Foreign owned banks are considered banks with foreign capital exceeding 50% of their capital structure

Ownership structure of the financial institutions on the basis of assets total (%)

Type of financial institution	2005	2006	2007
State ownership	1,6	1,6	1,4
Other domestic ownership	47,1	45,2	12,7
Domestic ownership total	48,7	46,8	14,1
Foreign ownership	51,3	53,2	85,9
Financial institutions, total	**100,00**	**100,00**	**100,00**

Note: The table includes data for the ownership structure of the banks.

Concentration of asset by the type of financial institutions

Type of the financial institutions	FOREX assets / Total assets	FOREX liabilities / Total liab.
Banks	67,1	76,6

Note: Savings Houses are not included due to their marginal participation in the total assets

Return on Asset (ROA) by type of financial institutions (%)

Type of financial institution	2005	2006	2007
Banks	1,3	1,8	1,8

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

Type of financial institution	2005	2006	2007
Banks	8,1	12,3	15,2

Distribution of market shares in balance sheet total (%)
(groupage of acting banks according to capital)

Type of financial institution	2005	2006	2007
Banks	98,6	98,7	98,7
Savings houses	1,4	1,3	1,3
Financial institutions, total	**100,00**	**100,00**	**100,00**

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

Assets	2005	2006	2007
Cash and balance with nbrm	5,7	6,4	6,9
Nbrm bills	6,4	5,4	9,4
Debt securities	5,3	7,6	5,9
Placements to other banks	30,7	27,1	20,9
Placements to clients	41,9	45,7	50,9
Accrued interest and other assets	4,4	2,9	2,2
Securities investments	1,1	0,9	0,6
Fixed assets	4,6	4,0	3,2
Nonalocated reserves for potential losses	-0,1	0,0	0,0
Total assets	**100,0**	**100,0**	**100,0**
Liabilities	**2005**	**2006**	**2007**
Deposits of banks	1,9	3,5	4,7
Sight deposits	34,4	32,8	31,2
Short-term deposits up to one year	32,7	35,0	36,6
Short-term borrowings up to one year	0,2	0,1	1,3
Other liabilities	2,6	3,1	3,1
Long-term deposits over one year	2,7	2,9	3,9
Long-term borrowings over one year	9,2	8,9	7,5
Provisions for off-balance sheet liabilities	0,5	0,4	0,4
Owned funds	15,9	13,3	11,4
Total liabilities	**100,0**	**100,0**	**100,0**

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

Type of financial institution	2005	2006	2007
Banks	11,0	14,0	17,8
Financial Institutions, total	**11,0**	**14,0**	**17,8**

Solvency ratio of financial institutions

Type of financial institution	2005	2006	2007
Banks	21,30	30,90	17,00
Savings Houses	/	/	/
Financial institutions, average	**21,30**	**30,90**	**17,00**

Asset portfolio quality of the banking system
in million denars

Asset Classification	2005	%	2006	%	2007	%
A	108 913	77,4	143 707	80,2	198 617	83,6
B	16 487	11,7	21 931	12,2	25 484	10,7
C	4 473	3,2	3 807	2,1	4 469	1,9
D	4 420	3,1	3 435	1,9	3 219	1,4
E	6 403	4,6	6 307	3,5	5 867	2,5
Classified Total	**140 696**	**100,0**	**179 188**	**100,0**	**237 656**	**100,0**
Provisions	**11 753**		**11 762**		**12 690**	

The structure of deposits and loans in 2007 (%)
(at year-end)

	Deposits	Loans
Households	55,1	37,6
Public sector	0,8	4,8
Corporate	33,4	54,6
Domestic Banks	2,7	1,8
Foreign banks	3,5	0,8
Other	4,5	0,4
Total	**100,0**	**100,0**

The structure of deposits and loans in 2007 (%)
by time at year-end in 2007

Maturity of Deposits		Maturity of Loans	
At sight	43,6	Long term loans*	70,3
Within one year	51,0	Medium term loans	
Over one year	5,4	Short term loans**	29,7
Total	**100,0**	**Total**	**100,0**

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

Proportion of foreign exchange assets and liabilities (%)
(at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Banks	57,8	56,7	52,0	50,2	50,6	47,4
Fin. institution, average	**57,8**	**56,7**	**52,0**	**50,2**	**50,6**	**47,4**

Structure of revenues and expenditures of financial institutions
(at year-ends)

Revenues	2005	2006	2007
Interest income	7 670	9 553	12 688
Other income	5 660	4 974	5 985
Expenditures	**2005**	**2006**	**2007**
Interest expenses	3 013	3 311	5 125
Provisions for potential loan losses	2 436	1 623	2 190
Other expenses	5 928	6 501	7 425
Income tax	249	292	284

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	EUR mln	%	EUR mln	%
Banks	416	11,4	453	12,4
Financial institutions, average	**416**	**11,4**	**453**	**12,4**

* Calculated by the exchange rate of NBRM on December 31, 2007

2007 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF MOLDOVA

MACROECONOMIC ENVIRONMENT

In 2007 year the nominal **Gross Domestic Product** increased in real terms by 3.0 % as against 2006 and amounted 53353.7 million lei.

Industrial output produced by enterprises of all property forms amounted 26186.8 million lei in 2007 year, decreasing by 2.7% in real terms as against the previous year.

Agricultural output according to preliminary assessment amounted 12550.0 million lei in 2007 year, decreasing by 23.1 % in real terms as against previous year.

Investments in fixed capital allocated in the national economy valuing 14935.9 million lei exceed the achievements in 2006 year by 19.9 % in real terms.

Average monthly salary[25] of en employee in the national economy totaled 2065.0 lei, recording an increase by 8.3 % in real terms as against the previous year.

The increasing rhythm of consumer prices in 2007 totaled 13.1 % in comparison with 14.1 % in the previous year. Prices to food products increased by 15.4 %, to non-food products - 11.6% and services rendered to the public - 13.0%.

The current account of the balance of payments recorded a deficit of US$ 694.7 million, registering an increase by 79.5 % as against the previous year. The value of *external trade with goods and services* rose from 2006 by 35.1 %, amounting US$ 6310.0 million. The average degree of imports by exports totaled 46.6 % and as regard to previous year diminished by 2.7 p. p.

Deficit of foreign trade with goods and services reached the level of US$ 2316.0 million (in FOB prices). The balance of income registered in 2007 a surplus of US$ 423.4 million. *The income of resident work abroad* was estimated at US$649 million. The *current transfers* registered a surplus of US$ 1178.3 million. The largest weight (69.9 %) in total inflows of current transfers from abroad had the transfers performed by Moldavian employees abroad amounting US$ 842.3 million.

Capital and Financial account of balance of payments resulted in a net inflow amounting US$ 528.2 million. *The net direct foreign investments* in national economy constituted (according to the assessment) US$ 459.3 million, increasing by 1.9 times as against 2006 year.

Total external debt of the Republic of Moldova as of 31.12.2007 amounted to US$ 3300.3 million. The public and publicly guaranteed external debt amounted to US$ 938.7 million, increasing by 7.1 % as against previous year.

The external non-guaranteed private debt has increased by 43.4 % in current year to US$ 2361.6 million.

[25] Enterprises with 20 workers or more

As of December 31, 2007, **domestic public debt** totaled 3748.66 million lei. From total domestic public dept, the debt of National Bank of Moldova constituted 2332.19 million lei.

BANKING SYSTEM DEVELOPMENT

Within the territory of Republic of Moldova as of December 31, 2007 were activating 16 commercial banks, including 3 subsidiaries of foreign banks, authorized by the National Bank of Moldova.

The total number of banking offices included 1060 units, out of which: 16 head offices of banks (placed in the city of Chişinău), 255 branches and 789 agencies.

During 2007 year the development of the banking sector of the Republic of Moldova denoted positive trend. Total assets of the banking sector rose by 9253.3[26] million lei (40.7%) and as of 31.12.2007 amounted 32002.0 million lei. At the same time, their weight in GDP increased from 50.8% to 60.0%.

The larger value of as set s was mainly due to increases in the balances of banking liabilities by 7637.8 million lei (40.6%) and equity capital by 1615.5 million lei (41.1%).

All the components of assets' structure displayed upward evolution. Increases were recorded as follows: cash - by 528.4 million lei (45.8%); money means due from banks and NBM - by 1437.1 million lei (30.8%); securities - by 0.9 million lei (0.04%); and other assets - by 524.8 million lei (34.0%). The largest increase was recorded by loan portfolio (net) - by 6762.0 million lei (51.5%).

Net credits form the maximum weight in total assets with about 62.1 %, thus increasing by 4.4 p.p. as against December 31, 2006. Within the context of distribution of risks and targeting of investment operations, the largest weight in total credit portfolio hold the credits lend to industry and trade - 48.6 %, followed by consumer credits - 14.1 %, credits lend to agriculture and food industry - 13.8 % and credits lend to mortgage, construction and development - 12.8 %.

The improved quality of the loan portfolio in the reported period following the betterment of internal control systems and internal procedures with regard to credit extension and supervision determined the reduction within total loans by 0.7 p.p. of nonperforming loans (substandard, doubtful and loss (3.7% of total loans as of 31.12.2007) and, respectively, by 1.0 p.p. of credit loss provisions (4.2% of credit portfolio as of 31.12.2007).

Liquid assets as of 31.12.2007 constituted 9296.3 million lei, increasing over the year by 1667.9 million lei (21.9%). The liquidity indicators of banking system show the banks' capacity to pay both current liabilities as well as long-term liabilities.

Thus, long-term liquidity as of 31.12.2007 (assets with a term over 2 years / financial resources with a term over 2 years ≤ l) constituted 0.7. The level of this indicator shows the available resources that can be used for long-term investment.

[26] as of December 31, 2007, l USD = 11.3192 lei

Current liquidity (liquid assets (expressed in cash, deposits with the NBM, state securities, net interbank credits with a term up to I month) / total assets ≥ 20%) accounted for 29.1 % as at the 2007 year-end.

Tier-I Capital as of 31.12.2007 increased by 1428.4 million lei (37.6%) and amounted 5227.5 million lei. The main sources for its increase were net income gained by banks (1086.7 million lei) and the share issuance at five commercial banks on the account of additional contribution by shareholders (338.9 million lei).

The average of risk-weighted capital sufficiency (total regulated capital to risk-weighted assets) for the banking sector accounted for a high value of 29.1 % as at year-end (as against 12% set as minimum level in the Republic of Moldova).

In this period the banking system maintained its attractiveness for foreign investors, fact that is confirmed by significant interest of foreign investments in banks' capital. As of 31.12.2007 the share of foreign investments in the banking capital accounted for 71.9%.

Within banking liabilities deposits held the largest share of 87.3% as of 31.12.2007; their weight decreased by 4.3 p.p. as against December 31, 2006. Out of total deposits: deposits by individuals accounted for 53.3%; deposits by legal entities - for 27.4%; and deposits by banks - for 6.6%, other loans and other liabilities constituted 9.6% and 3.0%, respectively.

Return on assets in the banking system (net income to average assets) accounted for 3.9% in 2007. Return on equity (net income to average equity capital) accounted for 24.0%. As against the beginning of the year the return on assets and return on equity increased respectively by 0.5 p.p. and 3.5 p.p.

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

The activity of the National Bank of Moldova as an institution authorized to regulate and supervise the activity commercial banks is stipulated in the Law on the National Bank of Moldova and Law on financial institutions, which provide the competence, main objective, basic attributions of the National Bank and its relationship with financial institutions.

The Law on the National Bank of Moldova provides the competence, main objective, basic attributions of the National Bank, as well as the exclusive right to issue national currency.

The Law on financial institutions provides the basic principles of supervision and regulation of the activity of financial institutions. At the same time, the mentioned law stipulates the requirements and mandatory measures regarding the activity of financial institutions, as well as remedial measures for commercial banks that do not comply with legislation in force.

As in accordance with banking legislative provisions, the National Bank established the mechanism of banking activity supervision and regulation through a number of requirements stipulated in the regulations worked out by the National Bank of Moldova. These regulations are under permanent revision and updating with the view to complying them with new legislative provisions, international general principles, especially recommendations of the Basel Committee on Banking Supervision and EU Directives. The prudential requirements issued by the National Bank of Moldova are available (in Romanian and English) on the NBM official WEB page at www.bnm.org.

At the same time, in its supervision activity the National Bank take into consideration other laws regulating banks' activity, such as Law on joint stock companies, Law on prevention and combat of money laundering and terrorism financing, Law on accounting, Law regarding audit, etc.

In the Republic of Moldova activates 16 banks, which are organized as joint stock companies and activate based on competitive principles. Banks have the right to accept deposits or their equivalents in order to make investments on its own behalf and risk, as well as make other bank operations.

MAIN STRATEGIC OBJECTIVES OF THE BANKING AUTHORITY IN 2007

In order to not admit the excessive vulnerabilities in the banking system, the National Bank of Moldova promoted the development on a continuous basis of the methods for managing banks' assets and liabilities, as well as with the aim to administrate efficient the credit, liquidity, foreign exchange, interest and country risks, thus contributing to banks' assets and liabilities proper protection and increment of banks' income. Within the framework of those related special emphasis was given to:

a) Development of the capacity of banks to plan and conduct their business in a accurate, prudent and efficient way;
b) Improvement of methods for regulation and timely managing of banks' asset quality, as well as improvement of methods for managing the capital, liquidity and profitability;
c) Promotion of an increased transparency level within the banking sector through maintenance in banks registers of truthful, complete and timely information and its regular and timely disclosure.

ACTIVITY OF THE BANKING SUPERVISORY AUTHORITY DURING 2007 YEAR

In the course of 2007, a series of actions was undertaken with a view to maintaining the stability of the banking system, as well as to further developing it. With this purpose, there were improved the prudential regulations and the supervision methods, taking into account the existent normative framework and the generally accepted standards by the banking supervision.

In order to intensify the activity in the field of the financial institutions' authorization, supervision and regulation, new prudential requirements were worked out the transparency degree of banks' shareholders. In this context, the procedure of the authorization of the foreign banks' investments in the local banks' capital was also improved.

The definition of "persons affiliated to the bank" was detailed specifying separately the persons affiliated to a legal entity, including to the bank, and the persons affiliated to an individual. The calculation of the net exposure to a person or to a group of persons acting in common was modified. Therefore, the total exposure was diminished by exposures backed with securities issued by the Ministry of Finance of the Republic of Moldova, the National Bank of Moldova (Certificates of the National Bank of Moldova) or the Government of a member country of the Organization for Economic Cooperation and Development.

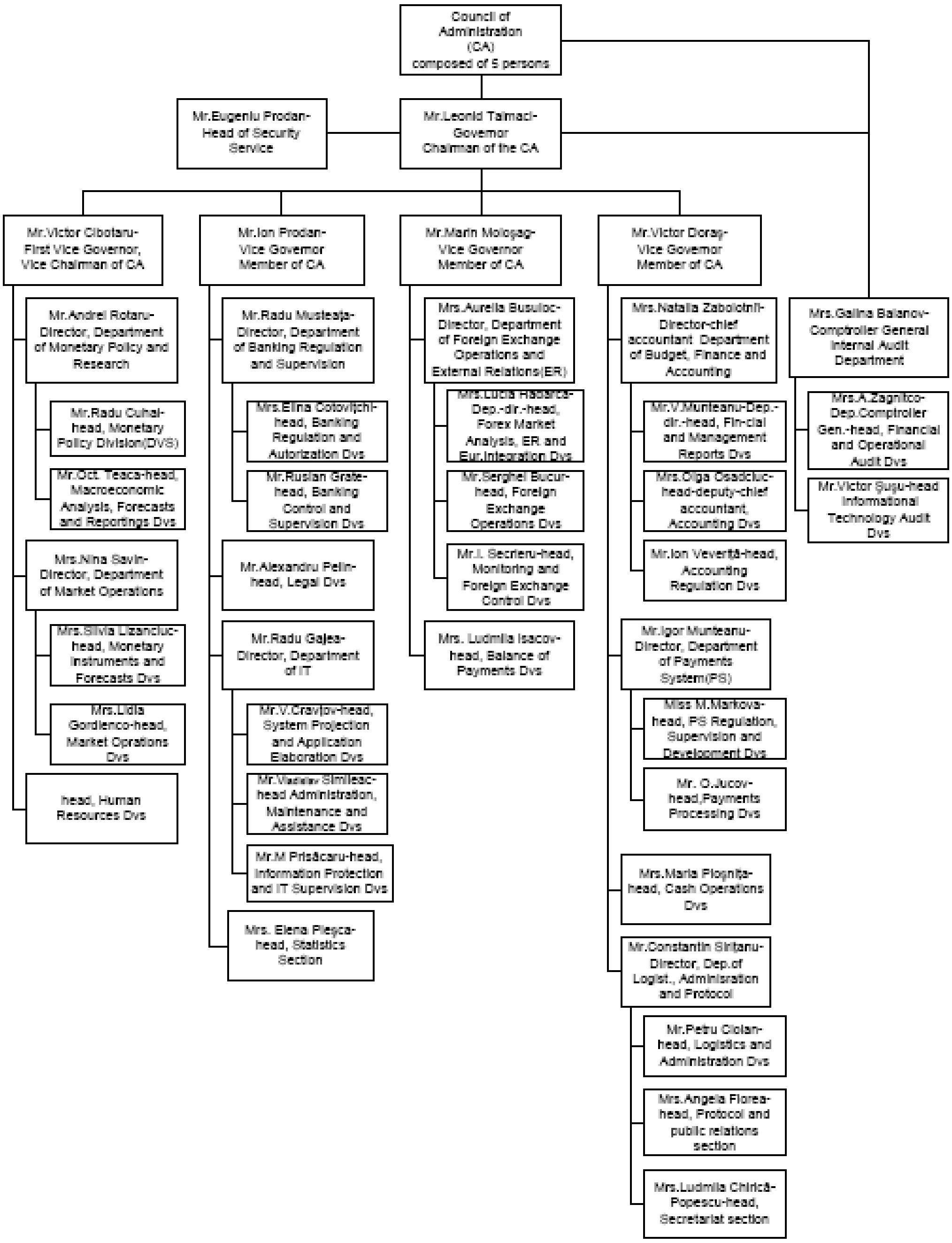
The banks' internal control systems were bettered with a view to increasing the transparency degree related to the structure of ownership, of corporate governance, of the bank's debtors identification, etc.

In order to fairly reflect the value of bank' s assets, prudential requirements were set out to evaluate the risks related to assets, other than credits, and to conditional commitments, as well as of creation of provisions thereto. Thus, the classification of assets and of conditional commitments exposed to credit risk shall be carried out by banks under the conditions similar to credit classification taking into consideration the financial risk's factors. In the event that the assets and the conditional commitments are influenced by circumstances and conditions existent in a foreign country, the respective country risk shall be also taken into account upon the evaluation thereof.

With a view to perform the bank regulation and supervision, the activity of financial institutions is undertaken both for an on-site and off-site supervision. For insuring an ongoing supervision, the National Bank monitors the activity and the financial performance of each financial institution individually, as well as the whole banking sector. The off-site supervision is performed based on periodically financial reports submitted by banks, as well as based on the information obtained from other sources, such as audit reports, annual financial institutions reports, etc.

The on-site supervision activity is based on complex controls (at least one time per year) or thematic controls performed according to the requirements appeared during the year. During the 2007 year were performed a series of controls where were evaluated the internal control systems and determined if policies, practices and risk managing procedures regarding banks' activity are carried out and adequate. As a result of cooperation with banks' management were determined the possible ways for banks' internal control systems optimization, especially of policies regarding lending, accounting, policies regarding know the owners, debtors, identification of customers at account opening, policies and procedures regarding prevention and combat of money laundering and terrorism financing, optimization of censor's commission and internal audit, etc.

ORGANIZATIONAL STRUCTURE OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL COOPERATION OF THE BANKING SUPERVISORY AUTHORITY

To assure consolidated banking supervision, the National Bank of Moldova concluded cooperation agreements in the filed of banking supervision with the supervision authorities of central banks of Romania, Russia and Belarus, Kazakhstan as well as a relevant agreement on cooperation in the filed of exchange of information and research in the financial and banking sector with the National Bank of the Republic of Kazakhstan, which allowed further maintenance of bilateral relationship.

In 2007 year the National Bank of Moldova continued to collaborate with central banks of other countries. Within the framework of bank licensing process, were solicited relevant information from similar supervision authorities (central banks and other authorities) and were sent similar information to supervision authorities at their request.

The National Bank of Moldova became part of the Bank Supervisors' Group of Central and Eastern Europe (BSCEE) in June 1996 by signing the Agreement on the rules of BSCEE Group organization and management.

The membership of BSCEE Group allows the National Bank of Moldova to participate in the exchange of experience between the group members, in the process of on-going professional training of the personnel, in the elaboration of new standards, as well as to benefit from methodological assistance in the field of banks' prudential regulation.

The mentioned facts facilitate the increment of the local banking sector competitiveness, its capacity to attract new investments, including foreign investments, which result in the increase of banks' possibility to satisfy the requirements of different branches of the national economy in bank services.

In 2007 year, at the request of Austrian Financial Market Authority, the National Bank of Moldova accepted the admission of the respective to become a member of BSCEE Group.

COOPERATION WITH OTHER SUPERVISORY AUTHORITIES OF MOLDOVA

Under the scope of further monitoring of risks related to banking activity in the Republic of Moldova, the National Bank cooperates with other supervision authorities of Moldova.

As a result of cooperation relationship established between the banking supervision authority with the supervision authority of the financial market, has been obtained the information regarding banks' activity on the securities market, this information being taken as the basis for estimation of commercial banks' activity as professional participants on the securities market. Simultaneously, has been obtained the information related to the activity of saving and loan associations, which has been examined as the basis for comparative analysis between crediting activities of non-bank organizations and authorized banks. At the same time, has been performed the analysis of the influence of the activity of insurance companies in which banks hold interests on banks financial situation.

With the scope to intensify the banks' monitoring activity in the domain of prevention and combat of money laundering and terrorism financing, National Bank of Moldova collaborates with different state bodies in this field by informing and submitting the respective materials to law enforcement bodies.

OTHER INFORMATION AND RELEVANT TRENDS IN 2007

In October 2007 the financial sector of the Republic of Moldova, including bank sector, was subjected to an examination performed by the World Bank and International Monetary Fund within the framework of the Financial Sector Assessment Program (FSAP). It is necessary to mention that during this program the National Bank of Moldova was detailed subjected to evaluation regarding its compliance with Core Principle for Effective Banking Supervision of the Basel Committee.

The Mission ascertained that, in general, the financial sector, and especially bank sector passed a positive trend as compared to the situation ascertained by the assessment of financial sector mission in 2004. At the same time, was mentioned that great performances were registered during the assessment of the level of compliance with core principles for effective banking supervision elaborated by Basel Committee for bank supervision, as regard to FSAP 2004 results. Simultaneously, according to the assessment results, was noticed that Republic of Moldova's bank legislation is in harmony with European Union Directives and modern central bank practices.

STATISTICAL[27] TABLES

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

Type of financial institution	2005	2006	2007
Banks including:	16	15	16
Subsidiaries of foreign banks	2	3	3

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

Type of financial institution	2005	2006	2007
Public sector ownership	3.4	2.6	2.0
Other domestic ownership	46.0	34.7	26.1
Domestic ownership total	49.4	37.3	28.1
Foreign ownership	50.6	62.7	71.9
Financial institutions, total	**100**	**100**	**100**

Note: Savings Houses are not included due to their marginal share (3.7%) in the total registered banks and savings house capital
'* Foreign owned banks are considered banks with foreign capital exceeding 50% of their capital structure

Ownership structure of the financial institutions on the basis of assets total (%)

Type of financial institution	2005	2006	2007
Public sector ownership	11.0	8.89	5.6
Other domestic ownership	61.5	54.39	42.0
Domestic ownership total	72.5	63.28	47.6
Foreign ownership	27.5	36.72	52.4
Financial institutions, total	**100**	**100**	**100**

[27] Data as of 31.12.2007 are adjusted following the modifications made by some banks according to the external audit.

Concentration of asset by the type of financial institutions

Type of the financial institutions	FOREX assets / Total assets	FOREX liabilities / Total liab.
Commercial Banks	45.75	63.76

Return on Asset (ROA) by type of financial institutions (%)

Type of financial institution	2005	2006	2007
Commercial Banks	2.80	3.40	3.91

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

Type of financial institution	2005	2006	2007
Commercial Banks	15.37	20.47	23.97

Distribution of market shares in balance sheet total (%)
(groupage of acting banks according to capital)

Type of financial institution	2005	2006	2007
Commercial Banks	95.76	87.75	78.80
Subsidiaries of foreign banks	4.24	12.25	21.20
Total banks	**100.0**	**100.0**	**100.0**

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

Assets	2005	2006	2007
Cash			
Due from banks and NBM	5.25	5.07	5.26
Loans and net financial lease	26.49	20.51	19.08
Total securities	53.23	57.66	62.12
Other	7.77	9.96	7.08
Total Assets	**7.26**	**6.8**	**6.46**
Liabilities	**100**	**100**	**100**
Deposits to individuals			
Deposits to legal entities	38.42	40.63	44.07
Other	35.34	30.35	22.66
Share capital	9.77	11.75	15.94
Total Liabilities and share capital	**16.47**	**17.27**	**17.33**

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

Type of financial institution	2005	2006	2007
Total banks	22.34	30.16	23.28

Solvency ratio of financial institutions

Type of financial institution	2005	2006	2007
Average of risk-weighted capital sufficiency for the banking system (≥ 12%)	26.98	27.86	29.07

Loan portfolio quality of the banking system (%)

Loan classification	2005	2006	2007
Standard	56.04	54.85	65.32
Under supervision	38.58	40.76	30.98
Substandard	4.15	2.86	2.73
Doubtful	0.84	1.51	0.91
Loss	0.32	0.02	0.06
Total	100	100	100
Specific reserves to total loans	5.24	5.15	4.2

The structure of deposits and loans in 2007 (%)
(at year-end)

	Deposits		Loans
Individuals	61.05	Industrial / commercial loans	48.57
Legal entities	31.22	Agricultural/food industry loans	13.85
State budgets and local budgets	0.16	Real estate / construction and development loans	12.78
Deposits to banks	7.57	Energy resources and fuel loans	2.03
		Other loans	5.58
		Consumer loans	14.06
		Road construction and transportation loans	2.23
		Loans to banks	0.5
		Government loans	0.4
Total	**100**	**Total**	**100.0**

The structure of deposits and loans in 2007 (%)
by time at year-end in 2007

Maturity of deposits				Loans			
	2005	2006	2007		2005	2006	2007
At sight	38.52	36.83	31.4	Short-term loans	24.45	18.88	23.49
At term	61.48	63.17	68.6	Long-term loans	75.55	81.12	76.51
Total				**Total**			

Proportion of foreign exchange assets and liabilities (%)[28]
(at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Banks	36.13	41.59	43.44	41.06	49.90	51.34

Structure of revenues and expenditures of financial institutions
(at year-ends)

Revenues	2005	2006	2007
Total interest income including:			
Interest income for loans and financial leasing	1549.25	2122.37	3242.88
Interest income for securities	1396.54	1866.68	2717.37
Interest income for other assets	75.18	115.55	353.91
Total non-interest income	77.53	1982.23	171.61
Expenditures:	**787.24**	**973.31**	**1344.09**
Total interest expenses			
Total non-interest expenses	791.84	1007.63	1630.3
Allowances for loan losses	898.97	1079.34	1494.59*
Total net income	130.31	206.91	190.69*

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	EUR mln	%	EUR mln	%
Commercial banks	118.28	6.15	333.16	20.96

As of 31.12.200 1 EURO - 16.6437 lei.

[28] Regulation position is not included (accounts "Placements in bank's central office and subsidiaries", "Subsidiaries' *"Nostro "* accounts ") and off-balance sheet accounts.

* Provisions for losses on interest bearing assets

Structure of off-balance items as of December 31, 2007

Conditional assets	/Total assets (%)	Conditional liabilities	/ Total liabilities (%)
Acquisitions to current operations	6.93	Sales to current operations	8.39
Acquisitions to time operations	7.67	Sales to time operations	9.79
Acquisition of loans and securities	0.08	Sale of loans and securities	0.009
Total conditional assets	14.99	Total conditional liabilities	18.18

2007 DEVELOPMENTS IN THE MONTENEGRIN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The major trends that characterized 2007 were: high GDP growth rate, budgetary surplus, record inflow of foreign direct investments, and an increase in the number of employees as well as very dynamic development of the banking system. An increase in both inflation rate and current account deficit and extremely high credit expansion can be singled as the negative trends. Montenegro became a full member of the International Monetary Fund and the World Bank in 2007.

According to preliminary estimates, GDP rose by 7% in 2007. The GDP increase was mostly driven by an increase in services, particularly in tourism, trade and financial intermediation.

Inflation was on an increase and amounted to 7.7%, measured by the cost-of-living index. The average annual inflation rate amounted to 4.2%.

Almost all of the monetary aggregates reached the record levels. The money in circulation (Monetary aggregate M21) was 71.9% higher, while the disbursed loans increased by 165% and deposits and household saving rose by 94% and 104%, respectively. The banks` assets amounted to almost EUR 3 billion and the deposits exceeded the amount of EUR 2 billion. The maturity structure of deposits improved but it is still not at the satisfactory level. The banking system proved to be, beside tourism, probably the most important initiator of economic growth.

The lending interest rates continued their downtrend. The average weighed effective interest rate at end-2007 was 9.09% and in comparison with end-2006, it was 0.85 percentage points lower. The interest rates downtrend was somewhat slower than in the previous years, but such a situation was expected, taking into consideration the growth of international reference interest rates, high demand for loans as well as the inflation growth. The real interest rate was low and amounted to only 1.4% at end-2007.

A budgetary surplus was recorded for the second year in a row, amounting to EUR 168.4 million (primary budget) or 7.4% of GDP. This is a record amount and such a trend can be regarded as quite positive. A budgetary surplus is an important prerequisite for the system sustainability in euroised/dollarized economies. Also, we consider it positive that the budget for the first time consisted of the current budget, the capital budget and the funds budget.

Tourism was still the branch with the most dynamic development and also affects the accelerated growth of other related braches. Tourism development is very important, for it largely influences the development of transportation, telecommunication, food-processing and furniture industry, as well as the whole set of other branches. The tourism industry in Montenegro recorded two-digit rates of increase for the fifth year in a row, and a positive trend is certainly the fact that the average number of tourist overnight stays increased. The number of tourists who visited Montenegro in 2007 and the number of recorded overnights were 18.8% and 23% higher than in 2006, respectively. For the first time since 1989, more than a million tourists (1.13 million) visited Montenegro.

The deficit was recorded only in one balance of payment sub-account, while all the other sub-accounts recorded a surplus.

The foreign direct investments inflow is record-breaking. The FDI net inflow amounted to EUR 529 million and it was 12% higher if compared to the previous year. However, we could not be fully satisfied with the recorded FDI inflow structure since over a half of the inflow was in the field of real estates and related businesses. This is the indicator that tourism is the field in which Montenegro has significant comparative advantages, but it would be of great importance to increase FDI inflow to other service and production industries.

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

A positive growth trend in the key balance sheet positions - assets, capital and deposits in the Montenegrin banking system as well as a declining trend in concentration continued as a result of strengthened interbank competition. At end-2007 there were 11 banks operating in Montenegro.

- Banks' total assets amounted to EUR 2,976 million, as of 12/31/2007, and rose at the rate of 107.93%, in relation to the same one-year period, that is 17.61% in relation to the previous quarter. Total assets' share in GDP amounted to 121.82%.
- Total loans disbursed by banks amounted to EUR 2,247 million, which represents the annual growth of 165.19%. Total loans' share in GDP amounted to 92.7%.
- Total banks' deposits as of 12/31/2007 amounted to EUR 2,091 million and they increased by 94.38% in relation to the same one-year period. Total deposits' share in GDP amounted to 86.3%.
- In the loan portfolio structure long-term loans (over one year) make up 70.70% of overall granted loans in the system.
- The most important loan users are private companies (60%) as well as natural persons (35%). From the aspect of granted loans classification by sectors, most loans in the banking system was granted to households to the amount of EUR 790 million (35%) which is simultaneously the largest net lender with EUR 229 million. Trade sector was also a significant user of loans to the amount of EUR 586 million (26%), but it appeared as net borrower of funds to the amount of EUR 362 million. Except for the households sector, the financial sector was also a significant net lender of funds.
- Positive credit to deposit ratio at the system level amounted to EUR 156 million.
- Non-performing assets of banks (C, D and E) amounted to EUR 75 million and accounted for 2.53% in overall assets.

- The level of criticized assets (B, C, D and E) was high, representing 215.99% of capital and reserves. The share of criticized assets in capital and reserves increased by 86 percentage points in the one-year period, under the impact of the new Decision on Assets Classification, Provisions for Loan Losses and Reserves for Credit Risk.
- Percentage of past due loans at system level amounted to 3.71% as of 12/31/2007. This indicator is in a downtrend in relation to one year comparative period when it amounted to 7.61%. Of total past due loans 55.38% were loans granted to private companies and 38.93% were loans granted to natural persons.
- Total capital of banks as of 12/31/2007 amounted to EUR 237 million. Capital growth rate in the one-year period amounted to 59.27%. The dominant share in the structure of total capital had foreign capital with 75.73%, then follows private capital with a share of 21.77%, and state with 2.49% of the share. As of 12/31/2007 three banks were majority private owned, while other eight banks were majority (three banks) or 100% foreign owned (five banks). Banks with majority foreign capital controlled 79% of the banking market in Montenegro.
- The banking system liquidity is characterized by a decrease in the key liquidity ratios in comparison with the same period in 2006. Liquid assets to total assets ratio amounted to 18.5%, and it declined by 12.21 percentage points. Also, the banks' lending activity growth of 165% in the one-year period significantly exceeded the deposit growth of 94%, which resulted in loan to deposit ratio to 107.44%, and point out to enhanced lending activity of banks from borrowings and capital. The adequate coverage of loans by deposits is evident in short run, whereas the increase of long-term loans was not followed by the increase of long-term deposits.
- Maturity match of financial assets and financial liabilities at an aggregate level showed negative maturity gap in period 8 to 15 days and 181 to 365 days, as well as the cumulative gap in three consecutive periods. Total cumulative gap at the system level was EUR 371 million representing 13.63% of total sources of funds.
- Total deposits of banks as of 12/31/2007 amounted to 2.091 million and recorded an annual increase at the rate of 94.38% or EUR 1.015 million. The most important depositors of banks were natural persons with the share of 48.75% as well as private companies with 32.25% of the share.
- Of total deposits in the system, 46% referred to demand deposits. The largest concentration of deposits was with households, trade, finance and administration sectors (74% of total deposits). Deposits of four large banks made up 78% of total deposits.
- Banks' financial result as of 12/31/2007 was positive, amounting to EUR 13.9 million. Two banks reported negative financial result in the amount of 10.6 and EUR 0.2 million, respectively. Return on average assets (ROA) at the aggregate level amounted to 0.72 and recorded the decline in relation with the same comparative period of 2006 when it amounted to 1.07%. Aggregate ROE

amounted to 6.17%, and in relation to the comparative period of 2006 it declined by 0.65 percentage points.

- Interest rates spread in the one-year period had declining trend and amounted to 4.46% as of 12/31/2007. Interest rates spread on the level of individual banks ranges between 2.74% and 11.14%.
- As of 12/31/2007 banks in Montenegro operated with an expanded network of 160 organisational units and 198 installed ATMs. The total number of employees in the banking sector in the one-year period increased by 337 reaching the figure of 1.979 employees.

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

During 2007, most of activities of the Bank Supervision Department related to regulatory area were focused on drafting the new Law on Banks.

Enactment of the new Law on Banks is caused by the necessity of harmonization of banking regulations with the development and specificities of the banking system and economic and financial trends in Montenegro. It should be born in mind that the dynamics in changing the banking regulations on the international level and in applying the improved standards and models in risk rating within the banking operations is very intensive. Therefore, the existing regulations need to be more harmonized with new EU regulations and Basel frame for the banking operations. In addition, new international documents related to banking sector, adopted during 2006 (Directives 2006/48 and 2006/49) should be taken in consideration.

Law on Banks incorporates the standards in banking operations based on the Basel frame and the principles of corporative management in banks, better defined principles, harmonized supervision system and procedures. It also prescribes conditions for establishing the foreign banks' branches, conditions and operational methods of MFIs, credit union, parties dealing with credit guarantee operations etc.

The new Law on Banks creates the regulatory frame for a gradual transition of the banking sector in Montenegro to the application of banking operations standards prescribed by Basel II. The Law incorporate basic principles from Basel II with the aim to provide their implementation through the adoption of by-laws.

At end-2007, Council of Central bank of Montenegro enacted a set of the following decisions, aimed at limitation of credit growth expansion:

– Decision on Amendments to the Decision on Minimum Standards for Credit Risk Management and Operations with Bank Related Parties - which, depending on the reached level of receivables on the basis of net loans and leasing operations as of 31 December 2007, limits the annual growth of this parameter in amount of 30%, 40%or 60% in

2008. The highest limitations refer to the largest banks because the negative consequences of credit expansion of those subjects would have the highest impact on safety and stability of the banking system;

- Decision on Amendments to the Decision on Minimum Standards for Bank Capital, which, depending on the realised annual growth of receivables on the basis of net loans and leasing operations (over 60% or over 100%), prescribes the minimum amount of solvency ratio of 10%, i.e. 12% in 2008, by which the increased amount of banks' capital provides the adequate protection of interests of depositors and other bank's creditors;

- Decision on Amendments to the Decision on the Manner and Procedures of and Fees for the Bank Supervision, which enables CBM to publish on its web site the information on imposed rehabilitation measures against a bank, apart from the measure of written warning as well as the information on suspension of rehabilitation measures, which will improve the financial discipline, better informing of the existing and potential depositors and other bank's creditors, efficiency in realization of imposed measures by the banks and reinforcement of insight of the public in CBM actions towards banks, on the basis of implemented supervision operations. The aforementioned solution is compatible with Basel principles referring to capital (Basel II).

Purpose of implementation of measures is reduction of growth rates at the aggregate level and it contributes to the enforcement of risk management functioning in banks. It is expected that these measures should have fast impact and should be valid for one year period of time. Implementation of the aforementioned measures started in January 2008, assuming that the financial discipline of all participants on the banking market will not be questioned. Net growth of loan portfolio at the aggregate level (of about 40%) is expected.

The abrupt growth of loan activities of the banks and their impact on risky profile of the banks on one side, and the safety and stability of the banking system on the other side, influenced changes of the existing Decision on Criteria and Procedure for Classifying Assets and Forming Assets Reserves and prescribing the reserves for the general banking differences, depending on the loan portfolio growth and off-balance sheet items which represent the potential bank's liabilities. According to the new Decision, banks are obliged to perform asset and off-balance sheet items classification at least on a monthly basis, which should improve credit risk management in banks, i.e. classification of assets and forming asset reserves. Monetary assets realised from business and other activities of debtors represent the primary source for the debt payment.

Apart from the abovementioned, the following decisions were drafted in 2007:

- Decision on Amendments to the Decision on Bank Reports to the Central Bank of Montenegro, which regulates conditions for obtaining detailed data on loan indebtedness of the clients of the banks and

MFIs, aiming at their unification within the Regulatory Credit Bureau frame;

- Decision on Amendments to the Decision on Microcredit Financial Institutions aimed at harmonization of this regulation with new provisions from the Decision on Asset Classification, as well as the improvement of certain provisions from the existing Decision.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2007

Key steps of the regulatory and supervisory actions of CBM in 2007 referred to:

- Improvement of the institutional regulatory frame by drafting the new Law on Banks and the adequate by-laws aimed at: providing legal assumptions for broadening the banking market, promotion and development of provisions from the existing Law and creation of the legal frame for the gradual transition to Basel II principles through:
    - Drafting the strategic document for the development of bank supervision and relation to the Basel II and relevant European directives;
    - Improvement of the manual for operations within individual organizational units of the Bank Supervision Department

- Continuous monitoring of the risk to which the banks are exposed with the reorganization of the Bank Supervision Department, through:
    - Integration of the on site and off site departments and increasing specialization of employees for individual types of risks;
    - Change of type of bank supervision from the full scope one to targeted and subject matter supervisions and consequently the reinforcement of the supervision on the basis of the risk through more clear definitions of the supervision coverage;
    - More intensive monitoring of the banks significant for the system;
    - Improved usage of resources of the Regulatory Credit Bureau in the supervision preparation phase, credit risk monitoring and drafting the instructions for implementation of the software for sharing the information with banks
    - Improvement of the relations with domestic and foreign regulatory bodies through signing the agreement on cooperation aimed at better efficiency;

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2007

Supervision of the banking sector in 2007 was outlined differently in relation to the previous year, aiming at reinforcement of the control on the basis of the risk, and at change of type of bank supervision from the full scope one to targeted and subject matter ones. Final result is continuous risk monitoring to which the banks are exposed through the integration of direct and indirect actions related to monitoring of the bank operations. The quality of performed supervisions and coverage of supervised risks are improved, as a consequence of supervisors' specialization for individual types of risks and more intensive monitoring of the banks significant for the system, observed from their market participation aspect as well as from the aspect of evaluation of different areas in each of the banks.

The Bank Supervision Department performed ten full scope and three targeted supervisions in 2006, while in 2007 it performed five full scope and sixteen targeted supervisions. During supervisions, special attention was dedicated to the preparation phase of planned supervisions, especially through the improved usage of Regulatory Credit Bureau resources, continuous credit risk monitoring, improvement of the system of reporting and usage of results of the stress testing of banks. The solvency and the legality of bank operations were supervised by the rating system on the basis of CAMELS methodology. Bearing in mind the credit risk dominance in the banking system and significant expansion of banks' credit operations, asset quality and credit risk (apart from being controlled through full scope supervisions) was controlled also through five targeted supervisions. Although credit portfolio growth rates of banks were high, supervision managed to achieve significant results related to percentage of coverage of loan portfolio and off-balance liabilities of banks.

Stress testing of the banking system and individual banks by the model for testing different risks which banks encounter is used often. Full valorisation of stress testing is achieved by establishing Stress Testing and Systemic Risk Supervision Department.

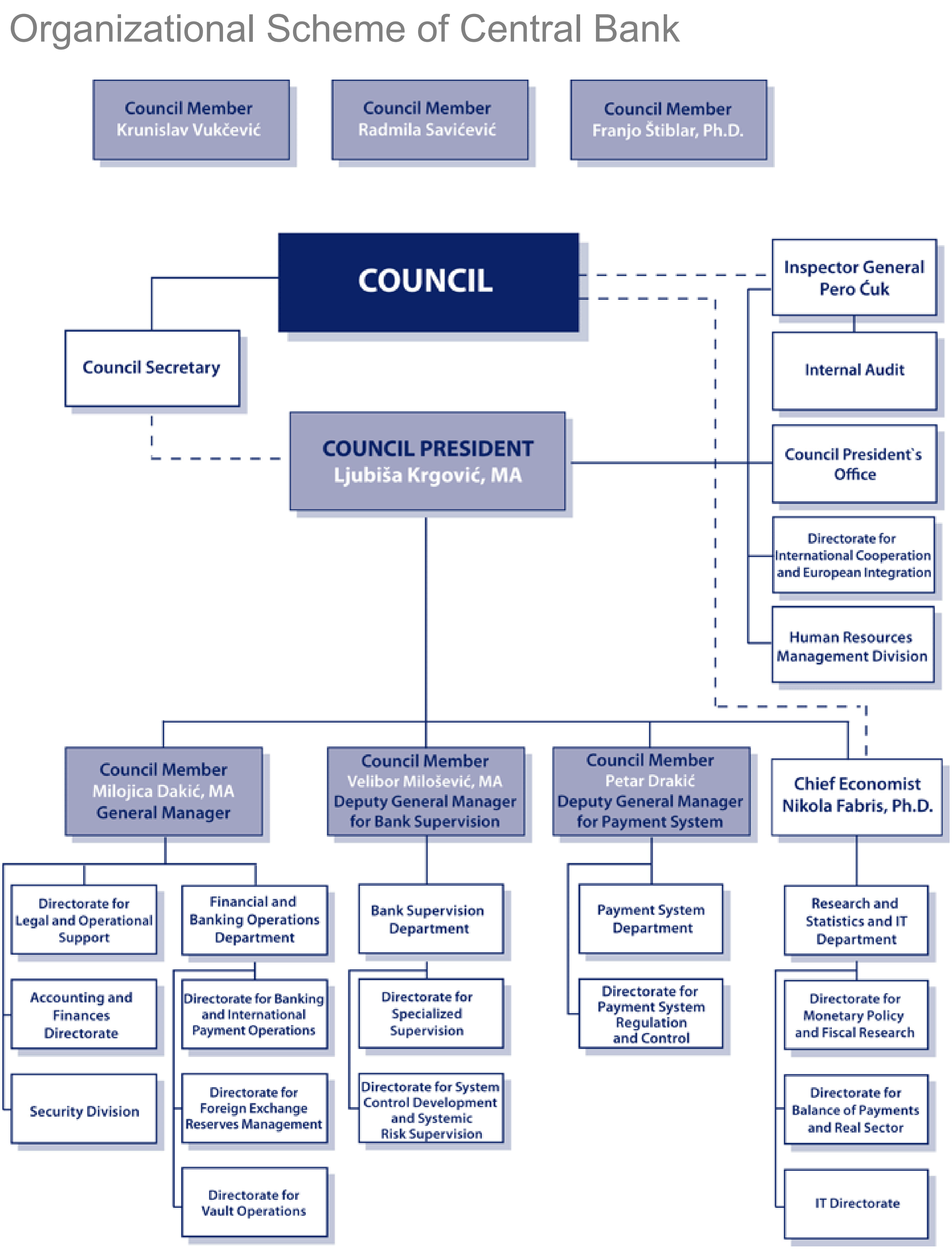
Implementation of the new organizational scheme of the Sector (2007) reinforced the efficiency of supervision operations and the development of the risk based concept of supervision which organizational units are connected through the net. Organisational division on direct and indirect supervision with the dominant portfolio management approach in bank supervision is eliminated. Bank supervision is organized in two segments aiming at precise division between specialized supervision of individual risks and general environment and systemic risk supervision. Part of the division where the portfolio management is located has a key role in determining compositional rating of banks, in planning and directing supervisions, checking the results and methodologies of supervisions and communicating with middle management of credit institutions.

Regulatory Credit Bureau operations were significantly improved in 2007 as well as the quality of its reports for the needs of supervision and future external beneficiaries of credit institutions. Therefore, as of 15 January 2008, commercial banks and MFIs started to use the application for obtaining the data from the Regulatory Credit Bureau of CBM, which are created on the basis of data from the reports which banks and MFIs submit to CBM. Regulatory Credit Bureau information is currently used only by commercial banks and MFIs. Bank Supervision Department concluded the four-year project by starting the data exchange.

Accelerated dynamics of development, banking system specificities, economic and financial trends in Montenegro more and more indicate that provisions of the existing Law on Banks could not represent the regulatory-legal frame any more, the frame which, according to its structure and the degree of development, would be the adequate one for the banking services market in Montenegro. Bearing in mind the circumstances of dynamic changes in banking regulations on the international level and implementation of improved standards and models in risk rating and bank operations, the new Law on Banks was drafted and enacted by the Montenegrin Parliament at the beginning of 2008. Adoption of modern standards in bank operations harmonized with Basel principles, EU legislation and new EU Directive on Capital Adequacy impose new challenges in front of supervision (implementation of these standards in 2008 and adoption of adequate by-laws).

The aforementioned operations were performed according to Basel principles referring to bank supervision, recommendations of FSAP mission of the World Bank and IMF and according to domestic experiences and best practices gained over seven years of supervision operations in Montenegro.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

AGREEMENTS ON COOPERATION IN BANK SUPERVISION AREA

Concluded with	Date
National Bank of the Republic of Macedonia	30 January 2007
Hungarian Financial Supervisory Authority	06 March 2007
Central Bank of Bosnia and Herzegovina, Banking Agency of Republika Srpska, Banking Agency of Bosnia and Herzegovina	05 March 2007
Central Bank of the Russian Federation	28 September 2007

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

Central Bank of Montenegro has a good cooperation with Administration for the Prevention of Money Laundering and Securities and Exchange Commission. The cooperation is based on the signed cooperation agreement.

STATISTICAL TABLES

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

Type of financial institution	2005	2006	2007
Banks	10	10	11
Financial Institutions, total	10	10	11

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

Type of financial institution	2005	2006	2007
Public sector ownership	13	18	22
Other domestic ownership	19	3	2
Domestic ownership total	32	21	24
Foreign ownership	68	79	76
Financial Institutions, total	**100.0**	**100.0**	**100.0**

Ownership structure of the financial institutions on the basis of assets total (%)

Type of financial institution	2005	2006	2007
Public sector ownership	5	-	-
Other domestic ownership	7	15	21
Domestic ownership total	12	15	21
Foreign ownership	88	85	79
Financial institutions, total	**100.0**	**100.0**	**100.00**

Concentration of asset by the type of financial institutions

Type of the financial institutions	FOREX assets / Total assets	FOREX liabilities / Total liab.
Banks	64.15	83.64

Return on Asset (ROA) by type of financial institutions (%)

Type of financial institution	2005	2006	2007
Banks	0.81	1.07	0.72

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

Type of financial institution	2005	2006	2007
Banks	4.16	6.82	6.17

Distribution of market shares in balance sheet total (%)
(groupage of acting banks according to capital)

Type of financial institution	2005	2006	2007
1 bank	43	38	34
3 banks	66	67	64
5 banks	81	84	84
7 banks	92	94	94
Financial institutions, total	**100.0**	**100.0**	**100.0**

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

Assets	2005	2006	2007
Cash Funds & Deposit Accounts with Depository Institutions	38.38	35.76	22.32
Loans and Lease Operations	54.03	59.18	75.48
Securities Held to Maturity	1.12	0.61	0.01
Business Premise and Other Fixed Assets	3.60	2.36	1.37
Acquired Assets	0.32	0.14	0.07
Equity Investments	1.39	1.41	1.08
Other Assets	3.35	1.93	1.39
Less: Reserves for Losses	-2.19	-1.39	-1.72
Total Assets	**100.0**	**100.0**	**100.0**
Liabilities	**2005**	**2006**	**2007**
Deposits	70.13	75.15	70.25
Borrowings Taken from Other Banks			
Obligations on Taken Loans and Borrowings	10.62	11.01	17.50
Obligations to Government	0.92	1.03	0.75
Reserves	0.54	0.30	0.26
Other Obligations	2.49	2.11	2.37
Subordinate debt			0.91
Total Liabilities	**84.70**	**89.60**	**92.04**
Total Capital	15.30	10.40	7.96
Total Liabilities and Capital	**100.0**	**100.0**	**100.0**

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

Type of financial institution	2005	2006	2007
Banks	12.33	13.29	7.34
Financial Institutions, total	**12.33**	**13.29**	**7.34**

Solvency ratio of financial institutions

Type of financial institution	2005	2006	2007
Banks	27.86	21	17.12
Financial institutions, average	**27.86**	**21**	**17.12**

Asset portfolio quality of the banking system

Asset Classification	2005	2006	2007
Pass (A)	55.15	62.66	60.32
Special Mention (B)	27.35	19.58	22.42
Substandard (C)	3.09	3.84	2.88
Doubtful (D)	2.07	0.55	0.13
Loss (E)	0.16	0.14	0.14
Classified total (000)	**464.941**	**880.947**	**2.302**
Specific reserves	**4.18**	**3.59**	**2.32**

The structure of deposits and loans in 2007 (%)
(at year-end)

	Deposits	Loans
Government sector	5.28	0.95
Municipalities	4.33	1.03
State Owned Companies	1.99	0.95
Private Companies	32.25	60.24
Banks	2.81	0.24
Financial Institutions	2.12	0.56
Natural person	48.75	34.54
Other	2.47	1.49
Total	**100.0**	**100.0**

The structure of deposits and loans in 2007 (%)
(at year-end)

Maturity of Deposits		Maturity of Loans	
At sight	45.99	Long term loans	50.96
Within one year	36.58	Short- term loans	49.04
Over one year	17.43		
Total	**100.0**	**Total**	**100.0**

Proportion of foreign exchange assets and liabilities (%)
(at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Banks	2.65	2.83	1.47	2.60	2.77	4.19
Fin. institution, average	**2.65**	**2.83**	**1.47**	**2.60**	**2.77**	**4.19**

Structure of revenues and expenditures of financial institutions
(at year-ends)

Revenues	2005	2006	2007
Interest Income	53.67	59.41	66.27
Fee Income	35.19	32.98	25.51
Other Operating Income	11.12	7.60	8.19
Extraordinary Income	0.02	0.01	0.03
Expenditures	**2005**	**2006**	**2007**
Interest Expense	19.03	26.96	33.28
Provision for losses	16.37	10.58	20.66
Fee Expenses	8.71	7.38	5.82
Operating Expenses	54.47	53.60	38.87
Extraordinary Expenses	0.52	0.24	0.13
Taxes	0.90	1.23	1.23
Net Profit / Loss (000 EUR)	**4184**	**9.009**	**13.907**

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	000 EUR	%	000 EUR	%
Banks	187.202	8.32	2.192.235	80.02
Financial institutions, average	**187.202**	**8.32**	**2.192.235**	**80.02**

2007 DEVELOPMENTS IN THE POLISH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT IN 2007

In 2007, the macroeconomic situation was satisfactory for banks and their clients. According to the Central Office of Statistics, the GDP growth rate in 2007 stood at 6.6% and was the highest in the past ten years. The GDP growth rate was strongly impacted by investment growth (gross fixed investment rose by 17.6%) that had not been recorded for years, a good economic situation in the construction sector, the fast rising consumption and good export results.

The situation on the labour market improved gradually. At the end of December 2007, the registered unemployment total declined to 1 747 thousand (less by 562 thousand than a year before) and the unemployment rate stood at 11.4% (down by 3.4% as compared to the previous year). Average monthly wages and salaries in the corporate sector went up by 8.7% and stood at PLN 2 691.

The economic boom was conductive to acceleration in inflationary processes. Average annual inflation rate was greater than in 2006 (4.0% against 1.4%).

Taking into account the high rate of economic growth and the accelerated inflationary processes the Monetary Policy Council decided that maintaining mid-term inflation on the level close to inflation target required a tightening of the monetary policy. The Monetary Policy Council decided to raise interest rates four times, by a total of 1.0 percentage points. At the end of the year NBP reference rate stood at 5.00% (the rediscount rate 5.25%, the lombard rate 6.50% and the deposit rate 3.50%).

Good macroeconomic condition of the economy and positive outlook was reflected in higher country ratings from Fitch and S&P which increased from BBB to A- (for long term liabilities in foreign currency).

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

The year 2007 was favorable for the Polish banking sector. We have observed strong increase in the scale of operations and banks have achieved record profits.

At the end of 2007, banking sector assets amounted to PLN 795.4 bn and were by 16.7% higher than in the previous year. The proportion of its assets to GDP reached the level of 68.2%, which represented an increase by 3.9 percentage points against the previous year.

The banking sector is the largest and the most developed segment of the Polish financial market although its share in the financial sector assets decreased, as a consequence of a more rapid growth in assets of non-bank financial institutions (investment funds, open pension funds, and insurance companies).

In 2007, operating activity was being carried on by 631 domestic banks (49 incorporated as public limited company, 1 state-owned bank and 581 cooperative banks) and 14 branches of credit institutions.

Foreign investors held a majority interest in 40 domestic commercial banks and 14 branches of credit institutions. Their assets accounted for 71,0% of total banking sector assets. These banks held 67.5% of all deposits from non-financial customers and extended 70.1% loans (net of provisions). It is worth adding that the large proportion of banks with the majority of foreign equity in the Polish banking sector results not only from privatisation, but also from the involvement of foreign investors in the recovery of distressed banks in the mid 1990s.

10 commercial banks (of which 4 banks were under the control of the State Treasury) and 581 co-operative banks were under the control of the Polish capital. Their assets accounted for: 29.0% of total banking sector assets, 32.5% in deposits and 29.9% in loans.

In 2007, the economic and financial standing of banks improved. Medium-sized and small retail banks grew faster than large universal banks, taking advantage of the household demand for loans.

Favorable macroeconomic conditions paired with relatively low interest rates largely influenced the growth in credit supply (process of tightening of monetary policy just began). Loans for non-financial sector increased by 32.5%. Housing and consumer loans to households increased by 50.5% and 32.3% respectively (in 2006 – by 54,3% and 21.5%).

Due to Recommendation S, issued in 2006 by the Commission for Banking Supervision and interest rate increase of CHF instruments (increase of interest rate in PLN just began), foreign currency housing loans grew lower than a year before.

Due to favorable macroeconomic situation the share of irregular claims in total claims from non-financial customers in banking sector dropped by 2.2 percentage points (to 5.2%) mostly because of portfolio growth.

Higher operating scale led to record profit in banking sector. The net financial result of the sector rose by 27.8% and reached PLN 13.7 bn.

Following the increase in earnings, ROE increased to 22.5 percentage points and ROA to 1.7 percentage points. The upsurge of banks' profits in recent years should be attributed not only to the growing Polish economy, but also to the continuing improvement of banks' efficiency –the cost-to-income ratio fell from 60.3% in 2006 to 57.8% in 2007, despite rising wage pressure and development of retail outlets.

Almost all domestic banks held capital exceeding the required minimum (for commercial banks 5 million euro, for co-operative 1 million euro). Only 2 co-operative banks held capital below required minimum. All banks have the capital adequacy ratio at a level higher than the statutory requirement. Banks had a capital base adequate to the assumed risk, both on the individual and the consolidated basis. The banks' capitals were corresponding to the incurred risk and allowed for their further development.

Even though banks' regulatory capital grew by a remarkable 20.2%, the capital adequacy ratio continued to decrease, as it amounted to 12.1% in the end of 2007, compared with 13.2% in the end of 2006.

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.

Main regulatory changes in 2007

Main legislative changes in 2007 were:

- final implementation of Capital Requirement Directive into Polish banking law
- introducing possibility of bank split into Polish banking law.

Main regulatory changes (approved by Commission for Banking Supervision) were number of resolutions implementing EU directives into Polish banking law UE 2006/48/WE and 2006/49/WE related to Capital Requirement Directive
and resolution on required liquidity norms.

Capital Requirements Directive
On 13-03-2007 the Commission for Banking Supervision approved a number of resolutions with regard to:

- the minimum capital requirements for credit, market and operational risk,
- other core capital reductions (the level, range and conditions reductions),
- specific rules and conditions of including specific exposures in limiting risks arising from the concentration of exposures and from high-level exposures,
- specific rules and conditions on functioning of risk management system and internal control system and detailed methods of estimating internal capital and the overview of estimation rules,
- identification, monitoring and control of exposure concentration, including large exposures.
- rules on quantitative and qualitative information published by banks with regards to capital adequacy and the range of information which needs to be published which constitutes transposition to Polish legislation of directives UE 2006/48/WE i 2006/49/WE known as directives CRD which implement the Basel II to the EU law.

The general assumptions behind changes initiated by the Basel Committee were to achieve higher sensitivity of the regulations to risks, and promote improvement in quality of risk management practices in banks.

Until the end of 2007, banks could still apply the old approach to calculating capital adequacy based on Basel I. Nearly all banks have taken advantage of that possibility.
Most banks use the standard method. The biggest banks plan to introduce advanced methods of risk assessment to comply with the regulations over the coming few years on consolidated group level.

A strategic challenge to both the financial supervision and the banking sector is to practically and efficiently implement the Capital Requirements Directive.

Resolution on required liquidity norms

New regulation should contribute to further strengthening of risk management process, and limit potential liquidity threats. It is expected to lead to improvement in soundness and stability of the banking sector.

The resolution introduces the following:

- responsibility to measure the level of liquidity
- measures of liquidity, and responsibility to keep the measure on an agreed level
- reporting responsibility
- responsibility to monitor future level of liquidity
- responsibility to inform the Commission on every decrease of liquidity measures below certain level, and immediately act to restore adequate level of liquidity.

Legal requirements with regard to the level of minimum capital

All commercial banks comply with minimum capital requirement of 5,000,000 EUR

At the end of 2007 only two cooperative banks had capital base less than 1,000,000 EUR equivalent in PLN, an approval of merger had been granted as of 1 January 2008 by Commission of Banking Supervision to both of them to merge with other cooperative banks.
At present all cooperative banks meet the capital requirement at 1,000,000 EUR level.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2007

Licensing
In 2007, the principal tasks of the Commission for Banking Supervision insofar as licensing covered the following issues:

- establishment of banks and the undertaking of operating activities;
- running operations via branches or in the form of cross-border activity;
- execution of voting rights at the general meeting of shareholders of the banks in the form
- of a joint-stock company;
- establishment of representative offices of foreign banks and credit institutions;
- changes to the composition of banks' management boards;
- amendments to the statutes of the banks.

Regulatory tasks
In 2007, the General Inspectorate of Banking Supervision's key regulatory tasks concerned the implementation of the provisions of the New Capital Accord (Basel II) and the Capital Requirements Directive (CRD) to the Polish banking practice.

Off-site analysis
Analytical supervision of GIBS is permanent and consists in:
- direct off-site surveillance over banks,
- supervision of banks in a difficult financial position,
- comprehensive analysis of the business climate in the banking sector.

On-site analysis
Main strategic objectives of on-site examination activities generally aimed at identification of high and increased risk areas and threats that could negatively influence the safety of customers deposits and stability of banking sector. On-site examinations performed in 2007 especially focused on:
- preparedness to implementation of provisions of the Capital Requirements Directive transposed into the Polish legal system (capital adequacy in terms of pillar I, 2 and 3),
- practices regarding risk management of mortgage loans, including loans to households denominated in foreign currencies, also regarding liquidity management.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2007

Licensing
In 2007, 3 applications were received for an authorisation to establish a new bank.

In 2007, the Commission for Banking Supervision received notifications from the relevant supervisory authorities of the Member States of European Economic Area:
- 7notifications concerning the commencement of activity via a branch by a credit
- institution on the territory of Poland;
- 72 notifications concerning the commencement of cross-border activity on the territory of Poland by credit institutions.

Regulatory tasks
(see point main regulatory changes).

Off-site analysis
In 2007, direct off-site supervision of banks covered:
- current and quarterly analysis and analysis of economic and financial position of individual banks within which:

  - analytical-supervisory spreadsheets including key financial information on the banks were updated;
  - individual risk areas were assigned ratings and a general rating was assigned in the CAEL system;
  - potential risk areas requiring detailed control were indicated;
- cooperation with foreign supervisory bodies, in particular with the supervisory bodies of subsidiary banks in Poland;
- ongoing analysis of the compliance of the banks' operations with legal regulations in force;
- monitoring of the banks' preparedness to implement New Capital Accord;
- monitoring of the implementation of post-control recommendations;
- preparation of information for the Commission for Banking Supervision related to the most important phenomena in the banks e.g. particular attention was paid to the problems related to the banks' exposure to the financing of real estate market, in particular to a significant growth of foreign currency loans;
- undertaking explanatory, informative and intervention actions;
- participation in the works of committees and working groups of the EU and the European System of Central Banks (ESCB).

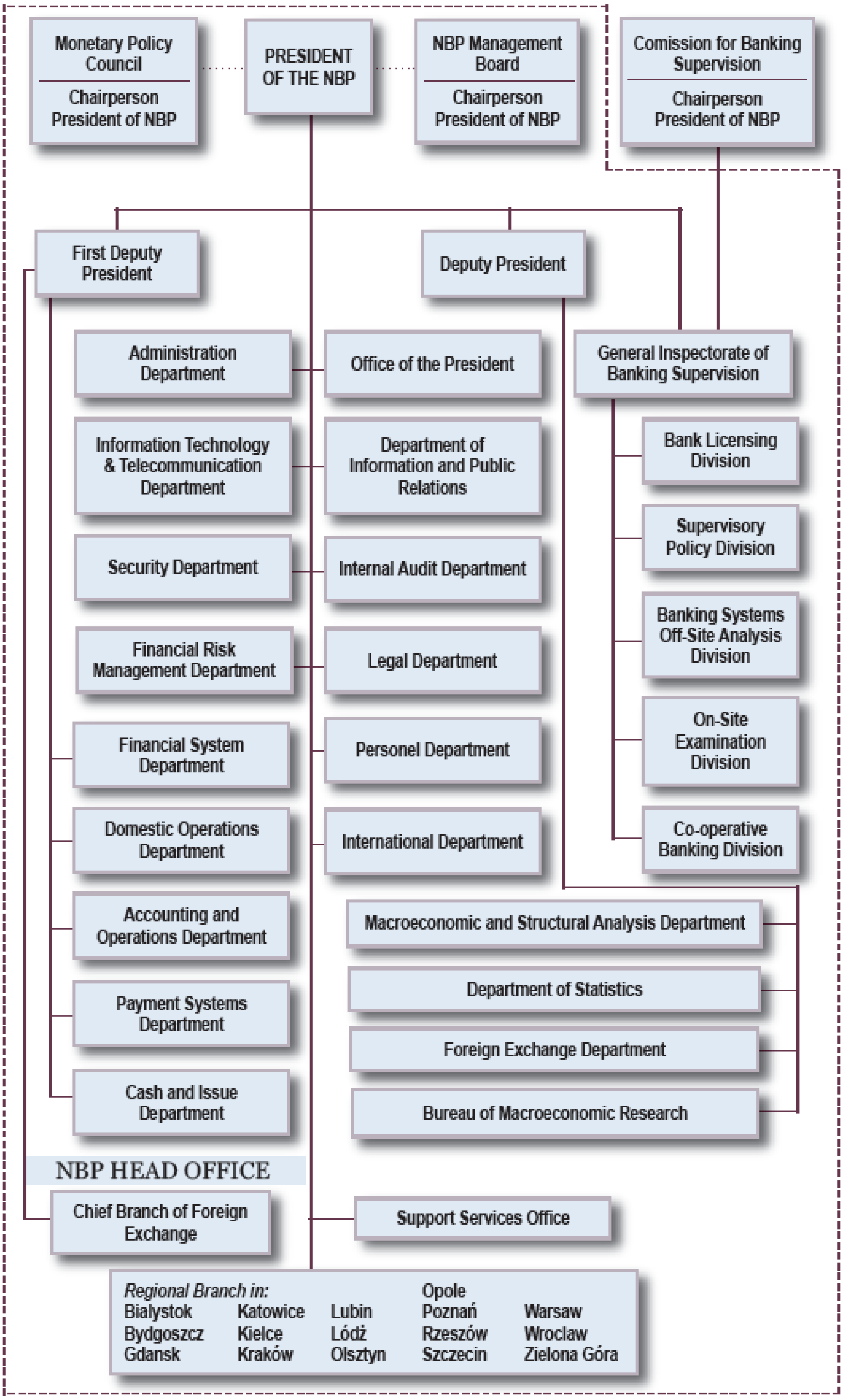
On-site analysis

During 2007 the following on-site examinations were conducted:

- 93 full-scope examinations (19 exams in commercial banks and 74 exams in cooperative banks),
- 43 targeted examinations regarding specific areas of banks' activities (20 exams in commercial banks and 23 exams in cooperative banks)
- 2 examinations in representative offices of foreign banks,
- 2 examinations in representative offices of credit institutions,
- 3 supervisory visits regarding assessment of the bank application for advanced methods of capital requirements calculation for credit risk.

After each full-scope examination every bank received its glob al rating as well as ratings in respective areas that were examined. Ratings were disclosed to a bank. Post-inspection recommendations including findings and recommended necessary correction actions were sent to a bank after each full-scope examination. The main findings were also given to home supervisor.

ORGANIZATIONAL CHART OF NBP



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In 2007 the international activities of the Banking Supervision concentrated on the works of the Commission for Banking Supervision which has concluded a valuable international initiative by signing the supervisory agreements (Memoranda of Understanding - MoU) with two countries.

The agreement with the New York State Banking Department has been signed on September 21, 2007. The MoU included the rules and principles as well as the course of executing the consolidated supervision of banks. This is the fifth supervisory institution from the United States of America, after the Office of Thrift Supervision (OTS), Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (FED) and Federal Deposit Insurance Corporation (FDIC), which signed the MoU with the Commission for Banking Supervision.

The second agreement on supervisory cooperation concluded in 2007 was the MoU with the National Bank of Ukraine. The document was signed on October 25, 2007 during a visit of the Polish delegation to Ukraine.

The international cooperation in 2007 concentrated also on activities regarding the works of the Banking Supervisors from Central and Eastern Europe (BSCEE) Secretariat. The BSCEE Secretariat is located in Poland since January 2006. The Secretariat is responsible for the cooperation between the Group Member countries, the Basle Committee, the FSI and other institutions or regional groups.

The year 2007 was the seventh year of activity of the Training Initiative for Banking Supervision of the National Bank of Poland (TIBS). This initiative involved a technical assistance and training program dedicated to the supervisors from Central and Eastern Europe.
In 2007, the TIBS held two seminars within his program:

- „Practical implementation of Pillar II" organized on June 4-5, 2007,
- „Financing the real estate market" organized on June 25-29, 2007.

Also in 2007, a two-year' training series was concluded. It covered the new regulations on capital requirements, introduced in the EU Member Countries by the Capital Requirements Directive (CRD). The program comprised 24 trainings with three levels of difficulty. In total, 568 representatives from the General Inspectorate of Banking Supervision participated in these seminars.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

Throughout the 2007, the Commission for Banking Supervision and the General Inspectorate of Banking Supervision continued enhanced efforts to conclude the implementation of the New Capital Accord (Basel II) and the Capital Requirements Directive (CRD). Apart from the acquis communautiare transposed in cooperation with the Ministry of Finance and other national administration bodies, banking supervisors further worked on CRD Pillar II and Pillar III aspects. Other legal initiatives were also introduced in cooperation with other national relevant authorities to guarantee efficient legal environment for stable banking sector.

OTHER RELEVANT INFORMATION

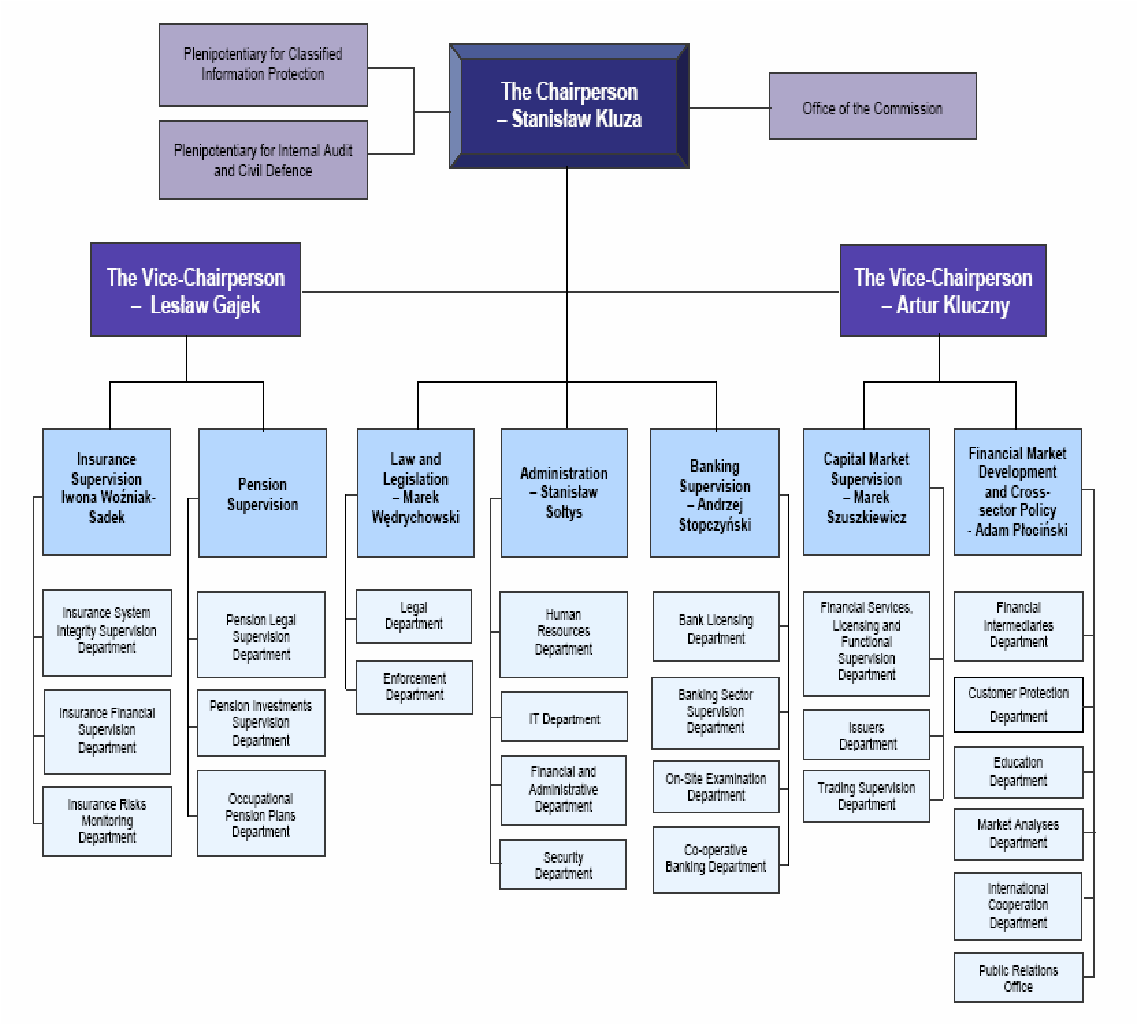
As of January 1st, 2008 banking supervision is carried out by the Polish Financial Supervision Authority (PFSA), as stipulated in the act of July 21st, 2006 on supervision of the financial market.

Merger of financial and banking supervision was a pragmatic decision based on evolution of the Polish financial market: growing significance of multinational financial groups and cross-sector financial products.

Before January 1st, 2008 banking supervision, conducted by the Commission for Banking Supervision, had a limited objective which was to ensure the safety of deposits held by banks. Tasks of the PFSA are much broader and they include undertaking measures aimed at ensuring regular operation of the financial market (its stability, safety and transparency). Consumer issues such as clients' complaints, financial education, codes of best practice, etc. were not considered particulary important before January 1st, 2008. For the PFSA these are top priorities.

As from January 1st, 2008 employees of the General Inspectorate of Banking Supervision (which was part of Poland's central bank) became employees of the PFSA.

ORGANIZATIONAL CHART OF PFSA:



STATISTICAL TABLES

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

Type of financial institution	2005	2006	2007
Commercial banks	61	63	64
Cooperative banks	588	584	581
Banking sector	**649**	**647**	**645**

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

Type of financial institution	2005	2006	2007
Public sector ownership	14.1	13.6	13.2
Other domestic ownership	8.4	9.7	12.8
Domestic ownership total	22.5	23.3	26.0
Foreign ownership	64.2	63.1	60.8
Dispersed holdings	13.3	13.6	13.2
Total commercial banks	**100.0**	**100.0**	**100.0**

Ownership structure of the financial institutions on the basis of assets total (%)

Type of financial institution	2005	2006	2007
Public sector ownership	21.6	21.0	19.4
Other domestic ownership	4.2	4.7	4.8
Domestic ownership total	25.8	25.7	24.2
Foreign ownership	74.2	74.3	75.8
Total commercial banks	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	FOREX assets / Total assets	FOREX liabilities / Total liab.
Commercial banks	37.9	49.6

Return on Asset (ROA) by type of financial institutions (%)

Type of financial institution	2005	2006	2007
Commercial banks	1.6	1.7	1.7
Co-operative banks	1.6	1.3	1.5
Banking sector	**1.6**	**1,7**	**1.7**

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

Type of financial institution	2005	2006	2007
Commercial banks	20.8	23.1	22.9
Co-operative banks	17.6	14.5	17.2
Banking sector	**20.6**	**22.5**	**22.5**

Distribution of market shares in balance sheet total (%)
(groupage of acting banks according to capital)

Type of financial institution	2005	2006	2007
Commercial banks	94.2	93.8	93.8
Co-operative banks	5.8	6.2	6.2
Banking sector	100.0	100.0	100.0
Commercial banks	**94.2**	**93.8**	**93.8**

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

Assets	2005	2006	2007
Cash and balance with Central bank	3.0	3.4	3.5
Interbank deposits	20.8	19.7	15.7
Due from non-financial and government entities	45.8	49.5	55.7
Secuirties	22.8	20.9	17.1
Other assets	7.6	6.5	8.0
Liabilities	**2005**	**2006**	**2007**
Borrowing from Central Bank	0.4	0.7	0.4
Interbank deposits	15.7	17.5	19.9
Deposits from non-financial and government entities	62.5	61.1	59.5
Bonds	1.6	2.3	1.6
Other liabilities	10.4	9.7	10.0

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

Type of financial institution	2005	2006	2007
Commercial banks	340.1	383.0	443.2
Co-operative banks	1.0	1.1	1.2
Banking sector	**341.1**	**384.1**	**444.3**

Solvency ratio of financial institutions

Type of financial institution	2005	2006	2007
Commercial banks	14.5	13.2	12.0
Co-operative banks	14.7	14.0	13.8
Banking sector	**14.6**	**13.2**	**12.1**

Asset portfolio quality of the banking system

Asset Classification		2005	2006	2007
- Special mention claims		5.6	3.9	3.1
- Irregular claims, of which:				
- substandard		1.4	0.9	0.8
- doubtful		1.6	0.9	0.6
- loss		8.0	5.5	3.7
Classified total		**11.0**	**7.4**	**5.2**
Specific reserves	zloty million	**18 843.5**	**15 584.8**	**15 610.8**

[a] of total claims

The structure of deposits and loans in 2007 (%)
(at year-end)

	Deposits	Loans
Households	56.5	56.6
Government sector	9.6	4.8
Corporate	31.2	38.2
Foreign [29]	1.5	1.1
Other	2.7	0.4
Total	**100.0**	**100.0**

The structure of deposits and loans in 2007 (%)
(at year-end)

Maturity of Deposits		Maturity of Loans	
At sight	54.0	Long term loans[30]	51.6
Within one year	43.4	Medium-term loans[31]	25.8
Over one year	2.6	Short-term loans[32]	22.6
Total	**100.0**	**Total**	**100.0**

[29] Deposits and loans are included in others items
[30] >5 years.
[31] (1-5] years
[32] (0-1] years including authorised overdrafts.

Proportion of foreign exchange assets and liabilities (%)
(at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Commercial banks	27.6	25.9	22.7	17.6	18.4	17.5
Co-operative banks	0.7	0.7	0.8	0.6	0.7	0.8
Banking sector	**26.1**	**24.3**	**21.4**	**16.7**	**17.3**	**16.5**

Structure of revenues and expenditures of financial institutions
(at year-ends)

Revenues	2005	2006	2007
Commercial banks	90 117.7	92 940.7	120 486.7
Co-operative banks	3 612.6	3 689.6	4 306.6
Banking sector	**93 730.3**	**96 630.3**	**124 793.3**
Expenditures	**2005**	**2006**	**2007**
Commercial banks	79 806.8	80 535.3	104 620.5
Co-operative banks	2 989.6	3 065.1	3 446.4
Banking sector	**82 796.3**	**83 600.4**	**108 066.9**

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	000 EUR	%	000 EUR	%
Commercial banks	3 836.7	1.7	15 941.9	7.2
Co-operative banks	177.0	0.1	1 245.6	0.6
Banking sector	**4 013.7**	**1.8**	**17 212-5**	**7.8**

2007 DEVELOPMENTS IN THE ROMANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The Romanian economy has continued to grow at a robust pace, with 2007 marking the sixth year of extended recovery following a difficult period in 1997-2000. Similar to most countries across the region, private consumption and gross fixed capital formation are the main drivers of economic growth, which contributed to deterioration in net exports. Household spending was boosted by the easy availability of credit and a strong labour market. Romania's economy made progress in achieving a structure of the economy by sector similar to that of advanced EU Member States, but the distortions caused by incidental factors should not be overlooked. Thus, in the aftermath of the most severe drought since 1946, the agricultural sector accounted for merely 6.6 percent of GDP. The annual inflation rate measured by the consumer price index (CPI) stood on average at 4.84 percent. However, according to the Harmonised Index of Consumer Prices (HICP) used by the European Commission and the European Central Bank, inflation rate equalled 4.9 percent compared to the reference value of 2.8 percent, i.e. 1.5 percentage points above the average of the three best performing EU Member States).

DEVELOPMENT IN THE BANKING SYSTEM

At end-2007, there were 42 credit institutions operating in Romania (41 banks and CREDITCOOP credit cooperative network). As for banking system composition by equity ownership, 2 banks were state-owned, 3 had majority domestic private capital, and 36 had majority privately-owned foreign capital (including branches of foreign banks). Majority privately-owned banks held 94.6 percent of total assets in the Romanian banking system, the remaining 5.4 percent being accounted for majority state-owned banks. Moreover, the share of assets owned by banks with majority foreign capital, including branches of foreign banks, ran at 87.9 percent of total.

The Romanian banking sector is still relatively highly concentrated. Top-five banks (in terms of assets) held 56.4 percent of aggregate assets on the credit institutions' balance sheets, 57.1 percent of loans, 60.0 percent of deposits, 55.7 percent of government securities outstanding and 50.1 percent of own capital.

Capitalisation of the Romanian banking system continued to increase in 2007. Share/endowment capital expanded year on year in both nominal and real terms, by 16.6 percent and 9.4 percent respectively. As regards the country of origin of the capital invested at end-2007 in banks and foreign bank branches operating in Romania, the top three countries were Austria (22.0 percent of aggregate equity), Greece (21.7 percent) and the Netherlands (7.7 percent).

EU accession opened up the Romanian banking market to other EU banking institutions. In 2007, 116 institutions from EU Member States notified their intention to provide services with Romania on a cross-border basis without establishing Romanian branches. Provision of such cross-border banking services is not regulated by the NBR.

In the effort of holding a bigger market share, credit institutions kept boosting their lending activity even after the onset of the global financial turmoil. Heightened credit risk was accompanied by a downtrend in the solvency ratio of local credit institutions. This indicator declined from 18.1 percent at end-2006 to 13.8 percent at end-2007, remaining however above the minimum required level of 8 percent (effective January 2007).

Against the backdrop of stronger competition, net profits rose more slowly (14.8 percent) than total assets (45.5 percent) and own capital (24.7 percent). As a result, return on assets (ROA) dropped to 1.01 percent at year-end 2007 compared with 1.28 percent in 2006 and return on equity (ROE) edged lower to 9.43 percent against 10.24 percent a year earlier.

The liquidity indicator for the overall banking system, i.e. effective liquidity/required liquidity, was 2.13 percent at end-2007, above the minimum requirement of 1. This level is further illustrative of banks' good capability to fulfil their commitments. At individual level, banks and foreign bank branches proved they were capable of managing liquidity risk in an adequate manner.

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

The Romanian banking regulatory framework is harmonised with the provisions of the acquis communautaire in this field.

In this respect, the provisions of Directive 2006/48/EC EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions, Directive No. 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions were transposed into the primary banking legislation and the regulatory framework, in place starting with January 1, 2007.

Government Emergency Ordinance No.99/2006 regarding credit institutions and capital adequacy, as it was approved by Law no.227/2007, transposed the provisions regarding minimum access requirements and the carrying out of activity by credit institutions, the operational requirements (at principle level), the supervision of credit institutions, and introduced specific provisions for various credit institutions (banks, credit co-operatives, savings institutions for housing, mortgage banks and electronic money institutions), whose specific requirements were provided in the past by special laws.

The transposition of the detailed technical aspects of the above-mentioned Directives was made within the prudential regulations issued by the National Bank of Romania (NBR), together with the National Securities Commission (NSC). The secondary legislation concerning the financial conglomerates completed the general framework of the supplementary supervision of the regulated entities, Romanian legal entities by the calculation of the supplementary capital adequacy requirements, identification and enforcement of certain reporting requirements for the intra-group transactions and risk concentration.

Government Emergency Ordinance No.99/2006 regulates the treatment of the credit institutions, Romanian legal entities, of credit institutions and financial institutions from other Member States operating in Romania and of credit institutions from third countries operating in Romania. The regime for credit institutions from other Member States is based on the principle of the "single passport" for carrying out the business activity through a branch or directly, as well as on the principle of the prudential supervision carried out by the competent authority in the home Member State. The branches of credit institutions from third countries operating in Romania must observe the same prudential requirements as those for credit institutions, Romanian legal entities, except for the case when it is considered, under conditions of reciprocity, that regulatory and supervisory framework of the country of origin is equivalent to the one established by the Romanian legislation.

In the same transposition process of the acquis communautaire into the national banking legislation, Government Emergency Ordinance No. 98/2006 regarding the supplementary supervision of credit institutions, insurance and/or re-insurance undertakings, investment firms and asset management companies in a financial conglomerate was issued at the end of 2006, and transposed the provisions of Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council. This government emergency ordinance regulates the supplementary supervision of the regulated entities that are part of groups carrying out cross-sectoral financial activities (financial conglomerates), in order to ensure the financial stability and to protect the depositors, the insurance policy holders and the investors.

Romania is also actively involved in the process of drafting the amendments of the acquis communautaire in the prudential field and the respective amendments are to be transposed into the national framework after their adoption at European level.

The NBR has adopted a new prudential reporting system, harmonised with COREP and FINREP requirements and is in the process of drawing up and adopting new regulations which will transpose the guidelines issued by the Committee of European Banking Supervisor (CEBS) applicable to credit institutions.

The NBR vested with the power and responsibility to license, regulate and supervise the banking system in Romania. To this end the NBR is empowered: to issue regulations, to enforce those regulations, and to apply legal penalties in the case of non-compliance; and to control and verify, based on the reports received and by on-site inspections, the records and accounts of licensed banks.

The prudential supervision system of the NBR consists of both off-site and on-site supervision. Off-site supervision consists mainly of regularly monitoring the activities of individual credit institutions, groups of credit institutions and the banking sector as a whole, reviewing compliance with the prudential rules and limits, and taking remedial measures when problems are identified. Conclusions and findings arising from off-site supervision assist in the selection of credit institutions to be supervised through on-site inspections and the related activities. On-site inspections must be carried out according to the annual program of inspections approved by the NBR's Supervisory Committee, focusing on areas such as credit, market, operational and reputational risks management, management of IT system, money laundering prevention and overall assessment of internal control systems.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2007

The first objective of NBR from the point of view of supervision activity, was assuming the requirements set for community credit institutions through the documents issued by the Committee of European Banking Supervisors (CEBS).

In September 2007 NBR carried on supervision actions at the headquarters of credit institutions, Romanian legal persons, pursuing the assessment of: (i) Basel II implementation policies, (ii) IT systems performance and (iii) policies regarding IT systems' adjustment to Basel II new requirements. Further to the examinations, the conclusion was that many of credit institutions held policies and strategies (own ones or parent group's), formalized procedures regarding Basel II requirements implementation, project management and have carried out independent examinations of implementation phases, periodical informs and analyses.

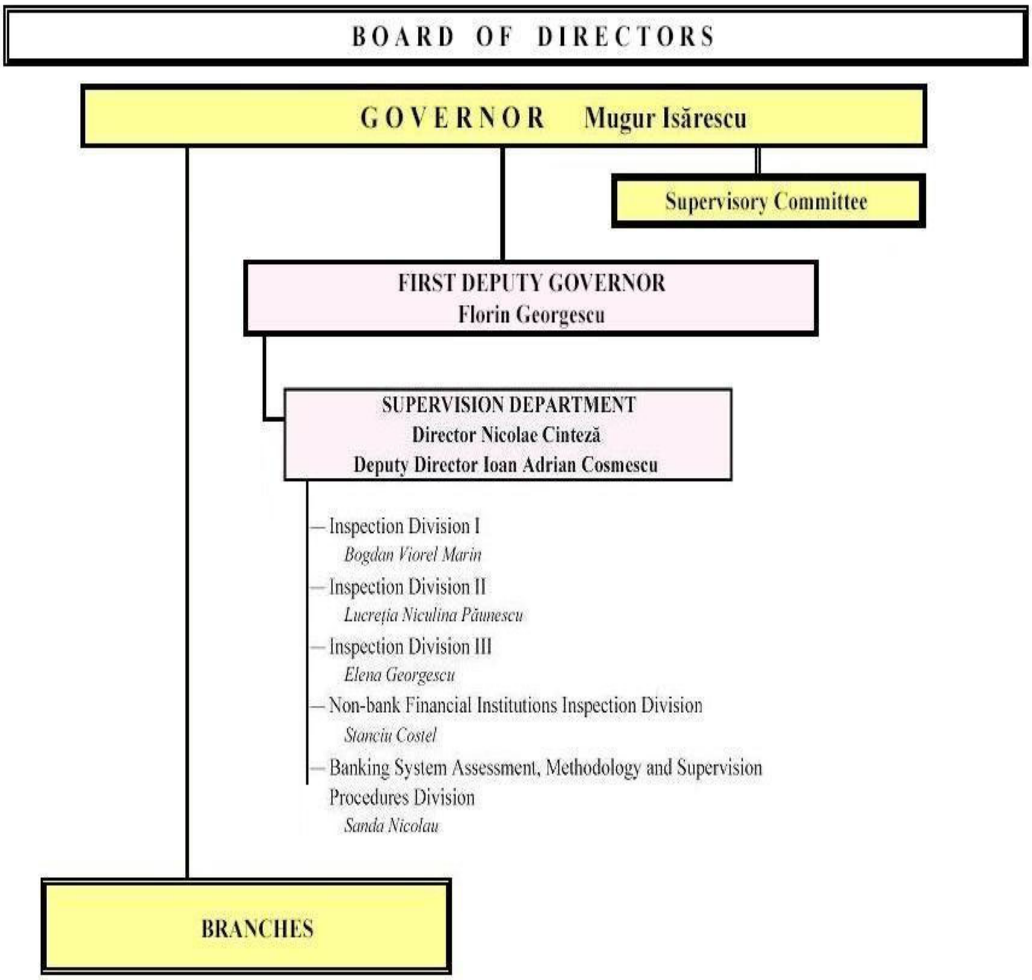
THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2007

Regulatory framework developments (mainly through the recent developments in the legal framework and in NBR regulations) changed substantially the supervisory methodology, from a compliance-based approach to a risk-based assessment. In this regard, the atention was given to the methods applied by credit institutions to measure, evaluate and monitor risks, to verify whether the information used in risk management is complete, reliable and up-to-date, and also to clear definition and assignment of responsibilities to competent departments and staff members. Based on the above assessments, one may draw relevant conclusions regarding the overall performance of credit institutions and their risk profiles. During the on site inspections, most of the deficiencies found at banks were remedied by programs of measures closely monitored by the NBR.

Non-bank financial institutions (NFIs) came under the prudential supervision of the central bank. The authorities intended to reduce specific risks and to enhance the efficiency of measures for monitoring credit developments by putting in place a more uniform regulatory framework. Thus, the Non-bank Financial Institutions Inspection Division was established within the Supervision Department with a view to supporting the NBR in ensuring financial stability, in compliance with the specific legislative framework, as well as in securing equal and non-discriminatory conditions for lending. The lending activity carried out by these entities has prompted the Supervision Department to resort to a differentiated approach which requires the creation of a system capable of monitoring the activity of the entities recorded in the General Register (according to the regular reports on key financial and accounting indicators, as well as to the notification of the changes in their situation), supplemented with on-site inspections at the institutions entered in the Special Register.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

Organizational chart of the Supervision Department of the National Bank of Romania



INTERNATIONAL ACTIVITIES OF NBR

The attainment of convergence criteria in the field of supervisory practices for the banking activity at the level of competent authorities in the EU, the fulfillment of tasks incumbent on the authorities in charge of consolidated supervision, as well as the implementation of Basel II provisions nationwide require closer bilateral and multilateral co-operation of the NBR in the international area.

Against this background, the NBR formalized the cooperation with ten supervisory authorities (National Bank of Moldova, Supervision and Regulation Agency from Turkey, Central Bank of Cyprus, Bank of Italy, Bank of Greece, Federal Office for Banking Supervision from Germany, Nederlandsche Bank N.V., Banking Commission from France, Austrian Financial Market Authority, and Hungarian Financial Supervisory Authority) and with other two supervisory bodies the negotiations are in progress (Bank of Spain and Bank of Portugal). In 2007, bilateral meetings were held with some representatives of the foreign supervisory authority in the spirit of developing a common culture on prudential supervision and occasioned the analysis of some issues relative to the recent developments in those countries' banking systems, especially in the banks in the respective jurisdictions, co-operation regarding the approach and validation of internal ratings-based models, scheduling of common inspections, exchange of information on crisis management and issues related to the management of credit institutions.

The NBR assumed to comply with the provisions of a number of agreements in the field of financial stability that had been concluded previously between the EU Member States. On 1 August 2007, the NBR adhered to: (i) Memorandum of understanding on co-operation between payment systems overseers and banking supervisors in stage three of the Economic and Monetary Union (2001); and (ii) Memorandum of Understanding on high-level principles of co-operation between the banking supervisors and central banks of the European Union in crisis management situations (2003).

Subsequently, on 4 April 2008, the NBR also adhered to the Memorandum of Understanding on co-operation between the financial supervisory authorities, central banks and finance ministries of the European Union in financial crisis situations (2005).

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

As concerns co-operation between local supervisory authorities, in June 2006, the Private Pension System Supervisory Commission requested the National Bank of Romania, the National Security Commission and the Insurance Supervisory Commission to be allowed participation in the memorandum of understanding concluded on 10 March 2006 for ensuring the stability of the financial system and its components (in this respect, an addendum to the existing MoU was concluded on 14 December 2006).

Also, in 31 July 2007, another agreement on the co-operation in the field of financial stability and financial crisis management between the Ministry for Public Finance, National Security Commission, National Bank of Romania, Insurance Supervisory Commission, Private Pension System Supervisory Commission, had been concluded. The parties undertake to co-operate in view to exchange and disseminate the information among them on this issue, both in normal and in crisis time. As a result, the National Committee for Financial Stability was established.

STATISTICAL TABLES

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

Type of financial institution	2005	2006	2007
Commercial Banks	33	31	31
Branches of Foreign Banks	6	7	10
Credit cooperatives	1	1	1
Financial Institutions, total	**40**	**39**	**42**

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

Type of financial institution	2005	2006	2007
Public sector Ownership	12.0	14.9	12.8
Other Domestic Ownership	19.1	6.3	7.8
Domestic Ownership, Total	31.1	21.2	20.6
Foreign Ownership	68.9	78.8	79.4
Financial Institutions, total *	**100**	**100**	**100**

*) excluding Credit cooperatives

Ownership structure of the financial institutions on the basis of assets total (%)

Type of financial institution	2005	2006	2007
Public sector Ownership	6.0	5.5	5.4
Other Domestic Ownership	31.8	5.9	6.7
Domestic Ownership, Total	37.8	11.4	12.1
Foreign Ownership	62.2	88.6	87.9
Financial Institutions, total *	**100**	**100**	**100**

*) excluding Credit cooperatives

Concentration of assets by type of financial institutions as of December 2007(%)

Type of the financial institutions	FOREX assets / Total assets	FOREX liabilities / Total liab.
Banks*	45.6	56.4
Credit cooperatives	-	-
Financial institutions	-	-
Savings cooperatives	-	-
Specialized credit institutions	-	-

*) commercial banks

Return on Asset (ROA) by type of financial institutions (%)

Type of financial institution	2005	2006	2007
Banks*	1.60	1.27	1.01
Credit cooperatives	3.09	2.20	1.68
Financial institutions	-	-	-
Savings cooperatives	-	-	-
Specialized credit institutions	-	-	-

*) including foreign banks branches

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

Type of financial institution	2005	2006	2007
Banks*	12.69	10.28	9.46
Credit cooperatives	9.27	6.54	5.04
Financial institutions	-	-	-
Savings cooperatives	-	-	-
Specialized credit institutions	-	-	-

*) including foreign banks branches

Distribution of market shares in balance sheet total (%)
(groupage of acting banks according to capital)

Type of financial institution	2005	2006	2007
Commercial Banks	92.2	93.9	94.7
Branches of Foreign Banks	7.5	5.8	5.0
Credit cooperatives	0.3	0.3	0.3
Financial Institutions, total	**100**	**100**	**100**

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

Assets	2005	2006	2007
Cash and Claims on Banks	31.8	38.7	33.1
Net Loans	47.3	53.9	59.6
Securities	16.4	3.6	3.9
Fixed Assets and Other Assets	4.5	3.8	3.4
Total Assets	**100**	**100**	**100**
Liabilities	**2005**	**2006**	**2007**
Due to Other Banks and Financial Institutions	20.0	23.8	29.4
Due to Clients	64.0	60.2	56.3
Other Liabilities	3.3	3.5	3.6
Own Capital	12.7	12.5	10.7
Total Liabilities and Capital	**100**	**100**	**100**

*) including Credit cooperatives

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

Type of financial institution	2005	2006	2007
Commercial Banks	16.7	18.7	18.0
Branches of Foreign Banks	12.2	18.2	20.5
Credit cooperatives	0.1	0.6	0.8
Financial Institutions, total	**16.3**	**18.6**	**18.1**

* commitments in favor of banking and non-banking customers

Solvency ratio of financial institutions

Type of financial institution	2005	2006	2007
Commercial Banks	21.0	18.0	13.7
Branches of Foreign Banks	-	-	-
Credit cooperatives	36.8	38.7	34.0
Financial Institutions, average	**21.1**	**18.1**	**13.8**

Asset portfolio quality of the banking system
Mill EUR

Asset Classification	2005	2006	2007
Standard	9,410	16,038	21,618
Watch	6,280	10,604	17,619
Substandard	885	1,356	2,303
Doubtful	192	277	575
Loss	219	466	1,035
Classified Total	**16,986**	**28,741**	**43,150**
Specific Reserves	**266.8**	**430.7**	**370.5**

According to the classification statement of Commercial Banks

The structure of deposits and loans in 2007 (%)
(at year-end)

	Deposits	Loans
Households	32.9	21.3
Government Sector	-	6.1
Corporate	30.9	20.6
Foreign	30.9	51.0
Other	5.3	1.0
Total	**100**	**100**

The structure of deposits and loans in 2007 (%)
(at year-end)

Maturity of Deposits		Maturity of Loans	
At sight	47.0	Short-term	28.6
Within one year	48.0	Medium-term	22.4
Over one year	5.0	Long-term	49.0
Total	**100**	**Total**	**100**

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

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Commercial Banks	43.3	43.9	50.6	43.6	42.9	42.7
Branches of Foreign Banks	51.6	55.0	53.1	54.0	34.0	37.2
Credit cooperatives	0.0	0.1	0.1	0.0	0.2	0.1
Financial Institutions, average	**43.7**	**44.4**	**50.6**	**44.2**	**42.3**	**42.3**

*The figures about off-balance Foreign Exchange sheet items are not available

Structure of revenues and expenditures of financial institutions
(at year-ends)

Revenues	2005	2006	2007
Interest Income	13.2	27.0	20.4
Income from Securities Transactions	1.6	2.2	1.2
Recoveries from Provisions	4.4	10.7	7.8
Income Not Derived from Interest	80.8	60.1	70.6
Extraordinary Income	0.0	0.0	0.0
Expenditures	**2005**	**2006**	**2007**
Interest Expenses	6.6	13.9	11.1
Expenses for Securities Transactions	0.3	0.7	0.6
Provisions Expenses	5.6	14.2	11.5
Expenses, Other Than Interest	86.9	70.0	75.9
Extraordinary Expenses	0.0	0.0	0.0
Profit Tax	0.6	1.2	0.9

*) including Credit cooperatives

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	Mill. EUR	%	Mill. EUR	%
Commercial Banks	2,862.5	4.3	6,225.2	9.4
Branches of Foreign Banks	188.8	5.4	237.1*	6.8
Credit cooperatives	30.0	16.8	51.0	28.7
Financial Institutions, total	**3,081.3**	**4.4**	**6,513.3**	**9.4**

2007 DEVELOPMENTS IN THE RUSSIAN BANKING SYSTEM

MACROECONOMIC SITUATION IN RUSSIA

Production growth in the Russian economy accelerated in 2007 as compared with 2006 practically in all types of economic activity, especially in construction, communications, retail and wholesale trade. Output expanded amid considerable growth in consumer and investor demand. The expansion of the production of goods and services in 2007 was largely stimulated by household demand backed by rapid growth in the volume of bank lending to the public. Household real disposable money income and fixed capital investment demonstrated high growth rates. The federal budget remained in surplus.

Inflation on the consumer goods market increased by 2.9 percentage points in 2007 year on year to 11.9% (December on December). Consumer prices grew faster largely due to rapid growth in the prices of foodstuffs that were mainly influenced by rising global food prices.

Russia's GDP expanded 8.1% in 2007 year on year (7.4% in 2006). As in 2006, industrial output grew 6.3% in 2007. Manufacturing industries made the biggest contribution to industrial production growth.

The favourable situation for Russian exporters on world commodity markets, the growing demand for Russian goods and also a considerable increase in foreign capital inflow into the private sector of the economy ensured large volumes of foreign currency receipts in the country and contributed to the accumulation of foreign exchange reserves. Russia's international reserves increased almost 60% in 2007 to $476.4 billion, providing for the country's financial stability in the medium-term perspective. Russia ranks third in the world in terms of international reserves (after China and Japan).

Russia's public external debt continued to decrease in 2007 both as a result of planned and early payments. Russia completed the repayment of its debt to the Paris Club of creditor nations. However, the debt burden[1] on the Russian economy slightly increased due to growth in the private sector's foreign debt.

Russia's balance of payments remained stable in 2007. The current account surplus remained sizeable in 2007 and stood at $76.6 billion, however it was smaller than in 2006. The net inflow of private capital into the country reached $82.3 billion in 2007 and was the highest since 1992.

---

[1] Foreign debt to GDP ratio.

BANKING SECTOR DEVELOPMENT

The main indicators of banks' performance in 2007 suggest that the reporting year was quite successful for the banking sector. In the second half of 2007, the banking sector demonstrated resistance to adverse external impacts caused by the liquidity crunch on world financial markets.

The relation between the banking sector's key indicators and GDP rose considerably in 2007. The ratio of banks' assets to GDP grew by 9.1 percentage points to 61.4%. The ratio of the banking sector's capital to GDP exceeded the 2006 level by 1.8 percentage points and stood at 8.1%. The ratio of individuals deposits to GDP grew by 1.5 percentage points to 15.6%. The ratio of the value of total loans to non-financial institutions and individuals to GDP rose by 7.4 percentage points to 37.3%.

As in 2006, the value of the banking sector's assets grew in 2007 largely due to the increased lending. The relation between the value of loans extended and GDP grew by 8.1 percentage points to 43.2% while the share of loans in aggregate bank assets increased from 67.2% to 70.5%. The most rapid growth was demonstrated by loans extended to individuals, which reached 9.8% of GDP (including housing mortgage loans – 1.9% of GDP).

Funds attracted from enterprises and organisations were the main source of credit institutions' funding in 2007: their ratio to GDP increased by 3.5 percentage points to 20.5% and their share in the banking sector's liabilities rose by 0.9 percentage points to 33.4%.

The high key indicators of banks' performance in the period under review and their increased ratio to GDP suggest the growing role of the banking sector in the Russian economy.

LEGISLATIVE AND INSTITUTIONAL FRAMEWORKS FOR THE ACTIVITY OF CREDIT INSTITUTIONS AND BANKING SUPERVISION, MAIN CHANGES. SUPERVISORY AUTHORITY'S LEGAL COMPETENCE

Under Federal Law No. 86-FZ, dated July 10, 2002, "On the Central Bank of the Russian Federation (Bank of Russia)" (hereinafter, the Law on the Bank of Russia), the Bank of Russia is a body of banking regulation and supervision which main goals are to maintain stability of the country's banking system and protect the interests of creditors and depositors. For these purposes, the Bank of Russia constantly monitors the compliance of credit institutions and banking groups with banking legislation, legislation on countering money laundering and terrorist financing and the Bank of Russia's regulations and required ratios.

In 2007, legislative efforts focused on improving the effective legislation for the purpose of creating legal frameworks for the functioning of credit institutions in accordance with international standards. In particular, the following federal laws, drafted with the participation of the Bank of Russia, were adopted:

- Federal Law No. 248-FZ, dated November 2, 2007, "On Amending Article 29 of the Federal Law 'On Banks and Banking Activities.'" Article 29 of this law was complemented by a new provision, which says that under an agreement of a bank deposit opened by an individual on the condition that the funds are returned after a specified period of time or upon the onset of circumstances stipulated by the agreement, a bank may not unilaterally reduce the term of the agreement, cut interest on the deposit, increase or establish a fee for operations, except for the cases stipulated by federal law.
- Federal Law No. 325-FZ, dated December 4, 2007, "On Amending Article 36 of the Federal Law 'On Banks and Banking Activities.'" The amendments stipulate that a newly registered bank or a bank registered by the state authority less than two years ago may be given the right to obtain a licence to take individuals' funds on deposit, provided that the bank complies with two mandatory requirements: 1) the authorised capital of a newly registered bank or the equity capital of an operating bank is no less than the ruble equivalent of 100 million euros; 2) the bank complies with the Bank of Russia's requirement to disclose to an unlimited group of persons information on persons that exercise material (directly or indirectly) effect upon decisions made by the bank's management.

In 2007, Federal Law No. 34-FZ, dated March 13, 2007, "On Amending Article 11 of the Federal Law 'On Insurance of Individuals Deposits in Russian Banks' and Article 6 of the Federal Law 'On Bank of Russia Payments on Individuals Deposits with Bankrupt Banks Uncovered by the Compulsory Deposit Insurance System' came into force. The said Federal Law, which was drafted with the participation of the Bank of Russia, increased the size of insurance compensation for individuals deposits to 400,000 rubles, with the simultaneous increase in Bank of Russia payments to depositors of bankrupt banks outside the deposit insurance system.

SUPERVISORY AUTHORITY'S MAIN STRATEGIC TASKS IN 2007

In compliance with the Russian Banking Sector Development Strategy until 2008 and the Guidelines for the Single State Monetary Policy in 2007, the Bank of Russia's tasks in the sphere of banking supervision improvement are as follows:

- to further develop risk-based supervision;
- to raise the quality of assessing the financial soundness of credit institutions;
- to draft amendments to legislation and make changes to regulatory documents aimed at introducing international approaches defined by the Basel II framework to assessing credit institutions' capital adequacy;
- to improve approaches to the procedure of making loan loss provisions, in particular, to specify the methodology of forming reserves for the portfolio of homogeneous loans, proceeding from

the prevalence of substance over form and liberalised requirements for the assessment of the quality of loans extended to microfinance organisations and used by them to grant credits to small businesses and individuals;
- to improve approaches to regulation and supervision of liquidity risk and the methodology for calculating corresponding ratios;
- to improve approaches to the assessment of risks assumed by credit institutions in the course of lending operations and transactions with a group of economically related borrowers and borrowers related with the credit institution;
- to improve approaches to assessing the quality of interest rate risk management at credit institutions, including the development of interest rate risk management systems at credit institutions for trading and banking (non-trading) portfolios of financial instruments sensitive to interest rate fluctuations;
- to improve consolidated reporting and consolidated analysis of risks assumed by banking groups and bank holdings;
- to improve approaches to assessing the quality of credit institutions corporate management, management of all existing banking risks, taking into account the improvement of automated banking systems and the development of information and analytical systems and technologies for the provision of banking services;
- to further improve the early warning system for credit institutions, banking groups (bank holdings) and the system as a whole;
- to improve the methods and tools of monitoring the financial soundness of the banking sector, including work to calculate and analyse the banking sector's financial soundness indicators recommended by the IMF.

SUPERVISORY AUTHORITY'S ACTIVITY IN 2007

The Bank of Russia adopted regulatory documents in 2007 to improve its main activities in the sphere of banking regulation and supervision, including the state registration of credit institutions, licensing of banking activities, assessment, management and supervision over banking risks, off-site supervision, inspections, financial rehabilitation and liquidation of credit institutions, measures to counter the legalisation of criminally obtained income and terrorist financing.

Along with formalised criteria for the assessment of credit institutions, the Bank of Russia started to use more actively substantive approaches based on a weighted and comprehensive analysis of their activities. More attention was paid to the assessment of the quality of management, risk management and internal control systems.

In view of the complex situation on international financial markets in the second half of 2007, the Bank of Russia focused on the assessment of credit institutions' liquidity and the adequacy of their liquidity risk management systems.

Last year, the Bank of Russia conducted monthly monitoring of banks included in the deposit insurance system. The Bank of Russia carried out work to analyse the causes of some banks' failure to comply with the requirements for admission to the deposit insurance system and measures taken by such banks to bring their activities into compliance with these requirements.

Considering the ongoing process of the active development of consumer lending, the Bank of Russia paid close attention to risks emerging for credit institutions in this sphere. The process of consumer lending organised by banks was regulated both at the legislative level and by way of making amendments to Bank of Russia regulations. In carrying out this work, the Bank of Russia closely cooperated with other government bodies.

The Bank of Russia enhanced control over the formation of the portfolios of homogeneous loans by banks as regards the inclusion of loans to individuals into these portfolios and the formation of loan loss provisions.

The Bank of Russia gives a work-out to the system of the banking sector financial soundness monitoring, which consists of three inter-related modules: regular monitoring of risks, stress testing and analysis of financial soundness indicators.

ORGANIZATIONAL STRUCTURE OF BANKING REGULATION AND SUPERVISION IN RUSSIA

The supervisory divisions of the Bank of Russia head office include the Banking Regulation and Supervision Department, Credit Institutions Licensing and Financial Rehabilitation Department, Financial Monitoring and Foreign Exchange Control Department and the Chief Inspection of Credit Institutions. The main goals of these units are to provide methodological and organisational support for the Bank of Russia's legislatively-sealed functions in the sphere of banking regulation and supervision within the framework of the entire "supervisory cycle:" from the licensing of credit institutions, current supervision over their activities and inspection to financial rehabilitation and the implementation of measures, if necessary, to liquidate financially unstable credit institutions.

The supervisory divisions are run by the Bank of Russia's Banking Supervision Committee headed by the Bank of Russia First Deputy Chairman who is responsible for this area. The Committee is responsible for the drafting of decisions on the implementation of policies in the sphere of banking regulation and supervision.

The Bank of Russia implements its policy in the field of banking regulation and supervision over the activities of credit institutions through its regional branches (national banks and main territorial branches). As of July 1, 2008, there were 20 national banks and 59 main territorial branches operating within the Bank of Russia system.

SUPERVISORY AUTHORITY'S INTERNATIONAL ACTIVITIES

In May and September 2007, the Bank of Russia took active part in the work of a joint mission of the International Monetary Fund (IMF) and the World Bank under the Financial Sector Assessment Program (FSAP), which discussed topical issues of banking regulation and supervision and measures taken following the results of the FSAP implementation in 2003. This work, in particular, included the assessment of the financial soundness of the Russian banking sector, using stress testing. In this process, stress testing was conducted both at the level of the banking sector (top down) and independently by some major banks, which agreed to participate in the project (bottom up) in accordance with the methodology agreed with the IMF.

Following the results of the assessment of the Russian banking sector's financial soundness by experts of the IMF/World Bank mission, a draft report, "Assessment of Compliance with Basel Core Principles for Effective Banking Supervision, Russia, October 2007," was prepared. The results of this report will be published in 2008.

STATISTICAL TABLES

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

Type of financial institution	2005	2006	2007
Banks	1205	1143	1092
Non-bank credit institutions	48	46	44
Non-bank credit institutions	1253	1189	1136

Share in Aggregate Banking Sector Registered Authorized Capital (%) (at year-ends)

Type of ownership	2005	2006	2007
Russian credit institutions	90,3	85,9	79,9
including			
public sector ownership	17,5	25	22,6
other domestic ownerghip	72,8	60,9	57,3
Foreign-controlled banks (banks with non-resident interest in excess of 50%)	9,7	14,1	20,1
Banking sector total	**100**	**100**	**100**

Share in Aggregate Banking Sector Assets

Type of ownership	2005	2006	2007
Russian credit institutions	91.7	87.9	82.8
including			
public sector ownership	38,5	34,8	36,3
other domestic ownerghip	53,2	53,1	46,5
Foreign-controlled banks (banks with non-resident interest in excess of 50 %)	8,3	12,1	17,2
Banking sector total	**100**	**100**	**100**

Credit Institutions Asset Concentration
(Share in assets, %)

Type of credit institutions	Three largest credit institutions (by assets)			Five largest credit institutions (by assets)		
	2005	2006	2007	2005	2006	2007
Non-bank credit institutions	38,9	37,4	37,3	44,0	42,8	42,5
Non-bank credit institutions	87,0	87,7	87,3	91,3	91,9	90,4
Banking sector total	**38,7**	**37,2**	**37,2**	**43,8**	**42,5**	**42,3**

Return on Asset (ROA) by type of financial institutions (%)

Type of credit institutions	2005	2006	2007
Banks	3,2	3,3	3,0
Non-bank credit institutions	1,1	1,2	1,6
Non-bank credit institutions	3,2	3,2	3,0

Share in Aggregate Banking Sector Registered Authorized Capital (%)
(at year-ends, %)

Type of credit institutions	2005	2006	2007
Banks	24,1	26,2	22,7
Non-bank credit institutions	39,9	44,5	57,2
Banking sector total	24,2	26,3	22,7

* Calculated as the ratio of the current years balance sheet profit to the average chronological value of assets (equity capital) over the accounting period

Share in Aggregate Banking Sector Assets
(at year-ends, %)

Type of credit institutions	2005	2006	2007
Banks	99,47	99,38	99,53
Non-bank credit institutions	0,53	0,62	0,47
Banking sector total	100	100	100

Structure of Credit Institutions' Assets
(at year-ends, %)

Asset	2005	2006	2007
Money, precious metals and gemstones	2,7	2,6	2,5
Accounts with the Bank of Russia	7,0	6,8	6,4
Correspondent accounts with banks	2,6	2,8	2,0
Securities acquired by banks	15,8	14,0	12,6
Of which:			
Russian government debt obligations	5,0	3,8	2,9
Loans	65,3	67,2	70,5
Other assets	6,5	6,6	6,0
Total assets	**100**	**100**	**100**

Structure of Credit Institutions' Liabilities
(at year-ends, %)

Liabilities	2005	2006	2007
Banks' funds and profits	13,5	12,7	13,9
Loans received by banks from the Bank of Russia	0,2	0,1	0,2
Bank accounts	1,3	1,1	1
Loans, deposits and other funds received from other banks - total	11,1	12,3	13,9
Customer funds	59,7	60,3	59,5
Of which:			
Deposits of legal entities	30,3	32,5	33,4
Individuals deposits	28,3	27	25,4
Debt obligations issued	7,7	7,2	5,8
Other liabilities	6,4	6,2	5,7
Total liabilities	**100**	**100**	**100**

Development of Off-balance Operations (off-balance sheet positions/balance sheet assets (liabilities))
(at year-ends, %)

Type of credit institutions	2005	2006	2007
Banks	26,11	27,75	33,28
Non-bank credit institutions	0	11,51	124,48
Banking sector total	25,97	27,65	33,71

Capital Adequacy Indicator
(at year-ends, %)

Type of credit institutions	2005	2006	2007
Banks	16	14,9	15,5
Non-bank credit institutions	87	100,9	117,3
Banking sector total	16	14,9	15,5

Quality of Banking Sector Loan Portfolio
(at year-ends, as % of total loans)

Loan quality	2005	2006	2007
Standard loans	48,2	51,6	53,2
Non-bank credit institutions	36,6	35,5	35,8
Non-bank credit institutions	12	10,3	8,8
Problem loans	1,5	1,2	1
Bad loans	1,7	1,5	1,2
Share in Aggregate Banking Sector Registered Authorized Capital (%)	**5**	**4.1**	**3.4**

calculations are made according to Form 0409115 Section 1 "Information on the Quality of Loans, Loan and Similar Debts" (Bank of Russia Ordinance No, 1376-U, dated January 16, 2004, "On the List, Forms and Procedure of Compiling and Presenting by Credit Institutions Statements to the Central Bank of the Russian Federation").

Deposit and Loan Structure in 2007
(at year-ends, %)

	Loans, deposits and other funds raised by credit institutions	Loans, deposits and other funds provided by credit institutions
Government financial authorities and extra-budgetary funds*	2,6	0,9
Non-bank credit institutions	18,4	60,7
Individuals	44,5	23
Banks	5,9	5,6
Non-residents **	28,6	9,8
Share in Aggregate Banking Sector Registered Authorized Capital (%)	**100**	**100**

* Including the Bank of Russia,
** Including banks and other legal entities and individuals

Deposit and loan structure in 2007*
(at year-ends, %)

Loans, deposits and other funds raised by credit institution		Loans, deposits and other funds provided by credit institutions	
Demand	2,4	Long-term (over 3 years)	31,2
Non-bank credit institutions	37	Mid-term (1-3 years)	24,3
Non-bank credit institutions	60,6	Short-term (less than 1 year)	44,4
Total	**100**	**Total**	**100**

Share of Foreign Currency Assets and Liabilities in Aggregate Banking Sector assets and liabilities
(at year-ends, %)

Type of credit institution	Foreign currency assets/ aggregate assets			Foreign currency liabilities/aggregate liabilities		
	2005	2006	2007	2005	2006	2007
Non-bank credit institutions	27,9	24,8	23	28,3	25	22,9
Non-bank credit institutions	2,9	4,6	3,3	2,8	2,9	1,9
Banking sector total	**27,8**	**24,6**	**22,9**	**28,2**	**24,8**	**22,8**

Structure of Incomes and Expenses of Operating Credit Institutions (at year-ends, %)

	2005	2006	2007
Incomes, total	**100**	**100**	**100**
Including:			
Non-bank credit institutions	13,08	14,17	15,37
Non-bank credit institutions	6,42	7,62	8,11
- Incomes received from operations with foreign exchange and foreign currency-denominated cheques, including travel cheques	45,05	39,33	36,9
- Penalties, fines, reimbursements	0,11	0,15	0,19
Share in Aggregate Banking Sector Registered Authorized Capital (%)	**35,34**	**38,74**	**39,43**
Of which:			
Recovery of sums from fund and reserve accounts	27,03	27,02	26,32
Commission received	3,66	4,57	4,51
Expenses, total	**100**	**100**	**100**
Including:			
- Interest paid on loans taken	0,93	1,2	1,35
- Interest paid to legal entities for borrowed funds	1,48	2,09	2,82
- Interest paid to individuals	3,14	3,24	3,4
- Expenses on operations with securities	3,88	5,35	6,21
- Expenses on operations with foreign exchange and foreign currency-denominated cheques, including travel cheques	46,93	41,12	38,64
- Administrative expenses	4,21	4,49	4,69
Share in Aggregate Banking Sector Assets	0,01	0,01	0,02
- Other expenses	39,43	42,49	42,88
Of which:			
Deductions to funds and reserves	30,83	30,95	30,02
Commission paid	0,44	0,51	0,48

Structure of the Registered Authorized Capital and Equity Capital of Credit Institutions in 2007

Type of credit institution	Registered capital	/Total assets	Own funds	/Total liab.
	Mill. EUR	%	Mill. EUR	%
Banks	20335,2	3,6	74242,9	13,2
Non-bank credit institutions	28,6	1,1	104	3,9
Non-bank credit institutions	20363,8	3,6	74346,9	13,2

2007 DEVELOPMENTS IN THE SERBIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The overall economic activity has been rising during the 2007 in Republic of Serbia. Gross domestic product (GDP) increased for 7.5% in 2007, which represents acceleration compared to the previous two years. Gross added value contributed with 6.2 pp to year-on-year GDP growth, while the taxes (less subsidies) contributed with 1.3 pp. The largest contribution to this growth came from the services sector: transport (2.7 pp), retail and wholesale trade (1.9 pp) and financial intermediation (1.3 pp). The negative contribution was made by the agriculture due to adverse weather circumstances (decrease in production of 8%). Industrial production gained year-on-year growth of 3.7%, which represents slowdown of growth in comparison with the previous year. Retail trade has accelerated its real growth for 22.4%, while the growth in construction was 9.1%. Transport, warehouse and connections realized increase in trade of 24%.

With regard to the fight against inflation and inflationary expectations, the National Bank of Serbia achieved its planned objective for 2007: end year core inflation was 5.4% and was within the targeted range of 4% - 8% determined by the New Monetary Policy Memorandum. The objective was accomplished despite of significant price increase of industrial – processing products, (caused by the draught) in the second half of 2007 and the rise of the core inflation. The overall growth of retail prices in 2007, as measured december – to - december, reached 10.1%, mostly as a result of movements in regulated prices (contribution of 6.5 pp). Market formed prices contributed 2.7 pp.

According to the estimates, the overall number of employed persons at the end of 2007 was 2,493 thousands, which is 0.8% less compared to the year before. Decrease in the number of the employees is connected to the structural changes and proprietary transformation, which is also confirmed by the fact that the greatest decrease in the number of the employed persons was recorded in the sector of processing industry. The rate of unemployment, based on the work force questionnaire, which was 20,9% in 2006 decreased to 18,1% in 2007. Nevertheless, the rate is still high compared to more advanced transitional countries.

The average net income realized in 2007 was 27,759 RSD which represents increase of 27.9% in nominal terms or 19.5% in real terms, compared to 2006. The growth of real income above the GDP growth rate shows that the earnings were one of the factors that influenced the inflation. The mass of earnings in public sector had approximately the same nominal growth as the overall earnings' growth in the Republic of Serbia.

The overall consolidated budget income without the donations (which, apart from the republic, include also the income from the other levels of government and incomes of obligatory social insurance organizations) was, according to the NBS estimates, 974.4 billions of RSD, while the overall consolidated expenses with repayments of domestic debt to the pensioners amounted to 1,021.9 billions of RSD. Fiscal deficit of 47.5 billions RSD was recorded in 2007. Compared to the year before, the total amount of consolidated income increased nominally for 16.1% (5.55% in real terms), while the expenses grew nominally 16.4% (5.7% in real terms).

Bearing in mind that the public incomes and expenses grew in line with the growth of GDP in real term, the level of public expenditure relative to the GDP did not change in greater extent.

Total public debt amounted to 756.2 billions RSD at the 31 December 2007 (14.1 billions USD middle rate on that date)

The structure of internal public debt is: 90.3% old foreign exchange savings, 3.96% long-term securities of the NBS, 3.98% obligations for unpaid pensions, and the rest are short-term securities. The total public debt is decreased for 4.5% in 2007 compared to 2006.

Open market operations were conducted to affect the level of banks' liquid assets supply, as well as to affect the movements of short-term interest rates on money market, and were executed with NBS's own securities through repo and permanent sales. In this way, the NBS sterilized 67.7 billions of RSD of primary money in 2007, while the level of NBS's securities in the banks' portfolios increased to 216.5 billions RSD. The obligatory reserve was used by the NBS as the classical instrument for credit activity regulation, but also as the instrument in making banks' dinar potential stronger. This was done, among other things, by decreasing the obligatory reserve rate for dinar based deposits and by increasing the obligatory reserve rate for foreign exchange based deposits.

Accelerated credit activity in 2007 contributed to the significant growth of aggregate demand.

The total households' savings have been seemingly increasing during the last few years and reached about 5.0 billions EUR (7.3 billions USD). The dominant part was foreign exchange savings in euros and other convertible currencies.

The foreign reserves of the NBS reached 14,218.2 millions USD at the end of 2007, which means that they were increased for 2,330.7 millions USD or 19.6%. This level of foreign reserves was achieved at the same time with the settlement of obligations to the foreign creditors in the total amount of 598.8 millions USD, including the pre-payment of a part of the debt towards the IMF in the amount of 231.9 millions USD. The remainder relates to the payment of due obligations towards other foreign debtors, IBRD, EIB, Paris and London Club etc. In 2007, 297.1 million USD were paid out of reserves for old foreign exchange savings, and 29.3 million USD for the obligations for Loans for economic development.

In counter fighting the inflation, the NBS was forced to influence the slowing down the credit growth, especially towards the households. Consequently, it passed the set of prudential measures in the second half of the year. With its measures, the NBS established the financial sector stability, capital increase of the banking sector, the growth of the markets, specially the insurance and voluntary pension funds' markets.

The banking sector equity amounted to 328 billion RSD on the 31. December 2007 which represents 112 billion RSD increase or 51.8% compared to the 2006. The total balance assets of commercial banks equaled 1,561.8 billion RSD at the end of the 2007. The capital growth is a result of successful banking business conduct, on the one hand and, the increase of shareholders' equity on the other hand, as the result of the new emissions, most notably of the largest banks. The number of insurance companies reached 20, together with the three new ones, and at the end of 2007, there were seven voluntary pensions funds active in the market with the net assets of over 3 billions RSD.

The main challenges for the next period are: current account deficit, decrease of unemployment and reductions of the effects of extraordinary jumps in world oil prices to domestic core and overall inflation.

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

At year-end 2007, there were 35 banks in Serbia with banking licence given by the NBS.

The most significant changes in ownership structure of Serbian banking sector in 2007: three banks (acquired by OTP bank from Hungary) merged, also two banks (owned by Intesa and San Paolo IMI) merged and one bank was set up by way of transforming of the savings-deposit organization.

Banking sector total balance sheet assets reached 1.561.822 million RSD at year-end 2007, which represented growth of 33,6% compared to year-end 2006. Deposits recorded growth of 44,1% which contributes with over 70% to balance sheet assets growth in 2007 and is still the main source of balance sheet growth. Deposits of natural persons make 27,4% of total bank funding sources. Maturity structure of deposits has been significantly improved because, for the first time, short term deposits (53,3%) prevailed upon sight deposits. Share of foreign currency deposits (64,2%) decreased, but these deposits are still predominant.

Foreign indebtedness decreased its share in total bank funding sources from 15,9% to 8,6% in 2007.

Banks recorded significant growth in own funding sources (51,8%) which resulted in increased proportion of own funds in total liabilities side of balance sheet (21,0%) which was enough to support expansive credit growth. This was mainly caused by regulatory demands whose aim was to provide capital base for further credit growth. At year-end 2007, capital adequacy ratio is relatively high (27,9%).

Share of banking sector balance sheet assets in GDP was increased compared to the year-end 2006: from 57,3% to 66,9%.

Intensive growth in banks' credit activity continued in 2007 (growth of 39,5%), primarily caused by dinar (mostly fx indexed) and long term loans growth to companies and households.

From 2005, banking sector has recorded net positive financial result (net profit) before taxes. In 2007, net profit was 23.473 million RSD. Net profit to total assets ratio (ROA) was 1,5%, and net profit to capital ratio (ROE) was 8,8%.

Bank business indicators reveal banks' growth and development, increase of productivity and number of employees, widening of branch networks and better quality and diversity of services. Banking sector recorded satisfactory level of liquidity and solvency in 2007. Significant liquidity reserves make Serbian banking sector resilient to external shocks and provide for further credit growth, while high capital adequacy ratio makes it less sensitive to business and macroeconomic environment risks.

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.

NBS is supervising banks, insurance companies, leasing companies and voluntary pension funds.

On the basis of new Law on Banks, which was adopted in 2005, the NBS has, within its supervisory function, adopted bylaws in December 2007 with the aim to comply, as much as it is possible, with International Convergence of Capital Measurements and Capital Standards (Basel I) and its later amendments. The NBS has adopted Decision on Banks' Risk Management, Decision on Bank Capital Adequacy, Decision on Classification of Balance Sheet Assets and Off-Balance Sheet Items and Decision on Liquidity Risk Management which come into force in July 1st 2008. Also, the NBS started activities concerning preparation for Basel II implementation and ensuring compliance with EU Directives demands in field of banking supervision.

Preparations for improving supervisory reporting and bank rating system in accordance with new bylaws and new Rules on the Chart of accounts and Content of accounts within the Chart for Banks started in 2007.

The second goal of regulatory activity was aimed to limit intensive credit activity of banking sector and persistent monitoring of all kinds of business risks. The NBS monitored movements in banks' credit activity from several aspects (maturity, currency and sectoral structure and credit activity by banks or by clients) and applied its prudential measures to slow down these activities. Prescribed ratio of gross household placements to Tier 1 capital of 200% was decreased to 150% thus leaving choice for banks to either decrease their household placements or increase their capital, which was the option that the most banks chose. Also, it is forbidden to grant cash loans with repayment period longer than 24 months.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2007

Implementation of new Law on Banks represents direction for the next stage of Serbian banking sector development, which is characterized by consolidation processes, emphasis to efficiency and transparency, development of more complex products and services and usage of more complex risk management tools and increasing bank sensitivity to unfavorable external influences.

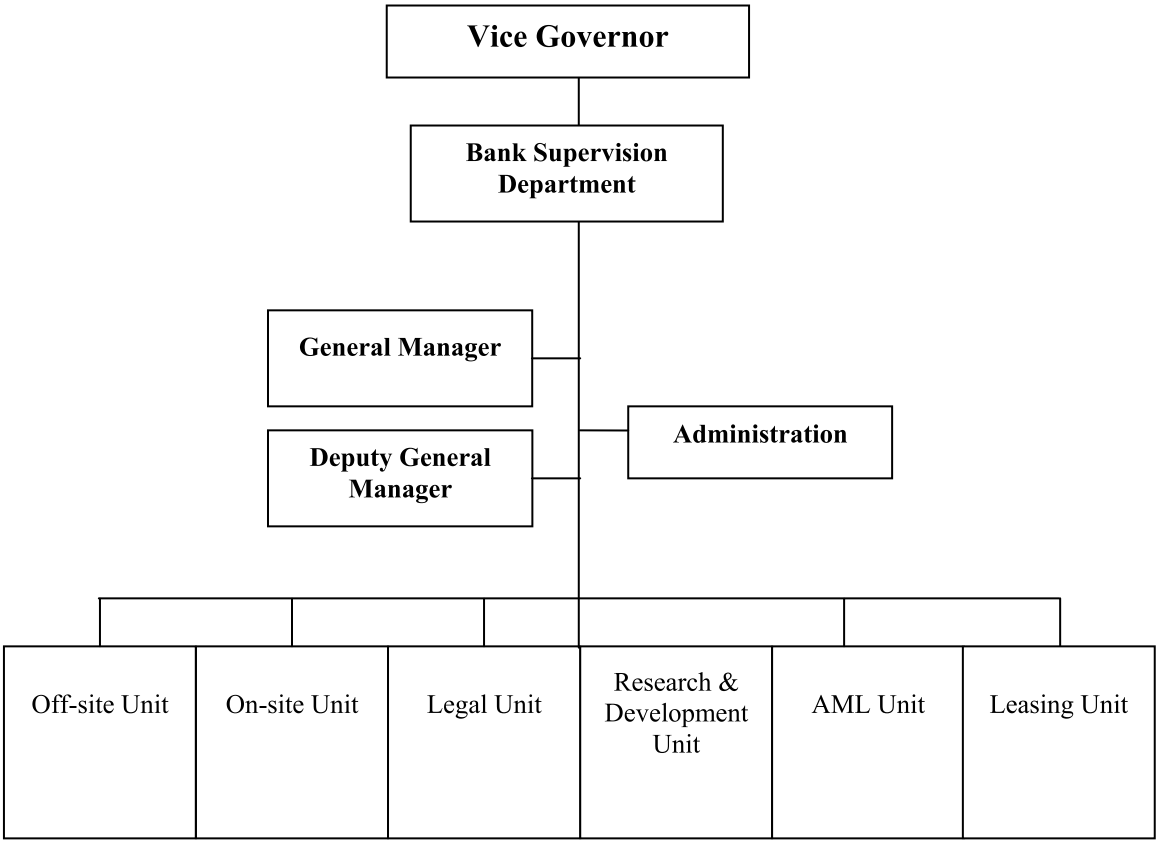
Main strategic objectives of the supervisory authority in 2007 were:

- ensure reliable, continuous and transparent operations of the banking sector;
- strengthen confidence in banks;
- promote the development of banking sector based upon fair competition;
- protect the legitimate interests of market participants;
- improve corporate governance in the banking sector;
- support the reduction of customers' risk by providing access to adequate information; and
- actively participate in eliminating financial crime
- improvement of personnel and technical resources, in the first place through personnel education and training.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2007

In 2007, the Supervision department of NBS implemented and continued to quarterly conduct banking sector stress tests (with two scenarios – mild and worst), which examine possible influence of different assumptions (shocks) to capital adequacy and liquidity of individual banks, peer groups and banking sector. Stress tests estimate potential individual and cummulative effects of several aspects of credit risk (sudden and severe changes in loan portfolio quality, loan currency structure, classification categories and loan types), domestic currency depreciation, interest rates change, and three assumptions about liquidity risk. Stress tests has shown that, even if previously mentioned shocks were to occur, it may be assumed with high level of certainty that banking sector would at all times keep prescribed liquidity level, and capital adequacy ratio would not fall below prescribed regulatory limit.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In 2007, continued regular meetings with IMF (concerning questions on banking sector credit activity, business indicators and compliance with prescribed minimal regulatory capital amount and questions on the NBS's supervisory activities) and World Bank mission (further implementation of Supervisory Development Plan – planning details of technical assistance in 2008 for training for off-site in March 2008 and on-site in September 2008) Also activities connected with the procedure for Republic of Serbia accession to EU (comparative analysis of domestic regulatory framework in the field of banking supervision and comparable framework of EU member countries) and its entering to World Trade Organization.

NBS continued with activities (meetings and presentations) within EPD (Enhanced Permanent Dialogue - Stabilisation and Association Process to EU).

Within IPA (Instrument for Pre-Accession Assistance) in 2007 was finished draft of main planning documents.

Also, activities whose aim was signing Memoranda of Understanding with central banks and other institutions in charge for banking supervision were continued in 2007. Bilateral agreement was signed with Banca d'Italia and multilateral agreement with supervisors of Southeastern Europe countries (Albania, Greece, Bulgaria, Cyprus, Macedonia and Romania).

Cooperation with supervisors from other central banks and supervision agencies in conducting on-site examinations was intensified in 2007, especially with Austrian Financial Markets Authority (FMA).

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The NBS has signed the Memorandum of Understanding with the Belgrade Stock Exchange and, at the beginning of 2008, Memorandum of Understanding with the Commission for Competition Protection.

Other relevant information and developments in the course of 2007

- The working group for the Implementation Basel II was formed at the end 2007. Until now, they prepared gap and comparative analysis, sent inquiry to banks regarding the Implementation of Basel II. The strategy with operational plan was accepted by the Banking Supervision Commission. Now the drafting of regulation is in process. The new regulation will be published at the end of 2009 and will come into force from January 1 2011.
- The operational convergence of supervisory knowledge for activities of all units is invested with portfolio managers (PM) who oversee the overall supervision of a bank. As an answer to increasing demands, the number of portfolio team members increased in 2007 and special emphasis was given to more intense contacts and cooperation with the banks. In addition to setting revised set of working procedures, BSD started developing the comprehensive Supervision Manual, taking into account best international practices in supervisory methodology and characteristics and developments of local banking sector.
- One of the NBS's main long-term strategic priorities whose realization started in 2007 is the function of continuing financial stability monitoring. The first Report on Financial Sector Condition for 2007 has been published with the aim to be constantly improved and published twice a year.

STATISTICAL TABLES

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

Type of institution	2005	2006	2007
Banks	40	37	35
Other financial institutions *	8	-	-
Financial institutions, total			

* Other financial institutions – savings banks, savings-credit organizations and savings-credit cooperatives.

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

Item	2005	2006	2007
State ownership	24,6	14,3	11,8
Other domestic ownership	21,6	12,6	11,0
Domestic ownership total	46,2	26,9	22,8
Foreign ownership	53,8	73,1	77,2
BANKS total	**100.0**	**100.0**	**100.0**

Ownership structure of the financial institutions on the basis of assets total (%)

Item	2005	2006	2007
State ownership	23,9	14,8	15,7
Other domestic ownership	10,1	6,5	8,8
Domestic ownership total	34,0	21,3	24,5
Foreign ownership	66,0	78,7	75,5
BANKS total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	FOREX assets / Total assets	FOREX liabilities / Total liab.
Bank	30,7	44,6

Return on Asset (ROA) by type of financial institutions (%)

Type of institution	2005	2006	2007
Bank	0,9	1,4	1,5
Other financial institutions	3,2	-	-

End of year data

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

Type of financial institution	2005	2006	2007
Bank	5,9	9,1	8,8
Other financial institutions	5,3	-	-

End of year data

Distribution of market shares in balance sheet total (%)
(groupage of acting banks according to capital)

Type of financial institution	2005	2006	2007
Bank	99,7	100,0	100,0
Other Financial Organization	0,3	-	-
Financial institutions, total	**100.0**	**100.0**	**100.0**

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

Assets	2005	2006	2007
CASH AND CASH EQUIVALENTS	9,4	6,7	6,7
DEPOSITS WITH CENTRAL BANK AND SECURITIES REFINANCEABLE WITH CENTRAL BANK	19,4	34,8	31,4
INTEREST, FEES AND COMMISSIONS RECEIVABLE	0,4	0,4	0,4
LOANS TO AND INVESTMENTS IN BANKS	4,3	2,8	2,8
LOANS TO AND INVESTMENTS IN CLIENTS	55,0	46,6	52,0
SECURITIES AND OTHER TRADING INVESTMENTS	1,3	0,7	0,4
INVESTMENTS IN SECURITIES HELD TO MATURITY	1,1	0,6	0,8
EQUITY SHARES AND OTHER SECURITIES AVAILABLE FOR SALE	1,3	1,3	0,5
INTANGIBLE INVESTMENTS	0,6	0,5	0,4
FIXED ASSETS	5,3	4,4	3,7
OTHER ASSETS, PREPAYMENTS AND ACCRUED INCOME	1,7	1,0	0,7
DEFERRED TAX ASSETS	0,2	0,2	0,2
TOTAL ASSETS	**100,0**	**100,0**	**100,0**
Liabilities	**2005**	**2006**	**2007**
Liabilities (from LO.I. to LO.X.)	**83,8**	**81,5**	**79,0**
LIABILITIES TO BANKS	4,6	5,4	5,1
LIABILITIES TO CLIENTS	74,9	69,9	67,1
INTEREST, FEES AND COMMISSIONS PAYABLE	0,1	0,1	0,2
LIABILITIES FOR SECURITIES	0,0	0,0	0,2
LIABILITIES FOR PROFIT	0,0	0,0	0,0
OTHER OPERATING LIABILITIES	1,0	0,7	0,7
DEFERRED NEGATIVE GOODWILL	0,0	0,0	0,0
OTHER RESERVERS	0,9	0,9	0,8
OTHER LIABILITIES, ACCRUALS AND DEFERRED INCOME	2,2	4,4	4,9
DEFERRED TAX LIABILITIES	0,1	0,1	0,0
CAPITAL	16,2	18,5	21,0
SHARE AND OTHER CAPITAL	13,8	15,6	17,5
RESERVES	2,5	2,6	3,1
ACCUMULATED PROFIT/LOSS	- 0,1	0,3	0,4

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

Type of financial institution	2005	2006	2007
Banks	0,94	1,00	1,01
Other financial institutions			
Financial institutions, total			

Solvency ratio of financial institutions

Type of financial institution	2005	2006	2007
Banks	26,0	24,7	27,9
Other financial institutions	66,7	-	-
Financial institutions, average			

Asset portfolio quality of the banking system (mill. CSD)

Asset Classification	2005	2006	2007
A	256.719	285.984	353.572
B	106.509	136.864	287.040
C	65.911	107.263	159.122
D	15.822	18.075	32.302
E	27.839	79.876	102.422
Classified total	**472.800**	**628.062**	**934.458**
Specific reserves	**61.702**	**99.138**	**120.614**

* Because of changes in methodology, data of 2006 and 2007 are not comparable with data of 2005

The structure of deposits and loans in 2007 (%)
(at year-end) banking system

	Deposits	Loans
Households	44,6	39,8
Government sector	2,9	1,8
Corporate	34,4	57,5
Foreign	3,2	0,0
Other	14,9	0,9
Total	**100.0**	**100.0**

The structure of deposits and loans in 2007 (%)
(at year-end)

Maturity of Deposits		Maturity of Loans	
At sight	42,0	Long term loans (over 1 year)	43,5
Within one year	53,3		
Over one year	4,7	Short-term loans	56,5
Total	**100.0**	**Total**	**100.0**

Proportion of foreign exchange assets and liabilities [*]
(at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Banks	37,3	32,5	28,2	62,6	59,0	53,6
Other financial institutions	0,2	-	-	2,7	-	-
Financial Institutions, average						

* FX indexed assets and liabilities are not included

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

Structure of revenues and expenditures of financial institutions (at year-ends)

Revenues	2005	2006	2007
INTEREST INCOME	18,8	16,7	16,2
FEE AND COMMISSION INCOME	9,0	6,1	5,3
GAINS ON SECURITIES	0,6	0,4	0,5
GAIN ON FOREIGN EXCHANGE RATE	47,0	59,4	58,5
DIVIDEND AND STAKE INCOME	0,1	0,0	0,2
OTHER OPERATING INCOME	22,0	14,2	9,2
INCOME FROM PROPERTY AND OBLIGAITONS VALUE CHANGE	2,5	3,2	10,1
EXTRAORDINARY INCOME	0,0	0,0	0,0
TOTAL Revenues	**100,0**	**100,0**	**100,0**
Expenditures	**2005**	**2006**	**2007**
Interest Expense	19.03	26.96	33.28
Provision for losses	16.37	10.58	20.66
Fee Expenses	8.71	7.38	5.82
Operating Expenses	54.47	53.60	38.87
Extraordinary Expenses	0.52	0.24	0.13
Taxes	0.90	1.23	1.23
Net Profit / Loss (000 EUR)	**4184**	**9.009**	**13.907**

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds	/Total liab.
	000 EUR	%	000 EUR	%
Banks	2.812.986	14,3	4.144.190	26,6

* Assets – own funds

2007 DEVELOPMENTS IN THE SLOVAKIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2007, the National Bank of Slovaia (NBS) implemented its monetary policy in an environment of dynamic economic growth and continued pursuing an inflation-targeting strategy under ERM II in line with its Monetary Programme for the Period until 2008. In view of the commitments arising from EU membership, the task to create conditions for the adoption of the single European currency in January 2009, and the commitment of the Government to reduce the fiscal deficit, NBS set a target rate for year-on-year inflation, expressed in terms of the Harmonised Index of Consumer Prices (HICP), below 2% for December 2007 and 2008, so that the Maastricht criterion for the average 12-month inflation rate is met.

At the end of 2007, HICP inflation stood at 2.5%, representing a slowdown of 1.2 percentage points compared with the end of December 2006. Since August 2007, inflation had been below the Maastricht inflation criterion. The inflation target of NBS for end- 2007 was exceeded, due to steep increases in food and oil prices in the last quarter of 2007. However, these causes represented exclusively inflation cost factors, whith were defined as escape clauses.

Economic and monetary developments in 2007 were characterised by dynamic GDP growth, reaching 10.4% at constant prices. In comparison with 2006, the pace of economic growth accelerated by 1.9 percentage points. The continuing strong GDP growth in 2007 was partly reflected in an increase in wages and employment, a decrease in the number of unemployed, labour productivity growth, and an improvement in the financial results of corporations (profit growth). The deficit in the balance of payments current account decreased in comparison with the previous year, due mainly to a year-on-year improvement in the trade balance.

During 2007, NBS changed the setting of its monetary policy by lowering its key interest rates in March and April by 0.25 of a percentage point, i.e. by a total of 0.50 of a percentage point. NBS also reduced its overnight sterilisation rate by 0.75 of a percentage point in March and by 0.25 of a percentage point in April.

Due to positive developments in the basic macroeconomic indicators, the central parity of the koruna against the euro was revalued by 8.5% with effect from 19 March 2007. The new central rate was set at SKK 35.4424 per euro (originally SKK/EUR 38.4550), the lower compulsory intervention rate at SKK/EUR 30.1260 and the upper rate at SKK/EUR 40.7588.

DEVELOPMENT IN THE BANKING SYSTEM

The Slovak banking sector reported positive trends in 2007. The ratio of the total assets/GDP reached 92, 9%, in comparison with the year 2006 it incrased above 3,3 %.

The asset growth in the banking sector was more moderate than that of pension and mutual funds, as

a result of which its share of the assets of the entire financial market fell slightly against 2006. At the end of 2007, the banking sector assets reached a value of SKK 1,660 billion. The dominant trend in the banking sector in 2007 was a continuing growth of loans to customers. Banks financed mainly the household and business sector, above all small and medium sized enterprises. The volume of corporate loans for real estate financing also continued to go up. Loans to households maintained their high growth rate, the household demand for loans having been influenced mainly by the growth of real estate prices. Banks decreased their investment in securities comparing to the previous year. Holdings of domestic government bonds were the main group to decrease; investment in foreign securities, on the other hand, rose.

In 2007, the growth of loans to customers was predominantly financed from the resources of clients

or by issuing debt securities. The Slovak banking sector is thus one of the few banking sectors in EU

countries not to be dependent on short-term interbank resources in financing loans to customers. Deposits of the retail continued to go up despite a reduction of interest rates; deposits in the domestic currency having grown the most. Deposits of businesses and financial companies except banks also continued to grow.

In 2007, the banking sector maintained its high profit generation level, the number of banks with a year-onyear profit growth increased, although the net profit of the banking sector fell by 1% against the previous year in 2007 to a level of SKK 17.6 billion as at 31 December 2007. Interest income made up the greatest share of bank income in 2007. Their share of gross income moved up from 63% in 2006 to 70% in 2007.

Interest income grew mainly in large banks, because the banks have taken advantage of their market position and increased the interest income by means of a higher volume of loans; the growth of interest income was more moderate in other banks. Non-interest income fell off against the previous year. Income from trading, above all income from debt securities trading, decreased in several banks. The ROE8 of the banking sector declined from 22% in 2006 to 20% in 2007. In addition to profitability, the development of this indicator was negatively affected by an increase of own funds in several banks.

In 2007, capital adequacy in all banks was above the set level of 8%. The trend towards a gradual decline of the average capital adequacy value (an average weighted by the volume of risk-weighted assets) abated in 2007. This value decreased from 13.0% to 12.8% against 2006; in some banks, however, it fell below 9%. Several banks have increased the volume of their own funds by drawing a subordinated debt or from the profit generated in 2006.

In the banking sector, the high growth of loans to households continued, which also increased theexposure of banks to credit risk resulting from those loans in 2007. However, the amount of debt of thehousehold sector at the macro level reached a low level in 2007. The interest rate risk of the banking sector did not change considerably in 2007. In terms of liquidity risk, the situation in 2007 was characterized by a high proportion of funds sterilized in NBS, as well as of other liquid assets.

THE LEGAL AND INSTITUTIONAL FRAMEWORK

Central Bank is responsible for banking supervision and its competences are defined in The National Bank of Slovakia Act.

From the legal point of view the regulation activity begins with the international cooperation while creating advanced systems of the financial market regulation and a new directives drafts. Follow-up implementation of directives is connected with cooperation with the Slovak legislative institutions on creating a new legislative. On this basis a couple of new acts and amendments were published, from which many has had a significant influence on the financial market. Based on these new acts, further supervision authority legislative activity is run off.

Banking supervision is carried out also by means of secondary legislation, licensing decrees and prudential regulations.

MAIN STRATEGIC OBJECTIVES IN 2007

A new area, falling within the competence of the financial market supervision unit from February 2007, is consumer protection by virtue of Art. 3(1) of Act ofthe National Council of Slovakia No. 566/1992 Coll. on NBS as amended.

Slovakia’s membership of the European Union means that foreign regulated entities may operate in the country without an authorization from Národná banka Slovenska, provided that they are authorized to conduct such activities in another EU Member State (the single passport principle).

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN THE YEAR 2007

Rulemaking activities of the supervision unit

In the field of financial market regulation, several acts, regulations, methodological instructions and

recommendations governing the legal environment of regulated entities were adopted in 2007. The purpose of this part is not to enumerate these measures, but rather to draw attention to those which have had the greatest effect on the activities of regulated entities in individual financial market sectors in Slovakia.

The main tasks of acts and regulations adopted in the banking sector in 2007 were an improvement of the criteria for prudential behaviour for banks and investment firms, as well as the criteria for the conduct of business and for keeping records of the conduct of business in the single market in the European Union.

The most important legal regulation for the banking sector and the investment services sector was the

adoption of Act No. 209/2007 Coll. amending Act No. 566/2001 Coll. on securities and investment services and on amendments to certain acts (the Securities Act) as amended and on amendments to

certain acts. This act has implemented the directive No. 2004/109/EC on the harmonization of transparency requirements (the Transparency Directive) and directive No. 2004/39/EC on markets in financial instruments (the MiFID directive). The most important regulation is NBS Decree No. 4/2007 on own funds for the financing of banks and capital requirements for the financing of banks and investment firms and on capital requirements for the financing of investment firms. The decree�even purpose is to make the capital requirements match true risks, to which banks and investment firms are exposed, and to prevent that groups providing financial services in more than one country are subject to an excessive burden resulting from several levels of legal regulation and supervision.

The newly regulated prudential rules, which, in this case, are represented by provisions on capital requirements and rules for the restriction of exposures, are also aimed at reinforcing the risk sensitivity, take into account the risk reduction resulting from the context, in which the individual exposures have arisen, and take into account the considerable progress in the measuring procedures and risk management procedures, which will enable reactions to market innovations and will contribute to the creation of a situation where the financial services of the EU continue to be effective and competitive. For the same reasons, provisions regulating the keeping of the trading book

have been rendered more precisely and provisions on the treatment of credit derivatives and other financial instruments have been introduced.

Licensing activities of the supervision unit

Within its licensing activities regarding financial market entities, the financial market supervision unit of NBS issued a total of 905 decisions in 2007, from which number of decisions in the banking sector and investment firms was 181.

Consumer protection

The responsibilities of NBS in the field of consumer protection result from Art. 3(1) of Act of the National Council of the Slovak Republic No. 566/1992 Coll. on Národná banka Slovenska as amended. 380 petitions, the content of which is discontent of natural and legal persons with the procedure of financial services providers, were submitted to the department from the creation of the client’s protection section in the financial market supervision unit in February 2007. 357 files could be completed and closed out of that number, which corresponds to a 93.95% success in processing petitions. Out of the total number of 380 petitions, 107 concerned the banking sector.

Supervision activities of the supervision unit

In conducting supervision of the supervised entities, NBS ascertains important facts on the supervised entities and their activity, especially deficiencies in their activity, the reasons of the detected deficiencies, the consequences of the detected deficiencies and the persons responsible for the detected deficiencies. Supervision of the supervised entities is performedas supervision on an individual basis for the supervision of individual supervised entities, as supervision on a consolidated basis for the supervision of groups of persons and special-purpose asset pools, part of which are also the supervised entities, and as supplementary supervision for the supervision of financial conglomerates.

Number of on-site supervision in 2007

	Comprehensive	Thematic	Follow-up	Total
Banks	-	10	4	14

In banks, thematic supervisions, focused on selected activities of the supervised institutions or on evaluation of a selected risk, and follow-up supervisions, focused on the assessment of the fulfillment of measures adopted by the supervised institution on the basis of comprehensive and thematic supervision, were conducted.

Foreign exchange supervision focused on the fulfilment of the reporting obligation, above all based on an inducement by the statistics department of NBS. In all cases of the conducted foreign exchange supervision focusing on the fulfilment of the reporting obligation, it was established that the obligation is not fulfilled. Foreign exchange supervision focusing on money exchange activities verified primarily the keeping of prescribed, special records (the issuing of purchase or sale statements, foreign exchange bookkeeping, etc.).

Analytical activities of the supervision unit

A part of the work of the NBS financial market supervisionunit is dedicated to analytical activities. The supervision unit prepares the Analysis of the Slovak Financial Sector on a semi-annual basis. The report is submitted to the Bank Board of NBS and is published in a shortened form[6]. Another regular analysis with semi-annual periodicity is the Report on the State and Development of the Slovak Financial Market, submitted for meetings of the government and of the National Council of the Slovak Republic under the Act on financial market supervision. The main content of the said reports is a description of the most important trends and an evaluation of risks resulting from them. In addition, a macro-stress testing model has been created, by means of which it is possible to estimate the impact of a possible slowdown of the growth of the Slovak economy on the financial sector by means of credit risk, foreign exchange risk and interest rate risk channels.

In 2007, within its analytical activities, the supervision unit also dealt with the impact of the adoption of the euro on the financial sector. The analysis has been also published on the website of NBS in a shortened form.

Special attention has been given to the fast growth of loans provided by banks. Extensive analytical activities have been carried out in examining the impacts of amendments of specific legal regulations on the financial market. It primarily related to amendments to the Act on voluntary auctions, Act on consumer credits (introduction of an interest rate cap), Income Tax Act.

ORGANISATIONAL CHART

Financial Market Supervision Unit

LICENSING AND ENFORCEMENT DEPARTMENT

- Licensing Section
- Cross-border Cooperation Section
- Enforcement Section
- Clients' Protection Section

REGULATORY AND RISK MANAGEMENT METHODOLOGY DEPARTMENT

- Insurance Regulatory Section
- Pension Savings Regulatory Section
- Collective Investment Regulatory Section
- Markets Regulation Section
- Banking Sector and Securities Dealers Regulatory Section
- Financial Market Risks Analyses Section

Risk Measurement Regulatory Models Section

SUPERVISORY DEPARTMENT

Quantitative Analyses Section

Banking Groups Supervisory Section 1

Banking Groups Supervisory Section 2

Insurance Groups Supervisory Section

Capital Market Entities Supervisory Section

Insurance and Reinsurance Mediation and Foreign Exchange Supervisory Section

INTERNATIONAL ACTIVITIES

The basic framework for the international cooperation of supervisors of all Member States of the European Union is the arrangement established at Level 2 by the European Supervisory Committee and at Level 3 by the Committee of European Banking Supervisors. The long-term objective is the achievement of the risk-oriented conduct of supervision of the entire financial market.

In order to exchange information between supervisory bodies of two different countries and to support the secure and sound functioning of financial institutions, the Financial Marker Supervision Unit cooperates with foreign supervisory authorities. The Memorandum of Understanding on Co-operation between the Banking Supervisors, Central Banks and Finance Ministries of the European Union in Financial Crisis Situations entered into effect on 1 July 2005. The Memorandum was concluded in order to improve the stability of financial systems.

COOPERATION WITH OTHER SUPERVISORY BODIES

In exercising supervision of the financial market – in banking, the capital market, the insurance industry and pension saving –NBS follows general procedural rules laid down in Act No. 747/2004 Coll. on financial market supervision and on amendments to certain acts as amended. This Act entered into force on 1 January 2006, the date when NBS assumed the competences of an integrated financial market regulator.

Until 31 December 2005, the said powers with respect to the insurance sector, capital market and pension saving had been exercised by the Financial Market Authority.

The aim of financial market supervision (responsibilityfor which lies with a Vice-Governor of NBS) is to support both the stability of the financial market as a whole and its secure and smooth operation. Based on this fact, the financial market supervision unit conducts financial market regulation, involving mainly the following activities:

- rulemaking activities (it produces draft generally binding legal regulations of NBS in the financial market field, in particular, draft prudential regulation, operational security rules and other requirements for the conduct of business by supervised entities, it participates in the preparation of generally binding legal regulations issued by central government bodies),
- licensing activities (it conducts proceedings, takes first-instance decisions, issues authorizations, approvals and prior approvals, and imposes sanctions and corrective measures),
- supervision activities (it supervises financial market entities through on-site and off-site supervision),
- analytical activities (it produces analyses of the financial market as a whole, as well as of individualfinancial entities).

STATISTICAL TABLES

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

Type of institution	2005	2006	2007
Banks	**18**	**17**	**16**
- Joint stock companies	15	14	13
- State financial institutions	-	-	-
- Building savings banks	3	3	3
Branches	**5**	**7**	**10**
Financial Institutions, total	**23**	**24**	**26**

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

Item	2005	2006	2007
Public sector ownership	1,9	2,0	1,7
Other domestic ownership	8,4	8,4	6,4
Domestic ownership total	**10,3**	**10,4**	**8,1**
Foreign ownership	**89,7**	**89,6**	**91,9**
Financial Institutions, total	**100,0**	**100,0**	**100,0**

Ownership structure of the financial institutions on the basis of assets total (%)

Item	2005	2006	2007
Public sector ownership	1,1	1,2	1,0
Other domestic ownership	1,6	1,8	0,0
Domestic ownership total	**2,7**	**3,0**	**1,0**
Foreign ownership	**97,3**	**97,0**	**99,0**
Financial Institutions, total	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	FOREX assets / Total assets	FOREX liabilities / Total liab.
Bank	49,53	68,00

Return on Asset (ROA) by type of financial institutions (%)

Type of institution	2005	2006	2007
Bank	1,05	1,27	1,04

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

Type of financial institution	2005	2006	2007
Bank	31,8	40,96	33,66

Distribution of market shares in balance sheet total (%)
(groupage of acting banks according to capital)

Type of financial institution	2005	2006	2007
Joint stock companies	73,94	79,95	75,85
State financial institutions	0,00	0,00	0,00
Building savings banks	4,33	4,72	4,22
Branches	21,73	15,33	19,93
Financial institutions, total	**100,00**	**100,00**	**100,00**

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

Assets	2005	2006	2007
Deposits and credits with banks	36,53	28,59	22,70
Granted credits	38,11	45,75	48,66
Securities	23,32	23,30	25,10
Tangible and intangible assets	2,04	2,35	3,53
Total assets	**100,00**	**100,00**	**100,00**
Liabilities	**2005**	**2006**	**2007**
Deposits and credits from banks	25,98	12,22	14,39
Received deposits	59,96	65,16	63,85
Securities	5,99	14,44	11,89
Permanent founds	8,08	8,18	9,87
Total liabilities	**100,00**	**100,00**	**100,00**

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

Type of financial institution	2005	2006	2007
Joint stock companies	170,65	53,92	60,53
State financial institutions	0,00	0,00	0,00
Building savings banks	3,82	4,59	6,51
Branches	107,21	106,53	89,82
Financial institutions, total	**281,68**	**59,66**	**64,09**

/* No compatible with the year 2005 in the result of significant methodological changes in banking reporting

Solvency ratio of financial institutions

Type of financial institution	2005	2006	2007
Joint stock companies	14,30%	12,41%	12,78%
State financial institutions	-	-	-
Building savings banks	21,23%	20,95%	20,10%
Branches	-	-	-
Financial institutions, average	**14,79%**	**12,98%**	**12,34%**

Asset portfolio quality of the banking system

Asset Classification	2005	2006	2007
Claims valued on individual basis without identified impairment (categ I)	x	261 539	198 367
Claims valued on portfolio basis (categ. II)	x	358 397	611 328
Claims valued on individual basis with identified impairment (categ. III)	x	46 177	19 588
From which : failed	x	21 812	22 834

The structure of deposits and loans in 2007 (%)
(at year-end)

	Deposits	Loans
Households	48,80	36,89
Government sector	2,18	2,79
Corporate	37,75	48,40
Foreign	2,97	3,81
Other	8,30	8,11
Total	**100,00**	**100,00**

The structure of deposits and loans in 2007 (%)
(at year-end)

Maturity of Deposits		Maturity of Loans	
At sight	27,41%	Long term loans	2,69%
Within one year	33,39%	Medium-term loans	2,31%
Over one year	39,20%	Short-term loans	94,99%
Total	**100,00%**	**Total**	**100,00%**

Proportion of foreign exchange assets and liabilities
(at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Joint stock companies	12,92	16,58	17,90	19,30	16,42	18,80
State financial institutions	-	-	-	-	-	-
Building savings banks	0,00	0,00	0,00	0,02	0,04	0,04
Branches	7,98	14,60	14,09	51,99	44,22	49,31
Financial institutions, average	**14,92**	**15,50**	**16,38**	**25,57**	**19,91**	**24,09**

Structure of revenues and expenditures of financial institutions (at year-ends)

in th. EUR

Expenditures	2005	2006	2007
Expenses from banking operations	6 065 453	x	x
Operational expenses	740 078	x	x
Provisions and reserves	775 512	x	x
Other operational expenses	390 036	x	x
Extraordinary expenses	0	x	x
Income taxes	61 334	x	x
Revenues	**2005**	**2006**	**2007**
Income from banking operations	7 366 127	x	x
Provisions and reserves	885 245	x	x
Other operational income	148 093	x	x
Extraordinary income	0	x	x
EUR	37,848		

Revenues	2005	2006	2007
Interest income	x	1 956 709	2 434 064
Non interest income	x	425 819	466 032
Income from banking operations	x	89 590	63 258
Other income	x	11 390	8 795
Other operational income	x	187 876	62 923
Expenditures	**2005**	**2006**	**2007**
Interest expenses	x	963 079	1 242 990
Non interest expenses	x	89 332	89 911
Expenses from banking operations	x	86 762	76 893
Other expenses	x	15 599	10 187
Other operational expenses	x	1 014 198	1 158 708
Income taxes	x	132 622	107 539
Other profit/loss (balance)	**2005**	**2006**	**2007**
Foreign exchange operations	x	287 528	263 389
Futures and options	x	-78 052	-34 317
Provisions and reserves	x	-70 237	-59 714
Other	x	675	697
EUR		34,870	33,394

Structure of registered capital and own funds of financial institutions in 2007

Type of financial institution	Registered capital	/Total assets	Own funds
	In mil. EUR	%	In mil. EUR
Joint stock companies	2 610	6,92	21 148
State financial institutions	0	0,00	0
Building savings banks	254	12,13	1 265
Branches	0	0,00	0
Financial institutions, total	**2 865**	**5,76**	**22 414**

SKK/EUR = 33,394

2007 DEVELOPMENTS IN THE SLOVENIAN BANKING SYSTEM

SLOVENIAN MACROECONOMIC ENVIRONMENT IN 2007

Slovenia introduced the euro as the national currency on 1 January 2007. The transition to and exchange of currency proceeded smoothly. The adaptation of all systems was carried out efficiently and according to plans. The population and economy adjusted quickly to the new currency. As expected, there were some cases of prices being "rounded up", particularly in the service and catering sectors. According to most estimates, the introduction of the euro contributed 0.3 percentage points to inflation, partly in December 2006 and the remainder in subsequent months.

The positive effects of Slovenia's entry to the European Union continued in 2007. A favourable economic climate in Europe and the international environment and the resulting high growth in foreign trade contributed to real aggregate economic growth of 6.1%, the highest level achieved since Slovenia's independence. In addition to exports, high growth in domestic spending also contributed to high growth in GDP. This growth was driven by very high investment growth, particularly in construction works. The first signs of a slowdown in high economic growth were seen at the end of 2007. There were several factors in this regard, particularly uncertainties on international financial markets. In addition, there was a slowing in domestic demand. High economic growth resulted in a significant increase in overall employment of 2.7%, and a drop in the unemployment rate to 4.6%. The first indications of pressures on wage increase were seen already at the end of 2006. Wage growth increased throughout 2007, coinciding with high cyclical growth in productivity, primarily in the export sector of the economy.

Inflation, which slowed somewhat in the first months of 2007, began to rise in the middle of the year and even more so towards the end of the year, being well above the euro area average. By the end of the year, the Harmonised Index of Consumer Prices (HICP) had already risen by 5.7%. The majority of this growth was driven by external supply-side shocks, particularly growth in prices of food, commodities and energy. Specific domestic factors, primarily structural problems in the market, also contributed to the above-average increase in Slovenian food prices. The prices of services and infrastructural activities also had an impact on inflation in the second half of the year.

Entry to the European Union resulted in high growth in imports, which was balanced with growth in exports in the first few years. With increased domestic spending, imports began to grow faster than exports, resulting in a significant increase of the external deficit. Rising outflows of interest payments, the payment of earnings to investors and the income and transfers of migrant workers also contributed to the deterioration of the external deficit. The current account deficit stood at 4.9% of GDP in 2007. Due to the prevailing net financing from abroad via debt instruments, net external debt is also rising and amounted to EUR 6.3 billion at the end of 2007.

The general government deficit in 2007 according to the ESA95 methodology stood at 0.1% of GDP. The general government debt stood at 24.1% of GDP, and was lower than at the end of 2006. These figures also form the basis for verifying that the reference values for the deficit and general government debt are met. According to data from the Stability Programme update and given the estimates of the European Commission, Slovenia also met its medium-term goal in 2007, which is defined as a structural deficit in the amount of 1% of GDP.

Growing financial needs of the domestic private sector were primarily linked to high economic and investment activity. At the same time, the process of financial deepening continued, in which the development of the domestic financial sector is catching up with the level of more developed economies. Following entry to ERM II in July 2004, the effectiveness of the Bank of Slovenia's monetary control has diminished due to the convergence of domestic interest rates with European rates. In addition, high inflation in 2007 has led to a significant drop in real interest rates. These factors have stimulated strong growth in bank lending.

STRUCTURE AND OWNERSHIP OF THE BANKING SECTOR

Banks held a market share of 99.4% at the end of 2007 as measured by total assets (the same as the share recorded at the end of 2006), with savings banks accounting for the remainder.

As at 31 December 2007, there were 21 banks operating in Slovenia, eight of which were subsidiaries. In addition, there were three savings banks and three branches of foreign banks (Austrian and French). There was an increase in the number of credit institutions subject to Bank of Slovenia supervision during the course of the year, which occurred with the establishment of SID – Slovenska izvozna in razvojna banka d.d., Ljubljana (arising from the transformation from Slovenska izvozna družba d.d. Ljubljana). On 1 January 2008, a third foreign bank branch, the Ljubljana branch of RCI Banque Societe Anonyme, began operating in Slovenia.

On 3 August 2007, the Ljubljana District Court issued a decision regarding the registration of the change of the name of the bank UniCredit Banka Slovenija d.d. On 3 September 2007, the Maribor District Court issued a similar decision for Raiffeisen banka d.d.

In addition to the eight subsidiaries and three branches that were under majority foreign ownership as at 31 December 2007, there were five banks under full domestic ownership, and eight banks under majority domestic ownership (of these eight banks, two had less than 2% foreign equity). The proportion of equity held by non-residents as measured by equity was unchanged from 31 December 2006 at 37.7% (of which the proportion held by non-residents holding more than 50% stood at 26.7%, or approximately one percentage point less than a year earlier). The proportion of non-resident owners rose most at one bank under majority foreign ownership and at one bank which was under full domestic ownership prior to the change in ownership. The proportion held by non-residents as measured by total assets was 3.9 percentage points more than the proportion held by non-residents as measured by equity as at 31 December 2007. Two banks are under majority state ownership.

The ratio of total assets of banks and savings banks to GDP is rising from year to year, although it remains considerably below the EU average. The average total assets of all credit institutions accounted for 113.2% of GDP at the end of 2007 (106.5% at end-2006).

Table 1: Average total assets and GDP

in EUR million	2005	2006	2007
Average total assets of banks and savings banks	26,247	31,657	37,958
GDP at current prices	27,625	29,736	33,542
Average total assets (as % of GDP)	95.0	106.5	113.2

Source: Bank of Slovenia

BANK PERFORMANCE IN 2007

Total assets of the banking system33 at the end of 2007 stood at EUR 42,195 million. Total assets rose by EUR 8,326 million during the year, an increase of nearly 25% in relative terms. In the first half of the year, year-on-year growth in total assets was approximately 16%, maintaining the moderate trend from 2006, followed by a sharp increase in the second half of the year. The total assets of six foreign and one domestic bank grew faster than the banking system average, while the total assets of one bank fell. Despite the fact that several foreign banks grew faster than the banking system, the group of foreign banks recorded slightly below average growth of 22.7%, and lagged behind the group of domestic banks whose total assets rose by 25,4%.

The pre-tax profit recorded by banks and branches of foreign banks in 2007 amounted to EUR 514 million. This was EUR 120 million or 30.5% up on the banking system's profit in the previous year. This is significantly less than the growth recorded in 2006 (50.7%), which was characterised by the changeover to the International Financial Reporting Standards.

The banking system’s gross income amounted to EUR 1,428 million in 2007, up EUR 212 million, an increase of 17.4% compared to 15.9% a year earlier. The biggest contribution to growth in gross income came from net interest (an increase of EUR 121 million or 17.5%), followed by net trading (an increase of 39.7% or EUR 39 million), net other financial effects (an increase of EUR 26 million or 31.0%, primarily as the result of an increase in dividend income) and net fees and commissions, which were up 8.7% or EUR 27 million.

The average return on assets (ROA) and the average return on equity (ROE) improved in 2007. Average ROA increased by 0.1 percentage points to 1.4% and average ROE rose by 1.2 percentage points to 16.3%.

Gross income per average total assets in 2007 (3.8%) continued to display a declining trend, while the interest margin remained at last year's

[33] Banks and branches of foreign banks

level of 2.2%. The modest decline in the value of gross income per total average assets, similar to past years, and the unchanged interest margin are due to the fact that growth in total average assets marginally outstrips growth in gross income and net interest. The non-interest margin declined compared to the previous year (from 1.67% to 1.64%) due to the modest increase in net fees and commissions and net trading.

The cost efficiency ratio (the ratio of operating costs to average assets) continues to improve (from 2.2% to 2.0%). Growth in operating costs continues to lag significantly behind (just under 13 percentage points) growth in average assets, which had a favourable impact on this ratio.

Capital adequacy rose sharply in the last quarter of 2007, with the ratio reaching the level from the end of 2006. This growth was primarily the result of a capital injection of the largest Slovenian bank and the entry of a new bank at the beginning of the year. At the end of 2007, capital was up 34.9% from the end of 2006, and was 4.6 percentage points higher than the growth in capital requirements of the banking system. The capital adequacy ratio of the Slovenian banking system stood at 11.2% as at 31 December 2007, compared to 11% as at 31 December 2006. All the banks met the minimum capital adequacy requirement as at 31 December 2007.

As at 31 December 2007, no bank exceeded the limits on the maximum allowable exposure to individual clients (25% of capital), to groups of related clients (25% of capital), to other persons in the group (20% of capital) or to persons with a special relationship with the bank (20% of capital).

LEGAL AND INSTITUTIONAL FRAMEWORK FOR SUPERVISION OF FINANCIAL INSTITUTIONS

In Slovenia three supervisory authorities are responsible for supervision and surveillance of financial institutions.

Slovenia's central bank, the Bank of Slovenia, is an independent institution that carries out the tasks conferred upon it by the Bank of Slovenia Act. The responsibility for the implementation and enforcement of the Bank of Slovenia's supervisory function is conferred upon the Banking Supervision Department. The Bank of Slovenia supervises banks and savings banks.

The Securities Market Agency was established as an independent institution by the Securities Market Act which entered into force on 13 March 1994. Continuity was ensured in the Agency's existence and operations when the new Securities Market Act entered into force on 28 July 1999, and when the Market in Financial Instruments Act entered into force on 11 August 2007. The Securities Market Agency supervises investment firms, management companies, investment funds, mutual pension funds and their managers, as well as some other institutions (the Central Securities Clearing Corporation and the Ljubljana Stock Exchange).

The Insurance Supervision Agency was established as an independent entity pursuant to the Insurance Act. Its responsibility is supervision of insurance undertakings, reinsurance undertakings, insurance agents and brokers, insurance agencies and insurance brokerage companies, pension companies, as well as some other institutions (the

Slovenian Nuclear Insurance and Reinsurance Pool, the Slovenian Insurance Association and the Pension Fund Management).

ACTIVITIES OF THE BANKING SUPERVISION DEPARTMENT IN 2007

Licensing

Licensing credit institutions is one of the Bank of Slovenia's most important tasks. In addition to issuing authorisations for the provision of banking services and the provision of mutually recognised and additional financial services, the Bank of Slovenia also issued authorisations to obtain a qualifying holding in the capital of a bank, authorisation to conclude a shareholders agreement and authorisation to hold office as a member of a bank's management board. The decision to issue or reject authorisation is taken by the members of the Governing Board of the Bank of Slovenia based on the opinions of the License Committee and the Committee of the Governing Board of the Bank of Slovenia for the Preparation of Opinions for the Issue of Authorisation to Hold Office as a Member of a Bank's Management Board.

In 2007, the Bank of Slovenia issued a total of 15 authorisations for various types of mutually recognised and additional financial services, for qualifying holdings, for concluding shareholders agreements, and for holding office as a member of the management board. No requests were rejected. The majority of authorisations in 2007 were issued to hold office as a member of the management board of a bank or savings bank and to obtain a qualifying holding in a bank (five of each type) and two authorisations to conclude a shareholders agreement. The number of authorisations issued to provide mutually recognised and additional financial services (three) was lower than in 2006. Authorisations were issued for the following: issuing electronic money, participation in the issuance of securities, and ancillary investment services and administrative services for investment funds.

Pursuant to Directive 2006/48/EC (previously: Directive 2000/12/EC) and Annex I (List of activities subject to mutual recognition), a bank of a Member State that is entitled to provide banking services and other financial or mutually recognised services may also provide these services in Slovenia. It may provide them via a branch (in the case of permanent pursuit of business) or directly (in the case of occasional provision of services without elements of a permanent presence in Slovenia) without authorisation from the Bank of Slovenia. However, the Bank of Slovenia must be notified by the relevant supervisory authority in the home Member State. In 2007, the Bank of Slovenia received 69 notifications of the direct provision of services, and no notifications of the provision of services via a branch. A list of banks of EU Member States that have carried out the notification procedure for the provision of banking services and other financial services in Slovenia via their home banking supervisors is available on the Bank of Slovenia's website. Different arrangements apply to banks of third countries. Banks of third countries may only provide banking and other (mutually recognised) financial services via a branch, a Bank of Slovenia authorisation being required to establish the branch.

On-site examinations of banks and savings banks

In 2007, the Banking Supervision Department continued to conduct its on-site examinations of banks and savings banks according to its internal risk assessment methodology, which is based on assessing the risks and quality of the control environment. On-site examinations of specific areas were prevalent among the on-site examinations conducted, practice having shown that shorter and thus more frequent and more detailed examinations of specific areas are more significant and more needed than full scope on-site examinations. Follow-ups of the implementation of requirements from orders and recommendations were frequent, as it was not always clear from the documentation submitted whether the banks had rectified the irregularities.

In 2007, examiners from the Banking Supervision Department placed particular attention during on-site examinations on the readiness of banks and savings banks for the introduction of the Capital Requirements Directives (Basel II), which entered into force on 1 January 2008 (except capital requirements for markets risks which have been in force since the beginning of 2007). On-site examinations were conducted in two, two-month cycles, in the spring and autumn. An internal methodology was drawn up before the on-site examinations of banks and savings banks were conducted.

In 2007, the Bank of Slovenia received two applications from banks under foreign ownership for authorisation to use advance approaches to calculate capital requirements for credit (IRB)34 and operational (AMA)35 risk. One bank is expected to use advanced approaches to a limited extent already in 2008.

In addition to the aforementioned activities, the following areas were subject to the most frequent examinations: credit risk, market risks with an emphasis on interest rate and liquidity risk, ensuring an adequate level of capital (capital adequacy), stable deposits, structured products, etc. On-site examinations to determine the risk profiles of banks and savings banks also continued in accordance with risk assessment methodology.

In 2007, there were 83 on-site examinations conducted, among which were 42 on-site examinations of the preparations of banks and savings banks for Basel II, several follow-ups of the implementation of measures and a range of one-day examinations or the monitoring of operations of a specific area. Based on the findings of examinations at banks and savings banks, the Bank of Slovenia may issue recommendations, warnings or orders. In 2007, the Bank of Slovenia issued four orders to rectify breaches, several orders and resolutions extending deadlines from orders, rejecting appeals and terminating proceedings against banks, and several letters to the management and supervisory

[34] Internal Ratings-Based Approach

[35] Advanced Measurement Approach

boards of banks and savings banks with a range of warnings and recommendations for improving operations. In 2007, the Banking Supervision Department participated in three misdemeanour proceedings in which the Bank of Slovenia issued two misdemeanour decisions. The proceedings have not yet been concluded.

In 2007, the Bank of Slovenia issued 12 authorisations to banks and savings banks for the inclusion of individual instruments in the calculation of capital, most frequently for the inclusion of hybrid instruments and subordinated debt in Tier 1 additional capital.

In line with the Core Principles for Effective Banking Supervision, the Banking Supervision Department of the Bank of Slovenia maintains regular contacts with the management of banks and savings banks through channels including regular annual meetings held at the completion of an examination or separately. These meetings are primarily intended to assess the bank or savings bank performance and to become familiar with its strategy. The exchange of views and information between supervisors and the management of banks or savings banks is also a prerequisite for timely and appropriate action in the event of operating difficulties. The Banking Supervision Department continued this practice in 2007, and conducted a number of interviews with the management of banks and savings banks.

Secondary legislation

In 2007, secondary legislation affecting banking supervision was issued primarily due to the new Banking Act and due to continuing harmonisation with Directive 2006/48/EC and the opinions of the Capital Requirements Directive Transposition Group (CRDTG).

CO-OPERATION WITH OTHER DOMESTIC SUPERVISORY AUTHORITIES

Co-operation with the other two Slovenian supervisory institutions (the Securities Market Agency and the Insurance Supervision Agency) took the form of an exchange of views and information between the institutions. Co-operation between the supervisory authorities is regulated by the Rules on Co-operation between Supervisory Authorities and the signed Memoranda of Understanding (MoUs). The Co-ordinating Committee was founded on the basis of the rules, presided over by the minister for finance, with cooperation from the Governor of the Bank of Slovenia, the presidents of the councils of experts at the Securities Market Agency and Insurance Supervision Agency.

The MoUs set out the form and content of co-operation and information exchange in more detail. There is also the Committee for Co-operation between Supervisory Authorities (hereinafter: the Committee), which is in charge of implementing the tasks passed by the Co-ordinating Committee. The Committee comprises the Member of the Governing Board of the Bank of Slovenia, the Director of the Banking Supervision Department, the Director of the Securities Market Agency and the Director of the Insurance Supervision Agency.

Supervisory institutions are required to inform the relevant supervisory institution if they identify any infringements that fall under the auspices of other institutions.

CO-OPERATION WITH FOREIGN SUPERVISORY AUTHORITIES

In 2007, the Banking Supervision Department continued to examine subsidiaries and other financial organisations abroad that are owned by Slovenian banks. On the basis of MoUs (the Bank of Slovenia concluded 12 MoUs with foreign supervisory institutions), the Banking Supervision Department participated in 6 on-site examinations of the operations of banks abroad under the majority ownership of the largest Slovenian bank (two of these on-site examinations were conducted independently, i.e. without the cooperation of host supervisors). Four annual discussions with foreign supervisors were conducted at the Bank of Slovenia (with De Nederlandsche Bank – DNB, Central Banking Authority of Kosovo – CBAK, Finanzmarktaufsicht – FMA and Oesterreichische Nationalbank – OeNB) and at the registered office of a foreign supervisory agency (Bundesanstalt für Finanzdienstleistungsaufsicht – BaFin).

ORGANISATIONAL CHART OF THE BANKING SUPERVISION DEPARTMENT

Governor Radovan Jelašić

Vice-Governor -	Vice-Governor Ana Gligorijević	Vice-Governor Mira Erić-Jović	Secretary General Gordana Petković	Head of Governor's Office
Monetary System and Policy Department	Foreign Exchange Department	Bank Supervision Department	Accounting and Finance	National Payment Card Centre
Payment System	International Relations Department	Insurance Supervision Department	IT	Legal Department
Economic Analyses and Research Department	Treasury Department	Pension Funds Supervision Department	Human Resources	Internal Audit
		Center for Financial Services Consumer Protection and Market Supervision	General Affairs	Public Registers and Enforced Collection
			Office Administration	Institute for Manufacturing Banknotes & Coins
			Branches	

STATISTICAL TABLES

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

Type of credit institution	2005	2006	2007
Banks	22	22	24
Savings banks	3	3	3
Credit institutions, total	**25**	**25**	**27**

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

Type of ownership	2005	2006	2007
Central Government	18,2	17,9	15,1
Other domestic ownership	46,9	44,4	47,2
Domestic ownership total	65,1	62,3	62,3
Foreign ownership	34,9	37,7	37,7
Bank, total	**100,0**	**100,0**	**100,0**

Ownership structure of the financial institutions on the basis of assets total (%)

Item	2005	2006	2007
Central Government	22,7	22,4	18,6
Other domestic ownership	38,7	37,4	39,7
Domestic ownership total	61,3	59,9	58,4
Foreign ownership	38,7	40,1	41,7
Bank, total	**100,0**	**100,0**	**100,0**

Concentration of assets by the type of credit institutions as at 31 December 2007

Type of credit institution	The first three largest (%)	The first three largest (%)
Banks	49,0	59,9
Savings banks	100,0	

Return on Asset (ROA) by type of financial institutions (%)

Type of credit institution	2005	2006	2007
Banks	1,00	1,25	1,36
Savings banks	1,09	0,60	1,00

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

Type of credit institution	2005	2006	2007
Banks	12,72	15,07	16,29
Savings banks	17,15	8,60	15,45

Distribution of market shares in balance sheet total (%)
(groupage of acting banks according to capital)

Type of credit institution	2005	2006	2007
Banks	99,5	99,4	99,4
Savings banks	0,5	0,6	0,6
Credit institutions, total	**100,0**	**100,0**	**100,0**

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

Assets	2005	2006	2007
Cash and balances with CB	2,1	3,1	1,4
Loans to banks	9,8	9,1	9,6
Loans to customers	55,1	60,3	66,8
Securities	27,7	22,3	17,2
Other assets	5,3	5,2	4,9
Liabilities	**2005**	**2006**	**2007**
Deposits from banks	28,7	31,9	37,6
Deposits from customers	54,7	51,7	45,8
Liabilities from securities	3,4	2,9	2,3
Capital and subordinated liabilities	10,9	11,3	11,9
Other liabilities	2,3	2,2	2,5

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

Type of credit institution	2005	2006	2007
Banks	19,7	17,7	16,6
Savings banks	1,4	1,8	3,0

Solvency ratio of financial institutions

Type of credit institution	2005	2006	2007
Banks, average	10,5	11,0	11,2
Savings banks, average	12,9	9,9	9,7

Assets Portfolio Quality of the Banking System in EUR thousands

Asset Classification	2005	2006	2007
A	21 009 396	24 364 110	29 942 739
B	2 982 401	5 923 145	9 324 671
C	596 937	494 267	550 088
D	281 418	373 072	286 353
E	340 115	426 423	437 731
Classified Total	**25 210 267**	**31 581 017**	**40 541 582**
Specific Provisions	1 170 081	1 240 700	1 313 061

The Structure of Deposits and Loans as at 31 December 2007 (%)

	Deposits	Loans
Households	62,5	22,7
Government sector	7,8	1,6
Corporate	19,0	60,2
Foreign	3,5	7,8
Other	7,3	7,6
Total	**100,0**	**100,0**

The Structure of Deposits and Loans by maturity as at 31 December 2007 (%)

Maturity of Deposits		Maturity of Loans	
At sight	37,3	Long-term loans	65,1
Within one year	53,7	Medium-term loans	
Over one year	9,1	Short-termn loans	35,0
Total	**100,0**	**Total**	**100,0**

Proportion of foreign exchange assets and liabilities (at year-ends)

Type of the financial institutions	FOREX assets / Total assets			FOREX liabilities / Total liab.		
	2005	2006	2007	2005	2006	2007
Banks	40,5	45,9	6,0	43,1	47,1	5,0
Savings banks	2,6	3,9	0,1	2,7	5,6	0,1

Profit ans Loss Account of Banks

	2005	2006	2007
	EUR thousands	EUR thousands	EUR thousands
Net interest income	631 463	689 847	816 357
Net fees and commissions	281 709	308 537	336 333
Net income from FI held for trading	70 822	97 190	135 747
Net other	64 644	120 031	144 582
Gross income	**1 048 638**	**1 215 605**	**1 433 019**
Operating expenses	647 391	702 130	755 894
- labour costs	342 466	367 434	401 808
Net income	**401 247**	**513 475**	**677 125**
Net provisions and impairments	-140 092	-119 798	-162 954
Profit before taxation	**261 155**	**393 677**	**514 171**

Structure of revenues and expenditures of financial institutions (at year-ends)

in th. EUR

Type of credit institution	Registered capital	/Total assets	Own funds	/Total liab.
	EUR thousands	%	EUR thousands	%
Banks	575 613	1,4	3 483 158	8,2
Savings banks	9 171	3,6	16 881	6,6

2007 DEVELOPMENTS IN THE UKRAINIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Acceleration of economic processes has been in place in Ukraine during 2007.

Upside dynamics of the economic development was marked by a high domestic demand secured by a growth of real available incomes of individuals and profits of economic entities and increasing of equity investments, as well as by a significant inflow of foreign investments.

Main macroeconomic indicators of the year 2007 featured a certain growth. Growth rate of: the real GDP reached 7.6% in 2007 year, value of the industrial products – 10.2%, real available incomes of the population – 12.8%.

Investment activity was maintained at a high level – equity investments grew by 29.8%.

2007 also marked a significant growth of the foreign capital inflow to Ukraine. Thus, net growth of direct foreign investments into the Ukrainian economy amounted to USD 8.7 bln., and as of 1 January 2008, their total volume reached USD 29.5 bln. In 2007, the highest increase of non-resident capital stemmed from such countries as Cyprus, the Netherlands, Sweden, Russia, Austria, Great Britain, Germany.

The year 2007 was a year of acceleration of inflationary processes in Ukraine. Inflation reached 16.6%. Such situation was caused by the objective global process of price-hikes of food products and energy carriers.

Level of the officially registered unemployment has been further falling in 2007 – from 2.8% of the population physically able to work as of 1 January 2007 down to 2.3% as of 1 January 2008.

DEVELOPMENT IN THE BANKING SYSTEM

As of 1 January 2008, 175 banks were licensed by the National Bank of Ukraine for the conduct of banking transactions, including: 143 banks (81.7 % of the total number of banks, who were issued a license for the conduct of banking transactions) – joint stock companies (of which: 101 banks (57.7%) – open joint stock companies, 42 banks (24.0%) – closed joint stock companies), 32 banks (18.3%) – limited liability companies. 6 banks were incorporated in 2007.

Banking sector substantially improved the main indicators of the activity during 2007 year.

Bank capital growth reached almost 76%. Due to this, the capital of banks in relation to the GDP reached 10%.

Assets of Ukrainian banks increased by 76%. In general, according to the results of 2007, total assets were estimated at 87% in relation to the GDP.

The lending by Ukrainian banks grew by 80% (up to 68% of the GDP).

Liabilities of banks were also increasing – by 78% in 2007 (up to 74% of GDP).

Main factor of liabilities' increase was a rapid growth of deposits of individuals. In general, in 2007 the volume of deposits of individuals, which are traditionally the main share of the banking resource basis, grew by 54% up to UAH 164 bln. (EUR 22 bln.). At the same time, the volume of deposits of legal entities increased by 46% up to UAH 112 bln. (EUR 15 bln.).

In 2007, a number of banks with the foreign capital increased from 35 to 47 banks (26.7% of the total number of active banks in Ukraine), of which a number of banks with 100% foreign capital increased from 13 to 17 banks (9.7 % of the total number of active banks).

As of 1 January 2008, the amount of foreign capital exceeded to UAH 15 bln. (EUR 2 bln.). Share of the foreign capital in the total registered capital of Ukrainian active banks increased from 27.6% to 35.0%.

Foreign capital in Ukraine is represented by 23 countries. The highest share in the total amount of the foreign capital belongs to Austria (20.3%), Cyprus (20.3%), France (12.5%), Russia (9.7%), the Netherlands (8.2%), Poland (7.9%) and Sweden (6.1%).

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 activity in Ukraine is regulated by the following legislative acts:

- "On Banks and Banking";
- "On the National Bank of Ukraine";
- "On Economic Entities";
- "On Individuals Deposit Guarantee Fund";
- "On Securities and Stock Market";
- "On Prevention and Counteraction of Legalization (Laundering) of Earnings Received from Criminal Activities";
- "On Ensuring Creditors Claims and Lien Registration";
- "On Mortgage";
- "On Mortgage Lending, Operations with Consolidated Mortgage Debt and Mortgage Certificates";
- "On Mortgage Bonds";
- "On Organization of Forming and Circulation of Credit Histories".

According to the provisions of the Laws of Ukraine "On the National Bank of Ukraine" and "On Banks and Banking" banking regulation and supervision in Ukraine are effected by the National Bank of Ukraine.

The National Bank of Ukraine performs state regulation of banking activities in the form of administrative and indicative regulation.

Supervisory activities of the National Bank of Ukraine extend to all banks, their units, affiliated and related persons of banks in the territory of

Ukraine and abroad, as well as other legal entities and individuals with regard to their abidance by the requirements of the Law "On Banks and Banking" and regulatory acts concerning the performance of banking activities.

The National Bank of Ukraine performs banking supervision on the individual and consolidated basis and applies enforcement measures for the breach of acting laws and regulations on banking.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2007

In order to enhance the efficiency of regulation of banking activities and banking supervision "Priority Lines for Further Development of Regulation of the Banking Activities and Banking Supervision in Ukraine for the Period Until the Year 2010" have been elaborated on the basis of further implementation of the Basel Core principles, optimization of organizational framework and functions of structural units of the banking supervision of the head office and regional offices of the National Bank of Ukraine.

Development and further improvement of the banking activity and supervision was focused on the following directions:

- Improvement of the off-site supervision and on-site examination of banks;
- Improvement of the procedure for the registration and licensing of banks and banking unions;
- Improvement of the procedure for the temporary reorganization and liquidation of banks;
- Supervisory strengthening in the field of counteraction to the legalization of incomes derived illegally;
- Ensuring the banking system transparency;
- Stage-by-stage implementation of the procedure for the capital adequacy assessment in accordance with the requirements of the document published by the Basel Committee on Banking Supervision „International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (Basel II);
- Development of cooperation with other domestic supervisors as well as with foreign supervisory authorities and international organizations in the field of banking supervision;
- Professional development and material incentives to banking supervisors.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2007

In 2007, the National Bank of Ukraine continued activity aimed at the improvement of the methodological and regulatory basis for the banking regulation and supervision, aimed at mitigation of risks inherent in the banking activities and ensuring compliance with the requirements of the

Basel Core Principles and legislation of the European Union on banking supervision.

The National Bank of Ukraine participated in the preparation of the revised version of the law "On Amendments to Certain Laws of Ukraine (regarding the banking regulation)" (reg. # 0884 of 23.11.2007), which was passed by the Verkhovna Rada of Ukraine (Parliament of Ukraine) in the first reading on 11 January 2007 and which refers to the following issues:

- improvement of the procedure for the state registration of banks;
- more distinct regulation of the procedures for the specification of beneficial bank owners and property structure;
- improvement of cooperation of banking supervisors and external bank auditors, and conduct of bank audits.

Jointly with representatives of banks and banking associations, the National Bank of Ukraine prepared a draft of amendments to the Law of Ukraine «On Banks and Banking», aimed at the implementation of generally accepted principles of corporate governance and strengthening of the corporate governance practice in Ukrainian banks. The draft law provides for the following:

- strengthening of the role and responsibilities of a bank supervisory board, which envisages expansion of its authorities and functions, establishment of requirements for the professional eligibility of supervisory board members;
- distinct distribution of functions of the supervisory board and management board of a bank;
- avoidance of a conflict of interests in the activities of bank managers or employees;
- ensuring efficient operation and independence of risk management functions;
- strengthening requirements for the organization of the internal audit function.

Amendments were introduced to the Regulation on the Procedure for the Formation and Utilization of Provisions for the Compensation of Possible Losses From Bank Credit Operations, according to which a term "portfolio of homogeneous consumer loans" was implemented, procedure for its formation was established and higher provisioning ratios for such loans and for loans in the foreign currency were set, procedures for the assessment of borrower's financial conditions and loan category definition were toughened, which would facilitate the formation of provisions for credit risks in more adequate volumes (regulations of the Board of the NBU of 19.03.2007, No. 83 and of 06.07.2007, No. 248).

With a view to improve the quality of assets invested by banks into securities, facilitate the conduct by banks of transactions with securities on the organized market (at stock exchanges), the procedure for the formation by banks of provisions for securities' transactions and resolution of problem issues, arising during banks' conduct of such transactions, the Board of the National Bank of Ukraine approved the Regulation on the Procedure for the Formation of Provisions for Transactions with Securities by Ukrainian Banks (Resolution No. 31 dated 02.02.2007). The afore-mentioned regulation provides for the establishment of a fair (real) value of securities being circulated on the organized stock exchange market, and those securities, whose quotation of market prices is unavailable, as well as the formation of the relevant provisions for the risks, pertinent to such transactions.

With a view to minimize risks, related with the lending to individuals, as well as to provide for banks' compliance with legislative requirements regarding the protection of consumers' rights (borrowers - individuals), the Board of the National Bank of Ukraine approved of the Rules for Furnishing the Information by Ukrainian Banks to a Consumer Regarding the Lending Terms and Total Cost of a Loan (Regulation of the NBU Board No. 168 dated 10.05.2007). Pursuant to these Rules, banks should furnish to a consumer full information about the total cost of a loan considering all accompanying services before concluding and at the time of concluding a loan agreement, and in case of disbursement of a loan in the foreign currency – warn consumers about possible FX risks, which would enable a borrower – individual to perform a real assessment of his/her financial capacities and solvency at the time of signing a loan agreement.

Activities were launched in the area of taking into consideration of market risks while determining a bank regulatory capital adequacy pursuant to the requirements of the Basel Committee document "Amendment to the Capital Accord to Incorporate Market Risks". The first result of these activities was introduction of amendments to the Instruction on the Procedure for the Regulation of Ukrainian Bank Activities Regarding Incorporation of Foreign Exchange Risk During the Computation of the Regulatory Capital Adequacy (Regulation of the Board of the NBU No. 458 dated 17.12.2007).

ORGANIZATIONAL STRUCTURE OF THE BANKING SUPERVISORY AUTHORITY

Within the National Bank of Ukraine the supervisory function is performed by the following structural divisions:

- Banks Registration and Licensing Department;
- Banking Regulation and Supervision Methodological and Regulatory Support Department;
- Department for On-site Inspections of Banks;
- Department for Banks Off-site Supervision;
- Department on Issues of Avoiding Using Banking System for Legalization of Criminal Gains and Financing Terrorism;
- Department for Reorganization and Termination of Banks Activity;
- Banking Supervision Legal Support Division;
- Supervision Quality Control Unit.

General management of afore-mentioned structural divisions' activities is carried out by Directorate on Banking Regulation and Supervision and the Deputy Governor of the National Bank of Ukraine who is responsible for banking supervision.

INTERNATIONAL ACTIVITIES

Throughout 2007, the National Bank of Ukraine continued activities, aimed at establishing and strengthening cooperation with foreign supervisors in the area of banking supervision. Cooperation with host supervisors of branches and subsidiary companies of Ukrainian banks abroad, as well as with home supervisors of banks which have subsidiary companies on the territory of Ukraine, aroused special interest.

In 2007, the National Bank of Ukraine signed bilateral Memoranda of Understanding on cooperation in the area of credit institutions' supervision with the China Banking Regulatory Commission, Commission for Banking Supervision of the Republic of Poland and a new Cooperation Agreement in the area of credit institutions' supervision with the National Bank of the Republic of Belarus.

COOPERATION WITH OTHER SUPERVISORY BODIES

Exercising the functions of banking supervision, the National Bank of Ukraine coordinates the activity and information exchange with other supervisory bodies within the country, in particular, the State Commission for Regulation of Financial Services Markets in Ukraine, the State Securities and Stock Market Commission, the Ministry of Finance, State Tax Administration.

Within the framework of Memorandum of cooperation and coordination of the activities between the authorities carrying out the state regulation of financial services markets, on 12 December, 2007 the National Bank of Ukraine and the State Commission for Regulation of Financial Services Markets in Ukraine signed the Memorandum regarding information exchange between the National Bank of Ukraine and the State Commission for Regulation of Financial Services Markets in Ukraine aimed at fostering information exchange between these supervisory bodies.

OTHER RELEVANT INFORMATION FOR 2007

In June-July 2007, a Joint Mission of IMF and World Bank performed the update of assessment of Ukraine's compliance with the Core Principles for Effective Banking Supervision, elaborated by the Basel Committee on Banking Supervision, within the framework of the Financial Sector Assessment Program (FSAP).

It is noteworthy that Ukraine was the first country of Eastern Europe where the assessment of compliance with the Basel Core Principles was performed according to their new version of 2006.

According to the results of this update Ukraine is fully or largely compliant with 25 out of 30 principles of the Basel Committee (considering that the 1st principle has 6 constituents to be assessed separately).

STATISTICAL TABLES

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

Type of financial institution	2005	2006	2007
Banks	165	170	175
Financial institutions, total			

Concentration of assets by the type of credit institutions as at 31 December 2007

Type of institution	The first three largest (%)	The first three largest (%)
Banks	23,1	33,1
Credit Cooperatives		
Financial Institutions		
Savings Cooperatives		
Specialized Credit Institutions		

Return on Asset (ROA) by type of financial institutions (%)

Type of institution	2005	2006	2007
Banks	1,31	1,61	1,50
Credit Cooperatives			
Financial Institutions			
Savings Cooperatives			
Specialized Credit Institutions			

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

Type of institution	2005	2006	2007
Banks	10,39	13,52	12,67
Credit Cooperatives			
Financial Institutions			
Savings Cooperatives			
Specialized Credit Institutions			

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

Assets	2005	2006	2007
High liquidity assets	16,4	12,7	10,3
Credit portfolio	70,1	76,4	78,4
Investments in securities	6,4	4,1	4,6
Accounts receivable	0,5	0,4	0,3
Fixed and intangible assets	5,3	5,3	4,5
	0,9	0,8	0,9
Other assets	0,4	0,3	1,0
Assets in total	100,0	100,0	100,0
Liabilities	**2005**	**2006**	**2007**
Funds of the NBU	0,4	0,5	0,3
Correspondent accounts of other banks	1,9	2,5	2,4
Budgetary and off-budget funds	1,1	0,6	0,8
Inter-bank credits and deposits	14,7	22,8	29,1
Funds of economic entities	32,5	25,8	21,1
Funds of natural persons	38,5	35,6	30,9
Funds of non-banking financial institutions	2,9	2,5	2,7
Credits from international and other financial organizations	1,8	2,8	3,7
Own debt securities	1,5	2,1	3,7
Subordinated debt	1,4	1,6	1,5
Accounts payable on transactions with banks and bank customers	0,9	0,6	0,5
Other liabilities	2,4	4,7	3,3
Liabilities in total	**100,0**	**100,0**	**100,0**

Solvency ratio of financial institutions

Type of credit institution	2005	2006	2007
Banks	14,95	14,19	13,92
Financial institutions, average			

Structure of revenues and expenditures of financial institutions (at year-ends)

Revenues	2005	2006	2007
	100,0	100,0	100,0
Interest earned	69,1	72,7	74,6
Income from commissions	21,0	20,0	18,3
Performance of trade transactions	4,3	4,9	4,2
Other operating income	4,7	1,9	2,3
Other income	0,8	0,5	0,6
Recovery of written off assets	0,04	0,2	0,03
Unexpected income	0,01	-	-
Expenditures	**2005**	**2006**	**2007**
	100,0	100,0	100,0
Interest paid	43,0	44,2	46,5
Commission paid	2,1	2,0	2,3
Other operating costs	6,3	5,2	5,5
General administration expenditures	34,4	32,4	30,6
Allocation to reserves	11,0	12,5	11,8
Extraordinary expenditures	0,0	0,0	0,0
Income tax	3,2	3,7	3,3

MAIN GROUP EVENTS OF THE YEAR 2007

20th Annual BSCEE Members' Conference
Budapest, Hungary, May 29 – June1, 2007

The Chairmanship of the BSCEE Group in 2007 was held by the Hungarian Financial Supervisory Authority and the position of the Chairman was entrusted to Mr. Peter Schiffer, Deputy Director General of the HFSA. Therefore, the 20th Annual BSCEE Members' Conference was hosted by the Hungarian Financial Supervisory Authority, on 29 May – 1 June 2007 in Budapest. During the Conference the National Bank of Serbia was accepted as the 20th member of the BSCEE Group.

The first day of the two day conference was devoted to implementation and practical experiences in respect of cp3, 4, 5 and 25 of core principles for effective banking supervision (October 2006), especially access to information about the fitness and propriety of boar members and senior management. Presentations were made by the representatives of the following institutions:

- Basel Committee on Banking Supervision, *Recent developments at BCBS and the implementation of Basel II*
- European Commission, *Corporate Governance vs. Social Responsibility*
- Financial Market Authority, *Assessment Process of Shareholders*
- Hungarian Financial Supervisory Authority, *Presentation on the Hungarian experiences*
- Central Bank of the Russian Federation, *Experiences of the Central Bank of the Russian Federation in respect of CPs 3, 4, 5 and 25 of the Core Principles for Effective Banking Supervision*

The second day focused on the Corporate Governance vs. Social Responsibility. Presentations were made by the representatives of the following institutions:

- Hungarian Financial Supervisory Authority, *Presentation of the Hungarian Financial Supervisory Authority experiences*
- Czech National Bank, *Banks Corporate Governance and Social Responsibility*
- National Bank of Poland, *Polish Experiences on Corporate Governance*

CREDIT RISK
BSCEE-FSI Regional Seminar
Belgrade, Serbia, June 7-8, 2007

The National Bank of Serbia in co-operation with the Financial Stability Institute and BSCEE Secretariat organized a regional seminar for BSCEE member countries on "Credit Risk" which was hosted by the National Bank of Serbia, on 7-8 June 2007in Belgrade.

PRACTICAL IMPLEMENTATION OF PILAR II
TIBS – FSA – Bank of Spain
Warsaw, Poland, June 4-5, 2007

Training Initiative for Banking Supervision (TIBS) of the National Bank of Poland in co-operation with the Financial Services Authority and the National Bank of Spain organized a regional seminar for BSCEE member states on Practical implementation of Pillar II, which took place in Warsaw on 4-5 June 2007.

FINANCING THE REAL ESTATE MARKET
Warsaw, Poland, June 25-29, 2007

Training Initiative for Banking Supervision (TIBS) of the National Bank of Poland organized a seminar for the BSCEE Group countries on *Financing the real estate market* which was hosted by the National Bank of Poland, 25-29 June 2007 in Warsaw.

BSCEE contact persons meeting

was organized at the premises of the National Bank of Poland in Warsaw in January 2007.

BSCEE CONTACT LIST

Supervisory Authorities of the Member Countries	Address	Web-site address
Bank of Albania	*Sheshi Skënderbej No. 1 Tirana, Albania*	www.bankofalbania.org
Austrian Financial Market Authority	*Praterstraße 23 1020 Wien Austria*	www.fma.gv.at
National Bank of the Republic of Belarus	*Fr. Skorina Av. 20 Minsk 220008 Republic of Belarus*	www.nbrb.by
Federal Banking Agency of Bosnia and Herzegovina	*Kosevo 3, Sarajevo Bosnia and Herzegovina*	www.fba.ba
Bulgarian National Bank	*1, Alexander Blattenberg Square Sofia 1000, Bulgaria*	www.bnbank.org
Croatian National Bank	*TRG Hrvatskih velikana 3 Zagreb 10002, Croatia*	www.hnb.hr
Czech National Bank	*Prague 1,Na Prikope 28 115 03 Czech Republic*	www.cnb.cz
Estonian Financial Supervision Authority	*Sakala 4, Tallin 15030, Estonia*	www.fi.ee
Hungarian Financial Supervisory Authority	*Krisztina krt. 39. 1013 Budapest, Hungary*	www.pszaf.hu
Financial and Capital Market Commission	*2A Kr. Valdemara str. Riga, LV-1050, Latvia*	www.fktk.lv
Bank of Lithuania	*Jogailos str. 14 Vilnius, 2629 Lithuania*	www.lbank.lt
National Bank of Macedonia	*Post Box 401, Kompleks banki bb Skopje, 1000 Macedonia*	www.nbrm.gov.mk
National Bank of Moldova	*Renasterii Ave. 7, Chisinau MD-2006 Moldova*	www.bnm.org

Central Bank of Montenegro	*Bulevar Svetog Petra Cetinjskog 7 Podgorica Montenegro*	www.cb-cg.org
Polish Financial Supervision Authority	*23, Syreny str. Warsaw, 01-150 Poland*	www.knf.gov.pl
National Bank of Romania	*25, Lipscani str. Bucharest 1, Romania*	www.bnro.ro
Central Bank of the Russian Federation (Bank of Russia)	*12 Neglinnaya str. Moscow, 103016, Russia*	www.cbr.ru
National Bank of Serbia	*Kralja Petra 12, 11000 Belgrade, Serbia*	www.nbs.yu
National Bank of Slovakia	*Imricha Karvasa 1, 813 25 Bratislava, Slovakia*	www.nbs.sk
Bank of Slovenia	*Slovenska 35 1505 Ljubljana , Slovenia*	www.bsi.si
National Bank of Ukraine	*Institutskaya Str. 9. 252007, Kiev Ukraine*	www.bank.gov.ua
Secretariat BSCEE	*23 Syreny Street, 01-150 Warsaw, Poland*	*www.bscee.org*