BSCEE
Review
2010

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 and Operational Bylaws that determine its organizational structure and the rules governing its operations. As of today it is signed by twenty two member institutions from twenty one member countries: Albania, Austria, Republic of Belarus, Bosnia and Herzegovina (Banking Agency of the Federation of Bosnia and Herzegovina and Banking Agency of Republika Srpska of 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 2010 Mr. Igor Davkov, General Director of the Division of Supervision, Banking Regulation and Financial Stability in the National Bank of the Republic of Macedonia chaired the Group.

In 1996 the Members of 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, leaders' 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 KNF – 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 2010. 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 other regional seminars. The 23rd Annual Members' Conference was organized by the National Bank of the Republic of Macedonia in Ohrid, Macedonia on June 15-17, 2010.

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.

We hope that you will find this publication informative and useful. We are 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.

BSCEE Secretariat

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2010 DEVELOPMENTS IN THE BANKING SYSTEM OF THE MEMBER COUNTRIES

2010 DEVELOPMENTS IN THE ALBANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The performance of the Albanian economy during 2010 was marked by a gradual improvement of aggregate demand, consolidation of macroeconomic stability and decreasing risk premiums. According to available data, the Albanian economy grew by 3.6% during the first nine months of 2010, while the average annual inflation rate has fluctuated around the BoA objective (2-4%), the budget deficit to GDP ratio decreased by 4 percentage points, while preliminary data suggest that the current account deficit to GDP decreased by 5 percentage points. Economic growth was mainly driven by foreign demand and the increase of Albanian exports, while domestic demand has recorded a moderate performance. The latter has been also affected by the consolidation of public finances and the decreasing budget deficit during 2010, while consumer spending and investment have come to a standstill due to insecurities about future developments and the performance of unused capacities. The development of Albanian economy has been mainly driven by the growth of service and industry sectors. Interest rates in financial markets have been decreasing during 2010, reflecting the monetary policy conducted by BoA and the lower borrowing by public sector in domestic financial markets. The exchange rate has continued to follow a slight depreciating course in line with structural changes in the Albanian economy and the performance of international financial markets.

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

The banking system continues to be the backbone of the financial system in Albania. The total assets amount to 81 percent of the GDP, demonstrating an increasing intermediary role of the banking sector in the economy[1]. During 2010, the total assets of the banking system have increased with a pace twice that of the previous year. Total assets have increased by 12 percent, or 104.3 billion Lek. The banking system continues to be financed mainly by deposits. Investments are primarily in loans to the private sector. At of the end of 2010, total loan portfolio of the banking system has reached a value of 491 billion Lek. The growth of the loan portfolio has been slow, but with an increasing yearly trend compared to the previous two years. Due to higher credit risk, banks have invested their funds in the interbank money market, mainly in the foreign banks. As a result, the second largest type of investment is "Treasury and inter-banking investment", with a value of 296 billion Lek or 30 percent of the total assets of the banking sector. Non-performing loan portfolio has increased by further deteriorating the credit loan quality. However, the pace of the non-performing loans is slowing down compared to the previous year. The most problematic

[1] Total assets/ GDP (2009) = 77.5 %

loans continue to be in the private sector and in the long term loans. The quality of loans denominated in the local currency has declined during the second half of the year. The financial performance of the banking system has improved as a result of an increasing banking activity and a decreasing cost of funds. The banking sector remains well capitalized, with a capital adequacy of 15.4 %.

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

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, conducting financial analyses of financial data received periodically, on-site inspections, corrective actions and cooperation agreements with other supervisory authorities abroad.

During the year 2010 banking supervision (BS) continues the revision process of the regulatory framework in accordance with the provisions of the banking law, the Basel Committee recommendations, the EU directive and the development in the Albanian banking system. In this regard, some regulations and amendments have been approved by Supervisory Council (SC) of Bank of Albania (BoA) and some others have been prepared and have to be completed during 2011.

►List of regulations and some amendments to the regulation in force approved by SC during 2010 (www.bankofalbania.org/banking supervision):

	Regulation	Approved	A brief description
1.	Abrogation of decision nr.28, dated 25.03.09 "On impediment (prohibition) of profit distribution by banks and foreign banks branches".	**Decision nr.10, dated 24.02.2010**	This decision was taken by supervisory authority aiming to create a better cushion for banks on risks administration process due to the situation of the global financial crises.
2.	Regulation "On risk management in the activity of non-bank financial institutions"	**Decision nr.25, dated 24.03.2010**	The purpose of this regulation is to set out the rules for the management of risk in the activity of non-bank financial institutions.
3.	"Unified Reporting System for non-bank financial institutions".	**Decision nr.26, dated 14.04.2010**	According to the new requirements of the regulation nr. 25, dated 24.03.2010 the new unified reporting system has been provided in compliance with these ones.
4.	Operational Policy on Banking Supervision.	**Decision nr.27, dated 14.04.2010**	According to the new Strategy on Banking Supervision as well as the new Organizational Structure of the Supervision Department, the whole revision of the existing operational policy on banking policy has been performed.

5.	Regulation "On defining decision-making levels in supervision of banking and financial activities".	**Decision nr.36, dated 26.05.2010**	This regulation lays down the level of competencies of managing bodies in decision making process of the BoA in relation to its supervisory function, through the application of the principle of devolution of competencies, closer to the persons that discharge the relevant specific functions.
6.	Regulation "On the open foreign exchange positions risk management"	**Decision nr.48, dated 14.07.2010**	The purpose of this Regulation is to set out the rules and criteria for the calculation, monitoring, reporting and the supervision of the banks' open foreign exchange positions, in order to manage the foreign exchange risk.
7.	Some amendments to the Regulation "On supervision of savings and credit associations and their unions"	**Decision nr.65, dated 29.09.2010**	The purpose of these amendments is to create the possibilities for the savings and credit associations (SCA) to lend in longer term especially for the agriculture areas and businesses, setting the requirements on specific policies and credit risk administration process.
8.	Some amendments to the Regulation "On risk arising from large exposures of banks"	**Decision nr.65, dated 22.12.2010**	These amendments stipulate eased measures by the authority during the global financial crisis for the management of the concentrated exposure (BoA reduced from 25 to 10 % – the maximum exposure of banks with their mother banks or within the group in order to promote the mitigation of concentration risk of bank investments in the international financial markets). This restriction was reversed, with the maximum allowed exposure restored to 20 %.
9.	Some amendments to the Regulation "On Capital Adequacy" and Regulation "On risk management in the activity of non-bank financial institutions".	**Decision nr.89 and nr. 90, dated 22.12.2010**	These amendments focused on updating the list of OECD countries applicable in counter-parties to which the banks are exposed, taken into consideration in the calculation of weighted assets with the risk for purposes of calculating capital adequacy.
10.	The manual "On bank conservatorship and liquidation procedures".	**Decision nr. 11207 of the Deputy Governor, dated 31.12.2010**	The purpose of this manual is to set out the main procedures to be used by conservator and liquidator during both processes (conservatorship and liquidation) as it is foreseen in the banking law.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2010

In 2010, the main objective of the supervisory authority was the adoption of a risk based supervisory approach. In this context:

- The implementation process started in January 2010 with the necessary changes in the department's organizational structure. The structure did not only add new human resources to the department, at about 25%, but it also added new supervisory tools and products currently at use, in line with this risk based philosophy.

- The Supervisory Authority has undertaken a variety of regulatory and methodological changes and revised or created new working manuals.
- The supervisory practice, both on-site and off-site was adapted to reflect the new risk based approach in operational terms.

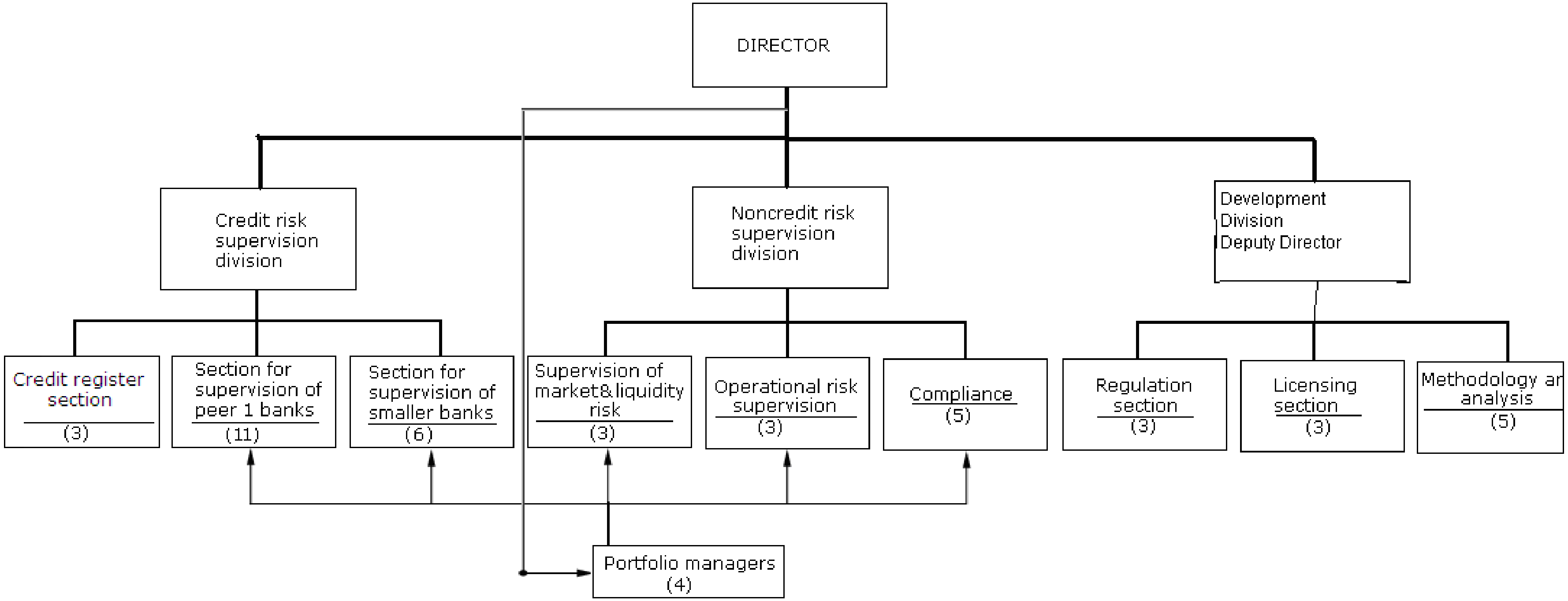
THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

During 2010, a new unit within the Supervision Department was established, the Portfolio Managers Unit. In addition to the other tasks, a special focus was given to the on-site inspections of banks and non-bank financial entities, full scope examinations as well as targeted ones. These examinations were mainly oriented on the credit activity of the banks and their level of capitalization.

Also frequent meeting with banks management were organized with the intention to discuss on the specific supervisory concerns.

Also during 2010, the Credit Registry has added in its reporting database other financial intermediaries, beside banks. Such financial intermediaries include credit and micro-credit firms. The broader base of users was accompanied by changes in the required regulation. Currently, Credit registry is in the process of including leasing companies as well.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

Relations with foreign supervisory authorities (supervisory authorities from the countries of origin of the foreign banks) are becoming more and more important in our practice. On the other hand, the association process with European Union structures requires more effective cooperation between national supervisory authorities and foreign ones. During 2010, continuous information was exchanged, especially for certain banks which are part of large European banking groups. This process was conducted in line with the mutual agreements between home and host authorities for the supervision of banking groups with presence in Albania. The Portfolio Managers also participated in supervisory colleges organized in this context.

Starting December 2010, Bank of Albania is involved in a Twinning Project (TP) with Banca d'Italia with the financial support of the European Commission. The Supervision Department's activities are mostly related with the areas of banking supervision.

The three main activities consist on the following:

- **Off-site and on-site supervision** – Banca d'Italia provides assistance to Bank of Albania staff for implementing a risk assessment process as well as for incorporating the main stages of a modern Risk Management System (identification, evaluation, and monitoring, corrective actions). The experience gained through this process shall be reflected in the process of drafting new manuals and developing existing ones by BoA in compliance with the Basel II and III requirements and methodologies. The reference target is a risk-based supervision approach, (a supervisory activity which is able to monitor banking risks both on an individual basis - micro-prudential supervision and for the whole system - macro-prudential supervision), while promoting sound risk management practices.
- **Regulatory and reporting** – Banca d'Italia provides assistance and consultations for drafting and implementing of Capital Requirements Directive (CRD), related reporting forms, IFRS, and other reporting standards as well as developing the regulatory framework in compliance with the best international practices of banking supervision.
- **IT support** – the aim of this activity is to create a new supervisory data model. On the other hand the existing data collection system will be replaced by a new one with a fragmented use of information sources.

COOPERATION WITH OTHER SUPERVISORY BODIES IN ALBANIA

During 2010, Bank of Albania has continuously cooperated with the Financial Supervisory Authority through exchange of information as well as carrying out joint on site examinations to verify the activity of the insurance companies in their banking accounts. On the other hand the Bank of Albania has cooperated with the Competition Authority, reflected in continuous communication and correspondence with this institution in order to enhance fair and transparent competition in the banking and financial system. There has been as well a close collaboration with the General Directorate of Prevention of Money Laundering. Supervision Department (Compliance, AML/ Transparency Unit) has attended in meetings organized by both bodies (BoA and GDPML) as well as by Albanian Banking Association. These meetings have been very important especially in the reporting of the National Strategy for Financial Crime Investigation, an important part of which is the institutional work to prevent money laundering and financing terrorism.

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	14	14	14
Branches of foreign credit institutions	2	2	2
Cooperative banks	n.a.	n.a.	n.a.
Banking sector, total:	**16**	**16**	**16**

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

Type of financial institution	2008	2009	2010
Public sector ownership	0.23	0	0
Other domestic ownership	5.86	6.74	7.92
Domestic ownership total	6.09	6.74	7.92
Foreign ownership	93.91	93.26	92.08
Banking sector, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	62.43	80.78	n/a
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**55.62**	**71.98**	**14**

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

Type of financial institution	2008	2009	2010
Commercial banks	12.77	7.79	11.32
Branches of foreign credit institutions	2.57	-15.47	-18.49
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**11.35**	**4.58**	**7.58**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	84.90	87.88	89.10
Branches of foreign credit institutions	15.10	12.12	10.90
Cooperative banks	0	0	0
Other	0	0	0
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2008	2009	2010
Financial sector	n/a	n/a	n/a
Nonfinancial sector	n/a	n/a	n/a
Government sector	n/a	n/a	n/a
Other	n/a	n/a	n/a
Liabilities	**2008**	**2009**	**2010**
Financial sector	n/a	n/a	n/a
Nonfinancial sector	n/a	n/a	n/a
Government sector	n/a	n/a	n/a
Capital	8.57	9.57	9.40
Other	n/a	n/a	n/a

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks	16,4*	16,1*	16,2*
Cooperative banks			
Banking sector, total:	16,4	16,1	16,2

` (* - for Basel I; ** - for Basel II)

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

Asset classification*	2008	2009	2010
Non financial sector**	6.64%	10.48%	13.96%
- households	5.50%	8.21%	11.77%
- corporate	7.60%	12.35%	15.49%

*share of non-performing loans
**data refer to the total loans portfolio (there is no separate information on financial/non financial sector loans)

The structure of deposits and loans of the banking sector in 2010 (%) (at year-end)

	Deposits	Loans
Households	84.73	30.10
Government sector	3.26	2.64
Corporate	12.01	67.26
Other (excluding banks)	0	0
Total	**100.0**	**100.0**

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

P&L account	2008	2009	2010
Interest income	60,159.25	62,892.89	69,332.68
Interest expenses	29,380.91	31,530.11	32,350.32
Net interest income	30,778.34	31,362.78	36,982.36
Net fee and commission income	4,611.84	4,640.85	5,353.33
Other (not specified above) operating income (net)	1,963.15	2,070.83	1,857.49
Gross income*	37,353.34	38,074.46	44,193.17
Administration costs	20,123.72	21,770.48	23,491.22
Depreciation	n/a	n/a	n/a
Provisions	8,454.13	11,841.48	13,078.47
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	8,454.13	11,841.48	13,078.47
Profit (loss) before tax	8,708.88	4,486.80	8,029.12
Net profit (loss)	7,335.68	3,544.50	6,715.13

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	649.70	613.37	36.34	0
Cooperative banks	n/a	n/a	n/a	n/a
Banking sector, total:	649.70	613.37	36.34	0

2010 DEVELOPMENTS IN THE AUSTRIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The Austrian economy reentered a positive growth path in 2010. Real GDP increased by 2.1%, broadly reaching 2007 levels in the annual average, thus exceeding euro area average growth by 0.4 percentage points. An analysis of intrayear dynamics shows that the economic path continued to be marked by above-average volatility. After posting stagnating quarterly growth in early 2010, the economy staged an exceptionally strong recovery in mid-2010. The growth rates observed in the second and third quarters of 2010 were roughly twice as high as the long-term average. Austrian GDP gained strength mainly on the back of powerful economic growth in Germany, Austria's major trading partner. As in previous upswings, external trade thus proved to be the mainstay of the current recovery.

The manufacturing industry was a key beneficiary of the dynamic export activities. By the end of 2010, this sector had been able to offset nearly two thirds of the drop in production by almost 20% brought about by the crisis. Thanks to growth in exports and industrial production, the contractionary phase of the investment cycle also came to an end in mid-2010. Manufacturers reported above-average levels of capacity utilization and investments in plant and equipment began to climb again for the first time in nearly two years. By contrast, construction investment delivered a disappointing performance. Investment in both residential and civil engineering construction has continued to contract. The growth of consumer spending had a stabilizing effect during the crisis. In 2010, however, private consumption did not provide an additional positive impact on growth, given moderate wage settlements, even though labor market conditions improved. The revival of the Austrian economy is projected to continue in 2011 and 2012.

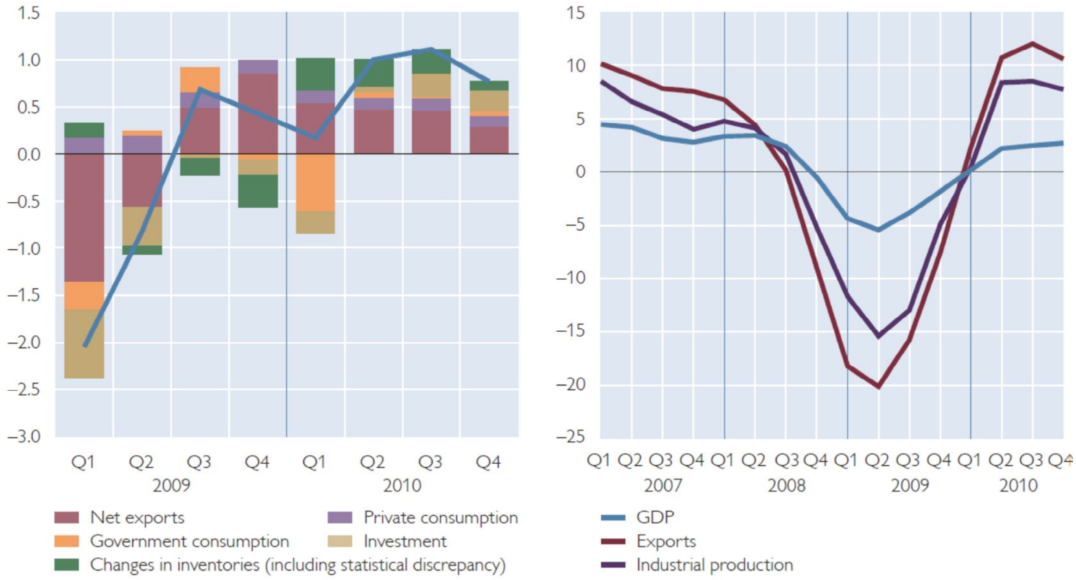
GDP Growth in Austria

Contribution of Demand Components to GDP Growth (real, seasonally adjusted)

Contributions to growth in percentage points, change on previous period in % (GDP)

Developments of GDP, Exports and Industrial Production (real, seasonally adjusted)

Change on the same period of the previous year in %



Source: Eurostat, Statistics Austria.

Given the scale of the slump in business activity, the economic and financial crisis has had only a relatively minor impact on the Austrian labor market. The unemployment rate (Eurostat definition) rose from 3.8% in 2008 to 4.8% in 2009. And, in the current upswing, the labor market developments are again proving to be a pleasant surprise. Stepped-up growth in 2010 boosted payroll employment substantially; the unemployment rate sank to 4.4%. Leading indicators such as the rising number of job vacancies, moreover, imply that this positive trend is likely to continue.

The budgetary notification of March 2011 brought significant revisions of the general government debt and deficit figures for previous years, reflecting above all the more stringent rules on public accounting for the debt of government units introduced with Eurostat's new Manual on Government Deficit and Debt (MGDD). Henceforth, liabilities of units not classified to the general government sector which are ultimately absorbed by taxpayers need to be booked as deficit increasing or debt increasing already when the debt is incurred.

The deterioration of the general government deficit ratio (Maastricht definition) from 4.1% of GDP in 2009 to 4.6% in 2010 is attributable above all to one-off effects following recapitalization measures for nationalized banks. Adjusted for these capital transfers, which drove up the deficit further, fiscal developments were actually better than expected, on account of low interest rate levels and relatively favorable economic conditions. The debt ratio slightly exceeded 72% of GDP at the end of 2010. The Austrian parliament adopted sweeping fiscal consolidation measures in late 2010. Revenue-side measures included the introduction of a stability tax ("bank tax") and the increase of petroleum and tobacco taxes. On the expenditure side, the spending caps for the federal budget adopted in spring 2010 were translated into actual measures, with spending cuts in the context of family transfer payments and pension payments accounting for the lion's share. The finance ministry expects these measures to help bring the general government deficit (Maastricht definition) back below 3% of GDP by 2013.

After dropping to a historical low of 0.4% in 2009, HICP inflation quickened to 1.7% in 2010. This increase was mainly attributable to the significant surge in fuel prices. At the same time, food prices augmented markedly in the second half of the year.

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

While the Austrian banking system came out of the economic and financial crisis relatively unscathed, the process of domestic structural reforms has been sluggish. A positive point to highlight from a financial stability perspective is that the moderate deleveraging process which had commenced in the second half of 2008 continued in 2010. Consolidated leverage, which indicates the level of debt financing, dropped to a ratio of 17.1 (end-2009: 19.2) in the course of the year. Total assets (unconsolidated) to GDP stood at approximately 346% in the end of 2010.

In terms of lending to domestic nonbanks, banks' lending growth in 2010 was subdued. At EUR 321.5 billion, the volume of loans outstanding was approximately 0.5% higher at end-December 2010 than a year earlier. As at the same date, foreign currency loans accounted for some 18.3% of total outstanding loans. The slight growth was traceable to increased lending to households (in particular as housing loans) as well as to nonfinancial corporations, while loans to nonbank financial intermediaries declined year on year.

The additional measures taken by the Financial Market Authority (FMA) and the OeNB since the onset of the financial crisis which aimed to reduce the systemic risk resulting from foreign currency lending and repayment vehicle-linked loans have been quite effective. Between October 2008 and March 2011, foreign currency lending to households diminished by 15.3% or EUR 6.2 billion adjusted for exchange rate changes, and in the fourth quarter of 2010, foreign currency loans accounted for only 4% of new loans to households. The outstanding volume of loans – some EUR 38 billion at the end of March 2011 – will, however, continue to pose a risk to Austrian banks for some time to come, as they will remain vulnerable to adverse exchange rate and asset developments (in case of repayment vehicle-linked loans).

By historical standards, the risk provisions created by Austrian banks (new net loan loss provisions) for lending operations are still high but nonetheless considerably lower than in the crisis year 2009. The lasting deterioration of credit quality resulted in a hike of loan loss provision ratios. In this context, regional differences, especially between Austria and the CESEE region, remain considerable. In 2010, the unconsolidated loan loss provision ratio of Austria's banking sector – which does not cover foreign subsidiaries' business activity and is hence clearly focused on Austria – climbed only slightly to some 3.2%. The loan loss provision ratio of all subsidiaries was almost twice as high by comparison at 6.5%. Lively economic activity in Austria and the CESEE region, however, suggests that the deterioration of credit quality will slow down further in the future. Driven by the lower volume of new credit risk provisions in comparison with 2009, the result of Austrian banks improved notably in 2010.

Austrian banks were also able to increase their operating results in 2010. Unconsolidated operating profits climbed by 20.5% on a year-on-year comparison. Cost-to-income ratio improved to 58.6% due to a stronger rise in operating income (+10.4%) in comparison to +4.2% of operating expenses. Above all, securities and investment earnings grew above average. Favorable market developments also lead to an improvement of net fee and commission income as well as a higher trading income. Annual result of Austrian banks in the year 2010 (unconsolidated) reached EUR 4.2 bn. Overall, the return on asset of domestic business was 0.4%, compared to 0.5% on a consolidated basis, i.e. including activities of subsidiaries abroad. The narrow interest margin on new domestic retail business is an indicator for lower domestic structural profitability, which is essentially a consequence of intense competition. Despite a slight increase of the interest margin on new business with nonbanks at end-2010, it remained clearly below the average euro area, even though the latter shrank somewhat in the course of the year, partly due to higher deposit rates in some euro area countries. The result for 2011 is likely to remain in the range of the 2010 result.

In 2010, the liquidity situation in Austria's banking system worsened slightly. The main drivers were a deterioration of net claims on banking deposits, a decline in net redemptions as well as a strong decrease of the "Other" category, which mostly contains reverse repos. Thanks to the high share of retail deposits, Austrian institutions depend on the international money market to a below-average degree by international comparison.

The capital situation of Austrian banks has improved but will need to be strengthened further in light of the CESEE risk exposure profiles of Austrian banks and the higher capital ratios of their international peers. Another point to consider is that a significant part of capital increases at some institutions in recent years is attributable to government participation capital, which will have to be paid back.

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

The Austrian Financial Market Authority (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 („banks"), payment institutions, insurance undertakings, pension funds, staff provision funds, investment funds, investment service providers, credit rating agencies and stock exchanges, as well as for prospectus supervision. The FMA is also responsible for monitoring trading in listed securities to ensure that it is carried out properly and for monitoring issuers' compliance with information and organisation obligations. The FMA is an integral part of the European System of Financial Supervisors (ESFS) and represents Austria in the relevant European institutions, closely cooperating with the network of supervisors and actively contributing to its work.

In accordance with its statutory mandate, the tasks of the Banking Supervision Department of the FMA include in particular the performance of licensing, authorisation and notification procedures, the performance of supervisory procedures, the official supervision of intra-bank models, commissioning the OeNB to carry out on-site inspections, officially monitoring action taken by the credit institution to remedy shortcomings, the interpretation of the law with regard to banking supervision, collecting and analysing qualitative information, evaluating analysis results with respect to official measures and the involvement in legislation related to banking supervision, sending departmental representatives to international bodies, supervising branches and representative offices of foreign credit institutions as well as cross-border supervision within the scope of the Consolidating Supervision concept.

In Austria, the reform of the supervisory framework in 2008 helped lay the foundation for keeping in step with the rapid evolution of financial markets. One of the primary aims of the supervisory reform was to establish clear responsibilities and to optimize the communication interfaces between the Oesterreichische Nationalbank (OeNB) and the FMA. The reform ensures that supervisory reviews are quick, effective and well-documented. The OeNB and the FMA are assured of having the same level of information at all times, which also reinforces both institutions' cooperative partnership in supervising the Austrian financial market.

The supervisory reform has resulted in further improvements in joint action and enabled closer supervisory collaboration, which has made it possible to take even more timely and efficient prudential measures to strengthen financial stability in Austria since beginning of 2008.

As supervisory authority the FMA supervises compliance with legal provisions and due diligence obligations in the area money laundering and terrorist financing and takes appropriate steps in case of violation of these responsibilities. With effect from 1 January 2011, a new FMA division dedicated to the "Prevention of money laundering and terrorist financing" has been in place. Its areas of responsibility include reviewing compliance with due diligence duties, conducting on-site inspections and other forms of inspection and, where necessary, leading the corresponding official supervisory procedures. The new division has also been assigned responsibility for interpreting the law in this area, and is also to represent the FMA in the relevant national and international bodies. This creation of a dedicated division and the transfer of additional powers in this area mean that the number of anti-money laundering on-site inspections can be more than doubled (2010: 11, 2011: 25 (planned)). By pooling resources and expertise within a single specialist division, any peculiarities on the financial market anywhere in Austria can be followed up in a uniform and consistent manner.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2010

The FMA's main strategic objects in the field of banking supervision for 2010 were:

- The activities of the FMA regarding bank internal risk measure models are conducted competent and efficient.

- The cooperation with the OeNB (Oesterreichische Nationalbank) is further optimized in the sense of the supervisory reform and contributes to a higher qualitative banking supervision.
- The preparation of the operative banking supervision regarding recent changes to the Capital Requirement Directive is fulfilled.
- The supervisory regime for payment institutions is established by publishing the relevant Regulations and setting up the processes.
- The adherence with the requirements as regards the self regulation on Foreign Currency Loans[2)] is permanently supervised and possible supervisory measures are taken.
- The procedures and operations are in line with the operative supervisory processes. The involvement of other divisions which are concerned is guaranteed.
- The cross border cooperation as regards supervisory colleges and the selected participation in international committees is further developed.
- Relevant topics regarding banking supervision are evaluated whether they are relevant for publishing and are therefore actively communicated to the stakeholders.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2010, the banking supervisory authority made use of its right to demand information from credit institutions in about 382 cases. Apart from these formal ad-hoc information request the FMA based its decisions on various sources such as the credit institution's financial statements, the reports of auditors and state commissioners, as well as on standardized meetings with the management of numerous credit institutions, the so called management talks. Another important source of information is the on-site inspections and analyses conducted by the OeNB. In 2010, the OeNB conducted 39 on-site inspections on behalf of the FMA. At the end of 2009 the FMA decided at short notice to focus its inspection activities on nine specialised banks, which explains the relatively high number of on-site inspections commissioned in 2009.

As banking supervisor the FMA is also responsible for granting, extending or withdrawing licenses. In 2010 the FMA granted one new license, enlarged seven existing and revoked four licenses.[3] One license application had to be refused due to formal deficiencies.

As mentioned above the FMA may take supervisory measures if there is danger to the fulfillment of a credit institution's obligations (danger of insolvency) or if a credit institution persistently breaches the law. In 2010 none of these measures had to be taken.

Other activities include inter alia in 2010:

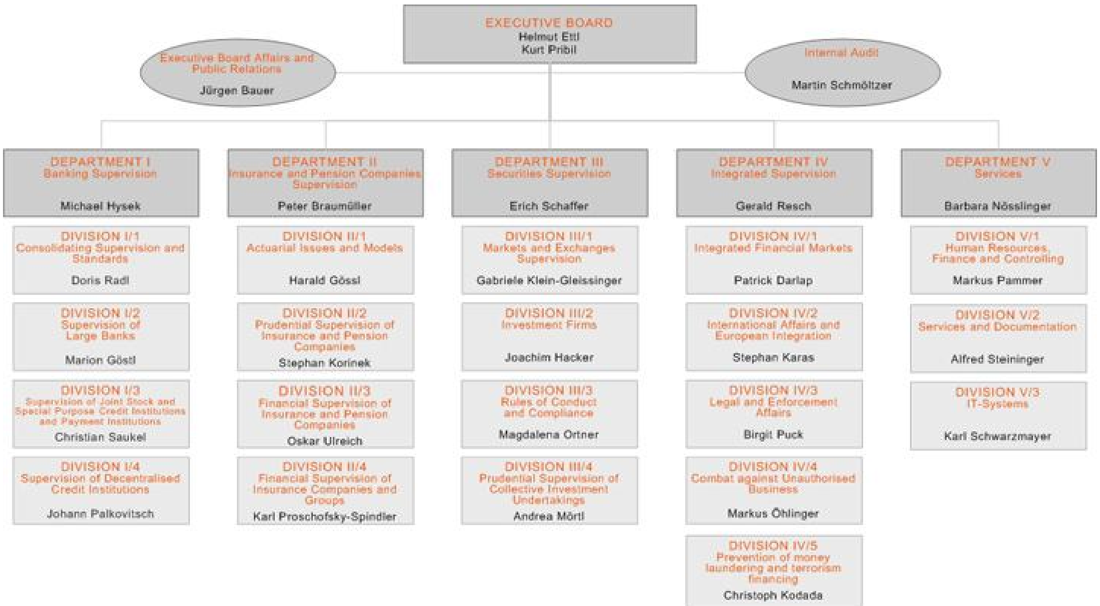
- 11 models approvals relating to the Austrian market
- 20 anti-money laundering company visits at credit institutions
- Consolidating Supervision: Following the negotiations in 2009 regarding the further institutionalisation of the supervisory colleges, the first

[2] Finally implemented as an amendment to the FMA Minimum Standards for Granting and Managing Foreign Currency Loans and Loans with Repayment Vehicles (FMA-FXTT-EMS) of 22nd of March 2010.

[3] Extending a license means to allow an existing credit institution to conduct additional banking business.

cooperation agreements ("Article 131 agreements") were concluded with other supervisory authorities in 2010. These agreements define rules and procedures for each supervisory college as well as the flow of information between the authorities. By the end of 2010, the FMA had set up four supervisory colleges with nine Member States in total. The supervisory colleges will become increasingly important in the future since Article 77c BWG, having entered into force on 31 December 2010, stipulates that in the future supervisory colleges are to consult in specifying any additional capital requirements and to coordinate the supervisory authorities involved in times of crisis.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY AND COOPERATION WITH OTHER SUPERVISORY BODIES

The FMA endeavours to further improve the cooperative dialogue and the existing contacts with the supervisory authorities of Central and Eastern and South Eastern Europe in particular. To this end, within the scope of strategic partnerships, it focuses its operative cooperation on regulators from those countries where the Austrian financial industry has a particularly strong presence.

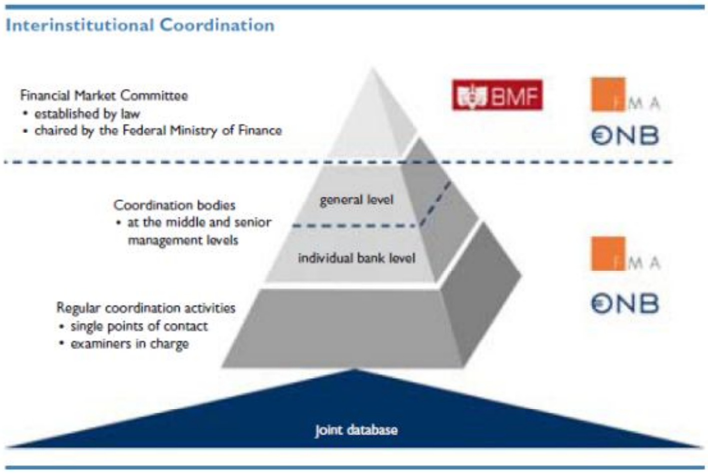
Accordingly, bilateral meetings were held as part of strategic partnerships and continued cooperation in the various areas of supervision and at various different levels. One focus of these meetings was, inter alia, the exchange of information on supervised institutions and groups engaging in cross-border activities (cooperation meetings, supervisory colleges in the banking sector, as well as coordination committees in the insurance sector).

In 2010, meetings were held with banking supervisors from Croatia, Czech Republic, Germany, Hungary, Russia, Slovakia and Serbia and with insurance supervisors from Kosovo, Macedonia and Montenegro and Serbia. Furthermore, representatives of the FMA attended the XXIII Conference of the Group of Banking Supervisors from Central and Eastern Europe (BSCEE Group) in Ohrid, Macedonia. The conference particularly addressed the issue of lessons learnt from the financial crisis as well as the resilience of the banking sector. In 2010 the FMA also participated at the Integrated Financial Supervisors' Conference, the annual forum for the exchange of information and experience among the integrated supervisory authorities.

Based on the relevant provisions of the supervisory laws, bilateral and multilateral cooperation agreements, i.e. Memoranda of Understanding (MoUs), may be concluded between the FMA and foreign supervisory authorities in the banking, insurance and securities sectors. In 2010, one MoU was concluded in the banking sector with the Central Bank of the Russian Federation, while in the insurance sector one MoU was concluded with the Macedonian Insurance Supervision Agency (ISA). The FMA was furthermore one of the first signatories to join the Multilateral Memorandum of Understanding of the International Association of Insurance Supervisors in 2010.

COOPERATION WITH OTHER SUPERVISORY BODIES IN AUSTRIA

In handling official activities related to supervision, the FMA must, as far as possible, draw on analysis and inspection results as well as the results of the expert opinions prepared by the OeNB during model approval procedures, in addition to using information from third parties or from the respective bank. This collaborative setup calls for intensive, timely coordination between the two institutions. To this end, the FMA and the OeNB each appoint a single point of contact (SPOC) for every bank and for every banking sector. These SPOCs exchange information frequently and are thus a key communication bridge between the two authorities.



For their part, banks are also required to appoint a SPOC as a first contact and communication partner for the FMA and the OeNB and as a hub for prudential issues. Every supervised bank was requested to provide the supervisory authorities with the name of a SPOC and of a deputy SPOC for the SPOC's absence.

The SPOC's tasks include harmonizing internal positions and obtaining authorizations, clearing relevant documentation for release, scheduling appointments, naming contacts for special issues, and coordinating investigations and national as well as international research. Moreover, the SPOC serves as the first contact for urgent matters related to supervision.

To fulfill his or her responsibilities effectively, a bank's SPOC must exhibit a basic knowledge of supervisory matters (risk management, accounting, supervisory law) and must be authorized to provide information about supervisory issues. If the SPOC is not a management executive, he or she should nevertheless be authorized to consult senior management and if necessary the supervisory board to agree on a joint course of action on important issues.

Also, the established forums in which basic prudential issues are harmonized between the FMA and the OeNB, namely the middle management-level forum and the senior management-level coordination forum, were supplemented by a bank forum (Einzelbankforum – EBF) which is in charge of handling issues at the individual bank level and ensuring that all relevant facts and perspectives will be taken care of in the decision making process. The new forum also ensures that broad agreement is reached on the approach chosen (at the middle or senior management level, depending on the issue). This reconciliation process is supported by a database, the joint information system. Various reporting data, relevant information available from the FMA's supervisory activities as well as data and results of OeNB analyses are filed in this database.

Moreover, a Financial Market Committee was established at the Federal Ministry of Finance to foster cooperation and the exchange of views, and to provide advice on financial market and financial stability issues. The committee has one member each from the FMA, the OeNB and the Federal Ministry of Finance and meets at least once every quarter. The committee discusses national legal and overall financial market policy issues, and discusses the Austrian position on drafts of European legislation. Moreover, the Financial Market Committee also coordinates action during financial crises; in this function, it acts as the domestic standing group established in line with the 2008 Memorandum of Understanding.[4]

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

Extension of the FMA Minimum Standards for Granting and Managing Foreign Currency Loans and Loans with Repayment Vehicles

Owing to the risks inherent in and the systemic relevance of foreign currency loans and loans with repayment vehicles, the FMA believes that there must be a more significant reduction in the risks arising from banking transactions with regard to the total volume of foreign currency loans granted to households. To this end, the FMA was working on an extension of the related Minimum Standards FMA-FX-MS and FMA-TT-MS with respect to limiting business risks in banking in the course of 2009. This extension is in line with its statutory remit to act, when carrying out its duties, in consideration of the national economic interest in a functioning banking system and the stability of the financial market. One of the core aims is to achieve a sustained reduction in the Austria-wide total volume of foreign currency loans to consumers; foreign currency loans must lose their status as a standardised mass product. The amendment to the FMA Minimum Standards for Granting and Managing Foreign Currency Loans and Loans with Repayment Vehicles (FMA-FXTT-EMS) was finally published on 22 March 2010 and can be found at www.fma.gv.at > providers > banks > minimum standards > FMA-FXTT-EMS.

Amendments to the Federal Banking Act (Bankwesengesetz - BWG)

There were eight amendments to the BWG in 2010, with the transposition of the amended European Capital Requirements Directive (CRD II and CRD III) into national law through Federal Law Gazettes I 2010/72 and I 2010/118 being of particular importance. The amendments include comprehensive modifications of the large exposure regime, changes with regard to the recognition of hybrid capital instruments, the formalization of supervisory colleges, stricter rules for securitization and liquidity risk management, as well as standards pertaining to the supervisory monitoring of remuneration policies.

Further amendments to the BWG concerned efforts to combat money laundering and terrorist financing. Federal Law Gazette I 2010/37 enlarged the scope for suspicious transaction reports by financial institutions and widened the powers of the FMA. Federal Law Gazette I 2010/28 moved the provisions pertaining to consumer credit from the BWG to the Verbraucherkreditgesetz

(VKrG; Consumer Credit Act). Federal Law Gazette I 2010/58 adapted the BWG in line with the new insolvency law (cf. Federal Law Gazette I 2010/29) and Federal Law Gazette I 2010/104 brought it into line with the Finanzstrafgesetz

[4] *Memorandum of Understanding on Cooperation between the Financial Supervisory Authorities, Central Banks and Finance Ministries of the European Union on Cross-Border Financial Stability agreed in April 2008 (entry into force: June 1, 2008).*

(FinStrG; Tax Offences Act). The E-Geldgesetz (E-GeldG; Act on Electronic Money) resulted in an expansion of the fields of activity for e-money institutions and the standardization of independent supervisory requirements for these institutions that adequately reflect risk.

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	215	213	207
Branches of foreign credit institutions	33	29	30
Cooperative banks	619	613	606
Banking sector, total:	**867**	**855**	**843**

Source: OeNB, unconsolidated data.

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

Type of financial institution	2008	2009	2010
Public sector ownership	4.07	10.49	11.53
Other domestic ownership	66.28	68.26	68.67
Domestic ownership total	70.35	78.75	80.20
Foreign ownership	29.65	21.25	19.20
Banking sector, total:	**100.0**	**100.0**	**100.0**

Source: OeNB, unconsolidated data.

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	37.47	48.15	714.46
Branches of foreign credit institutions	72.18	78.56	3,326.40
Cooperative banks	30.68	53.51	754.63
Banking sector, total:	**28.06**	**35.39**	**378.33**

Source: OeNB, unconsolidated data.

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

Type of financial institution	2008	2009	2010
Commercial banks	0.43	0.14	4.83
Branches of foreign credit institutions	n.a.	n.a.	n.a.
Cooperative banks	8.33	-0.12	6.60
Banking sector, total:	**3.02**	**0.06**	**5.79**

Source: OeNB, unconsolidated data.

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	66.62	64.24	62.25
Branches of foreign credit institutions	1.10	1.08	1.17
Cooperative banks	32.28	34.68	36.58
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

Source: OeNB, unconsolidated data.

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

Assets	2008	2009	2010
Financial sector	n/a	n/a	n/a
Nonfinancial sector	n/a	n/a	n/a
Government sector	n/a	n/a	n/a
Other	n/a	n/a	n/a
Liabilities	**2008**	**2009**	**2010**
Financial sector	n/a	n/a	n/a
Nonfinancial sector	n/a	n/a	n/a
Government sector	n/a	n/a	n/a
Capital	n/a	n/a	n/a
Other	n/a	n/a	n/a

A breakdown of the whole balance sheet into these categories is not possible because only for loans and deposits this structure is given (see later table)

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks**	10.30	12.17	13.16
Cooperative banks**	12.06	13.72	13.39
Banking sector, total:**	11.02	12.81	13.20

Source: OeNB, unconsolidated data.
(* - for Basel I; ** - for Basel II)

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

Asset classification	2008	2009	2010
Non financial sector	2.97	4.22	4.66
- households	**n.a.**	**n.a.**	**n.a.**
- corporate	**n.a.**	**n.a.**	**n.a.**

Source: OeNB, unconsolidated data; NPL of domestic business.

The structure of deposits and loans of the banking sector in 2010 (%) (at year-end)

	Deposits	Loans
Households	74.43	41.73
Government sector	4.04	8.64
Corporate	17.02	42.37
Other (excluding banks)	4.51	7.26
Total	**100.0**	**100.0**

Source: OeNB, unconsolidated data; only domestic business

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

P&L account	2008	2009	2010
Interest income	45.85	32.75	36.87
Interest expenses	37.60	23.98	17.75
Net interest income	8.25	8.77	9.12
Net fee and commission income	4.22	3.61	3.95
Other (not specified above) operating income (net)	8.09	5.48	6.63
Gross income	20.56	17.85	19.71
Administration costs	9.73	9.46	9.74
Depreciation	0.64	0.56	0.55
Provisions	7.00	8.51	3.32
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	n.a.	n.a.	n.a.
Profit (loss) before tax	2.15	0.44	4.81
Net profit (loss)	1.89	0.04	4.21

Source: OeNB, unconsolidated data in EUR bn.

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	51.19	40.22	12.81	0.73
Cooperative banks	35.33	26.99	10.01	0.16
Banking sector, total:	**86.52**	**67.21**	**22.82**	**0.89**

Source: OeNB, consolidated data in EUR bn.
Total own funds before deductions; Tier capital after deductions

2010 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF BELARUS

MACROECONOMIC ENVIRONMENT

The year 2010 saw economic development of the Republic of Belarus at a time of recovery of the global economy and the economies of its main trading partners. At the same time, the negative impact of external shocks associated with an increase in energy prices for the Republic of Belarus and residual repercussions of the global financial and economic crisis persisted.

GDP increased in comparable prices by 7.6% on the previous year (in 2009 – by 0.2%). Inflation in the consumer market stood at 9.9%, compared with 10.1% in 2009.

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

As at January 1, 2011, the banking sector of the Republic of Belarus included 31 operating banks and 226 branches. Foreign banks ran 8 representative offices in the territory of the country.

Foreign capital participated in the authorized capital of 26 banks, including nine wholly-foreign owned banks. As at January 1, 2011, the non-residents' share in the aggregate authorized capital of the Belarusian banks amounted to 24.22%. The state's share (the share held by the State Committee on Property of the Republic of Belarus) in three banks exceeded 50% of the authorized capital.

In 2010, the banks' aggregate authorized capital grew by 25.7%, amounting to BYR12.02 trillion as at year-end 2010 or EUR3 billion in equivalent.

In the period under review the banking sector's assets increased by 53.2%, amounting to BYR127.54 trillion (EUR32.1 billion in equivalent) and the assets/GDP ratio rose from 53.4 to 60.3%.

In 2010, the banks' profits amounted to BYR1.7 trillion, exceeding 1.6 times the profit made in 2009. The banking sector yielded return on assets[5] to the tune of 1.7% (as at January 1, 2010 – 1.4%) and return on the regulatory capital to the tune of 11.8% (as at January 1, 2010 – 8.9%).

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

During 2010, the work was continued to enhance the efficiency of banking supervision by dint of streamlining the regulatory framework, bringing it into line

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

with international standards, and developing the instruments of risk-oriented supervision.

The list of grounds for conducting unscheduled inspections which enable the National Bank to take prompt actions with a view to ensuring stability of the banking system and protecting the interests of depositors and other creditors of the banks was compiled.

Procedures for providing the National Bank's staff with information from the Credit Register for the purposes of supervision over the banks' activities, including on a consolidated basis, were defined with a view to streamlining the supervisory process.

Recommendations for improving the practice of stress testing in the banks were submitted to commercial banks in order to enhance risk management in the banking sector.

To make the banking sector's information more transparent the banks are required to post annual financial statements compiled in compliance with the international accounting standards along with reporting compiled in compliance with the requirements set out by Belarusian legislation as well as auditor's opinion confirming the authenticity thereof on their official websites.

LEGAL COMPETENCE OF THE BANKING SUPERVISION AUTHORITY IN THE REPUBLIC OF BELARUS

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

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;
- development of relevant secure functioning requirements and corporate governance 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 its operational risks;
- revealing the infringements of banking legislation;
- determination of the rules of publication and contents of information which is published in order to assess the degree of reliability of banks and non-bank financial institutions;
- analysis of banks' reports;
- regulation of the foreign capital's access to the banking system of the country;
- monitoring of the banking sector's risks; and
- regulation of banks' reorganization and liquidation.

Also, the system for guaranteeing the repayment of funds attracted by banks from natural persons exists in the Republic of Belarus. It is governed by regulatory legal acts of the Republic of Belarus and is created at the expense of monthly irrevocable contributions that are made by banks licensed to accept deposits from natural persons and are accumulated by the Agency on the Guaranteed Repayment of the Natural Persons' Deposits.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2010

In 2010, the primary objective of the National Bank was to ensure stability of the banking system of the Republic of Belarus and protect the interests of the banks' creditors and depositors. The above-mentioned objective was achieved by:

- setting up prudential limits with respect to banking risks and capital and reserves adequacy requirements which comply with the international practice and take into account the economic situation in the country;
- execution of efficient supervision over banks by analyzing their official reports and inspecting them; and
- implementation of remedial measures in a timely fashion.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

The banking supervision system in the Republic of Belarus includes registration and licensing, off-site supervision based on reporting, on-site supervision in the form of inspections, relevant supervisory response measures imposed against the banks in the event that they violate banking legislation, their financial standing deteriorates, and they are reorganized or liquidated, as well as macroprudential supervision which provides for monitoring of the banking sector's state as a whole.

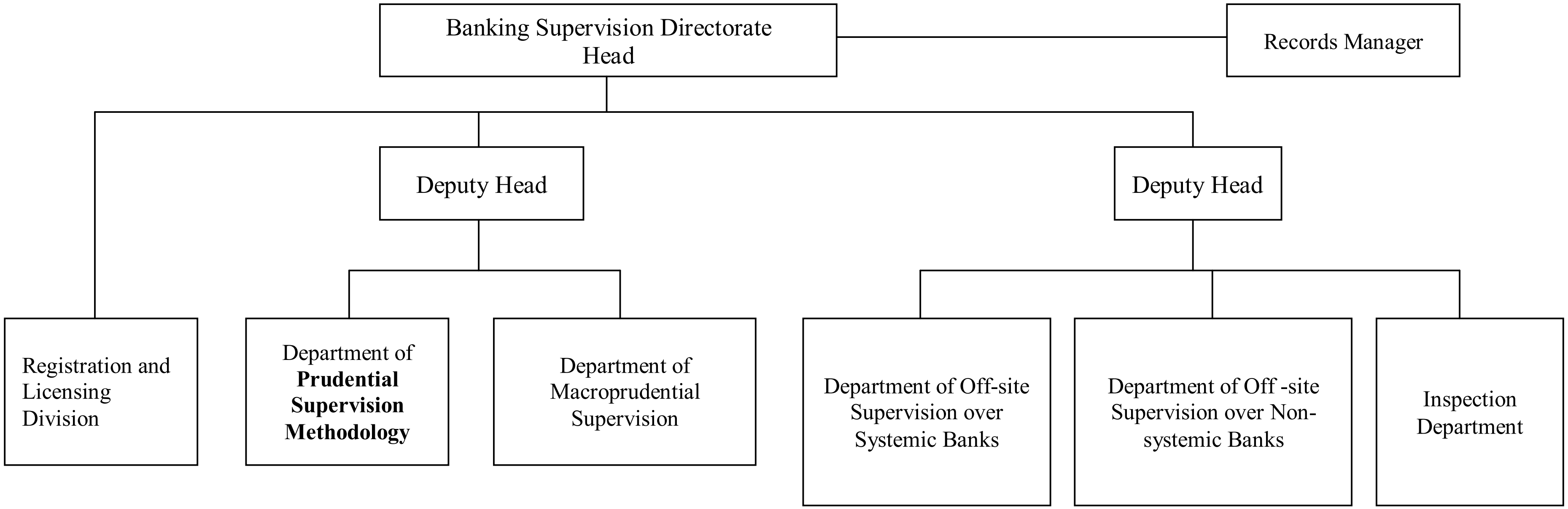
The banks' compliance with secure functioning requirements was monitored throughout the year on an ongoing basis. The work was continued to ban the practice of granting preferences to the banks so that they could comply with prudential requirements and limitations prescribed for the banks. The National Bank endeavored to strengthen 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 conducts on-site inspections of the banks in order to find out their real financial state; and to assess the risks assumed by the bank, the state of the internal control system, the organization of management, the compliance with the prescribed prudential requirements, the accuracy of transactions' accounting, and authenticity of reports.

In 2010, the National Bank conducted 7 comprehensive inspections and one unscheduled thematic inspection of the banks, and inspected 16 bank branches for the assets' quality and compliance with foreign exchange legislation.

In 2010, the National Bank continued to develop macroprudential supervision whose key tools are scenario analysis, stress testing, and early warning systems along with monitoring and analysis of the trends in the dynamics of financial stability indicators.

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 supervisory authorities. Cooperation with those countries in which representative offices of the Belarusian banks are located and whose banks established subsidiaries and representative offices in the Republic of Belarus is of particular interest.

In 2010, the Memorandum of Understanding between the National Bank of the Republic of Belarus and the State Bank of Vietnam in the sphere of banking supervision was agreed and signed. At year-end 2010, 16 bilateral agreements with foreign banking supervisory authorities were in force.

In 2010, the National Bank was aided, in the course of technical assistance from the IMF, in such areas as creation of early warning and risk management system, and an improvement of methodology and practice of inspecting in the banking sector. The IMF was regularly provided with information within the framework of the loan agreement under the stand-by arrangement.

COOPERATION WITH THE OTHER SUPERVISORY BODIES IN THE REPUBLIC OF BELARUS

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

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

More detailed information on the developments in the banking sector and banking supervision in the Republic of Belarus can be found on the official website of the National Bank of the Republic of Belarus (www.nbrb.by/engl/).

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	31	32	31
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total	**31**	**32**	**31**

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

Type of financial institution	2008	2009	2010
Public sector ownership	77,9	72,4	71,7
Other domestic ownership	1,6	1,2	1,0
Domestic ownership total	**79,4**	**73,6**	**72,7**
Foreign ownership	20,6	26,4	27,3
Banking sector, total	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	72,23	83,51	24,03
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**72,23**	**83,51**	**24,03**

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

Type of financial institution	2008	2009	2010
Commercial banks	9,60	8,93	11,77
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**9,60**	**8,93**	**11,77**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions			
Cooperative banks			
Other			
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2008	2009	2010
Claims on general government	9,9%	4,8%	4,1%
Claims on economic entities*	54,3%	60,4%	54,9%
Claims on natural persons	20,1%	19,3%	17,9%
Claims on the National Bank	5,5%	4,2%	14,8%
Claims on banks	3,0%	3,7%	2,7%
Claims on non-residents	4,5%	4,9%	3,5%
Other assets	2,7%	2,6%	2,1%
Liabilities	**2008**	**2009**	**2010**
Central government funds	13,5%	11,7%	8,7%
Local government funds	5,6%	2,8%	2,5%
National Bank funds	5,1%	10,2%	21,9%
Economic entities' funds*	20,7%	19,8%	18,1%
Natural persons' funds	20,9%	21,8%	18,0%
Banks' funds	3,3%	4,3%	2,9%
Funds received from non-residents	10,7%	12,2%	13,5%
Other liabilities	20,1%	17,2%	14,5%

* Economic entities - non-bank financial institutions, commercial and non-profit non-financial enterprises and organizations, individual entrepreneurs.

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks	21,8%*	19,8%*	20,5%*
Cooperative banks			
Banking sector, total:	**21,8%***	**19,8%***	**20,5%***

(* - for Basel I; ** - for Basel II)

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

Asset classification	2008	2009	2010
Non financial sector			
- households	**n/a**	**39,2**	**43,6**
- corporate	**n/a**	**35,2**	**39,0**

The structure of deposits and loans of the banking sector in 2010 (%)
(at year-end)

	Deposits	Loans
Households	45,8	47,4
Government sector	7,9	1,3
Corporate	25,2	50,6
Other (excluding banks)	**6,2**	**0,6**
Total		

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

P&L account	2008	2009	2010
Interest income	946177	918692	856528
Interest expenses	427313	396702	325773
Net interest income	518864	521990	530755
Net fee and commission income	n/a	n/a	n/a
Other (not specified above) operating income (net)	n/a	n/a	n/a
Gross income	**836374**	**816015**	**859328**
Administration costs	**243089**	**248716**	**242690**
Depreciation	n/a	n/a	n/a
Provisions	157552	237596	386102
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	n/a		n/a
Profit (loss) before tax	72912	6396	-94219
Net profit (loss)	50039	807	-102976

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	1054194	803668	250526	
Cooperative banks				
Banking sector, total:				

2010 DEVELOPMENTS IN THE BANKING SYSTEM OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

MACROECONOMIC ENVIRONMENT

According to the preliminary estimates[6], the nominal value of the GDP for Bosnia and Herzegovina (B&H) in 2010 was KM 24.750,0 bn, which represents a nominal increase of 0,9%, compared to the year 2009. According to the preliminary estimates7, GDP for the Federation of Bosnia and Herzegovina (FB&H) for the year 2010 amounted to KM 24.750 mil, while GDP/ per capita amounted to KM 5.362. An analysis of the composition of the Industrial Output Index in FB&H, December 2010, relative to December 2009, reveals that all three sectors that comprise industrial production – mining, manufacturing industry and supply of electric power, gas and water – recorded output increases by 0,7% , 9,3% per cent and 29,8%, respectively.

The composition of the Consumer Price Index in B&H indicated that the price level in December 2010, in annual terms, was determined by increases in both the prices of goods and of services. Namely, goods' prices rose by 3,5%, while services' prices rose by 2,6%. The composition of the Consumer Price Index indicates that the highest price increases in annual terms (December 2010/ December 2009) were recorded in the cost category related to alcoholic beverages and tobacco (11,9%).

The annual rate of inflation recorded in December 2010 in B&H was 0,9% above the euro area inflation rate and 0,5% higher in comparison with the EU. In monthly terms, prices in B&H were 0,8% higher in December 2010. relative to the preceding month, and 3,1% higher relative to December 2009. Average annual inflation in B&H in 2010 was 2,1%. In Q4, relative to Q3 2010, the recorded rise in prices was 2,0% . At the same time, in December 2010, the annual inflation rate in B&H was higher relative to Montenegro, Croatia, Slovenia and Macedonia by 2,3 %, 1,3%, 1,2% and 0,1%, respectively. On the other hand, relative to inflation in Serbia, inflation in B&H was as much as 7,2% lower. Republika Srpska (RS) and FB&H in December 2010, prices in FB&H were 0,9% higher relative to the previous month and 3,1% relative to the same month of 2009. In 2010, average inflation was 1,8% relative to 2009. The prices in December 2010 were 19,9% higher, relative to average prices in 2005.

The average net wage in B&H in December 2010 was KM 818 and it was 1,7% higher relative to December 2009. In December 2010, the average net wages in FB&H, RS and Brčko District were KM 827, KM 804 and KM 798, respectively. The average net wages in FB&H, RS and Brčko District were KM 19 (2,4%), KM 14 (1,8%) and KM 10 (1,3%) higher, respectively.

The number of employees in B&H in December 2010 amounted to 843.000 persons; out of that number 500.000 are employed in the FB&H, 329.000 in RS and 14.000 people in the Brčko District.

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[6] Estimates of Central Bank of Bosnia and Herzegovina which are in use as preliminary data till publishing of BH Agency of statistics official GDP

[7] Estimates of Federal office of Statistics (first results)

The maximum amount for insured deposits had been raised to KM 35,000 since April 1st, 2010, and it applies exclusively to physical persons, with 25 commercial banks participating in the deposit insurance scheme under the auspices of the Deposit Insurance Agency. Total Deposits and Loans of Commercial Banks: At the end of 2010, the total deposits were KM 12.52 billion, which constituted an increase of KM 191.73 million, or 1,6% , in comparison with the end of Q3 2010, while the increase in annual terms was KM 440.5 million, or 3,6% . In terms of currency composition, 51,6% of deposits were in KM. The total deposits of the government sector at the end of 2010 were KM 1.61 billion. They accounted for 12,8% of the total deposits, which was 0,9% lower relative to the end of the preceding quarter and KM 396.3 million, or 19,8%, in annual terms. The total deposits of the non-governmental sector in December were KM 10.91 billion and increased by KM 278.3 million, or 2,6%, relative to the preceding quarter, and by KM 836.9 million, or 9,1%, in annual terms.

In December 2010, the spread between lending rates of commercial banks in B&H and the twelve-month EURIBOR was 6,69%, which was 32 basis points lower relative to the end of the previous quarter. As the interest rates in the euro area remained rather stable in the previous period, this decrease was mainly caused by reduction of lending rates in B&H. The weighted average of active interest rates was 8,22% in December 2010, 21 basis points lower relative to the end of Q3 2010. The average interest rate for short-term loans in KM to private companies continued to follow a declining trend in the Q3 2010 and in December 2010 was 7,84%, 20 basis points lower relative to the previous quarter. In December 2010, the spread between lending rates of commercial banks in BH and the twelve-month EURIBOR was 6,69% , which was 32 basis points lower relative to the end of the previous quarter. As the interest rates in the euro area remained rather stable in the previous period, this decrease was mainly caused by reduction of lending rates in B&H.

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

The performance of the banking sector of the FB&H in 2010, as in the previous year, was under the impact of the global economic crisis and recession. Although, there were recorded some signs of slight economic recovery, the situation and the condition in the economy, that is the real sector is still not satisfactory, and coming out of the crises will be slow and related to numerous external and internal factors and risks. The banking sector remains stable and safe, well capitalized, with a satisfactory liquidity.

However, the growth and the development is still stagnating, a slight credit growth has been realized, which is still a positive change in relation to the relatively significant decline of the credit activities in 2009. The key problem is still the increase of the credit risk, that is the downfall of the asset quality (increase of nonperforming assets), which resulted in a deterioration of profitability, the profits are significantly lower, and in some banks the losses are increasing. The banks kept the enhanced focus on the credit risk, more restrictive and rigorous policies in managing the credit risk, especially in the credit approval process. The structure of the financing sources is determined by the needs of the banks and their availability, which is resulting in an increased participation of local deposits and decreased foreign credits. That can be a limiting factor and a problem for the future credit growth, taken the maturity profile of the sources and the needs for lending with longer maturity dates.

At the end of 2010, there were 19 banks with banking license issued in the FB&H (18 banks with majority private ownership, and one bank in majority state owned). The number of banks declined in comparison to 31.12.2009, since the license of one bank was revoked on 20.12.2010. By the end of 31.12.2009. two banks were under provisional administration. In 2010, the trend of decrease of the number of employees in banks continued, which is another negative effect of the economic crises on the banking system in FB&H.

Concentration rate is an indicator of assets participation of the five largest banks, which at the end of 2010 in the banking system of the FB&H amounted to 75,8% (78% in 2009), but there is still dominant participation of the two largest banks in the system that „hold" 49% of the market.

The aggregate balance sheet of the banking sector, as of 31.12.2010., amounted to 15,1 billion KM, representing a decrease by 1% or 161 million KM compared to the previous year. In comparison to the previous year, when the increase was 1% or 166 million KM, the decline of the balance sheet of 1% in 2010 was expected and is realistic taken into account the continued strong impact of the financial and economic crises on the banking sector in the FB&H.

Capital of banks in the FB&H, as of 31.12.2010., amounted to two billion KM. In 2010, capital remained on almost the same level, it decreased by only 0,6 million KM in comparison to 2009, while the changes in core and supplementary capital influenced the changes in the structure of regulatory capital. The core capital increased by 1% or 17 million KM, and supplementary capital decreased by 3% or 18 million KM.

Although the growth of the core capital is minimal, it should be noted that stopping the decline and the weakening of the capital base, under the influence of the major losses in performance, and its maintenance on the same level, that is slightly higher level, is a result of two significant events: first, the FBA's request to banks to keep the realized profit for 2009 in capital, which all banks implemented. The second important event is the completion of the additional capitalization. The banks' capital level rate as of 30. 12. 2010. was 13,1%, at the same level as at the end of 2009. Capital adequacy rate of the banking system, as of 31.12.2010., was 16,2%, which is still much more than the minimum prescribed by the law (12%), representing satisfactory capitalization of the entire system and very strong basis and foundation to preserve its safety and stability.

While the decline of the credit portfolio quality continued in 2010, it can be concluded that there was a slight recovery in the lending segment, which is evident in a minimal growth of the loans. Following significant downfall of credit placements of 6% in 2009, in 2010 there was a minor growth of 2% that could be assessed positive, since banks have increased their volume of new placements based on which the negative trend from the previous periods came to an end. It should be noted that during 2010, and approximately the same amount of loans was written off (transferred into the off-balance), which resulted in a decreased loans growth rate.

General liquidity indicators were improved thanks to primarily decreased lending activity, with a tendency of slight deterioration in the first half of 2010. due to decrease of cash funds from investment in securities and payment of loan liabilities.

Liquidity of the banking system in the FB&H is still good, with satisfactory participation of liquid assets in total assets and coverage of short term liabilities by liquid assets. However, since the financial crisis is still present worldwide which has an adverse reflection to the banking systems of certain European countries, and since majority of banks in FB&H are owned by the European banking groups that provide financial support to our banks through deposit and credit funding, it is estimated that liquidity risk still needs to be under enhanced supervision. In 2010, a total of 4,9 billion KM were generated in new loans, which is by 20 higher than in comparison to 2009.

According to the financial reports data that indicate the success of bank's performance, that is from the income statements for 2010, at the banking system level of the FB&H, there was realized a negative financial result, while in 2009, there was profit generated at the banking system level.

Banking sector of the FBH during the period of implementation of the reform has reached an enviable level. The upcoming activities should be aimed at preserving its stability as priority task in the current stressful conditions and its further progress and development. These goals require continuous and vigilant engagement of all parts of the system, legislative and executive authorities, which is a prerequisite to create the most favorable economic environment that would be stimulating to both banks and consequently to the real sector of the economy and citizens.

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

A) LAWS (new developments in 2010):

1. Law on modifications and amendments to the Law on Criminal/Penal Procedure (Official Gazette of the F,
2. B&H", number 12/10),
3. Law on modifications and amendments to the Law on Debt, Indebting, and Guarantees in the Federation of
4. Bosnia and Herzegovina, (Official Gazette of the F B&H", number 44/10),
5. Law on Foreign Currency Operations, (Official Gazette of the F B&H", number 47/10),
6. Law on modifications and amendments to the Law on Trade Companies, (Official Gazette of the F B&H",
7. number 63/10).

B) PRUDENTIAL REGULATIONS ISSUED BY FBA - Federal Banking Agency (new developments in 2010):

8. Decision on Minimum Standards for Capital Management in Banks ("Official Gazette of the F BiH",
9. number 3/03, 18/03, 53/06, 55/07, 81/07, 6/08 and 86/10),

10. Decision on Minimum Standards for Loan Risk and Assets Classification Management in Banks ("Official
11. Gazette of the FBiH", number 3/03, 12/04, 88/07, 6/08 and 86/10),
12. Decision on Reporting Forms Submitted by Banks to the Banking Agency of the Federation of BiH
13. ("Official Gazette of the F BiH", number 3/03, 18/03, 52/03, 64/03 correct., 6/04, 14/04, 54/04, 5/05,
14. 43/07, 55/07, 81/07, 88/07, 6/08 and 86/10),
15. Decision on Provisional Measures for Renegotiation of Credit Liabilities of Citizens and Legal Entities in
16. Banks (Official Gazette of the FBiH, number 20/10 and 86/10),
17. Decision on Requirements and Manner of Bank's Action taken upon Customer's Complaint (Official
18. Gazette of the FBiH, number 32/10),
19. Decision on Temporary Measures for Renegotiation of Citizen and Legal Entities' Credit Liabilities
("Official Gazette of the FBiH", number 02/10).

Legal competences of FBA:

1. Issuance of license for establishment and work of banks, micro-credit organizations and leasing companies, issuance of license for changes of organizational system of banks, micro-credit organizations and leasing companies, type of activity and approvals for appointment of their managing staff;
2. Supervision of banks, micro-credit organizations and leasing companies, undertaking of measures in accordance with law;
3. Revoking work license from banks, micro-credit organizations and leasing companies 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, micro-credit organizations and leasing companies;
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, 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 2010

FBA set up the following priorities:

1. Continue implementing activities, from the scope of its authority, to consolidate supervision on state level.
2. Take measures and activities within its powers to overcome and mitigate adverse effects to the banking sector of the FBiH caused by the global financial crisis.
3. Proceed with a continues supervision of banks through on-site and off-site examinations, focusing on targeted examination of dominant risk segments of banking operations, which will make supervision more effective, in regard to:
   - Persist on capital strengthening of banks, especially those recording outstanding assets growth,
   - Continue permanent monitoring of banks, primarily those with systemic importance to development of credit activities with the highest concentration of savings and other deposits in order to protect depositors,
   - Continue a systematic monitoring of banks' activities in prevention of money laundering and terrorism financing and improve cooperation with other supervisory and examination institutions,
   - Maintain continuity in payment system examinations,
   - Continue working on further development of regulation based on the Basle Principles, the Basle Capital Accord, and the European Banking Directives, as part of BiH’s preparation to join the European Union,
   - Establish and expand cooperation with ome country supervisors of the investors present in the banking sector of the FBiH, and other countries in order to have more effective supervision,
   - Improve cooperation with the Banks Association in all banking performance segments.
4. Continuous operational development of the IT system for early warning and prevention in elimination of weaknesses in banks.
5. Work on continuous education and training of staff.
6. Make effort to accelerate finalization of the remaining provisional administrations and Liquidations in banks based on the conclusion made by the Management Board.

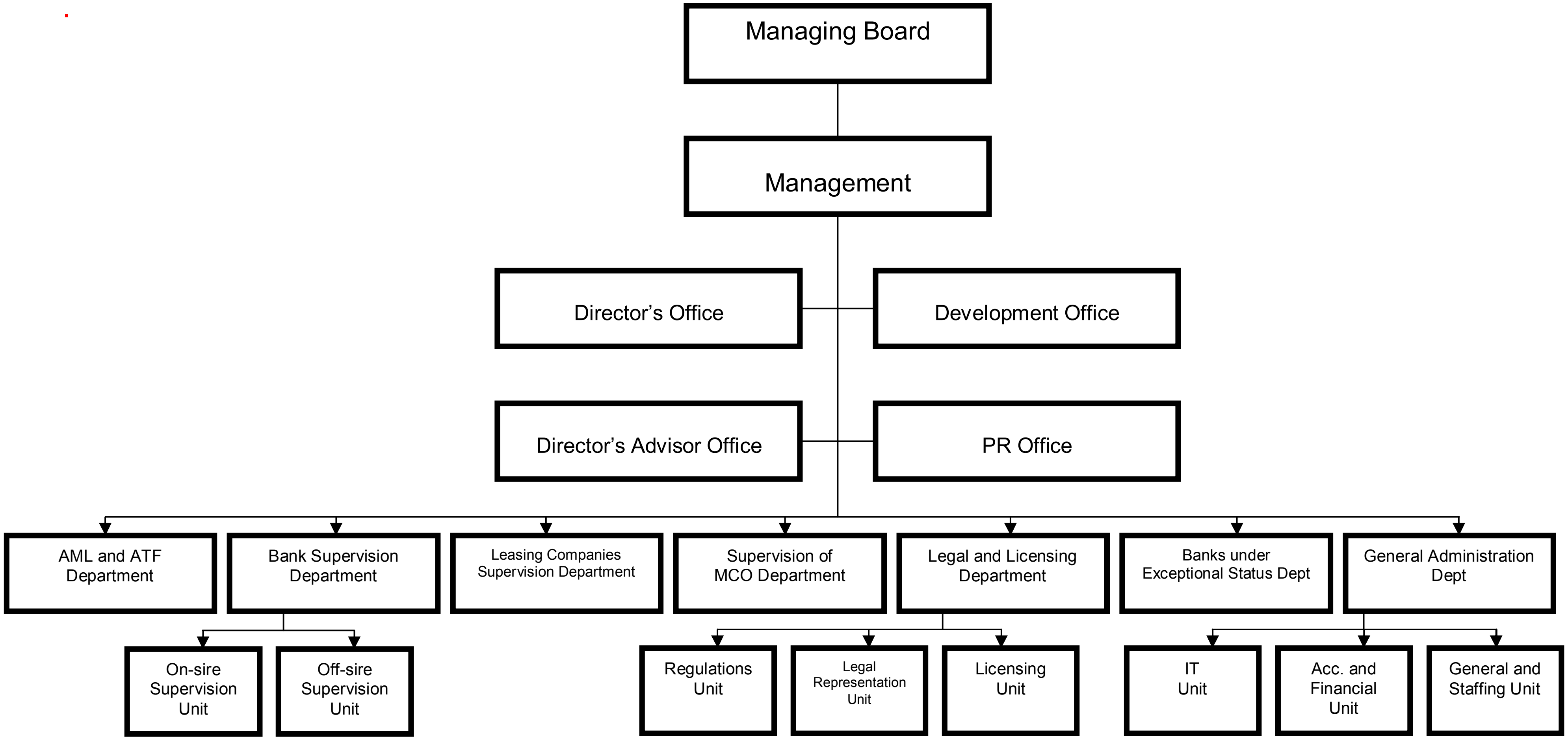
THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

The FBA, in 2010, among other things, implemented the following activities:

1. Continuous monitoring through reports (off-site examination), monitoring of financial condition of banks.
2. Taking measures anticipated by laws and other regulations within the scope of its authority.

3. Further implementing of the Strategy to Introduce Basel II - “International Convergence of Capital Measurement and Capital Standards”.
4. Development and advancement of the regulatory framework in accordance with the law, development trends of generally acceptable international principles and standards, as well as recommendations made by the international bank supervision institutions.
5. Strengthening of banks capital, enhancement of their lending policies and their consistent implementation in practice, raising prudency to the highest possible level in credit risk management that is still dominant in BiH and liquidity risk, as well as strengthening of the capacities for potential crisis situation management.
6. Further cooperation with domestic and foreign global and other institutions, as the International Monetary Fund, European Central Bank (ECB), the World Bank, Group of Banking Supervisors of Central and Eastern Europe and others, as well as with supervisory authorities from home countries of parent banks that in the FBiH have their banks-subsidiaries with whom the FBA, together with the Central Bank of BiH and Banking Agency of RS, has signed Memorandums of Understanding.
7. In cooperation with the International Monetary Fund (IMF), Central Bank and the Banking Agency of the Republic of Srpska, continued implementation of the project "stress tests" for assessing resistance to crises of banking system, and contacting with the bank about the results of completed "stress tests" (macro and micro level).

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

The FBA participated, as beneficiary, in Project called „Strengthening macro and micro-prudential supervision in EU candidates and potential candidates". FBA signed, within this project, Memorandum of Understanding (MoU) with ECB. Also, FBA signed trilateral MoU with Bank of France (Banque de France)- assistance in implementing Risk assessment system and Supervisory Review Process, and with Bank of Portugal (Banco de Portugal) – in assistance in the area of consumer protection and financial literacy.

In the last year, FBA conducted bilateral cooperation with banking regulatory authorities from countries (Slovenia, Turkey, Austria, Italy, and Croatia) whose parent banks have their banks-subsidiaries in the FBiH.

COOPERATION WITH OTHER SUPERVISORY BODIES IN BOSNIA AND HERZEGOVINA

The FBA has established cooperation with many supervisory bodies and other institutions in our country (e.g. Memorandum of Understanding with: Central Bank of Bosnia and Herzegovina, Deposit Insurance Agency of B&H, Insurance Companies Supervision Agency, Intelligence-Security Agency of B&H and other domestic institutions).

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

The FBA, as beneficiary, continue participating in the activities regarding the Project called „Strengthening macro and micro-prudential supervision in EU candidates and potential candidates". The program was created by the European Central Bank 13 national central banks of the Eurosystem. From BiH, the Project involves joint activities of the CBBiH, FBA and BARS (Banking Agency of Republic Srpska) in cooperation with regulatory authorities of 7 EU candidates and potential candidates (apart from BiH, participants of the project are: Albania, Montenegro, Croatia, Kosovo, Macedonia, Serbia, and Turkey).

CBBH participation, as well as participation of entity banking agencies in this project was of high importance for further strengthening of banking supervision in BiH, using experience, knowledge and skills, a stronger connection to the activities of experts in the region, including EU institutions. The program includes regional training programs for customers, workshops for managers of regulatory institutions, self-education through access to FSI Connect, the technical simulation exercises that focus on cross-border cooperation.

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	20	20	19
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**20**	**20**	**19**

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

Type of financial institution	2008	2009	2010
Public sector ownership	1,3	1,1	1,1
Other domestic ownership	4,4	5,0	7,0
Domestic ownership total	5,7	5,61	8,1
Foreign ownership	94,3	93,9	91,9
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	61%	76%	1526
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**61%**	**76%**	**1526**

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

Type of financial institution	2008	2009	2010
Commercial banks	5,22	0,00	-6,15
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**5,22**	**0,00**	**-6,15**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	n/a	n/a	n/a
Branches of foreign credit institutions			
Cooperative banks			
Other			
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2008	2009	2010
Financial sector	n/a	n/a	n/a
Nonfinancial sector	n/a	n/a	n/a
Government sector	n/a	n/a	n/a
Other	n/a	n/a	n/a
Liabilities	**2008**	**2009**	**2010**
Financial sector	n/a	n/a	n/a
Nonfinancial sector	n/a	n/a	n/a
Government sector	n/a	n/a	n/a
Capital	n/a	n/a	n/a
Other	n/a	n/a	n/a

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks	16,4*	16,1*	16,2*
Cooperative banks			
Banking sector, total:	16,4	16,1	16,2

(* - for Basel I; ** - for Basel II)

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

Asset classification	2008	2009	2010
Non financial sector			
- households	**n/a**	**39,2**	**43,6**
- corporate	**n/a**	**35,2**	**39,0**

The structure of deposits and loans of the banking sector in 2010 (%) (at year-end)

	Deposits	Loans
Households	45,8	47,4
Government sector	7,9	1,3
Corporate	25,2	50,6
Other (excluding banks)	**6,2**	**0,6**
Total		

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

P&L account	2008	2009	2010
Interest income	946177	918692	856528
Interest expenses	427313	396702	325773
Net interest income	518864	521990	530755
Net fee and commission income	n/a	n/a	n/a
Other (not specified above) operating income (net)	n/a	n/a	n/a
Gross income	**836374**	**816015**	**859328**
Administration costs	**243089**	**248716**	**242690**
Depreciation	n/a	n/a	n/a
Provisions	157552	237596	386102
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	n/a		n/a
Profit (loss) before tax	72912	6396	-94219
Net profit (loss)	50039	807	-102976

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	1054194	803668	250526	
Cooperative banks				
Banking sector, total:				

2010 DEVELOPMENTS IN THE BANKING SYSTEM IN REPUBLIKA SRPSKA OF BOSNIA AND HERZEGOVINA

MACROECONOMIC ENVIRONMENT

In the course of 2010 economy of Republika Srpska (hereinafter: RS) started getting out of recession. RS was on its way out of the recession already in the second quarter of 2010 when GDP increased by 0.4% (YoY). That positive trend continued up to the end of the year as domestic economy grew at the rate of 1.5% in the 3rdQ i.e. 1.4% (YoY) in the 4thQ when RS GDP amounted to EUR 4,275,947 thousand.

Continuing a positive trend of expansion from the previous period, RS industry production grew at the rate of 5.0% (YoY) in 2010, which, at the same time, was the highest rate of increase in the region.

The year 2010 was characterized also by a moderate lending expansion which amounted to 6.9% (YoY) as of the end of 2010.

The economy recovery at the global level had a positive influence on the total RS export-import, which recorded year-to-year increase of value of 18.9%, where export increased by 30.2%, and import by 13.6%.

On the other hand, negative effects of the world economy crisis caused plummeting of construction activities, which recorded contraction of 21.9% at the year-to-year level.

2010 average unemployment amounted to 145343, and increased by 4.1%, while average salaries and pensions almost stagnated.

At the very first signs of global, as well as domestic recovery, RS consumption reacted positively, whose level reflected on inflation amounting 2.5% in 2010.

Objectives of 2011 RS economy policy are protection and preservation of jobs, support to economy and positive economy growth, social stability safeguarding, maintaining the level of public investments, promoting and putting into realization projects through public-private partnership, protection of population and property of Republika Srpska against natural disasters, fiscal stability continuance, and support to financial sector.

DEVELOPMENT IN THE BANKING SYSTEM

Although RS banking sector faced negative consequences of the global financial and economy crisis also in 2010, condition of the sector was stable maintaining and even strengthening citizens' and legal entities' confidence in banks. Banks' reaction to financial crisis was more restrictive and prudent lending policy, stricter classification of loan and other receivables, capital increase, while special emphasis was placed on liquidity position maintenance and planning.

In early April 2010 and in order to strengthen confidence in banking system the Managing Board of the Agency for Deposit Insurance of Bosnia and Herzegovina increased the amount of deposits in banks insured from EUR 10,000 to EUR 18,000.

Coming into force the Law on Accounting and Audit of Republika Srpska with complementing regulation introduced obligatory implementation of International Accounting Standards (hereinafter: IAS) and International Financial reporting Standards (hereinafter: IFRS) in developing business operation records and financial reports.

Additionally, an earlier started reform of banking regulation under adopted Strategy of Introduction of "International Agreement on Capital Measurement and Standards" (Basel II) also contributed to choose as a transitional solution partial modification of regulation and reporting basis of the Banking Agency of Republika Srpska (hereinafter: the Agency). The goal of the modification was creation of conditions for a more complete implementation of IAS and IFRS with keeping regulatory requirements for loan and other loss provisioning. The modification was applied to the condition as of 31.12.2010. Effects of the modification in the reporting basis were increase of the total balance sheet level for assets classified into "E" risk category, which was transferred from balance sheet into off-balance sheet, measurement of decrease of the value of loans and other assets as per IAS, and deduction of lacking provisioning amount from the total net capital as per regulatory requirement. Under IAS balance sheet included all receivables regardless the degree of risk giving a more realistic picture of the assets structure.

In 2010 banking sector of Republika Srpska was also characterized by increase of loan based receivables, NPLs, and provisioning for potential loan loss, but also by strengthening of banks' capital and improvement of deposit maturity structure.

Banking sector of Republika Srpska was liquid and capable of meeting all obligations within due term. All banks complied with terms prescribed for liquidity maintenance.

As of 31.12.2010 the ratio of RS banking sector's total assets/RS GDP amounted to 71.82 percentage points.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF THE OPERATION AND SUPERVISION OF FINANCIAL INSTITUTIONS. LEGAL COMPETENCE OF THE BANKING SUPERVISION IN RS AND BH

Laws regulating supervision, scope of business activities, and operation of financial institutions are the following:

- Law on Banking Agency of Republika Srpska ("Official Gazette of Republika Srpska", no. 67/07) - revised text,
- Law on Banks ("Official Gazette of Repubika Srpska", nos. 44/03 and 74/04),
- Law on Micro-Credit Organizations ("Official Gazette of Republika Srpska", no. 64/06),
- Law on Saving-Credit Organizations ("Official Gazette of Republika Srpska", no. 93/06),
- Law on Leasing ("Official Gazette of Republika Srpska", no.70/07),

- Law on Insurance of Deposits in Banks of Bosnia and Herzegovina ("Official Gazette of Republika Srpska", nos. 20/02, 18/05, 100/08 and 75/09),
- Law on Prevention of Money Laundering ("("Official Gazette of BiH", nos. 29/04 and 53/09).

Basic tasks of the Agency, as an independent non-profit institution, under the Law on Banking Agency of Republika Srpska (hereinafter: the Law) are issuing and revoking operation licenses of banks, microcredit organization, saving-credit organization and leasing providers (hereinafter: financial organizations), issuing approvals on changes of organizational capacity and types of business activities performed by financial organizations, passing sub-legal enactments to regulate operation of financial organizations, supervision of financial organizations' operation and undertaking appropriate measures pursuant to the Law and the Agency's Decisions, managing and supervising processes of rehabilitation and liquidation of financial organizations, granting approvals for issuance of shares, undertaking activities to assist anti-terrorist measures related to financial organizations under request of authorities in charge, etc.

Within the scope of its authority, the Agency has passed a series of sub-legal enactments (decisions) regulating supervision and operation of financial organizations, as well as instructions defining in more detail manners and methods for applying decisions stated.

In 2006 IMF and the World Bank, within the Financial Stability Assessment Program for BiH (FSAP), carried out a detailed assessment of compliance of the Agency's operation with Basel core principles for effective banking supervision (The World Bank and International Monetary Fund, Detailed Assessments of Compliance with Standards and Codes, Assessments of Basel Core Principles for Effective Banking Supervision, May 2006.), where it was confirmed that the Agency's operation was in a great measure consistent with Basel core principles for effective banking supervision.

Legal and sub-legal framework for operation of banks in Republika Srpska is on a large scale adjusted to the "International Accord on Capital Measurement and Standards – Basel I", and in the area of market and operational risk management, it is partly adjusted to Basel II, since the Agency continuously harmonizes current regulation under recommendations by the Basel Banking Supervision Committee.

The Agency supervises and examines banks' operation primarily by monitoring solvency, liquidity and profitability of individual banks as well as of the overall banking sector, with a main goal to timely detect and prevent risk events in the banking sector.

Fully applying complete legal regulation prescribed, the Agency supervises financial organizations by means of four departments (off-site department examines prescribed reports submitted by financial organizations; on-site department examines each bank's operation in the very bank; department in charge of micro-credit organizations, saving-credit organizations, and leasing providers performs on-site examinations of those organizations; and anti-money laundering department carries out both on-site and off-site examinations of financial organizations).

Under the Law on RS Banks in cases of irregularities and incompliances found during examinations, the Agency is authorized to undertake a series of measures against financial organizations (to issue written warnings, convene Assembly of Shareholders or other bank's owners to discuss and consider rehabilitation measures to be carried out, issue a written order requesting the bank to stop and to restrain itself from violating the Agency's law and sub-legal enactments, and to undertake rehabilitating measures, impose special request for prudent operation, charge fines, revoke the bank's operating license, etc.)

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2010

The Agency's main strategic objective is to maintain sound and stable banking system of Republika Srpska, as well as to improve its safe, quality and legal operation. In that sense the Agency will continue exercising intensified monitoring of credit risk in banks, primarily from the aspect of adequacy of provisioning for potential loan loss, banks' capital adequacy, intensified off-site examination of banks' current liquidity, as well as strengthening transparency of business operation in banks and other financial organizations, maintaining confidentiality into banking system etc.

Strategically the Agency is committed to a complete harmonization of the banking regulation with European Union provisions and international standards for banking operation, which are to be observed primarily into EU Directives 48/2006 and 49/2006, and "International Accord on Capital Measurement and Standards – Basel II" thus the Agency, in its activities to improve regulation, strengthen the system, and reinforce staff competence, focused on the following areas:

- Introduction of „ International Accord on Capital Measurement and Standards „ – Basel II through the project of technical assistance to BiH financial sector - Partnership for Advancing Reforms in Economy – PARE, under auspices of USAID. In 2009 a working group, consisting of representatives of entity banking agencies and CBBH, started drafting a new legal and regulatory framework based on implementation of fundamental approaches to Basel II (standardized approach for credit and market risk, and basic indicators and standardized approach for operational risk), developing new action plans in accordance with precisely determined deadlines for activities in each segment and staff education on continuous basis, etc.
- Strengthening Macro and Micro-Prudential Supervision Project in Candidate and Potential Candidate Countries under auspices of European Central Bank and funded by EU with a goal to familiarize users of the program with EU banking regulation and good supervisory practices (with emphasis on Home-Host Supervision), as well as with development of European legislation and improvements planned in bank supervision.
- Establishment and development of international cooperation with bank supervision authorities in other countries.
- Cooperation with supervisors of EU mother banks whose subsidiaries are operating in RS.
- Carrying out stress tests (in cooperation with CBBH, Banking Agency of Federation BiH - FBA and IMF Technical Mission in BiH, the Agency carried out a series of stress tests applied to soundness of banking sector, the last one using financial data as of 31.03.2010. Based on IMF parameters for the region, those tests indicated a solid soundness and stability of RS banking sector).

- International Accounting Standards (IAS) implementation (as of 01.01.2010 RS banks have completely harmonized their financial reporting with IAS).

ACTIVITIES OF THE RS BANKING AGENCY IN 2010

Applying complete legal regulation and enactments prescribed the Agency through its Off-Site Examination Department in continuity supervised and analyzed operation of financial organizations based on decade, monthly and quarterly reports complying with the law, international accounting standards, and provisions of the Agency. Also, in accordance with the 2010 Supervision Plan the Agency performed overall and targeted on-site examinations of financial organizations.

The Off-Site Examination Department based its operation on preliminary and final annual reports as of 31.12.2009 and 30.06.2011 of 10 banks, 7 microcredit organizations (MCOs), three saving-credit organizations (SCOs), and one leasing provider (LP).

Based on preliminary and final reports as of 31.12.2009, and quarterly reports as of 31.03.2010, 30.06.2010, and 30.09.2010 the Department developed reports on condition of the RS banking system including banking sector, MCO sector, and SCO sector and LP sector.

In 2010 based on cooperation with IMF and Central Bank of BiH the Agency continued developing methodology for applying stress tests in RS banks. The Agency presented stress test results as of 31.12.2009 to each individual bank's management (10 banks) during separate meetings held in the Agency's premises during August 2010. In the course of the 4thQ 2010 another stress test was done based on financial data as of 30.06.2010.

Some new quarterly reports were introduced for the purpose of stress testing.

In cooperation with IMF and Central Bank of BiH the Agency continued developing methodology for collecting and analyzing FSI indicators (indicators of financial soundness), which is a precondition of efficient supervision over banking system.

Also, the Department was engaged in preparation of data, analyses, information, recommendations, and indication of particular areas of each bank's operation where special supervisory attention should be paid in targeted or overall on-site examinations.

Through its continuous coordination with the on-site examination function, the Department was included in post-examination bank supervision process by observing contents of examination reports and corrective measures undertaken, and monitored implementation of corrective orders falling into domain of the off-site examination function.

Compliance of each bank's operation with standards prescribed by the RS Law on Banks and the Agency's enactments was examined based on off-site reports. In accordance with Article 125 of the RS Law on Banks the Agency issued 14 warnings to banks and 2 warnings to saving-credit organizations.

In the course of 2010 the On-Site Examination Department performed inspections of business records, accounting and other documentation within the scope of seven overall and 11 targeted on-site examinations of RS banks. Department for supervision of microcredit, saving-credit and leasing provider organizations performed seven overall and four targeted examinations of MCOs, and two overall examinations of SCOs.

Department for Prevention of Money Laundering and Terrorism Financing performed nine overall and three targeted examinations of banks having their HQs in Republika Srpska, and five examinations of branch-offices of banks having their HQs in Federation BiH.

In post-examination period the Agency issued a total of 288 orders for irregularities found to be removed within specific deadlines (127 orders to banks, 38 orders to MCOs, and 23 orders to SCOs). Orders were primarily directed to capital strengthening, improvement of lending policy and strict implementation of such policies, as well as to enhancement of credit risk and liquidity risk management.

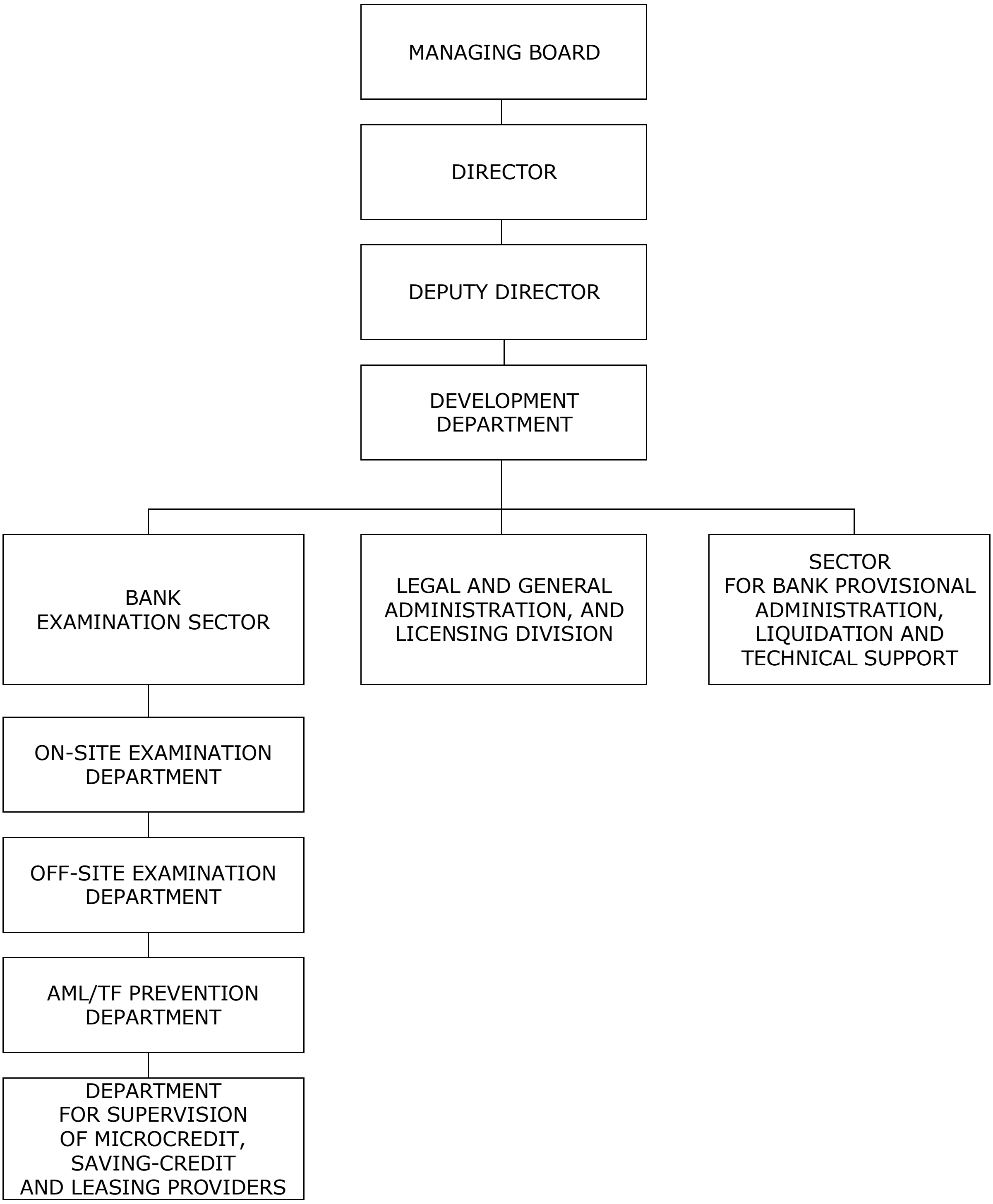
Within its regular activities the Legal and General Administration Sector issued various permits and approvals to financial organizations in accordance with the Instruction on Licensing and Other Approvals as stipulated by the Agency's provisions (in total 111 decisions).

In 2010 the Sector for Provisional Administration and Liquidation of Banks and Technical Support continued liquidation process of one state-owned bank, which had started in 2006.

In order to alleviate negative effects of the global financial crisis the Agency prolonged validity of the Decision on Temporary Measures for Rescheduling Credit Obligations of Legal and Physical Entities to be in force in 2011 as well.

In cooperation with the Central Bank of Bosnia and Herzegovina (CBBH) and under the IMF methodology and expert assistance bank stress-test project has being implemented. At the end of the 1st half of the year the CBBH completed aggregated and individual bank's stress testing as of 31.12.2009 for the RS banking sector within stress-testing of BiH banking sector.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE RS BANKING AGENCY

The Agency has established cooperation with bank supervision authorities from countries whose banks have equity share in banks of Republika Srpska and Bosnia and Herzegovina. Up to now the Agency has signed Memoranda on Understanding (MOUs) with bank supervisory authorities of: Macedonia, Romania, Bulgaria, Serbia, Monte Negro, Cyprus, Croatia, Slovenia, Albania, Greece and Turkey. Among other issues, such Memoranda prescribe exchange of information on change of ownership and managing structures, policies and procedures, capital, assets quality, levels of profitability, liquidity and corrective measures.

The Agency is also involved in activities lead by IMF and other relevant financial institutions related to signing MoUs with mother banks from EU countries having equity shares in banks from Republika Srpska and Bosnia and Herzegovina ("Vienna Initiative").

In the course of 2010 the Agency continued its active participation in the project of strengthening micro and macro prudent supervision in candidate and potential candidate countries under auspices of European Central Bank and funded by EU, where the objective is to familiarize beneficiaries of the program with the EU banking regulation, good supervisory practices, supervisory cooperation methods (emphases on Home-Host supervision), as well as development of European legislation and improvements anticipated in banking supervision. Special attention is paid to enhancement of banking supervision process, as well as to modalities of protection of consumers of banking services.

Also, as an equal member the Agency participates in activities of the BSCEE Group (Banking Supervision in Central and Eastern Europe) comprised of 20 countries in transition plus Austria.

COOPERATION WITH OTHER SUPERVISORY BODIES IN REPUBLIKA SRPSKA (RS) AND BOSNIA AND HERZEGOVINA (BH)

In the course of 2010, and within its tasks and in accordance with the Law on Committee for Coordination of Republika Srpska Financial Sector Supervision, the Agency continued its active cooperation with the Agency for Deposit Insurance of Republika Srpska and Securities Commission of Republika Srpska.

Also, under the Memorandum of Understanding from December 2009 the Agency participated in work of permanent Financial Stability Committee established by Fiscal Council BiH, CBBH, Banking Agency of Republika Srpska, Banking Agency of Federation BH, and Deposit Insurance Agency of Bosnia and Herzegovina. Besides its work in the Committee above, the Agency continued its intensive bilateral cooperation with Central Bank of Bosnia and Herzegovina, Banking Agency of Federation of BiH, and Deposit Insurance Agency of Bosnia and Herzegovina.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2008	2009	2010
Banks	10	10	10
Micro-Credit Organizations	7	7	7
Saving-Credit Organizations	-	3	3
Leasing Providers	-	1	1
Financial institutions, total			

Ownership structure of the financial institutions on the basis of assets total

Item	2008	2009	2010
Public sector ownership	-	-	-
Other domestic ownership	8,1	8,9	8,7
Domestic ownership total	8,1	8,9	8,7
Foreign ownership	91,9	91,1	91,3
Financial institutions, total	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Bank	60,5	78,8	1563
Credit Cooperatives			
Financial Institutions	99,4	-	-
Savings Cooperatives	100,0	-	-
Specialized Credit Institutions	100,0	-	-

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

Type of financial institution	2008	2009	2010
Bank	6,5	3,4	-4,6
Credit Cooperatives			
Financial Institutions (MCO)	14,3	-	2,5
Savings Cooperatives			
Specialized Credit Institutions			

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Banks	94,9	94,5	95,5
Micro-Credit Organizations	5,1	5,4	4,4
Saving-Credit Organizations	-	-	-
Leasing Providers	-	0,1	0,1
Financial institutions, total	**100.0**	**100.0**	**100.0**

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

Assets	2008	2009	2010
Financial Sector	34	27	25
Nonfinancial Sector	56	62	61
Government	4	5	6
Other	6	6	8
Total:	**100.0**	**100.0**	**100.0**
Liabilities	**2008**	**2009**	**2010**
Financial Sector	26	31	30
Nonfinancial Sector	37	38	42
Government	25	18	11
Capital	9	9	13
Total:	**100.0**	**100.0**	**100.0**

Solvency ratio of financial institutions

Type of financial institution	2008	2009	2010
Banks	15,7	15,8	16,9
Micro-Credit Organizations	-	-	
Saving-Credit Organizations			
Leasing Providers			
Financial institutions, average	**16,5**	**15,7**	**15,8**

* Law on Banks of Republika Srpska stipulates capital adequacy rate of 12%.
** Adequacy rate has not been stipulated for MCOs, SCOs, LPs.

Asset portfolio quality of the banking system (share of impaired receivables)

Asset classification	2008	2009	2010
Non financial sector	0,0	0,0	0,0
- households	**2,21**	**9,63**	**18,25**
- corporate	**3,97**	**5,11**	**7,39**

The structure of deposits and loans in 2010 (%) (at year-end)

	Deposits	Loans
Households	39	40
Government sector	24	10
Corporate	36	49
Foreign	-	-
Other	1	1
Total	**100.0**	**100.0**

The structure of deposits and loans in 2010 (%) (at year-end)

Maturity of deposits		Loans	
At sight	33	Long term loans	77
Within one year	26	Medium-term loans	-
Over one year	41	Short-term loans	33
Total	**100.0**	**Total**	**100.0**

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

P&L account	2008	2009	2010
Interest income	179,0	167,7	159,0
Interest expenses	85,6	72,3	64,6
Net interest income	93,4	95,4	94,4
Net fee and commission income			
Net banking activity income			
Administration costs	48,2	66,2	77,4
Depreciation			
Provisions	42,3	60,0	70,1
Impairment on financial assets not measured at fair value through profit or loss			
Net operating income	(26,7)	(16,9)	(25,6)
Total profit (loss) before tax from continuing operations	19	14,4	(25,1)
Profit (loss) for the year	15,9	8,7	(25,1)

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Banks	358,5	288,2	70,3	-
Micro-Credit Organizations	30,7	25,6	5,1	-
Saving-Credit Organizations				
Leasing Providers	0,7	0,7	-	-
Financial institutions, average	**389,9**	**314,5**	**75,4**	**-**

2010 DEVELOPMENTS IN THE BULGARIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

After the decline of real GDP in 2009 it began slightly to recover and grew by 0.2% in 2010. A major contribution to that had exports of goods and services that started to grow in the middle of 2009 with the first signs of improvement of the world economy. During 2010 export increased by 16.2% in real terms and surpassed pre-crisis levels. Imports of goods and services increased during the last quarter of the year as a result of higher domestic demand, reaching for the entire 2010 a real growth of 4.5%.

Fixed capital investment decreased by 16.5% in 2010 because of uncertainty about sustainability of the recovery of the world economy. Further negative impact had the slowdown of FDI inflows, restructuring of economic sectors (which during the years before the crisis had a high growth rate), contracted domestic demand and cautious policy of banks in terms of lending.

The condition of the labour market did not improve in 2010 despite the gradual recovery of economic activity. The unemployment rate continued growing and at the end of 2010 reached 11.2%.

The total deficit of the current and capital account for 2010 shrank to EUR 65.4 million (0.2% of GDP) while in 2009 it was EUR 2640.6 million (7.6% of GDP). This improvement is based mainly on the decrease of trade deficit that reached EUR 2412.5 million during the current year – with EUR 1761.1 million less in comparison to the previous year.

The reduction of trade deficit of the balance of payment is as a result of the positive nominal growth (33.2%) of goods export during 2010 and the significantly lower rate (13.4%) of growth of the nominal import of goods. Net inflow of FDI in the country was also positive during 2010 reaching EUR 1458.9 million (4% of GDP).

In 2010 the SOFIX and BG40 indices fluctuated greatly. During the first quarter they retained the late 2009 levels, dipping in the second and beginning of the third quarter to reflect the Greek debt crisis. August and September saw some recovery followed by a new fall and high index volatility. For 2010 SOFIX and BG40 annual declines are 15.2 per cent and 2.1 per cent respectively.

DEVELOPMENT IN THE BANKING SYSTEM

The slower rate of recovery of the economy in 2010 continued to have a negative impact on banks' balance sheets. The difficulties that corporates and households faced in servicing their loans continued to worsen the quality of loans portfolio of banks. A major contribution to the increase of non-performing loans during the year had the corporate sector, while the processes in worsening the quality of loans for households were slower. The capital buffers in the system were maintained in spite of the growing share of non-performing loans and the connected to them impairment costs. The banking system managed to generate profit despite the unfavourable economic processes but the level reached at the end of 2010 is lower compared to previous year. The Bulgarian banking system is one of the very few EU banking systems which stability is not based on any kind of financial support from public sources.

Asset quality

During the last 12 months the level of classified assets (EUR 2.15 billion) is similar to that for the period 2008-2009, while at the same time the growth rates decline from 147% to 59%. The share of loans past-due more than 90 days continues to grow, reaching 11.92%[8].

The formed total provisions (impairment and specific provisions for credit risk) cover 75% of loans which have accumulated arrears over 90 days and totally cover the exposures past due over 180 days. At the same time banks are protected also in terms of the accepted collaterals, which in spite of the decline of property prices still have a high enough value.

Profitability

The profitability of the banking system during the year is impacted by two major factors – weak opportunities for growth (primarily through lending) and the need for allocation of provisions against the already worsened loans. With a view to restore profits credit institutions tried to activate lending which was expressed more strongly during the second half of the year.

Income revenue at the end of the year is smaller compared to that of 2009 - due to the decrease of problem loans' profitability. At the same time the declining price of financing of assets had a positive effect on the reported net interest income. The deterioration of loans was accompanied by an increase of impairment costs which reached EUR 0.7 billion at the end of 2010 but with much slower growth rates compared to previous year (24% compared to 210% for 2009).

The reported by banks gross operating incomes for 2010 are EUR 1.9 billion and surpass with EUR 73 million (3.8%) those for 2009.

Profit for 2010 is EUR 307 million or with EUR 78 million less than that during 2009. The reached ROA decreases from 1.08% to 0.84% and correspondingly the ROE – from 8.95% to 6.55%.

Solvency

The capital position of the banking system remains stable throughout the year. At the end of 2010 it has a reliable capacity for neutralization of new risks in case the relatively unfavourable for the banking activity conditions remain. The accumulated buffers are preserved. The total capital adequacy of the system for end 2010 increases to 17.39% reaching its highest level for the last six years. The capital surplus (the excess of capital over the regulatory minimum) is preserved in respect to December 2009 and is EUR 1.4 billion (3.9% of GDP for 2010). Further potential support for the capital is the audited financial result for 2010. The increase of the registered and paid capital and reserves is a prerequisite for the increase of Tier 1 capital adequacy from 14.03% to 15.16% (having a recommended by BNB minimum level of 10%). The leverage ratio shows a low rate of indebtedness of the Bulgarian banking sector.

Liquidity

The liquidity position of the credit institutions remains at a level that guarantees financial operations. The stability of the attracted resources and high liquidity of the system are influenced by the sustainable growth of deposits and the still limited investment opportunities. At the end of 2010 the amount of liquid

[8] It should be noted that the reached level concerns gross loans and includes risk, that is already reflected by the made impairments in the profit and loss account. If the gross amount of loans is deducted by them, at the end of 2010 the share of net non-performing loans (over 90 days) to total net loans would be 8%.

assets is with EUR 1 billion (15.2%) more than December 2009 and reach EUR 7.9 billion. The liquid assets ratio increases from 21.91% to 24.35%.

Market structure

In 2010 the number of credit institutions remains 30. For end of the year the total amount of assets for the Bulgarian banking sector is EUR 37.7 billion (a growth of 4.1% compared to end 2009). The top five largest banks have a market share of 54% (compared to 58% in 2009). The ratio of banking sector assets to GDP for 2010 is 104.6%.

Foreign presence

For end 2010 the eight domestically controlled institutions increased their market share to 19.27% (compared to 16% in 2009) in terms of total assets. The market share of EU institutions operating in Bulgaria decreased compared to 2009 and at end 2010 are 77.80% (81.33% in 2009). Also the market share of banks and branches under the control of Greek shareholders decreased and at end 2010 are 27.70% (compared to 29% in 2009).

Products and distribution channels

The banking system in Bulgaria consists of banks (licensed as universal credit institutions) that offer a broad range of products and services to corporate and household clients. For end 2010 there are 79 points of sale (branches, offices, representative offices and remote workstations), 72 ATMs and 809 POS terminals per 100 000 population.

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

Supervising the credit institutions operating in Bulgaria is a major function of the BNB and it aims to maintain the stability of the banking system, and to protect the interests of depositors. The Law on the BNB, as well as the Law on Credit Institutions (LCI), and secondary legal acts for its implementation constitute the legal framework defining the objectives and instruments of banking regulation, as well as the rules for credit institutions' activities. Banks that offer investment services apply the respective supervisory regulations on financial markets, and are controlled also by the Financial Supervision Commission.

Supervisory efforts to limit the impact of the crisis on the banking system continued in 2010. Supervisory policy aimed at harmonising national regulations with the new bank supervision requirements in the European Union. The major priority of developing anti-cyclic measures for maintaining a flexible and stable bank market continued.

In March 2009 amendments to Ordinance No 8 of the BNB on Capital Adequacy of Credit Institutions were made, in order to alleviate capital burden on banks and stimulate their credit activity – risk weights for qualified residential mortgages were decreased from 50% to 35%, risk weights for retail exposures were decreased from 100% to 75%, easier requirements for recognition of current profit as regulatory own funds. Previously applied higher risk weights were used at the time of credit boom, and current levels are in conformity with the relevant standard provisions of the EU directive.

The BNB Governing Council adopted new ordinance No 14 on the Content of the Audit Report for Supervisory Purposes which summarizes and develops practices and supervisory requirements in this area.

The implementation of the so-called package CRD II imposed amendments to three of the most important ordinances – on capital requirements of credit institutions, on large exposures regime, on bank liquidity management and supervision. In relation to Bulgarian banking system, the implementation of CRD II requirements is in force as of 31-December-2010, i.e.:

- Law on Credit Institutions – Inclusion of legal texts for colleges of supervisors and other supervisory arrangements;
- Ordinance No 8 on Capital Adequacy of Credit Institutions – The most significant amendments are related to the adoption of harmonised rules for inclusion of hybrid instruments in Tier 1 own funds. In addition the amendments introduced new requirements for retention of net economic interest in relation to securitisation transactions and some technical adjustments related to credit risk mitigation techniques;
- Ordinance No 7 on Large Exposures – These changes make the overall regime on large exposures more conservative than the previous one. The amendments to large exposures regime of banks provide for changes in the regime of treatment of large interbank exposures, and is aimed at reducing risk concentration towards companies within the group;
- With the latest changes in Ordinance No 11 on Bank Liquidity Management and Supervision, BNB introduced substantial part of the new Basel requirements for liquidity management with regard to the maintenance by banks of reliable strategies, policies, procedures, and systems for identification, measurement, management and monitoring of liquidity risk;
- Update on reporting templates, in force from 31-December-2010 - COREP reporting forms (capital adequacy) and reporting forms on Ordinance No 7 (large exposures) were improved.

Requirements for Remunerations in Banks which are part of the CRD III revision that are applicable as of 1-January-2011 were introduced by a new Ordinance No 4. Some very limited technical changes were made in Ordinance No 8, required by the same directive. The amendments primarily pertain to the requirements regarding reporting and disclosure of remuneration policies and practices in banks.

In 2010 BNB implemented also new guidelines issued by the Committee of European Banking Supervisors (CEBS) whose functions were discharged by the European Banking Authority (EBA): High-level principles for risk management (structuring of internal reviews of capital adequacy and the process of supervisory reviews and assessments), Guidelines on liquidity buffers and survival periods (instructions for establishing and maintaining the levels, composition and quality of liquidity buffers), Guidelines on instruments under Article 3a of Ordinance No 8 (guidelines on recognition of hybrid instruments in Tier 1 capital), Guidelines on requirements for remunerations in banks (in force from 1-January-2011).

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2010

The strategic objectives of the Banking Supervision are:

- to maintain the stability of the banking system in compliance with legal acts and to protect the interests of depositors;
- to ensure proper and effective regulation of credit institutions and the banking system;
- to deliver a more assertive, risk based and challenging approach to banking supervision;
- to ensure a greater focus on macro-prudential analysis to identify the risks and stresses for business models, sectors of the economy and banking system;
- to translate the macro-prudential analysis and micro-prudential oversight into agreement on and imposition of, supervisory actions necessary to address identified risks;
- to continue the implementation of the EU directives , to prepare amendments to national regulations in accordance with the recommendations of international supervisory authorities and the best international practices.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In terms of general financial uncertainty, in 2010 frequency, intensity and efficiency of oversight of banks were increased within available resources. The analysis of system's risk profile and risk management at individual banks was based on regular reports and on-site inspections. Major risk areas of credit institutions were evaluated based on quantitative financial ratios and indicators. The results of the supervisory review and evaluation, carried out by means of current control, provided an important input for planning supervisory activities and performing on-site inspections.

During the year BNB conducted 25 on-sight inspections. In the light of trends in the real economy and banking system during these inspections BNB focused its attention on the state and management of credit and liquidity risk, and the assessment of the capital adequacy. Levels of operational risk and its management were also assessed. The results of the overall supervisory review showed that banks maintain higher statutory solvency requirements, sufficient capital buffers, good liquidity and credit risk management, adequate to prevailing conditions.

During the reporting period the credit institutions' policy for internal capital adequacy assessment was reviewed. The results of the review were assessed as satisfactory.

Work on approving methods for determining capital requirements for credit risk by applying internal rating models intensified. One institution was authorized to apply an advanced approach for calculating capital requirements for credit risk.

In supervisory macro-prudential analyses and strategies, the financial parameters of individual credit institutions and the banking system were continuously monitored and analysed. Maintaining banking sector and financial system stability involved the timely identification of problems and monitoring bank risk developments. The relations with risk identification/analysis and forecast units at credit institutions intensified. Various aspects of banks' performance and expected 2010 and 2011 results were studied. Regular financial and supervisory reports and up-to-date information acquainted the public with the state of banking. Supervisory indicators, measures, and practices in other EU countries were surveyed to deepen the study of banking processes.

Events on international markets and recent cooperation within the new European supervisory architecture increased intensity of analyses and surveys. The state of the parent institutions of Bulgarian subsidiaries and factors determining European banking trends were carefully monitored. The outcome of 2010 in Bulgarian banking confirmed supervisory expectations. Though unfavourable foreign forecasts failed to materialise, all hypotheses were analysed and preventive measures intensified.

Testing methodologies for major risk types (credit, liquidity and market) improved further. Stress tests continued to check the ability of the system and individual institutions to withstand various real and hypothetical influences, and the results were used to initiate timely supervisory measures. Experts from the Banking Supervision Department took part in the pan-European banking system stability test in July 2010.

The Single Data Depository/Banking Supervision Reports provided continuity of information on data collection and processing. In 2010 credit institutions were asked to extend reporting. Number of non-bank financial institutions under Article 3, paragraph 2 of the Law on Credit Institutions increased significantly. The inclusion of the additional Financial Institutions Module to the Single Data Depository provided timely and reliable information about registered financial institutions.

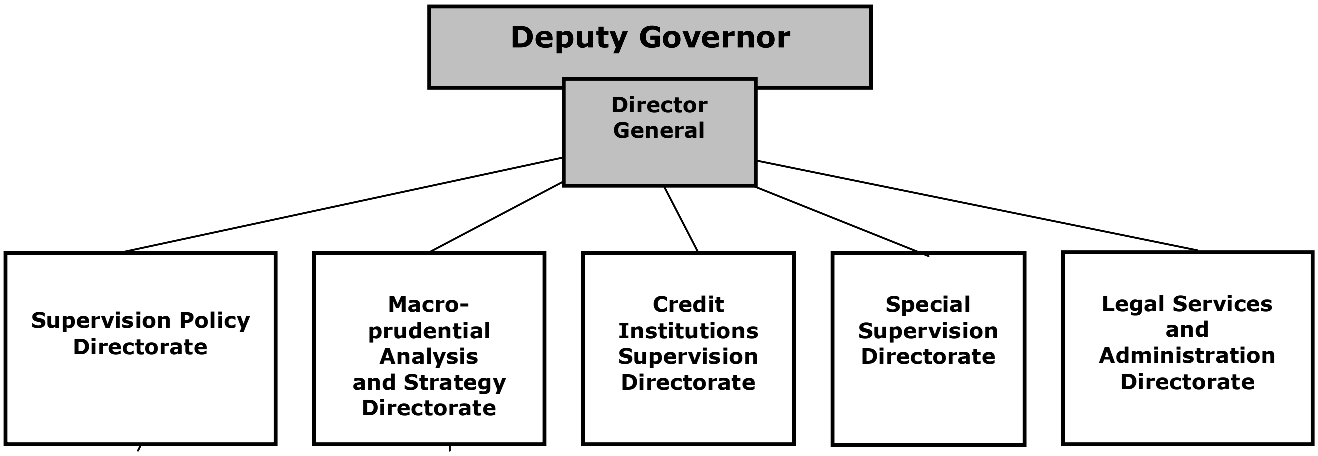
Combating financial fraud, money laundering and the financing of terrorism was also a key priority for the BNB. Banks and finance houses adhered to international standards on counteracting money laundering and implemented effective procedures and policies to minimize risk of transferring funds of unclear or supposed criminal nature.

Moreover, efforts were put for increasing transparency in offering bank products and services and supervisory recommendations for raising customers' awareness were provided.

Corporate governance oversight practices converged in line with legal requirements and trends. Our efforts focused on transparency through disclosure of additional financial and other business information.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

Banking Supervision Department



INTERNATIONAL ACTIVITIES

In 2010 BNB continued its contribution to work and functioning of supervisory colleges. During the year BNB signed two more multilateral Memoranda for home-host supervisory cooperation, and recently total number of colleges that BNB was participating in is 11. The exchange of supervisory information within the colleges was regular, mutually beneficial and in compliance with the Multilateral agreements for cooperation and coordination on the supervision of cross-border banking groups.

Over the review period BNB took an active part in deliberations and policymaking at the ESCB, Ecofin, the Economic and Finance Committee, and other EU Council and European Commission committees and working groups. EU work over the review year addressed the future European supervisory framework, obtaining consensus on a more effective financial regulatory and supervisory architecture acceptable to all Member States, and action to improve financial stability. Within the year, BNB expressed positions on several supervisory issues, which have direct impact on the financial sector in Bulgaria, and in particular, on the draft Omnibus Directive, which amends sector directives on the Supervisory Bodies in EU. During 2010 BNB representatives contributed also to the discussion on amendments of the Credit Rating Agencies regulation.

BNB continued its active policy on cooperation with other supervisory authorities with main priority on technical assistance to regional countries in their preparation for EU membership. The number of projects for providing technical assistance with the participation of BNB was increasing in 2010. Thus, BNB contributes to strengthening the capacity of other regulatory and supervisory authorities, and the financial stability in the region.

BNB is the leading MS institution of the Twinning project between the Central Bank of Montenegro, Montenegrin Securities and Exchange Commission, Montenegrin Insurance Supervision Agency on the one side, and De Nederlandsche Bank, Financial Supervision Commission (Bulgaria) and BNB - on the other. The aim of the project is to support beneficiaries in introducing consistently the EU acquis communautaire in the field of financial sector regulation and supervision, anti-money laundering, payment services, as well as to provide training for BC experts and capacity building for the financial supervisory authorities of Montenegro.

A European Commission-funded three year cooperation programme with the Central Bank of Egypt on bringing banking supervision into line with Basel II principles was launched in 2009 and continued over 2010. The BNB provides assistance in three strategic areas: own funds, a standardised approach to credit risk, and reporting.

COOPERATION WITH OTHER SUPERVISORY BODIES IN BULGARIA

In 2010 BNB continued its active policy of supervisory cooperation with the Financial Supervision Commission mainly by exchanging information and professional expertise in relation to participating in European committees and working groups, the work of which is focused on elaborating common supervisory standards for overcoming the sector-specific differences in supervision over credit and financial institutions.

BNB and the Ministry of Finance are participating in the Working Group of Financial and budgetary issues under the Council for European Affairs, in which joint positions and statements on a number of recommendations for amending and updating financial regulations, directives and programs were discussed and developed.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2008	2009	2010
Commercial banks	24	24	24
Branches of foreign credit institutions	6	6	6
Cooperative banks	-	-	-
Banking sector, total:	**30**	**30**	**30**

Ownership structure of banks on the basis of assets total

Type of financial institution	2008	2009	2010
Public sector ownership	0.62	1.27	1.9
Other domestic ownership	15.47	14.60	17.4
Domestic ownership total	16.09	15.87	19.3
Foreign ownership	83.91	84.13	80.7
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	37.02%	54.49%	95.17%
Branches of foreign credit institutions	4.11%	4.82%	4.83%
Cooperative banks	-	-	-
Banking sector, total:			**100**

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

Type of financial institution	2008	2009	2010
Commercial banks	20.26	8.95	6.55
Branches of foreign credit institutions			
Cooperative banks	-	-	-
Banking sector, total:	**20.26**	**8.95**	**6.55**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	94.5	94.9	95.2
Branches of foreign credit institutions	5.5	5.1	4.8
Cooperative banks	-	-	-
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2008	2009	2010
Cash in hand, balances with central banks	9.67	9.02	9.94
Loans and advances to credit institutions	9.71	10.45	10.39
Loans and advances to customers	70.46	69.59	67.13
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	7.49	6.68	8.06
Tangible assets and Intangible assets	2.19	2.23	2.12
Residual assets	0.47	2.03	2.36
Total assets	100.00	100.00	100.00
Liabilities	**2008**	**2009**	**2010**
Amounts owed to credit institutions	21.98	20.33	17.75
Amounts owed to customers	60.33	61.31	63.93
Debts evidenced by certificates	1.35	0.98	0.81
Residual liabilities	2.16	1.41	1.39
Provisions	0.14	0.10	0.10
Subordinated liabilities	2.64	2.56	2.53
Equity (including valuation adjustments)	9.42	12.25	12.77
Profit or loss for the financial year	1.98	1.06	0.81
Total liabilities and equity	**100.00**	**100.00**	**100.00**

Note: The common way to present information about the banking sector assets/liabilities is not the aggregated balance sheet. In Bulgaria banks use FinRep reporting framework since the beginning of 2007 and the data presented here are based on annual reports of credit institutions for 2010.

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks	14.93**	17.04**	17.39**
Cooperative banks	-	-	-
Banking sector, total:	14.93**	17.04**	17.39**

(* - for Basel I; ** - for Basel II)

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

Asset classification	2008	2009	2010
Total **Loans and Advances** - gross value in mln. EURO	29 109	30 603	31 443
Standard loans and advances %	94.9	88.0	81.39
Total adversely Classified loans and advances %	5.1	12.0	18.61
-Including NPL>90 days %	**2.2**	**5.6**	**10.48**

Note: The breakdown of asset quality information is based on FinRep category loans and advances.

The structure of deposits and loans of the banking sector in 2010 (%) (at year-end)

	Deposits	Loans
Households[9]	44.3	35.6
Government sector[10]	2.8	0.9
Corporate[11]	19.6	59.4
Foreign[12]	23.7	1.5
Other[13]	9.6	2.6
Total	**100.0**	**100.0**

[9] Data refer to ESA'95 sectors S.14 Households and S.15 Non-profit institutions serving households.
[10] ESA'95 sector S.13 General government (S.1311 Central government, S.1313 Local government and S.1314 Social security funds).
[11] The item covers ESA'95 sector S.11 Non-financial corporations.
[12] ESA'95 sector S.2 Rest of the world.
[13] Data refer to ESA'95 sector S.12 Financial corporations (monetary financial institutions, other financial intermediaries, financial auxiliaries, insurance corporations and pension funds).

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

P&L account	2008	2009	2010
Interest income	2,517,821	2,633,280	2,592,565
Interest expenses	1,090,382	1,183,238	1,101,200
Net interest income	1,427,440	1,450,042	1,491,365
Net fee and commission income	396,582	375,734	388,186
Other (not specified above) operating income (net)	16,175	16,025	19,768
Gross income	1,901,768	1,938,858	2,012,102
Administration costs	854,520	861,768	865,598
Depreciation	100,982	114,641	116,069
Provisions	-2,664	-8,738	5,913
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	175,916	547,444	680,999
Profit (loss) before tax	778,044	428,514	344,955
Net profit (loss)	702,406	384,475	306,573

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	4,525,349	3,945,101	580,251	-
Cooperative banks	-	-	-	
Banking sector, total:	4,525,349	3,945,101	580,251	-

2010 DEVELOPMENTS IN THE CROATIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Croatia witnessed a fall in overall economic activity for the second consecutive year in 2010. After falling 6.0% in 2009, the gross domestic product fell by 1.2% in real terms in 2010. Unfavourable developments in the real sector in 2010 were largely due to a further fall in the gross fixed capital formation in all sectors. Household consumption also continued to fall steadily, mainly due to unfavourable developments in the labour market, with a negative contribution to the change in the overall economic activity coming also from government consumption. Such developments in domestic demand resulted in a further decline in goods and services imports. The total gross value added declined 1.7% in 2010 as a result of a fall in all activities except financial intermediation, and in particular a fall in construction activity. Unfavourable trends in the real sector of the economy had a negative impact on the labour market indicators. The average registered unemployment rate rose to 17.4% and was accompanied by a concomitant fall in employment which was down 3.7% at the end of 2010 compared to the year before. The nominal gross wages fell by 0.5% in 2010 compared to the previous year. One of the main characteristics of the macroeconomic environment in 2010 was law consumer price inflation whose average annual rate fell from 2.4% in 2009 to 1.1% in 2010. Consumer price inflation deceleration was due not only to the fall in domestic demand but also to a fall in unit labour costs. The exchange rate of the kuna against the euro remained stable throughout 2010, underpinning domestic price stability and the stability of the total macroeconomic environment.

The reduction in current account imbalances which started in 2009, continued throughout 2010. Current account deficit declined and its relative indicator improved from 5.3% of GDP to only 1.3% of GDP. The bulk of this decline was due, in the same way as in the year before, to exports recovery and a stagnation in imports. The low value of the current account deficit resulted in a much smaller need for foreign financing while the relatively modest foreign direct investment in Croatia mainly involved financial intermediation and various trade and real estate activities. The country's gross external debt stood at EUR 46.4bn at the end of 2010, or 101.0% of GDP.

The main objective of the monetary policy pursued by the Croatian National Bank (CNB) in 2010 was to keep the exchange rate of the domestic currency, as the main anchor of price and financial system stability, stable and to maintain high domestic banking system liquidity. Such a policy aimed at boosting credit activity of banks through improved financing terms while trying at the same time to downsize the effects of the still present economic activity weakening in the country. The CNB also cut the reserve requirements rate from 14% to 13%, thus providing impetus to government efforts to kick-start economic recovery in cooperation with the Croatian Bank for Reconstruction and Development.

DEVELOPMENTS IN THE BANKING SYSTEM

At the end of 2010, there were 38 credit institutions operating in the Republic of Croatia: 32 banks, one savings bank and five housing savings banks. Compared to the end of 2009, the number of credit institutions fell by one as a result of a compulsory winding up proceedings initiated in one savings bank and withdrawal of this savings banks authorization. Bank assets accounted for 98.3% and housing savings bank assets for 1.7% of the total assets of credit institutions. The total assets of credit institutions stood at HRK 398.0bn, or 119.0% of GDP. At the end of 2010, 19 credit institutions were in the majority ownership of foreign shareholders and they accounted for 90.4% of the total assets of all credit institutions. Three credit institutions were in the majority state ownership and their assets accounted for 4.3% of the total assets of all institutions. The remaining 16 credit institutions were in the majority ownership of domestic shareholders and their assets accounted for 5.3% of the total assets of all credit institutions. At the end of 2010, credit institutions employed 22,175 persons.

Negative developments in the real sector and credit portfolio quality worsening kept bank balance sheet growth restrained at 3.4% in 2010. The annual growth rate of assets accelerated somewhat at the end of 2010 compared to the year before, though this acceleration was primarily the result of changes in the exchange rate of the kuna against the Swiss franc and to a lesser extent towards the euro and the American dollar, which make up almost the entire stock of foreign exchange assets. Growing uncertainty, coupled with the fact that the citizens were less inclined to invest in other forms of investment, boosted the domestic sources of growth in bank assets. This resulted in a slow but steady increase in household savings, in line with the trend present since the second half of 2009, making it possible for the banks to rely less on the sources of funding from their majority foreign owners.

Credit activity was slow again, though it picked up slightly compared to 2009. The largest share of the credit increase of 5.3% was channeled to the corporates, while household loans, influenced by poorer demand for individual types of household loans, fell in real terms. Increased risk of default on bank loans and low credit activity in relation to new and low-risk clients, led to a significant increase in the level of partly recoverable or fully irrecoverable corporate loans. The largest impact of such a development was the deterioration in the quality of total bank loans while the quality of household loans, partly as a result of materialisation of the currency-induced credit risk, particularly in relation to household loans indexed to the Swiss franc, also worsened considerably.

The absence of any significant credit activity and the growth in the share of partly recoverable and fully irrecoverable loans to 11.2% of total bank loans led to a fall in interest income and profit of the majority of banks. Nevertheless, and owing to improved cost effectiveness and the growth in other sources of income, most notably those from commissions and fees, the indicators of bank returns remained solid, with ROAA standing at 1.1% and ROAE at 6.6%.

In the light of growing credit portfolio losses, good liquidity position and strong capitalisation of the majority of banks had a positive influence on banking system stability. The capital adequacy of banks thus stood at 18.8% at the end of 2010, and its considerable increase compared to the year before can be attributed to legislative alignment with the relevant EU directives, i.e. with the so called Basel II framework. Unlike the previous regulations, the new regulatory framework for the calculation of the minimum capital adequacy ratio does not envisage increased weights for the currency-induced credit risk, with the result that the average credit risk weight has decreased significantly. In an effort to offset the effect of this decline, the CNB increased the minimum capital adequacy ratio from 10% to 12%, using the national discretionary power which enables the competent authorities to prescribe the capital adequacy ratio at the rate exceeding that prescribed by the Capital Requirements Directive (8%).

According to regularly conducted stress test results, relatively good profitability of banks, combined with an exceptionally high capital adequacy provides a good buffer in case of a new worsening in the macroeconomic environment. In a not very likely but possible case that such an unfavourable scenario should take place, the banking system would remain stable and well-capitalised.

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

Among CNB tasks regulated by the Act on the Croatian National Bank is the exercise of supervision and oversight of credit institutions and credit unions in accordance with the Credit Institutions Act and the Credit Unions Act, as the fundamental acts which govern the conditions for the establishment, operation and dissolution of these institutions, as well as supervision of their operations. The main objectives of supervision exercised by the CNB are to maintain confidence in the Croatian banking system, and to promote and safeguard its safety and stability.

Supervision of credit institutions consists of several coordinated activities aimed at verifying whether credit institutions (banks, savings banks and housing savings banks) operate in compliance with risk management rules, provisions of the Credit Institutions Act and regulations adopted under that act, other relevant laws and regulations governing the carrying out of financial activities, their own rules, standards and rules of the profession. In addition to supervision, the CNB exercises oversight of the implementation of the Act on the Croatian National Bank, regulations adopted under that act, and the implementation of other laws and regulations for which it is competent.

Other supervisory bodies in the Republic of Croatia that operate in the area of financial system supervision are the Ministry of Finance and the Croatian Financial Services Supervisory Agency (HANFA). Their field of competence includes regulation and supervision of non-banking financial services.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2010

On several occasions in the last two years, the European Commission issued sets of potential changes in the regulatory framework. The CNB made projections of the effects of the main proposed changes on the business of credit institutions. In this context, CNB experts prepared a plan for the implementation of the required changes in the domestic legislative framework that relates to the business of credit institutions in line with EU legislation, so as to be able to finalize the working versions of all regulations as early as in the first half of 2011. In addition to legislative alignment and improvement in the area of the business of credit institutions, the key strategic projects in 2010 in the area of supervision involved CNB reporting system and credit institution risk assessment methodology improvement.

The new reporting of credit institutions is being implemented under two projects whose realisation will provide data needed for the compilation of European supervisory reports (FINREP), the implementation of which is expected in 2013, and European reports on the capital adequacy and capital requirements (COREP). Supervisory reports of credit institutions that are compiled by the CNB on the basis of data submitted by credit institutions have been in official use since 2010. This completed the project started in 2007 with a view to optimising financial reporting by credit institutions in the light of various reporting requirements, most notably those of statistical and prudential nature. The second project concerning the new reporting requirement includes further activities on the development and improvement of reports by credit institutions related to capital adequacy, liquidity, interest rate risk in the non-trading book and currency risk. The bulk of the project was implemented in early 2010 with the entry into force of new regulations and the completion of the test cycle of form receipt.

To provide adequate supervisory tools for systematic monitoring and analysis of risks to which credit institutions are exposed in their operations, a project was launched in May 2009 aimed at enhancing the methodology for assessing risks in credit institutions. Activities were underway in 2010 on the preparation of a detailed methodology concerning market and liquidity risk and risk assessment of credit institutions as well as the designing, testing and enhancing the statistical model for capital, assets and earnings indicators. The working group included experts in the area of statistical regressions of capital, assets and earnings indicators, drafting of a detailed methodology for asset quality and earnings and a methodology for issuing internal capital data and establishment of a methodology for IT risk management. These efforts resulted in a proposal of the information to be publicly disclosed.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

Heightened supervisory activities in 2010 were again associated with the alignment of the domestic legislation in the area of banking with the acquis communautaire. The beginning of 2010 saw the entry into force of the Act on Amendments to the Credit Institutions Act introduced in 2009 with a view to achieving alignment with changes in the acquis communautaire in the area of financial services, most notably the Capital Requirements Directive. In addition to alignment of the Credit Institutions Act, the authorities also made the necessary amendments to all relevant subordinate legislation while the implementation of the fully-aligned subordinated legislation began on 31 March 2010. Reporting on the business operations of credit institutions was adjusted accordingly to accommodate such changes and the first reports to the CNB prepared in accordance with the new reporting system were received at the end of April 2010. The changes in the reporting system called for methodological adjustment on the part of the CNB in terms of adjustment of off-site examination process implementation. Throughout 2010, special attention in the context of off-site examination was paid to liquidity analysis, data on due but unpaid receivables and credit risk quality.

All the tasks planned under CNB's strategic guidelines relating to on-site examination were completed in 2010. In addition to the main tasks of on-site examination of credit institutions, on-site examinations were also conducted in 2010 for the purpose of validation of the internal ratings based approach (IRB) for credit risk and assessment of the framework for the use of the advanced measurement approach for the calculation of capital requirements for operational risk. There was a range of activities in 2010 which focused on the adoption of a new and the improvement of the existing methodology for validation of the advanced approach for the calculation of capital requirements for operational risk, drafting of the methodology for the supervision of credit risk management by credit institutions, drafting of the methodology for the supervision of IRB approach in credit institutions, drafting of reporting standards on findings and assessments of IT systems of credit institutions in audit reports and improvement of the existing methodology for the performance of on-site examinations.

Following the adoption of relevant regulations governing in detail the field of consumer protection, the year 2010 was marked by intensive CNB activities related to the supervision of the implementation of new regulations. Since insufficient or inadequate transparency of credit institutions' business operations were the most frequently cited consumer complaints in the previous period, the CNB took appropriate actions to improve the situation.

Until the date of accession, the CNB is the institution responsible for market competition in the banking and financial services market when these are performed by credit institutions. As regards activities in the area of market competition, the CNB conducted a comprehensive set of sector-wide analyses of the behaviour of commercial banks in individual household sector segments. Given that the responsibility of the CNB in the area of market competition will be transferred to the Croatian Competition Agency on the date of Croatia's accession to the EU, a draft Memorandum of Understanding between that agency and the CNB was prepared.

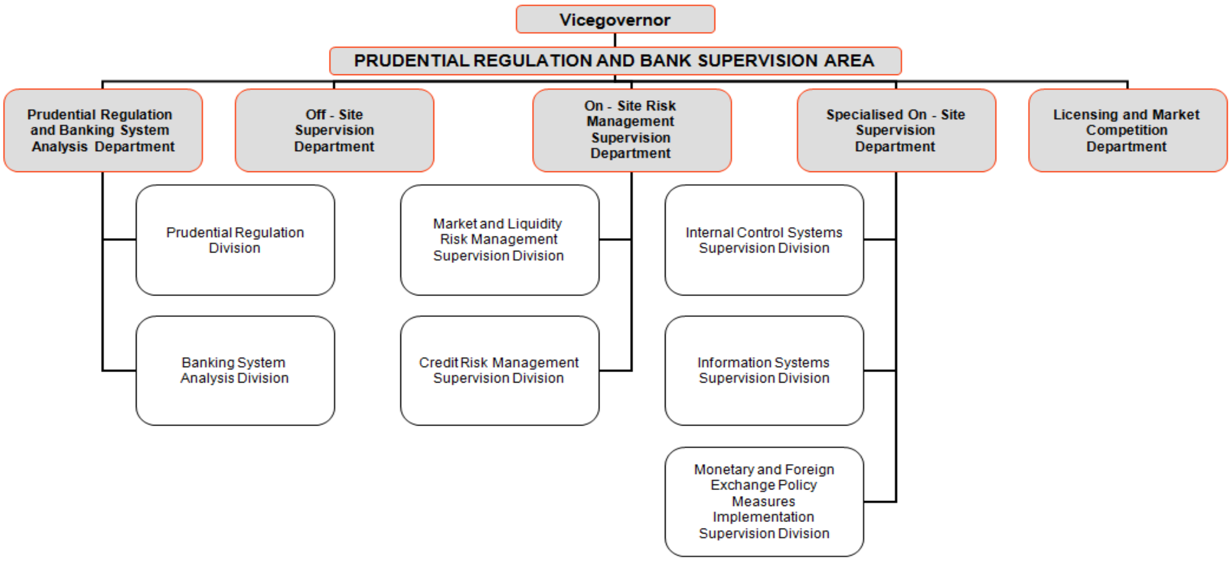
In 2010, the CNB supervised the operations of credit unions by collecting, monitoring and analysing data presented in financial and supervisory reports. To ensure better regulation and enhance business operations of these institutions, the CNB prepared in 2010 a proposal of amendments to the Credit Unions Act. There were 23 credit unions operating in the Republic of Croatia at the end 2010.

As regards licensing operations, a number of applications for licensing were processed and decisions issued on issuing or withdrawing of authorisations and approvals as regards banks, housing savings banks, savings banks and credit unions.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

The activities of supervision of credit institutions have been organised through the Prudential Regulation and Bank Supervision Area. At the end of 2010, the Prudential Regulation and Bank Supervision Area employed 117 employees.

The Organisational scheme of the Prudential Regulation and Bank Supervision Area:



INTERNATIONAL ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

Enhancing the role of the college of supervisors at the European level, which is in line with the new CEBS guidelines, further intensified cooperation with foreign supervisors. Based on signed memoranda of understanding on the supervision of a banking group and with a view to improving cooperation with external supervisors, in 2010 CNB representatives participated in a range of workshops and/or colleges of supervisors relating to the supervision of European banking groups that include domestic credit institutions. CNB's participation in the above-mentioned events and efforts included analyses of the general risk profile of credit institutions, methodology of risk analysis of each individual risk to which a credit institution is exposed and the impact of the financial crisis on the operation of a credit institution together with prudential and/or monetary measures and future development aspects.

In 2010, the CNB delivered to consolidating supervisors the main findings, conclusions and recommendations of on-site examinations of domestic credit institutions that are members of banking groups. Within the framework of cooperation with foreign supervisors, the CNB is responsible for the creation of the Supervisory Risk Report, i.e. the annual assessment of the domestic credit institution, which is used in the making of the final risk assessment of a banking group by the consolidating (home) supervisor.

Memoranda of understanding in the field of banking supervision of groups of credit institutions, which the CNB concluded with the Austrian, Italian and Hungarian supervisory authorities, were updated in 2010. The preparation of a memorandum of understanding in the field of banking group supervision of housing saving banks in majority foreign ownership has been announced.

COOPERATION WITH OTHER SUPERVISORY BODIES IN CROATIA

The CNB has entered into relevant agreements with other supervisory bodies in the country, as follows:

- Agreement on co-operation with the Croatian Financial Services Supervisory Agency
- Agreement on co-operation with the Office for the Prevention of Money Laundering
- Agreement on cooperation in the area of market competition in the market for banking and financial services 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
- Crisis management memorandum with the Ministry of Finance and HANFA.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

For further information on the supervisory activities of the CNB, the legislative basis which governs CNB supervision as well as access to the relevant regulations, visit CNB Web site at www.hnb.hr.

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Banks	33	32	32
Savings banks	1	2	1
Housing savings banks	5	5	5
Banking sector, total:	**39**	**39**	**38**

*Data refer to credit institutions operating in Republic of Croatia (RoC): banks, savings banks and housing savings banks. There are no branches of foreign credit institutions operating in RoC.

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

Type of financial institution	2008	2009	2010
Public sector ownership	4,4	4,1	4,3
Other domestic ownership	4,8	4,9	5,3
Domestic ownership total	9,2	9,0	9,6
Foreign ownership	90,8	91,0	90,4
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Banks*	54,9	75,2	1 361,6
Housing savings banks	54,4	100,0	2 400,3
Banking sector, total:	**54,0**	**73,9**	**1315,6**

*From this table onwards, data for savings banks are included in line Banks.

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

Type of financial institution	2008	2009	2010
Banks	9,9	6,4	6,6
Housing savings banks	4,7	13,5	3,9
Banking sector, total:	**9,9**	**6,4**	**6,5**

*ROAE

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Banks	98,2	98,3	98,3
Housing savings banks	1,8	1,7	1,7
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2008	2009	2010
Financial sector	n/a	n/a	13,5
Nonfinancial sector	n/a	n/a	59,4
Government sector	n/a	n/a	12,7
Other*	n/a	n/a	14,5
Liabilities	**2008**	**2009**	**2010**
Financial sector	n/a	n/a	10,2
Nonfinancial sector	n/a	n/a	52,5
Government sector	n/a	n/a	1,9
Capital	n/a	n/a	13,8
Other*	n/a	n/a	21,6

* includes non-residents

Capital adequacy ratio of banks

Type of financial institution	2008*	2009*	2010**
Banks	15,2	16,4	18,8
Housing savings banks	13,2	16,3	20,3
Banking sector, total:	**15,1**	**16,4**	**18,8**

* Modified Basel I (Basel I plus higher risk-weights for claims from clients with unmatched FX position)
** Basel II

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

Asset classification	2008	2009	2010
Non financial sector			
- households	**4,0**	**5,8**	**7,8**
- corporate	**7,5**	**12,9**	**18,0**

*share of partly recoverable (risk category B) and fully irrecoverable (risk category C) loans
Bank loans are classified into risk categories A, B and C pursuant to the Decision on the classification on placements and contingent liabilities of banks (OG 17/2003, 149/2005 and 74/2006) and from March 2010 onwards pursuant to the Decision on the classification on placements and off-balance sheet liabilities of credit institutions (OG 1/2009, 75/2009 and 2/2010).

The structure of deposits and loans of the banking sector in 2010 (%) (at year-end)

	Deposits	Loans
Households	57,0	46,6
Government sector	1,9	9,7
Corporate	17,1	40,0
Other (excluding banks)*	23,9	3,7
Total	**100.0**	**100.0**

*excluding domestic banks, including non-residents

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

P&L account	2008	2009	2010
Interest income	21 767	22 830	21 215
Interest expenses	11 809	13 279	10 251
Net interest income	9 958	9 551	10 964
Net fee and commission income	2 981	2 983	3 209
Other (not specified above) operating income (net)	1 431	2 761	1 479
Gross income	14 370	15 295	15 653
Administration costs	6 614	6 643	6 551
Depreciation	920	940	1 013
Provisions	27	61	-75
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	1 072	3 454	3 789
Profit (loss) before tax	5 737	4 196	4 375
Net profit (loss)	4 612	3 278	3 503

*in million HRK

Total own funds in 2010 (in EUR*)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Banks	7 370,7	6 873,9	496,8	0,0
Housing savings banks	71,8	58,9	12,9	0,0
Banking sector, total:	7 442,5	6 932,8	509,8	0,0

*HRK/EUR 7,385173

2010 DEVELOPMENTS IN THE CZECH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Economic growth in the Czech Republic rebounded in 2010. A modest annual GDP growth was recorded already at the start of the year. It picked up further during the year, showing a rise of 2.2% for the year as a whole. However, the previous year's adverse economic trends continued to affect the financial performance of institutions operating on the domestic financial market and the ability of businesses and individuals to repay their obligations also in 2010.

Economic growth recovered thanks to improved export opportunities, as the world trade also got out from the economic recession and financial crisis. In 2010 H1, domestic economic growth was driven mainly by net exports, while in 2010 H2 it was chiefly due to a pronounced renewal in additions to inventories. Real foreign trade turnover grew significantly throughout the year. Both exports and imports rose by 18% in 2010 as a whole. For most of 2010, growth was, to a lesser extent, also fostered by household consumption. A recovery in gross value added formation was visible in industry, trade and banking.

Inflation rose compared to the previous year. The average inflation rate in 2010 was 1.5%, up by 0.4 percentage point on a year earlier. The pick-up in inflation was due to a rise in indirect taxes at the start of the year, a higher increase in regulated prices and a pick-up in food and fuel price inflation owing to growth in commodity prices in the world.

The koruna appreciated against the euro and was flat against the dollar in 2010. The average CZK/EUR exchange rates appreciated from 26.5 in 2009 to 25.3 in 2010. The average koruna-dollar exchange rate was unchanged, standing at CZK 19.1/USD in 2010.

The current account deficit increased to 3.8% of GDP, amounting to CZK 139.2 billion in absolute terms. The current account deficit was due to the income deficit, whereas the goods and services balance continued to run a surplus. As in previous years, the financial account showed a surplus in 2010. It reached CZK 182.1 billion, up by almost CZK 28 billion on a year earlier.

The labour market situation still deteriorated on average during 2010, as labour market developments copy changes in economic activity with a usual lag and economic recovery was only modest. The number of vacancies remained at very low levels and the number of unemployed persons (seasonally adjusted) was still rising in early 2010. Compared to 2009, the average registered unemployment rate rose by 1.0 percentage point on average to 9.3% under current The Ministry of Labour and Social Affairs (MoLSA) methodology. Nominal wage growth in the organisations under review slowed gradually during 2010. It was only 2% on average for the entire year, half the figure recorded in 2009. Average real wages increased only by 0.5% year on year, a decline of 2.5 percentage points compared to 2009. Aggregate labour productivity saw an annual increase of 3.1% compared to a decline of 3.0% in 2009.

Despite the efforts to reduce the state finance deficit and the measures taken to decrease the state debt, public finances showed a sizeable deficit in 2010. The deficit under ESA95 methodology amounted to CZK 172.8 billion, or

4.7% of GDP, in 2010. The government debt-to-GDP ratio increased in 2010, totaling 38.5% at the end of the year.

The Czech National Bank responded to the economic developments by lowering its key interest rates in May 2010. The two-week repo rate fell from 1.00% to 0.75%, the discount rate was unchanged at 0.25%, and the Lombard rate was lowered from 2.00% to 1.75%. In the remaining part of 2010, the monetary policy rates were unchanged – in line with the CNB's forecast for the Czech economy.

DEVELOPMENT IN THE BANKING SYSTEM

As of 31 December 2010, the Czech banking sector consisted of 41 banks and foreign bank branches. The structure of the banking sector is stable.

The Czech banking sector was sound and well capitalised in 2010 and continued to generate profit.

Banking intermediation saw a recovery in 2010. The assets of the banking sector increased by 2.4% to CZK 4,192.3 billion in this period.

The recovery in bank transactions was reflected in a larger volume of the banking sector's receivables, which account for a substantial part of its balance-sheet assets. The most dynamic development was recorded in lending to individuals, although its annual growth rate decreased to 7.0% at the end of 2010, and the total value of such loans exceeded CZK 960 billion. Loans for house purchase, which rose by 6.4% year on year and amounted to almost CZK 730 billion, accounted for more than 75% of all loans provided to individuals. Of this, mortgage loans for housing recorded an annual increase of 9.1% at the end of 2010, accounting for almost 63% of all loans to individuals. The annual growth rate of consumer credit, which amounted to CZK 199.2 billion, slowed to 7.3%. Loans to resident non-financial corporations fell by 0.3% to CZK 780.0 billion.

The banking sector was profitable in 2010. It generated net profit of CZK 55.5 billion, down by 7.0% on a year earlier. Profit from financial activities of CZK 157.4 billion, particularly from interest profit, which increased by 2.1% year on year and accounted for more than 66% of profit from financial activities, was the main source of net profit. Profit from fees and commissions, which rose by 5.2% to CZK 38.3 billion, was another source. Total administrative expenses grew by 3.1% to CZK 62.4 billion. At CZK 10.1 billion, aggregate income tax decreased by 8.1% year on year.

Credit risk has recently been the most significant risk undertaken by the Czech banking sector. Non-default loans accounted for 94.6% of the investment portfolio at the end of 2010. The value of all default receivables increased by CZK 27.0 billion (23.4%) to CZK 142.4 billion owing to the reduced ability of non-financial corporations and individuals to repay their obligations. The share of default receivables in total investment portfolio liabilities was 5.4% at the end of 2010.

Domestic banks' activities are mostly focused on domestic clients. The share of transactions with non-residents and the share of foreign currency activities are relatively low. The exposure of the banking sector to territorial and foreign exchange risk was assessed as limited in 2010, too. Operations on foreign markets are usually executed by other entities from the financial group to which the domestic bank belongs. Transactions with non-residents are significant mainly on the interbank market, particularly as regards derivatives transactions.

As usual, the Czech banking sector had enough liquid funds and the liquidity sub-indicators were stable during 2010. Quick assets were up by 5.6% year on year, reaching CZK 1,093.8 billion. Sufficient primary funds are available to finance the loans of the banking sector.

The capitalisation of the banking sector was sufficient at the end of 2010. Capital adequacy increased to 15.51% as a result of a 9.3% rise in the regulatory capital of the banking sector to CZK 289.4 billion. Tier 1 increased to CZK 263.4 billion, thanks mainly to retained earnings. A partial repayment of subordinated debt in several banks led to a decrease in the additional capital (Tier 2). Tier 1 traditionally has a dominant position in the banking sector's capital, accounting for roughly 91% of total regulatory capital. Capital requirements of the banking sector were flat (at CZK 149.2 billion at the end of 2010), showing an annual decline of only CZK 840.5 million.

All banks were compliant with the set minimum capital ratio of 8% during 2010.

The depth of banking intermediation as measured by the ratio of total bank assets to GDP has been increasing in the Czech Republic since 2006. It stood at 114.2% at the end of 2010, 1.2 percentage points higher than in the same period of 2009.

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

In accordance with Act No. 6/1993 Coll., on the Czech National Bank (pdf, 190 kB), the Czech National Bank is a supervisory authority of the financial market in the Czech Republic. The CNB therefore supervises the banking sector, the capital market, the insurance industry, pension funds, credit unions, bureaux-de-change and payment system institutions. The CNB lays down rules safeguarding the stability of the banking sector, the capital market, the insurance industry and the pension scheme industry. It systematically regulates, supervises and, where appropriate, issues penalties for non-compliance with these rules.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2010

In 2010, the CNB worked to implement the rapidly changing EU rules for the financial market and modify the regulatory framework in the Czech Republic. The CNB activities included mainly cooperation with the Ministry of Finance (MF) and other state administration bodies in the preparation of new legislation. It prepared a number of decrees and official information documents for the individual sectors of the financial market and explanatory opinions on the application of regulatory requirements by financial market participants.

In 2010, intensive work continued at the level of the European Commission, the Council and the European Parliament on new or amended European financial market regulation with the aim to eliminate the causes of the global economic crisis and achieve sustainable growth and competitiveness of the EU. The CNB paid extraordinary attention to the European Commission's proposals and continuously prepared relevant opinions. CNB representatives in committees and working groups within EU structures actively promoted the CNB's positions. In the case of consultative documents, the opinions were sent directly to the European Commission.

The legislative preparation of a new institutional set-up of EU financial market regulation and supervision was completed in 2010. Regulations of the European Parliament and of the Council established the European Systemic Risk Board and three European Supervisory Authorities (ESAs), namely the European Banking Authority, the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority as from 1 January 2011. The former Level 3 committees ceased to exist at the end of 2010.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

The conduct of financial market supervision involves a range of activities encompassing licensing and approval proceedings, fulfillment of information duties, on-site and off-site supervision, international cooperation and so on. Following the integration of financial market supervision into the CNB, these processes are gradually being united and unified.

Off-site surveillance performed by the CNB consists in continuously monitoring the activity and financial performance of the individual entities operating on the financial market and assessing the evolution of the market as a whole, including its key segments. The supervisory work involves checking compliance with the relevant legal rules, compliance with prudential rules and regular assessment of the financial condition of individual regulated entities.

Information is obtained mainly from the statements and reports regularly submitted by individual entities on a solo and consolidated basis. Where more intensive monitoring of the economic situation is needed, an extraordinary reporting duty is imposed on financial institutions.

In addition to the regular reports, all available information from various sources is used for continuous monitoring of entities and the market. These sources include financial statements, annual reports, auditors' reports, information from on-site inspections and information-gathering visits, public presentations and press releases. Where additional information is needed, meetings with representatives of the supervised entities are organised.

Off-site surveillance forms a comprehensive picture of the financial condition of the supervised financial market entities and allows it to identify potential problems and risks, which provide a starting signal for conducting on-site inspections or making decisions on further action to be taken against a supervised entity.

In connection with the situation on global financial markets increased attention was paid to performance of financial institutions subject to off-site surveillance by the CNB in 2010. In this context, the portfolios of the supervised institutions were analysed in more detail and their exposure to risky entities or instruments was determined. The risk exposure was relatively low and its impacts on institutions' financial results were only limited.

The on-site inspections were performed in compliance with the legislation in force and focused on checking compliance with the regulatory rules laid down in legal and implementing regulations. The individual examinations focus either on verifying all the relevant activities of the examined entity (comprehensive examinations) or on verifying selected areas thereof (partial examinations).

The on-site inspections are based on an annual plan of activity, reflecting internal requirements of the CNB and foreign regulators and especially the current developments on global financial markets, at the moment particularly with regard to the financial crisis.

In addition to on-site inspections, the supervisory activities also include approvals of advanced methods for calculating capital requirements. Owing to the links between financial markets, cooperation with foreign regulators is consistently being stepped up, particularly in the form of intensive exchange of information, cooperation during the validations of internal models applied within financial groups and also the participation of CNB staff in inspections abroad and vice versa.

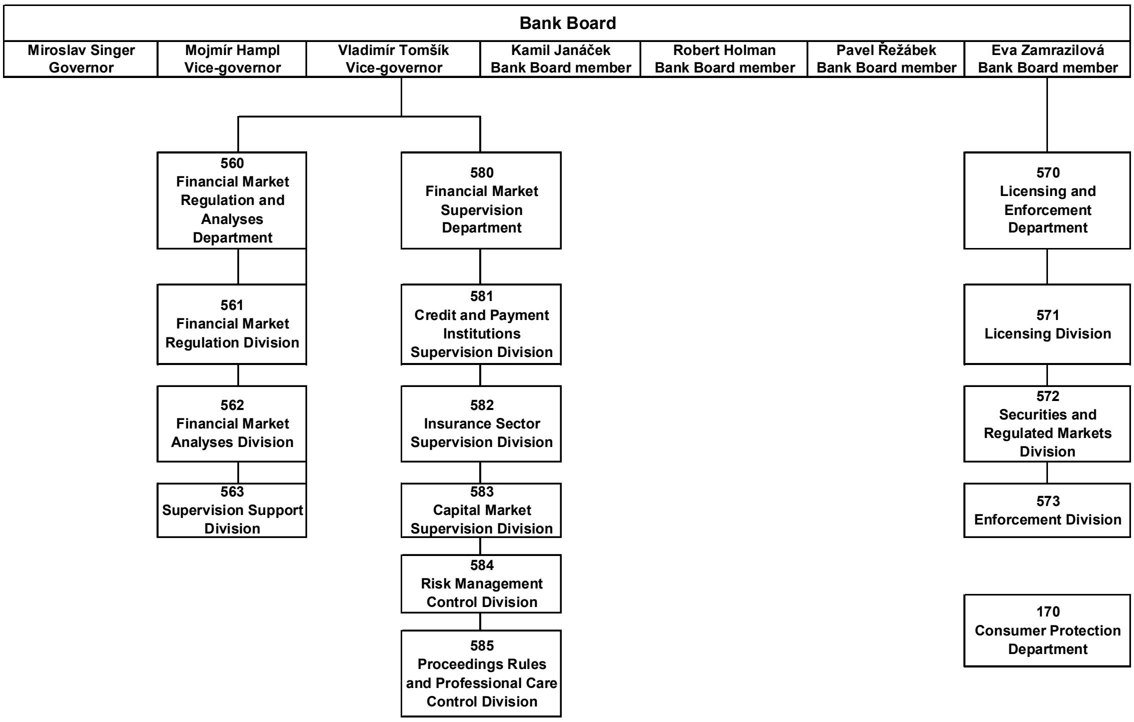
The examined entities' managements are notified of the findings through a report based on which remedial measures are imposed, implementation and compliance of which are systematically monitored. In justified cases, the CNB opens administrative proceedings with relevant entities based on the inspection results.

Since 2008 the Czech National Bank has been entrusted with supervising compliance with the rules of consumer protection on the basis of an amendment to the Consumer Protection Act and the Act on the Czech National Bank. Supervision in this area is performed in a reactive manner, on the basis of complaints received, and aims to identify shortcomings, especially those of a systemic nature, and ensuring remedy either on a voluntary basis by the supervised entities, or by imposing remedial measures or sanctions.

ORGANIZATIONAL CHART OF BANKING AUTHORITY

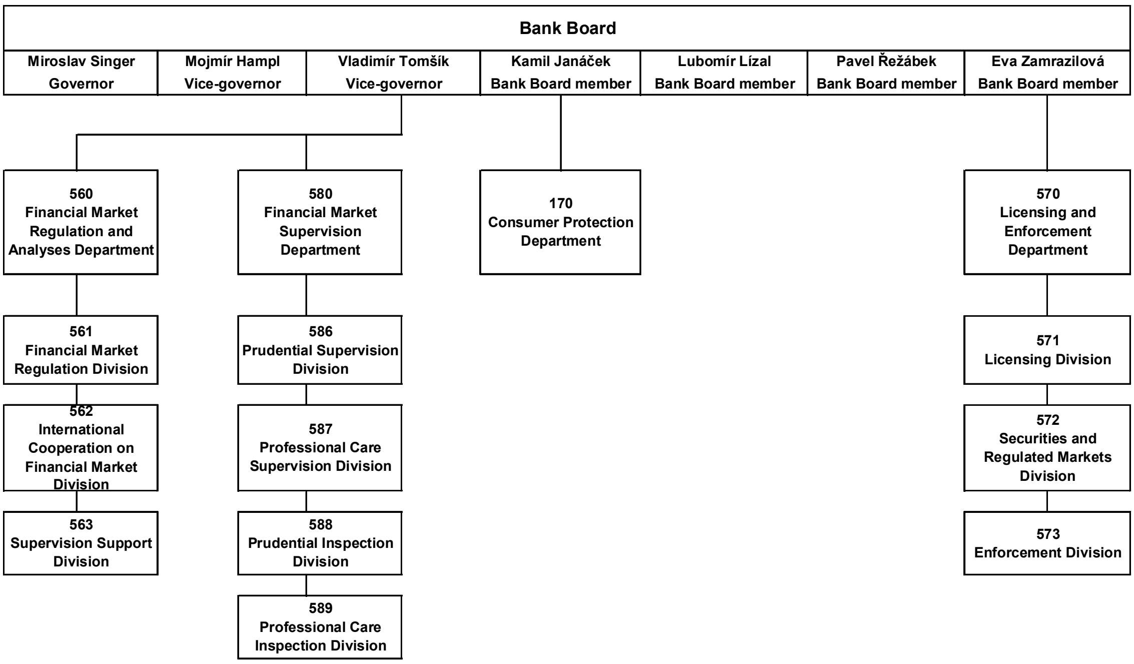
Organisational chart of the Czech National Bank's financial market supervision

as of 31 December 2010



Organisational chart of Czech National Bank's financial market supervision

as of 1 March 2011



The President of the Czech Republic appointed Lubomír Lízal a member of the CNB Bank Board with effect from 13 February 2011. He replaced Robert Holman, whose term of office had expired.

INTERNATIONAL ACTIVITIES OF THE CZECH NATIONAL BANK

To a great extent, 2010 marked a turning point in financial market regulation and supervision in the EU, as legislative changes in the institutional set-up of EU financial market regulation and supervision were discussed and approved, including the definition of the responsibilities of new European supervisory authorities. The legal transformation of the Level 3 committees, i.e. CEBS, CESR and CEIOPS, to European supervisory authorities was thus completed.

The European Banking Authority, the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority were established by Regulations of the European Parliament and of the Council of 24 November 2010. All three authorities started work on 1 January 2011.

During 2010 the Level 3 committees gave their opinions on the negotiations between the Council and the European Parliament and participated in the transformation, including efforts to influence the budgets of the new authorities. The CNB was actively involved in these activities.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE CZECH REPUBLIC

The CNB's activities include cooperation with the Czech Ministry of Finance and other state administration bodies. The CNB works in close cooperation with the Czech Ministry of Finance, which has primary responsibility for preparing laws in the financial market area. It thus acts in accordance with the agreement on cooperation in the preparation of draft national legislation concerning the financial market and other regulations concluded between the CNB and the Ministry of Finance in May 2006.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

The CNB is an institution open to the general public, aiming to provide experts and the general public with basic, mostly quantitative, information on individual sectors of the financial market.

The Basic indicators of the financial market subsection contains a set of basic tables for each financial market sector containing key indicators characterizing the activities and prudential business of entities in that sector. They correspond in scope to the information that individual entities are obliged to disclose and can thus be used for cross-checking. The information is updated at quarterly or longer frequency, depending on the frequency of the source reports.

The Financial Market Supervision Reports subsection contains regular annual publications containing brief analyses of individual financial market sectors and an overview of financial market supervision activities in the given year.

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	37	39	41
Branches of foreign credit institutions	16	18	19
Cooperative banks	17	17	14
Banking sector, total:	**70**	**74**	**74**

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

Type of financial institution	2008	2009	2010
Public sector ownership	2,9	2,7	2,9
Other domestic ownership	0,2	0,2	0,6
Domestic ownership total	3,1	2,9	3,5
Foreign ownership	96,9	97,1	96,5
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	51,5	62,4	0,13
Branches of foreign credit institutions	35,1	41,1	0,14
Cooperative banks	66,0	87,0	0,18
Banking sector, total:	51,5	62,4	0,10

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

Type of financial institution	2008	2009	2010
Commercial banks	21,7	25,9	21,8
Branches of foreign credit institutions	n.a.	n.a.	n.a.
Cooperative banks	0,47	-1,34	2,06
Banking sector, total:	20,7	25,0	21,0

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	85,8	87,6	88,3
Branches of foreign banks	14,0	12,1	11,2
Credit unions	0,2	0,3	0,5
Other	n.a.	n.a.	n.a.
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2008	2009	2010
Financial sector (loans and advances)	10,3	10,5	11,3
Nonfinancial sector (loans and advances)	49,4	48,6	48,9
Government sector (loans and advances)	1,4	1,7	1,7
Other	38,9	39,3	38,1
Liabilities	**2008**	**2009**	**2010**
Financial sector (deposits)	10,6	10,4	10,7
Nonfinancial sector (deposits)	56,9	59,0	60,3
Government sector (deposits)	7,3	7,6	7,0
Capital	7,2	7,8	8,2
Other	18,0	15,1	13,8

Note: Banking sector = commercial banks + bank foreign branches

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks **	12,32	14,11	15,51
Credit unions **	17,31	14,80	12,57
Banking sector, total:	n.a.	n.a.	n.a.

(* - for Basel I; ** - for Basel II)

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

Asset classification	2008	2009	2010
Non financial sector	3,4	5,5	6,5
- households	3,0	4,1	5,2
- corporate	4,2	7,9	8,9

Note: Banking sector = commercial banks + bank foreign branches; share of receivables in default (substandard, doubtful and loss) by sector.

The structure of deposits and loans of the banking sector in 2010 (%) (at year-end)

	Deposits	Loans
Households	61,4	50,0
Government sector	10,7	3,2
Corporate	23,7	37,9
Other (excluding banks)	4,2	8,9
Total	**100.0**	**100.0**

P&L account of the banking sector (at year-ends)
Income statement of the banking sector
Absolute indicators

(data as of the given date; in CZK millions)

P&L account	2008	2009	2010
1. Financial & operating income and expenses	138 024	168 409	157 358
1.1 Interest income	191 917	174 434	167 048
1.2 Interest expenses	93 874	71 161	61 653
1.3 Dividend income	3 730	9 623	5 885
1.4 Fee and commission income	46 779	46 756	48 257
1.5 Fee and commission expenses	10 658	10 314	9 887
1.6 Realised gains (losses) on financial assets and liabilities not measured at FV through profit or loss, net	-943	6 327	-1 451
1.7 Gains (losses) on financial assets and liabilities held for trading, net	-2 685	4 399	11 032
1.8 Gains (losses) on financial assets and liabilities designated at fair value through profit or loss, net	-11 191	1 683	2 398
1.9 Gains (losses) from hedge accounting, net	-272	-330	-208
1.10 Exchange differences, net	11 938	7 480	-3 097
1.11 Gains (losses) on derecognition of assets other than held for sale, net	4 191	580	18
1.12 Other operating income	3 062	2 880	3 339
1.13 Other operating expenses	3 971	3 949	4 324
2. Administration costs	61 685	60 455	62 376
2.1 Staff expenses	31 197	31 103	31 603
2.2 General and administrative expenses	30 488	29 352	30 773
3. Depreciation	7 345	7 442	6 907
4. Provisions	455	4	-249
5. Impairment	15 221	29 792	22 535
5.1 Impairment on financial assets not measured at fair value through profit or loss	15 207	26 573	22 316
5.2 Impairment on non-financial assets	15	3 219	218
6. Negative goodwill immediately recognised in profit or loss	0	0	0
7. Share of the profit or loss of associates and joint ventures	0	0	0
8. Profit or loss from noncurrent assets and disposal groups	722	61	-157
Total profit or loss before tax from continuing operations (1 - 8)	54 039	70 778	65 633
9. Tax expense	8 345	11 038	9 989
10. Profit (loss) after taxation, total	45 695	59 740	55 644
10.1 Profit (loss) from continuing operations after taxation	45 695	59 740	55 644
10.2 Profit (loss) from discontinued operations after taxation	0	0	0

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	11 103 318	10 511 669	1 408 322	0
Credit unions	75 615	75 615	0	0
Banking sector, total:	**111 789 33**	**10 587 284**	**1 408 322**	**0**

2010 DEVELOPMENTS IN THE ESTONIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The recovery of world economy continued in 2010 and growth prospects improved. According to the Statistical Office, the Estonian GDP grew by 3.1% in 2010. In 2009, the Estonian GDP decreased by 13.9%. The gradual recovery of Estonian economy began from the second quarter of 2010. Rapid growth of processing industry supported by strong export contributed to the recovery of Estonian economy the most. External demand was supported by the economic development of largest economic partners of Estonia that exceeded former expectations in the second half of 2010. The second half of the year witnessed also the gradual recovery of domestic demand. Due to the increasing external demand, the export of goods and services increased by 22% in 2010 and the import increased by 21%. The external trade balance improved in comparison with 2009. The share of net export in the GDP was 6.7%, which is the best annual figure of the last 16 years. Due to the increase of import of goods and services, the current account surplus was smaller in 2010 that a year ago, accounting for 3.6% of the GDP (4.5% of the GDP in 2009). In 2010, the consumer price index increased in comparison with the last year's average by 3% driven by the increase in prices of motor fuel, thermal energy, food and non-alcoholic beverages (the average consumer price index decreased by 0,1% in 2009). The average unemployment rate was 16.9% in 2010 and the number of unemployed was the highest since 1991. In 2009, the unemployment rate had been 13.8%. According to the Statistical Office, the number of unemployed persons peaked in the first quarter of 2010 and decreased during the subsequent quarters. The number of active unemployed persons dropped below 100,000 in the last quarter of 2010 for the first time during the last year and a half. In 2010, the average number of active persons was 571,000, being 25,000 (4.2%) less than a year ago.

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

As at 31 December 2010, there were 7 locally authorized credit institutions and 11 branches of foreign credit institutions operating in Estonia. The ratio of banking sector's total assets to GDP was 136%.

Estonian banking market is still very concentrated. The aggregate market share of 4 major banks – Swedbank AS, AS SEB Pank, Nordea Bank Finland Plc Estonian Branch and Danske Bank A/S Estonian Branch – by loan volumes totalled 93%. Branches of foreign credit institutions were more active in the lending market.

Total assets of credit institutions decreased by 5% in 2010 and totalled 307.9 billion kroons as at 31 December 2010. Asset volume decrease was mostly driven by amortization in loan portfolio causing the balance of combined loan portfolio to decrease by 5% by the end of the year (decrease of 6% in 2009).

The combined loan portfolio of credit institutions amounted to 233.3 billion kroons at the end of 2010, accounting for 76% of total assets. This share remained unchanged compared to 2009.

The quality of loan portfolios of credit institutions improved in the end of 2010 and the total volume of overdue loans decreased, both in absolute figures and as a share of the whole loan portfolio. The volume of long-term loans overdue, i.e. loans overdue for more than 90 days, somewhat increased in comparison with the previous year. Still, there were some signs of improvement during the last months of the year. Loans overdue for more than 90 days formed 6.1% of the combined loan portfolio of credit institutions at the end of 2010 (5.5% of the combined loan portfolio at the end of 2009).

At the end of 2010, the total volume of resources of credit institutions totalled 273.3 billion kroons, decreasing by 6% in 2010. Resources decreased mostly due to the drop in the volume of loans received from foreign credit institutions. Consequently, the share of external institutional borrowing also decreased by the end of 2010. While these loans accounted for 44% of total resources at the end of 2009, their share decreased to 35% by the end of 2010. Nevertheless, the volume of deposits increased considerably at the same time – by 5% in 2010. The share of client deposits increased and accounted for 60% of total resources of credit institutions at the end of 2010 (54% at the end of 2009). Due to the drop in the volume of composite loan portfolio and significant increase in the volume of deposits, the ratio of loans to deposits continued to improve in 2010: from 156% at the end of 2009 to 142% at the end of 2010.

While credit institutions earned significant losses in 2009 due to high cost of valuation reserves, the year 2010 was ended with profits both on solo and consolidated basis. Credit institutions earned on solo basis the profit of 896 million kroons (loss of 9.1 billion kroons in 2009). Banking groups earned on consolidated basis the profit of 1.5 billion kroons in 2010 (loss of 15.1 billion kroons in 2009). Profitability increased both on solo and consolidated basis primarily because of smaller amounts transferred to loan loss reserve. The increase in credit institutions' profitability on the account of smaller valuation reserves and increasing interest revenue is a continuing trend. The profitability is supported also by low price of resources, the decrease in the volume of loans overdue and the increase of Euribor.

As at 31 December 2010, the composite capital adequacy of credit institutions on solo basis was 22.07% (22.25% in 2009). Consolidated capital adequacy of banking groups was 16.25% at the end of 2010 (15.72% in 2009). Also the Tier 1 capital remained on an adequate level both on solo and consolidated basis: Tier 1 capital was on solo basis 16.43% and on consolidated basis 12.66% at the end of 2010 (15.96% and 11.74% respectively at the end of 2009). The biggest risk in the banking sector is the credit risk: assets weighted with credit risk accounted for about 80% of all positions converted into risk-weighted assets at the end of 2010.

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

Pursuant to the Financial Supervision Authority Act, one of the tasks of the Financial Supervision Authority in developing the legal environment is to make proposals for the establishment and amendment of Acts and other legislation concerning the financial sector and related supervision, and participate in the drafting of such Acts and legislation. According to the Financial Supervision Authority Act, the Financial Supervision Authority must approve draft legislation regulating supervised entities or the activities of the Financial Supervision Authority or having otherwise an effect on the achievement of objectives of financial supervision.

In order to solve potential crises, there were two important and necessary amendments made in the legal framework of financial supervision in 2010. The state gained the right to expropriate holdings of bank's shareholders in extraordinary circumstances, primarily when other measures would not deliver desired results. A holding can be expropriated if managers and shareholders of a credit institution do not wish to cooperate with the state and if they are inactive in raising holdings and additional capital or reorganizing the share capital or taking other steps that are necessary for ensuring the sustainability of credit institution's activities. Expropriation as a measure for solving or prevention of crisis is necessary primarily in case of credit institutions of systemic importance, where the initiation of a regular bankruptcy proceeding may bring along the occurrence of systemic risk, causing serious failures in the financial environment and thus also in the society as a whole.

Since 2011, the Financial Supervision Authority is entitled in limited number of cases to adopt a binding administrative legislation, so that the statement of reasons is adopted within three working days after the adoption of the administrative legislation. The purpose of this rule is to ensure the adoption of the Authority's administrative legislation as soon as possible in case of urgent problems. This is important in situations where it is necessary to act immediately and where the overriding reason in the public interest may be in danger and there is no time to prepare the statement of reasons in necessary details. Nevertheless, an administrative legislation must contain a statement of reasons both in fact and in law pursuant to the principle of administrative proceeding. Therefore, the Financial Supervision Authority has to add the statement of reasons within three working days at the latest in order to ensure the verifiability of the legislation. Submission period of a court appeal usually begins after the adoption of the statement of reasons.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2010

The Financial Supervision Authority's strategy for 2007–2010 sets the following main objectives for the Authority's activities: to improve cross-border supervisory capabilities; to increase the share of preventive supervisory methods; to raise the awareness level of financial services customers; to promote an open communication and working culture and to increase the effectiveness and minimize red tape through ensuring the competitiveness of Estonia's financial sector at the international level.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

Preparations for joining the eurozone as from 1 January 2011 were extremely important for the Estonia's economy in 2010. Credit institutions had to prepare their processes and systems for the successful adoption of the common EU currency – Euro. In order to have an overview of the preparations and potential problems, the Financial Supervision Authority organized meetings with supervised entities and made various inquiries to market participants for receiving information on the status of preparations made for the transition to Euro and for preventing potential problems.

In 2010, the Financial Supervision Authority performed regular risk analyses on a monthly and quarterly basis during the supervision of all financial market participants. In addition, the Authority analysed the capitalization within the framework of the Supervisory Review Evaluation Process (SREP), performed stress testing of credit risk, and made several risk-based specific analyses (real estate loans, liquidity risk) as well as impact analyses in relation to changes in regulative environment. The Authority participated also in the work of supervisory colleges for cross-border financial groups, including in joint risk evaluation activities.

In 2010, the risk analysis of credit institutions was based on traditional monthly and quarterly reports. Major risk areas of credit institutions – credit risk, operational risk, liquidity risk, market risk, etc. – are evaluated during such an analysis based both on quantitative and qualitative information. Profitability and adherence to standards is also monitored. Results of this analysis provide an important input for planning supervisory activities and are regarded as a primary source of information for performing on-site inspections. In 2010, the Financial Supervision Authority focused its attention primarily on the quality of banks' loan portfolios and the adequacy of capital buffers.

In the supervision of investment services offered by banks, the Financial Supervision Authority focused on controlling the implementation of the Financial Instruments Directive (MiFID) in 2010, especially on the evaluation of the adequacy of organizational solutions in providing investment services. The control covered also the question whether banks perform the obligations accompanying the evaluation of service adequacy when they offer investment services to their clients. The supervision focused primarily on the presentation of information and advertising. Also, the activities of banks in providing depository service to investment funds were monitored.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY 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

As Estonia is one of the EU Member States, its financial sector forms a part of the European integrated financial services market. Estonia's financial stability is dependent on cooperation with other EU Member States, especially with Nordic countries. The Financial Supervision Authority is able to influence the shaping of international supervision practices and policies by participating in the work of the EU financial sector supervisory committees: the Committee of European Securities Regulators (CESR), the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the Committee of European Banking Supervisors (CEBS). (Since 2011 the supervision over EU credit institutions, insurers and the securities market is performed by three joint financial supervision institutions: the European Banking Authority in London, the European Insurance and Occupational Pensions Authority in Frankfurt and the European Securities and Markets Authority in Paris.) Increasing influence in the cooperation network of European supervisory Authorities is one of the priorities provided by the Strategy 2007-2010 of the Financial Supervision Authority.

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	6	7	7
Branches of foreign credit institutions	10	12	11
Banking sector, total:	**16**	**19**	**18**

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

Type of financial institution	2008	2009	2010
Public sector ownership	0.0	0.0	0.0
Other domestic ownership	1.8	1.8	2.0
Domestic ownership total	1.8	1.8	2.0
Foreign ownership	98.2	98.2	98.0
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Banks	80.6	91.8	2,899.2

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

Type of financial institution	2008	2009	2010
Banks	13.5	-31.7	2.1

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	73.7	73.1	71.1
Branches of foreign credit institutions	26.3	26.9	28.9
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks	18.9 **	22.2 **	22.1 **
Cooperative banks			
Banking sector, total:	**18.9 ****	**22.2 ****	**22.1 ****

(* - for Basel I; ** - for Basel II)

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

Asset classification	2008	2009	2010
Non financial sector	2.2	5.7	6.3
- households	**2.0**	**4.4**	**5.0**
- corporate	**2.8**	**7.7**	**8.5**

The structure of deposits and loans of the banking sector in 2010 (%) (at year-end)

	Deposits	Loans
Households	39.8	49.0
Government sector	7.3	2.9
Corporate	47.3	44.9
Other (excluding banks)	5.6	3.2
Total	**100.0**	**100.0**

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

P&L account	2008	2009	2010
Interest income	1 286	827	583
Interest expenses	873	557	260
Net interest income	413	270	323
Net fee and commission income	152	125	133
Other (not specified above) operating income (net)	131	131	101
Gross income	**1 621**	**1 132**	**866**
Administration costs	275	246	249
Depreciation	11	12	11
Provisions	3	24	8
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	126	798	223
Profit (loss) before tax	251	-579	57
Net profit (loss)	**251**	**-579**	**57**

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	2 360 043 843	1 757 767 310	602 276 533	0
Cooperative banks				
Banking sector, total:	**2 360 043 843**	**1 757 767 310**	**602 276 533**	**0**

2010 DEVELOPMENTS IN THE HUNGARIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2010, the Hungarian economy entered an initial recovery phase. GDP rose by 1.2%, on average, during the year, and growth accelerated to 1.9% yoy by the fourth quarter. The recovery was driven by rapidly strengthening external demand, exports rose by 14% in volume terms. However, this strength was largely confined to the manufacturing sector, while other sectors, more dominated by weak domestic demand, remained sluggish. Unemployment peaked at close to 12% in Q1 2010 and fell moderately in the rest of the year. The corporate bankruptcy ratio also peaked in Q3 2010, and the number of sold cars rose again in H2. However, the property market did not recover, and housing prices fell a total 15% between the start of the crisis and end-2010.

Following a rather tight stance in 2009, fiscal policy turned more neutral in 2010. The fiscal deficit fell marginally, to 4.2% of GDP by ESA-95 standards, and the external current account surplus rose further to 2% of GDP. Foreign exchange reserves reached 34bn Euros by end-year, a slight increase from 2009. Consumer inflation was 4.9% on average during the year, as a lower rise in the core index was compensated by more rapidly rising food and energy prices. Monetary policy reached the end of its loose cycle around mid-year, and the central bank base rate stabilised at 6% towards the end of the year.

DEVELOPMENTS IN THE BANKING SYSTEM

The banking sector went through a post-crisis correction regarding the size of its assets in 2010. Its balance sheet total fell by 3% during the year, due to low demand for credit, tightening lending conditions and significant losses linked to bad credits. Thus the loans to GDP ratio sank from 111% to 103%. Asset quality remained a problem, as the NPL ratio (90-day past due items to the total loan book) rose from 6.3% to 8.5%. Even so, the trough of the portfolio quality cycle was already passed in 2009 from the point of view of profitability, as in 2010, the rise in the NPL-ratio slowed down significantly, and the need for new risk provisioning fell moderately.

Liquidity levels were maintained at significantly above pre-crisis levels, with cash, assets vis-a-vis the central bank, and securities for trading reaching 25% of total assets at end-2010, the same level as in 2009. Profitability, on the other hand, fell sharply, with return on equity (ROE) dropping from 8.9% to only 1.4% in 2010. Key factors behind this change were weakening trading results, due to less lucrative capital markets than in 2009, increasing loss provisioning and a new levy imposed on financial service providers in H2 2010. Capitalisation improved slightly, as the average capital adequacy ratio rose to 13.3%, and the average Tier 1 ratio reached 11.3% at year end. In 2010, consumer protection policies were greatly strengthened on the credit market, and FX mortgage lending to unhedged household borrowers was in practice prohibited.

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

Main changes to the Hungarian Financial Supervisory Authority's (HFSA's) legal status as defined in laws

In the second half of 2010, three significant laws imposed positive changes on the HFSA's operation and independence. The most significant of these was the amendment to the Constitution, transforming the HFSA into an independent constitutional institution empowered with regulatory mandate. The second was the amendment to the Act on the Hungarian Financial Supervisory Authority (HFSA Act) whereby the HFSA became a more modern, efficient institution and an active participant in the work of European Supervisory Authorities. The third change was a package of new laws aimed principally at further developing and harmonising the sector-specific laws applied by the HFSA.
Before the new HFSA Act entered into effect, an important development was the upgrading of the HFSA's legal status to "constitutional institution" through the amendment to the Constitution. Pursuant to Paragraph (1) in Article 40/D of the Constitution, *"The Hungarian Financial Supervisory Authority is an institution of the Republic of Hungary responsible for supervising, controlling and regulating the financial intermediation system. As defined in laws, the Hungarian Financial Supervisory Authority is responsible for the undisturbed functioning of the financial intermediation system."*

Mandate to issue binding regulations

One of the most important achievements of the new HFSA Act is to providing HFSA with a mandate to generate regulations. The basis for this new mandate was laid out in the 2010 amendment to the Constitution followed by the new legislation law. This Parliament decision put an end to a decade long debate, bringing to an end all professional disputes regarding the regulatory mandate of the HFSA. Accordingly, the following regulatory tools are available to the President of the HFSA: decrees, recommendation, CEO letters and methodology guidelines. Out of these, decrees are binding legal provisions while the other regulatory tools are not mandatory in legal terms for the natural persons and organisations that are subject of the HFSA Act.

Following the amendment to the Constitution, regulations issued by the HFSA's President are at the same level in the hierarchy of legal regulations as ministerial decrees. The right to generate regulations enables the HFSA President to prepare and issue legal standards that are mandatory for a specific group of organisations (principally those subject to mandatory data provision to the HFSA) and for a limited period of time (i.e. temporarily, to ensure the secure operation of the financial intermediation system). This power also puts the HFSA in a position to adapt quickly and effectively into Hungarian supervision the binding technical standards, guidelines and recommendations to be issued by the European Supervisory Authorities (ESAs).

Financial Arbitration Board

Passed in 2010, the new HFSA Act established a new consumer protection entity within the HFSA's organisational framework, the Financial Arbitration Board (hereinafter FAB). The Act on Consumer Protection has included the legal institution of the reconciliation body as an alternative forum for settling disputes. In practice, however, this legal institution could not function effectively in the financial sector, mainly because of the lack of adequately trained specialists able to decide on legal disputes of a financial nature. By making the FAB part of the HFSA's responsibilities, the HFSA Act strengthened this alternative dispute settlement forum. As a result, such disputes can now be judged quickly, free of charge and effectively by a board of well-trained specialists. The FAB's independence and impartiality are guaranteed by the HFSA's management and organisational structure and by the legal prohibition of any managerial influence regarding the decision on matters referred to the FAB.

Further developments

a) After a new management came on board, the HFSA's former procedures and specific proceedings were also rationalised. Supervisory procedures underwent standardisation and fragmented sections were replaced along the principle of ongoing supervision. Regular comprehensive inspections with mandatory on-site phase have become general requirement in the supervisory work. Supervisory colleges are providing for the appropriate cross-border supervisory information exchange.
b) The new HFSA Act enables the HFSA to represent the interests of a natural person in a court proceeding in the form of a so-called claim of public interest if the contract or the business conditions of the financial service provider are thought to be unfair or incompatible with legal provisions.
c) Entering into force on 1 January 2011, the new HFSA Act brought into effect a number of important amendments for (e.g. the revised role of the supervisory commissioner etc.) along with several other changes that were prerequisites for the HFSA to become a constitutional institution (e.g. the HFSA's entitlement to assess and provide an opinion on bills, the participation of the HFSA president in government meetings when topics of HFSA relevance are on the agenda etc.).

The EU's new supervision system and its impact on the HFSA

For the financial supervisors of all EU member states and thus the HFSA as well, the establishment of the new, EU-wide supervision structure that encompasses all financial services was an event of fundamental significance in 2010.

As a member of the new EU-wide supervisory system, the HFSA's participation can now take a significantly broader scope. It can be stronger than before regarding the regulation of financial services provided in the EU, the proper presentation of the specific market characteristics of the region, the identification of systemic risks, the prevention and management of cross-border crisis situations, the supervision of significant European financial groups and cooperation with the European Central Bank (ECB) and the European System of Central Banks (ESCB).

The HFSA's President is a member of the Board of Supervisors of all three European supervisory authorities and the ESRB. As a major recognition of the

HFSA's accomplishments, its president was also elected to the seven-member operational Management Board of the European Banking Authority (EBA). Throughout 2010, the HFSA actively participated in the harmonisation meeting series, consultation sessions, debates, proposal-elaboration and assessment efforts within the EU, primarily by way of submitting comments and wording proposals to the 3L3 Committees, the predecessors of the new European supervisory authorities. Through the analysis and transformation of its internal organisation and regulations, the HFSA was well prepared to establish the mechanisms and to participate in the new European system from its onset. Under this framework, the president and specialists of the HFSA regularly hold ESFS (European System of Financial Supervision)-related meetings to discuss current EU supervisory system matters; furthermore, documents to be debated at European supervisory authority management board meetings are also processed and discussed thoroughly.

(Concerning the operation of the Financial Stability Board see the answer for "Cooperation with other supervisory bodies in the country")

MAIN STRATEGIC OBJECTIVES OF THE HFSA IN 2010

The HFSA's core mission is to:

- ensure, or, if needed, enforce the **solid, transparent and effective operation of the financial intermediation system** and the prudent functioning of persons and organisations participating therein,
- provide for the **stability and undisturbed operation of financial markets** and establish **through decrees and other proposed regulations** a safe and competitive framework that complies with EU legislation,
- **reveal risks of financial organizations and sectors,** effective prevention of the occurrence of these risks by proactive measures, mitigation and elimination of already evolved risks,
- **consistently and proactively protect** the **rights and interests of** customers of financial institutions, provide a forum for settling disputes and increase the financial awareness of consumers,
- **strengthen public confidence in the financial intermediation system**,
- **as a member of the European System of Financial Supervisors represents the interests of Hungary and** cooperates with European and other supervisory authorities.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

Priorities of supervision for 2010

When the HFSA's priorities for 2010 were elaborated, the main consideration was to manage the adverse cross sector impacts of the global financial crisis. In accordance with the principle of integrated supervision, priorities apply to all supervised sectors i.e. they set the overall direction and focus points of supervision.

The **HFSA's priorities set for 2010** were as follows:

Credit risk – responsible lending

In 2010, credit risk was the largest threat to the Hungarian financial system. As a consequence of the global financial crisis, real incomes fell and unemployment increased; loan conditions were increasingly strict, foreign exchange rates fluctuated heavily and debt burdens rose. Furthermore, falls in collateral values due to weakening asset markets resulted in an uncommon deterioration of loan portfolio quality. These developments inevitably gave special significance to credit risk and made it a key supervisory priority. Application and enforcement of strict lending conditions, prudent credit eligibility assessments and responsible lending standards, furthermore, the realistic valuation of mortgage loan collateral and the proper management of rescheduled loans were also of outstanding significance.

Profitability and capital planning

When defining the priorities of supervision, continued deterioration had to be envisaged in 2010 regarding the profitability and capital-generating capability of the domestic financial sector, due to increased allowances for impairment, lost revenues from non-performing assets and a fall in demand for financial products. Thus, the HFSA paid special attention to the service providers' proper choice of business strategy for 2010, the careful budgeting of expected revenues, expenditures and capital position, the prudent identification and assessment of relevant profitability and capital risks and the establishment of an adequate capital buffer. The HFSA deemed capital risk as a key investigation item in respect of the ICAAP-SREP dialogue.

Liquidity

Liquidity risk decreased significantly owing to the improvement on global financial markets and an increase in investor risk appetite after March 2009. Risk premiums that had seen an earlier dramatic increase were now falling slightly and the availability of funding improved significantly. Still, it seemed reasonable to keep liquidity risk management on the list of supervision priorities, especially given the fragility of financial markets and of the global macroeconomic environment.

Protection of customers

The shortcomings of the effectiveness of customer protection in the Hungarian financial sector were further increased by the crisis as deteriorating business conditions intensified the endeavours of service providers to pass on negative effects to customers. This increased the vulnerability of those consumers that were both under-informed and had limited lobbying capabilities. In this environment, verifying service providers' compliance with legal and contractual obligations is of special importance, as is the enforcement of standards regarding the mandatory informing of customers. The financial literacy of Hungarian households is relatively limited thus the HFSA's consumer protection responsibilities play a key role in propagating financial culture.

In August 2010, the HFSA drew up a strategic consumer protection concept on how best to achieve the consumer protection objectives outlined in the HFSA Act. In order to manage proficiently the large number of pre-existing unsettled claims, the HFSA's new management took measures as from September 2010. Among others they carried out organisational changes, and initiated the establishment of a Financial Arbitration Board that will function as a proficient alternative forum to settle debates as opposed to costly court proceedings that often take years.

Modification of priorities in H2 2010

The actual trends in 2010 confirmed that the priorities set at the end of 2009 were fundamentally correct. Based on what was learnt from these actual developments, in the course of 2010 the new management of the HFSA was compelled to shift the primary supervisory focus from the priorities announced in 2009. These necessary changes were carried out mainly by introducing changes to the HFSA's organisational structure, supervisory procedures and techniques and through reassigning resources, all without formally setting new priorities.

The shift in focus was implemented in the following two areas: First, the HFSA's consumer protection activities received more attention than in previous years. Second, supervisory were modified by increasing considerably the role and weight of on-site investigations. These changes are further detailed in the consumer protection and institution supervision chapters of this report.

Risk-based supervision, impact assessment

Until the last third of the 1990s, the HFSA's predecessors principally focused on "supervision for compliance", i.e. supervision was mainly targeted at verifying compliance with legal requirements. Over time, the focus of supervision increasingly shifted from compliance to prudential supervision, i.e. to the risks and threats inherent in the operation of institutions. In accordance with the principles of risk-based supervision, a Credit Risk Manual and a Profitability Risk Manual was prepared in 2010.

On-site and off-site supervision – organizational separation

The HFSA carries out continual supervision of organisations and persons subject to legal acts regulating financial sector. This is implemented by way of on-site supervision and the verification and analysis of data obtained from regular and ad-hoc data provision, documents submitted to the HFSA and other officially obtained information. As part of its investigation procedures, the HFSA carries out comprehensive investigations at supervised institutions at intervals defined by the HFSA Act and performs targeted or thematic investigations as well. Comprehensive investigations always include an on-site component. Similarly, each comprehensive investigation scrutinizes the institution's efforts to combat money laundering and the financing of terrorism for compliance with legal provisions and HFSA requirements. In 2010, the method and practice of the supervision of institutions were transformed markedly; effective as of 1 September 2010, a new organisational model was implemented at the Supervisory Directorate, separating on-site and off-site investigation functions.

The number of comprehensive investigations went up considerably in 2010. One reason was that the focus of investigations, as required by legal provisions, was shifted from targeted and thematic investigations to comprehensive investigations. Second, the HFSA concentrated on the investigation of eight large banking groups in 2009, which tied up significant supervisory resources while in 2010 smaller institutions were the main targets.

The HFSA regularly assesses the capital position of supervised institutions and assesses their internal capital adequacy assessment process (SREP). Since 2010 the HFSA carries out SREP investigations preferably in the framework of comprehensive investigations.

One characteristic feature of supervisory duties is that they become increasingly international in parallel with the expansion of cross-border services. Tasks deriving from EU and other international cooperation, participation in specific committees, the establishment of supervisory colleges and contribution to their work all form part of this.

The HFSA participates in 20 banking and 15 insurance colleges. In the case of the OTP Group, the HFSA leads the banking supervisory college, regularly holding meetings in Budapest with the participation of the supervisors of OTP group member institutions abroad. In the case of other EU-based supervisory colleges, the HFSA attends meetings in the capacity of host y supervisor. Furthermore, the HFSA also cooperates with the supervisory authorities of certain non-EU countries. Concerning its scope and content, this cooperation is the same as that in supervisory colleges.

Prudential enforcement

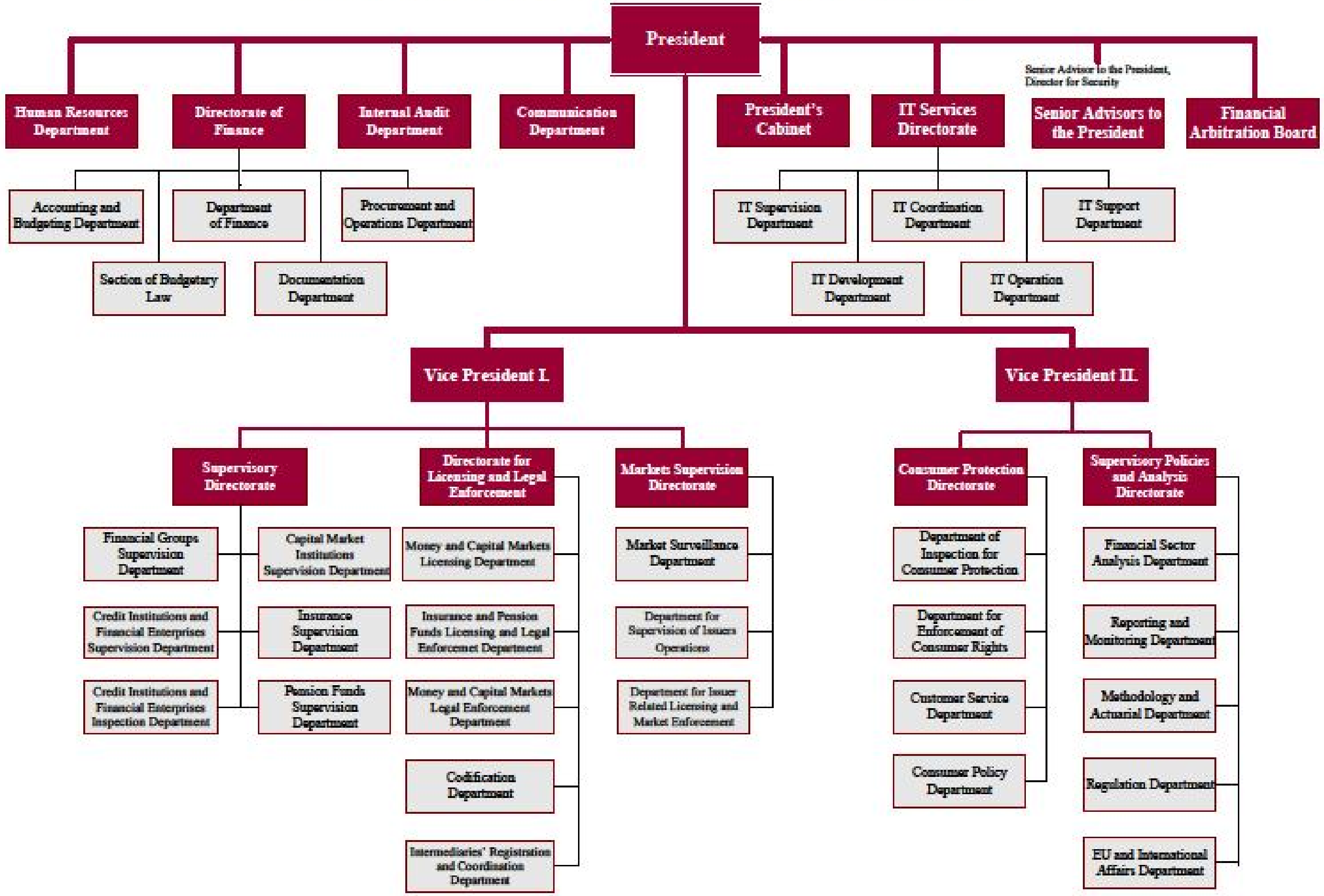
At the end of 2010, the HFSA introduced stricter sanctions on late data provision by supervised institutions. The HFSA’s Money and Capital Markets Legal Enforcement Department took part in nine comprehensive investigations in 2010, each of which ended with a resolution. In addition, it carried out a number of supervisory measures especially against financial and capital market institutions that struggled with capital problems or were late with supplying of data provision.

Financial market licensing

On 1 January 2010, an amendment to the Act on Credit Institutions relating to financial intermediaries entered into effect. As a result, the intermediation market changed completely and new professional requirements were set. The number of new applications for licence decreased in 2010 compared to the previous year and the scope of activities of new companies also narrowed. In 2010, the HFSA revoked the operating license of four financial enterprises.

ORGANIZATIONAL CHART OF THE HFSA

The Structure of the Hungarian Financial Supervisory Authority



INTERNATIONAL ACTIVITY OF THE HFSA

Cooperation at European level

Participation in EU expert groups

In 2010, the vast majority of tasks that are subject to the HFSA's mandate was related to the 3L3 committees that encompassed three European committees (CEBS, CESR, CEIOPS) until the establishment of the new European Supervisory Authorities (ESA's). The participation of HFSA experts in the working committees of the three European Supervisory Committees (CEBS, CESR, CEIOPS: 3L3 Committees) was significant, as they were members to a total of 44 standing subcommittees and ad-hoc working groups in 2010. In preparation for the switch to the ESAs, the structure of most of the subcommittees was already changed in 2010. Partly to keep up with these changes and partly to manage its resources as efficiently as possible, and taking into consideration the fact that a full-time staff of experts was engaged at the ESAs, the HFSA reviewed the participation in each committee based on the accomplishments of the individual committees and the usefulness of Hungarian participation. Based on the review, a decision was made on the level of future participation.

Data provision at EU level

With the establishment of the European System of Financial Supervisors (ESFS), demand is increasing for the European reporting systems of standardised content and format. The HFSA is becoming an active participant in the creation of shared European databases. Credit institution and capital market reports already include tables that comply with EU data requirements and their range is expected to expand in the future.

Preparation for participation in the Hungarian EU presidency

One key task set by the HFSA in 2010 for the following year was fostering the success of the Hungarian EU presidency in H1 2011 with the HFSA's own professional tools. To this end, a so-called "dossier manager" system was established within the HFSA for each potential EU financial legislative dossier. Dossier managers are specialists with up-to-date, expert knowledge of the given issue. Consultation sessions were held regularly where dossier managers report the latest developments and exchange opinions with HFSA management. Due to the Hungarian EU Presidency the cooperation agreement in effect between the Ministry of National Economy, the Magyar Nemzeti Bank (the central bank of Hungary)and the HFSA has been extended. Pursuant to the amended agreement, HFSA experts provide specialist support during the preparatory phase and the presidency. In preparation for the Hungarian EU presidency, HFSA experts attended ministry meetings and prepared for sessions in Brussels in advisory capacity.

Participation in non-EU international organisations

In order to ensure that consumer protection is treated as a key priority, the HFSA – among others - actively participated in the work of **INFE (International Network on Financial Education), the OECD's financial literacy improvement network**. With a view to the new consumer protection responsibilities assigned to the HFSA in 2011, this topic is a key task for the HFSA. The HFSA's participation in other OECD committees in 2010 usually involved data provision, completion of questionnaires and commenting on documents.

The HFSA is a member of the **Council of Europe's Moneyval Committee**, one of the global and regional organisations established to combat money laundering and terrorism financing. The Hungarian delegation includes representatives from several Hungarian authorities and is led by one of the HFSA's directors. Through 2010, Moneyval experts carried out the fourth round of on-site and off-site investigations at authorities and supervised institutions to assess the status of these activities in Hungary. In international comparison, financial supervision and the compliance of at supervised Hungarian institutions with AML/CFT standards and legal requirements received a favourable assessment. On assignment from Moneyval or organisations such as the IMF and the World Bank, HFSA associates on Moneyval's expert list continued to regularly carry out country assessments in Europe.

Conferences, presentations, consultations, and meetings with international organisations, foreign supervisory authorities and financial organizations at the HFSA

As speakers and panellists, the managers and experts of the HFSA attended several conferences in 2010 (e.g. the EUROFI Financial Forum 2010, the International Conference of Banking Supervisors (ICBS), the CEE financial stability meeting, the European conference of the Anti Money Laundering Professionals Forum, and the Investor Education Conference).

Under the framework of bilateral relations, executives of partner supervisory authorities are regular guests at the HFSA. E.g. in 2010, the HFSA hosted high-level delegations from the Austrian Market Supervision Authority (FMA) and the China Securities Regulatory Commission. Based on agreements, the HFSA regularly hosts visits and presentations involving middle management and experts with the supervisory authorities of neighbouring countries.

The representatives of large global banks, securities traders and credit rating agencies are also regular visitors to the HFSA, seeking information on financial trends, regulatory changes in Hungary and the EU and the HFSA's opinion on market trends.

(See also the answer for "Main strategic objectives of the supervisory authority in 2010" and "The activities of the Banking Supervisory Authority last year")

COOPERATION WITH OTHER SUPERVISORY BODIES

Cooperation agreements

The HFSA renewed its cooperation agreements with the National Consumer Protection Authority and the National Tax and Customs Administration (NAV).

As a sign of intensifying cooperation between the HFSA and non-governmental organisations, the HFSA signed cooperation agreements with the Indra National Insured Persons Association and with the Hungarian Association of Consumer Protection Organisations. The purpose of these agreements is to assist non-governmental organisations that cooperate with the HFSA in their efforts to inform and train consumers and in providing consumer protection advice.

In a joint effort with supervised institutions, partner organisations and partner authorities, the HFSA regularly holds consultation sessions on combating money laundering and terrorism financing issues.

Financial Stability Board

With the passing of the package of bills to strengthen the supervision of the financial intermediation system and pursuant to the amendment of the HFSA Act entering into effect on 1 January 2010, the Financial Stability Board (FSB) began its activities on 15 January 2010 as a high-level consultative body. Its main task is to harmonize micro and macro prudential financial supervision. It deliberates on financial policy, regulation, and risk mitigation issues, analyses potential systemic risks, identifies risk factors.

The Board consists of the leaders of authorities that have a key role in ensuring financial stability and which are independent of each other and are equal partners in the Board. These institutions are the Ministry for National Economy, the Magyar Nemzeti Bank (the central bank of Hungary: MNB) and the Hungarian Financial Supervisory Authority. The chairmanship of the Board is accomplished on an annual rotating basis, the secretariat functions are provided by the HFSA. The Board takes its positions on the stability of the financial system on consensus basis.

The Board assesses the stability of the money, capital, insurance and fund markets, and discusses the risk reports of the HFSA.

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	36	35	35
Branches of foreign credit institutions	11	12	12
Cooperative banks	148	140	138
Banking sector, total:	**195**	**187**	**185**

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

Type of financial institution	2008	2009	2010
Public sector ownership	3,35	3,66	3,94
Other domestic ownership	12,00	13,91	13,23
Domestic ownership total	**15,35**	**17,57**	**17,17**
Foreign ownership	84,65	82,43	82,83
Banking sector, total:	**100**	**100**	**100**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	44	63	11
Branches of foreign credit institutions	73	97	21
Cooperative banks	11	17	1
Banking sector, total:	**38**	**55**	**8**

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

Type of financial institution	2008	2009	2010
Commercial banks	10,6	8,7	1,3
Branches of foreign credit institutions	55,9	30,6	6,2
Cooperative banks	9,5	6,5	5,7
Banking sector, total:	**10,8**	**9,6**	**1,7**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	88	85	84
Branches of foreign credit institutions	3	6	7
Cooperative banks	5	5	5
Other	4	4	4
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2008	2009	2010
Financial sector	21,0	26,0	22,2
Nonfinancial sector	48,6	45,7	47,5
Government sector	12,6	12,6	13,8
Other	17,8	15,8	16,6
Liabilities	**2008**	**2009**	**2010**
Financial sector	12,1	13,4	12,9
Nonfinancial sector	35,7	36,1	36,8
Government sector	2,0	2,2	2,0
Capital	7,3	8,1	8,6
Other	42,9	40,2	39,8

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks	11,2	13,1	13,3
Cooperative banks	14,8	14,8	14,7
Banking sector, total:	**11,4**	**13,2**	**13,4**

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

Asset classification	2008	2009	2010
Non financial sector	10,2	23,3	27,6
- households	**8,1**	**15,2**	**22,7**
- corporate	**12,4**	**31,9**	**33,4**

The structure of deposits and loans of the banking sector in 2010 (%) (at year-end)

	Deposits	Loans
Households	53,5	39,9
Government sector	3,5	2,7
Corporate	29,8	33,9
Other (excluding banks)	13,2	23,5
Total	**100.0**	**100.0**

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

P&L account *(in EUR)*	2008	2009	2010
Interest income	9 107 772 490	9 937 948 604	8 563 870 852
Interest expenses	6 066 436 287	6 790 776 842	4 808 301 345
Net interest income	3 041 336 204	3 147 171 762	3 755 569 507
Net fee and commission income	1 005 257 195	1 041 053 759	1 057 122 870
Other (not specified above) operating income (net)	402 062 089	959 765 913	-504 742 601
Gross income	4 448 655 488	5 147 991 434	4 307 949 776
Administration costs	2 478 661 530	2 241 607 591	2 403 375 785
Depreciation	242 582 521	215 898 686	211 626 906
Provisions	-581 444 973	-1 729 807 266	-1 484 717 489
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	1 145 966 463	960 677 891	208 229 596
Net profit (loss)	962 935 267	813 934 426	206 812 556

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	8 926 156 940	7 555 871 738	1 373 169 507	-2 884 305
Cooperative banks	441 206 863	390 571 422	50 635 440	0
Banking sector, total:	9 367 363 803	7 946 443 161	1 423 804 947	-2 884 305

2010 DEVELOPMENTS IN THE LATVIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Following the lowest GDP level observed in the third quarter of 2009 in the contraction phase of the business cycle, the average quarterly growth in 2010 was 0.7%, with even positive annual changes (a rise from −6.1% in the first quarter to 3.6% in the fourth quarter) recorded for the third quarter.

Real exports of goods and services, the main driver of the economy, overall picked up 10.3% in 2010. Export expansion was supported by both regained competitiveness and improved external demand.

Private consumption, the largest component of the domestic demand, strengthened substantially at the beginning of the year when household sentiment improved. Nevertheless, a number of factors caused the situation to deteriorate. Population's precautionary spending behaviour intensified again when the anticipated 2011 government fiscal consolidation measures were defined more precisely, confirming an increase in tax burden to be further expected. In 2010 overall, private consumption remained almost unchanged vis-á-vis the previous year (a drop of 0.1%). At the same time, public consumption contracted by 11.0% due to government budget expenditure cuts.

Imports expanded buoyantly (by 8.6%) on account of stronger domestic demand and larger volumes of raw materials for manufacturing. Due to more swiftly rising exports, however, the contribution of net exports remained positive (0.6 percentage point).

In 2010, the price dynamics was substantially affected by both demand and supply factors. The low domestic demand affected by the crisis-triggered income drop and high unemployment rate, on the one hand, exerted significant downward pressure on prices, which companies managed to lower as labour costs were falling and productivity was improving. On the other hand, external factors made raw material prices go up, global energy prices increased throughout the entire 2010, and food prices also rose notably in the second half of the year due to weather conditions unfavourable for agricultural activities. Nevertheless, for 2010 on the whole, the average consumer price level was 1.1% below that of 2009.

As the demand continued to be weak, consumer price core inflation was negative during the year. However, due to rising energy and food prices, core inflation rose from its February low of −5.4% to −0.3% in December, and in the year on average stood at −3.2%, reducing overall inflation by 2.3 percentage points.

The year 2010 marked a turning point in the labour market. Following the massive layoffs and the sharp decline in wages and salaries in 2009, the labour market stabilised and, since spring, started to show some signs of gradual improvement resulting from higher labour demand under the impact of the economic recovery. According to the Central Statistical Bureau labour survey, jobseekers constituted 18.7% of economically active population at the end of 2010 and according to State Employment Agency the registered unemployment rate stood at 14.3% at the end of the year (down from a 17.3% peak in March 2010).

DEVELOPMENT IN BANKING SYSTEM

Banks dominate the financial sector in Latvia, accounting for about 93 per cent of its total assets. In 2010 there were 21 licensed domestic banks in Latvia and branches of ten banks licensed elsewhere in the EU. All the banks in Latvia have been licensed as universal banks and can provide a full range of financial and investment services. The assets total / GDP in thousand of lats to the end of 2010 were 172.5% (21 967 183(assets)/12 735 936 (GDP)).

As at end-2010, almost 65 per cent of the Latvian banks' share capital was owned by foreign investors. Four subsidiaries of EU banks and ten branches of EU banks accounted for approximately 58 per cent of total Latvian bank assets and approximately 68 per cent of total Latvian bank loans. All other banks in Latvia are privately owned, except for 3 banks that are controlled by the government (Parex Bank, Citadele banka and Mortgage and Land Bank of Latvia). The market share of these banks in total assets made up 15.5 per cent of the total assets of Latvian banks at end-2010.

The economic situation in Latvia remained complicated in 2010. Still low household income, high unemployment rate, uncertain future prospects resulted in a low demand in banking loans. As lending activities declined, the banking sector loan portfolio annual growth rate at end-2010 was negative (-7.1 per cent) and total loans amounted to 14.3 billion lats (outstanding loan portfolio shrinking on average by 0.6–0.7 per cent per month as from February 2009). Though banks issued new loans in the amount of 956.6 million lats in the 2nd half of 2010, they still were not exceeding the amortization of loan portfolio.

The loan quality showed first signs of stabilization in 2010, since July the amount of overdue loans was shrinking. The share of past due loans in the total loans made up 26.6 per cent at end-2010 (compared to 16.4 per cent at end-2009). The amount of loans with more than 90 days overdue payments (NPLs) had been gradually diminishing month on month already since August, also their share in the banking loan portfolio decreased and at end-2010 made up 19 per cent (compared to 19.3 per cent at end-August). The loans issued to resident households for housing purchase and to corporates dealing with real estate operations constituted the major share of NPLs (28 and 27 per cent, respectively).

Banks continued to restructure loans during 2010. The amount of restructured loans reached 2.852 million lats or 19.9 per cent of total banking loans at end-2010 (compared to 16.1 per cent at end-2009). The loans in work-out process totalled 2.192 million lats or 15.3 per cent of total banking loan portfolio at end-2010 (compared to 9.5 per cent at end-2009).

Upon stabilization of loan quality, the total amount of loan loss provisioning had been gradually decreasing since August-2010. By the end of 2010 banks had made provisions at the total amount of 1.6 billion lats, comprising 11.3 per cent of banking sector loan portfolio.

Bank liquidity has improved with the average liquidity ratio at end-2010 being 67.9 per cent (compared to 62.8 per cent at end-2009) (minimum requirement of 30 per cent). In addition, the capital adequacy ratio (CAR) of all banks in Latvia was above the minimum requirement of 8 per cent, with the average CAR of the banking sector at end-2010 being 14.64 per cent (compared to 14.56 per cent at end-2009) and the Tier I CAR being 11.47 per cent at end-2010 (compared to 11.45 per cent at end-2009). Latvian banks continued strengthening their capital base. 14 banks increased their capital overall by

324.4 million lats, including share capital by 278.8 million lats, subordinated capital by 20.7 million lats and reserve capital by 24.8 million lats in 2010.

Funding sources of Latvian banks are dominated by borrowings from parent banks which accounted for 26.5 per cent of total assets at end-2010 (constituting 85 per cent of liabilities to MFI) and deposits which accounted for 50.6 per cent of total assets at end-2010. Funding from the parent banks has slightly decreased in 2010 (by 140 million lats or 2.3 per cent). Deposit base stabilized and since April 2010 bank deposits hit the pre-crisis level in Latvia (i.e. September 2008). Both resident and non-resident depositors' confidence was restored, as evidenced by the ongoing increase in deposits since the beginning of the year by 1,561 million lats or 16.3 per cent (9.6 per cent for resident and 27.4 per cent for non-resident deposits), and at the end-2010 total deposits amounted to 11.1 billion lats.

Latvian banks so far have been repaying syndicated borrowings without rollover. At the end of 2010 only two banks still had syndicated loans on their books in total amount of 202.8 million lats, including 200.5 million lats that both banks have to repay in 2011, and no problems are expected with repayment.

In 2010, the banking sector profit before provisions and taxes amounted to 143.5 million lats or by 55.4 per cent down from 2009. In 2010, expenses for loan loss provisioning (almost 506 million lats by-end December) were the main reason for total losses in the banking sector, amounting to 360.7 million lats by end of year (or by 53.4 per cent less than the previous year with losses of 773.4 million lats). In 2010, 10 banks (representing 15.6 per cent of total banking sector assets) operated with profit that amounted to 8.3 million lats.

In light of recent stabilization trends in economy and cautiously optimistic economic growth forecast, it is expected that the banking sector will gradually return to profitability in 2011.

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

Regulatory framework was further enhanced taking into account amendments to the Capital Requirement Directive, recommendations and guidelines issued by CEBS and other international institutions as well as for ensuring stringent supervisory regime. In the reporting period the Parliament adopted amendments to the Credit Institution Law to transpose provisions of the CRD II and partly CRD III (effective as of 31.12.2010), to introduce disclosure requirements regarding remuneration policy and practices as well as introduce requirements regarding remuneration in credit institutions that benefit from exceptional government intervention, to enhance restructuring process for credit institutions as well as adopted amendments to the Deposit Guarantee Law to increase coverage limit for deposits up to EUR 100 000. The Financial and Capital Market Commission (FCMC) has developed/amended several regulations - Regulations on Underlying Principles of Remuneration Policies, Regulations on Calculation of Minimum Capital Requirements, Regulations on Compliance with Restrictions on Exposures, Regulations on Information Disclosure.

Legal competence of the Banking Supervisory Authority in the country

The FCMC is an autonomous public institution, which carries out the supervision of Latvian banks, credit unions, insurance companies and insurance brokerage companies, investment management companies, participants of financial instruments market, as well as private pension funds. The FCMC objectives are to take responsibility for the following:

- ensuring the stability of the banking system, boosting depositor confidence,
- protecting the interests of depositors,
- protecting the interest of borrowers.

The competence of the FCMC is set forth in the Law on the Financial and Capital Market Commission and the Credit Institution Law. As regards the banking sector, the FCMC has authority to issue regulations and guidelines governing activities of banks; to request and receive information from banks necessary for the execution of its functions; to set forth restrictions on the activities of banks; to examine compliance of the activities with the legislation, and regulations and directives of the FCMC; to apply sanctions set forth by the regulatory requirement on banks and their officials in case said requirements are violated.

MAIN STRATEGIC OBJECTIVES OF FCMC IN 2010

Main strategic objectives - to continue performing the stabilization programme of the Latvian economy as approved by the Saeima in the areas within FCMC's competence.

In relation with the global financial crisis – to maintain public confidence in the Latvian financial system, to identify essential risks for banking management maximum precisely and to take immediate measures for reducing the impact of these risks and for market stabilization.

Continuing the implementation of the EU directives in the Latvian financial and capital market, the FCMC planned to improve legislative enactments and prepare amendments to several national regulations and laws, in accordance with the recommendations of international financial supervisory authorities and the best international practices in this field.

Strengthen the supervision of the banking sector, ensure a sufficient capital base and liquidity of the banking sector, strengthen the supervision power for realization intervention in the banks and improve the problem solving framework in banks.

Actively participate in the work of European Supervisory Authorities, implement guidelines and recommendations of all European Supervisory Authorities to ensure the harmonized interpretation and application of EU legislation.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In the reporting year, two Latvian branches of banks were granted authorization to commence their operation, one license was withdrawn, and restrictive measures were imposed on the activities of two banks. Specific provisioning policy or asset recognition policy was applied to nine banks during the reporting year. The FCMC took corrective measures determining additional requirements in relation to the credit risk area for three banks, fines were imposed on four banks and a warning was issued to one bank.

In the reporting year the FCMC conducted 34 bank inspections, in particular focusing on the capital adequacy assessment process and lending in the banks, as well as risk management functions, i.e. credit risk, operational risk, liquidity risk, strategic and business risk management and compliance control functions.

Maintaining sufficient Latvian banking capital base through effective debt restructuring still was the top priority in the supervisory area. In 2010, supervisory methods still were based on the assessment of operational risk of market participants using appropriate approaches as monitoring bank performance on the basis of the analysis of financial statements and on-site inspections.

The FCMC continued enhanced off-site bank monitoring based on updated and regular bank performance statements and accounts:

- daily reporting on deposit dynamics,
- account on liabilities to affiliated financial institutions,
- monthly reporting on the structure and quality of bank loan portfolio, monthly reporting on problem loans, i.e. restructured loans, loans with modified principal or interest repayment terms and loans in work-out process,
- decisions of bank credit committees and bank boards as well as bank internal auditor reports.

Also, in 2010 the FCMC required the banks to prepare interim financial statements for six months until 30 June 2010 and carry out their audit. These reports enabled the FCMC to hear an independent third party opinion regarding the financial situation of banks.

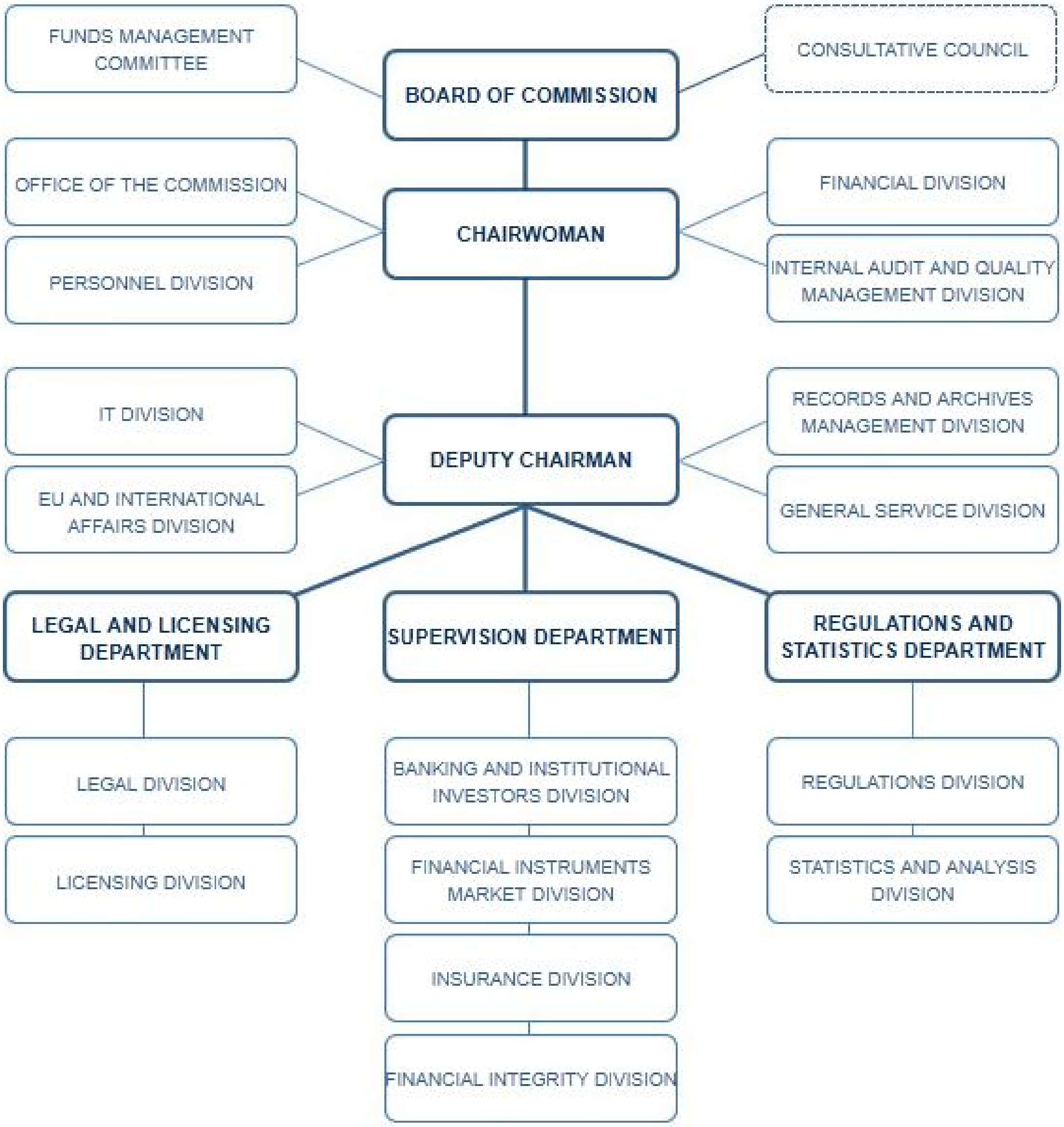
Acting in concert with the Bank of Latvia, the FCMC continued regular stress testing to have a comprehensive assessment of risks inherent in the activities of a particular bank taking into account the macro-economic projections. Based on test results potential losses in loan portfolio under conservative economic development scenarios were determined as well as the ability of a bank capital to absorb above losses. Within the framework of liquidity risk stress testing, customer behaviour scenarios were analysed as well as the bank ability to meet customer legal demands in a timely manner. If required, the FCMC in a dialogue with a bank discussed capital contingency plans and the measures the bank was planning to take for maintaining liquidity.

The FCMC performed analysis of bank performance, risk rate and risk management quality on a quarterly basis in view of risk monitoring results, planned supervisory measures if required, including on-site inspections. Credit risk, liquidity risk, strategic risk and business risk were identified as essential risks in the banking activities in 2010. Particular attention was paid to the bank strategies and profitability. Both quantitative and qualitative information was used in risk analysis.

The FCMC continued cooperation with the Member State supervisory authorities performing consolidated supervision of credit institutions in accordance with regulatory requirements. The FCMC staff took part in the work of five colleges of credit institution supervisors. The issues on coordinating the supervisory actions, capital adequacy assessment process and group-level risk profile assessment were high on the agenda of colleges.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

http://www.fktk.lv/en/commission/about_us/structure_new/



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

The FCMC employees continued participation in the work of the EU Council and European Commission regarding financial services, in the working groups developing new draft directives, responded to questionnaires and public consultations released by the European Commission, as well as shared opinions on such issues as prevention and resolution of financial crisis, introduction of stability levy on the financial sector, conditions for setting up stabilization funds, imposition of other taxes in the financial sector, the united EU position for enhancing G-20 financial market supervisory framework.

Also, the FCMC experts participated in the work of working groups established within the framework of the Committee of European Banking Supervisors (CEBS), Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and Committee of European Securities Regulators (CESR). The most topical issues of the European committees were related to the supervisory framework reform and transforming the existing committees into European supervisory authorities.

In 2010, three new cooperation and coordination agreements were signed with respect to group supervision of Nordea, DnB Nor and Citadele banka. Cooperation and coordination agreement between Finish Financial Supervisory Authority (Finanssivalvonta) and FCMC with respect to supervision of Nordea Bank Finland Plc branch in Latvia was re-signed.

In June 2010 Cooperation agreement on cross-border financial stability, crisis management and resolution between relevant Ministries, Central Banks and Financial Supervisory Authorities of Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden was signed and first meeting of Nordic – Baltic Stability group took place.

COOPERATION WITH OTHER SUPERVISORY BODIES IN LATVIA

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

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	21	21	21
Branches of foreign credit institutions	6	6	8
Cooperative banks	0	0	0
Banking sector, total:	**27**	**27**	**29**

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

Type of financial institution	2008	2009	2010
Public sector ownership	19.5	17.1	15.5
Other domestic ownership	12.6	13.7	15.5
Domestic ownership total	32.1	30.7	31.0
Foreign ownership	67.9	69.3	69.0
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	42.4	55.9	0.113
Branches of foreign credit institutions	11.7	12.0	0.699
Cooperative banks	0	0	0
Banking sector, total:	**43.9**	**59.3**	**0.097**

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

Type of financial institution	2008	2009	2010
Commercial banks	3.6	-41.6	-20.4
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	-	-	-
Banking sector, total:	**3.6**	**-41.6**	**-20.4**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	88.5	88.0	87.9
Branches of foreign credit institutions	11.5	12.0	12.1
Cooperative banks	0	0	0
Other	0	0	0
Banking sector, total:	**100**	**100**	**100**

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

Assets	2008	2009	2010
Financial sector	20.0	21.0	25.2
Nonfinancial sector	69.9	70.3	64.9
Government sector	5.9	3.4	4.2
Other	4.2	5.2	5.7
Liabilities	**2008**	**2009**	**2010**
Financial sector	47.8	40.8	35.1
Nonfinancial sector	34.9	36.2	42.4
Government sector	4.0	3.6	4.4
Capital	7.3	7.4	7.3
Other	6.0	12.0	10.8

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks	3.9	17.2	19.8
Cooperative banks	5.2	16.7	18.7
Banking sector, total:	**2.9**	**18.0**	**21.0**

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

Asset classification	2008	2009	2010
Non financial sector			
- households	**n/a**	**39,2**	**43,6**
- corporate	**n/a**	**35,2**	**39,0**

The structure of deposits and loans of the banking sector in 2010 (%) (at year-end)

	Deposits	Loans
Households	30.8	41.1
Government sector	8.6	0.4
Corporate	52.4	54.0
Other (excluding banks)	8.2	4.5
Total	**100.0**	**100.0**

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

P&L account	2008	2009	2010
Interest income	1 992 543	1 442 905	973 758
Interest expenses	1 207 348	932 473	633 532
Net interest income	785 195	510 432	340 226
Net fee and commission income	235 353	187 085	200 263
Other (not specified above) operating income (net)	179 935	307 279	188 507
Gross income	1 200 483	1 004 796	728 996
Administration costs	569 555	493 503	472 000
Depreciation	51 550	53 415	52 923
Provisions	445 580	1 707 075	721 905
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	445 580	1 707 075	721 905
Profit (loss) before tax	133 798	-1 249 197	-517 832
Net profit (loss)	48 323	-148 718	-4 603

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	2 739 132	2 145 745	593 386	0
Cooperative banks	0	0	0	0
Banking sector, total:	**2 739 132**	**2 145 745**	**593 386**	**0**

2010 DEVELOPMENTS IN THE LITHUANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2010, the global economy started to recover after the deep recession caused by the global financial crisis. Signs of the marginal growth of consumption and investment and intensification of the international trade started to emerge. In particular, the global economy strengthened in the first half of the year. As some countries initiated fiscal consolidation and the impact of incentive measures weakened, the economic development slowed down slightly in the second half of the year, however, it became more sustainable.

Real GDP of Lithuania grew by 1.3%. Our economy was mostly supported by increased foreign demand. Particularly strong growth in exports of goods and services, industrial production and transport services was observed in 2010. Recovery of industrial production and improved expectations of the enterprises helped to restore more actively the inventories, which shrank somewhat during the economic downturn. Growing inventories were the key factor supporting the growth of real GDP.

Owing to sluggish domestic demand and favourable movements in foreign demand, the current account continued to show surplus in 2010. Notwithstanding the deterioration in the balance of goods, the deficit remained noticeably smaller than before the economic downturn. The surplus in the trade in services grew markedly in 2010. Same as earlier, the current account balance was positively affected by current transfers. They consisted basically of the EU structural aid funds and remittances by emigrants to Lithuania.

The average annual inflation rate in Lithuania was 1.2% in 2010 – noticeably lower, compared to the inflation in 2009, and lower than in the EU and the euro area. Inflation was mostly influenced by external factors, whereas the prices of industrial goods and market services – related mainly to domestic demand – were lower, compared to those registered one year ago.

DEVELOPMENT OF THE BANKING SYSTEM

The banking system of Lithuania consists of 9 commercial banks, 11 foreign bank branches and 2 representative offices of foreign banks. Two foreign bank branches have not yet started their operation. By 31 December 2010, the Bank of Lithuania had received 239 notifications from the supervisory authorities of the EU Member States regarding intentions of the banks licensed by them to provide services in Lithuania without establishing branches.

2010 was a breakthrough year that was much more favourable for the operation of banks than the previous year. The positive trends in banking activities became evident in the second half of 2010, when the growth of assets and loans was observed during some months. In 2010, the increase in customer deposits exceeded the growth in the previous year, whereas the decline in bank assets and the volume of loans to customers was several times smaller than last year.

Bank assets fell over the year by 3 per cent to LTL 81.7 billion on 31 December 2010, while loans to their customers decreased by 5.2 per cent to LTL 58.3 billion. Although deposit interest rates went down significantly in all of the banks, deposits kept growing fast in 2010. Deposits climbed over the year by 10.6 per cent to LTL 45.4 billion. As in the previous year, a notable increase was observed in household deposits (by LTL 1.3 billion) and deposits of government institutions (by LTL 880.8 million). On 31 December 2010, household deposits made up 34.4 per cent of liabilities and were the major source of financing for the banking sector.

Such changes led to the growth of the loan portfolio share that was financed with deposits: a year ago, customer deposits were used to finance 66.7 per cent of the loan portfolio, whereas other bank resources (mainly the funds borrowed from parent banks) made up the smaller share, while in 2010 the loan portfolio share financed with deposits reached 77.9 per cent. Furthermore, owing to the above changes in the structure of banks' financing sources, the Lithuanian banking system became less reliant on the financing from other countries: on 31 December 2010, the funds received from non-residents accounted for 40.1 per cent of the banking system's liabilities, a year-on-year drop of 6.1 percentage points.

In 2010, performance results of the banking sector revealed positive changes; after almost two years of operating with loss, the banking sector began to earn profit since the middle of the year. Nevertheless, because of the negative performance result in the first half of 2010, the banking sector suffered the loss of LTL 276.2 million over the year. The performance result for 2010 improved significantly however, compared with 2009, when the loss made up LTL 3.7 billion. In 2010, two banks and five foreign bank branches reported profit, while seven banks and four foreign bank branches incurred losses.

With the improvement in the economic situation of the country and the intensification of bank operations, the banking sector liquidity ratio started to decrease. It declined by 7.1 percentage points in 2010 and made up 42.8 per cent on 31 December 2010, i.e. it was almost 13 percentage points higher than the minimum set by the Bank of Lithuania (30%). In 2010, all banks complied with the set liquidity ratio.

To curtail the operational risk of banks, the Bank of Lithuania applies the capital adequacy ratio. In 2010, all banks complied with the established capital adequacy ratio, and the banking system complied with this ratio with quite a large reserve. Over the year, the capital adequacy ratio grew by 1.4 percentage points to 15.6 per cent on 31 December 2010. It grew despite the tightening of requirements for financial instruments included in bank capital in late 2010. The capital structure of the domestic banking system was sound, since as much as 78 per cent of the capital consisted of Tier I capital. It should be noted that both the European Commission and the Basel Committee on Banking Supervision plan to further tighten the capital definition and to introduce new capital adequacy ratios for Tier I capital and financial leverage. Although the approval of the envisaged changes has not been finalised yet, the preliminary calculations show that the Lithuanian banks would have sufficient capital to comply with the future requirements.

On 31 December 2010, the foreign investors' share in the banks' authorised capital made up 87 per cent. The capital of the Scandinavian investors continued to prevail in the banking system of Lithuania. The capital adequacy report data showed that on 31 December 2010 the capital required to absorb market risks amounted to LTL 376.7 million or 8.5 per cent of the overall capital requirement for the absorption of all types of risks estimated by banks.

With the improvement of operational results, banks continued to boost their capital. Many of them used various measures to do this in 2010: their authorised capital was increased by LTL 157 million, reserve capital by LTL 173 million. Consequently, in spite of the operational loss, the banking system capital grew by LTL 450 million to LTL 7.3 billion.

After the migration to Basel II capital adequacy regime two years ago, banks started measuring operational risk as a distinct risk type and calculating the capital requirement for covering potential losses resulting from people, systems, inadequate or failed internal processes or from external events, including legal risk. The capital adequacy report showed that 6.5 per cent of the banking system's capital requirement was allocated to absorb operational risk on 31 December 2010.

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

As stated in the Law on the Bank of Lithuania, the BoL supervises the activities of credit institutions holding a license of the BoL. The supervision of the activities of credit institutions consists of licensing, off-site monitoring and on-site inspection.

Following the Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC the BoL carries out the supervision of payment institutions.

When exercising the supervision of credit institutions, the Bank of Lithuania continues to pursue a targeted policy on credit institutions supervision with a main goal to maintain the sustainability and development of credit institutions sector, and to achieve its transparency and competitiveness on the international markets. It also monitors credit institutions' compliance with laws and requirements laid down by legal acts of the Bank of Lithuania, the International Accounting Standards and recommendations of the Basel Committee on Banking Supervision regarding safe and sound banking practices. It submits proposals on preventive measures designed to allow effective and reliable functioning of individual banks and the entire banking system.

In performing supervision of the activities of credit institutions, the BoL 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) examine credit institutions holding a license 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 license issued by the BoL;

(4) take measures in order to ensure efficient operation of the credit system.

MAIN STRATEGIC OBJECTIVES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

The Bank of Lithuania's priority in the supervision of credit institutions remains the prevention of the activities risk in banks. In 2010, the Bank of Lithuania focused on the management of various types of risks encountered by banks and the strengthening of bank capital (capital base), which is the main source for absorbing risk-related losses.

Additional requirements were laid down to further enhance internal control and risk management for the improvement of risk management processes in banks and other credit institutions. Much attention was paid to credit and liquidity risk management; new requirements were set for building up liquidity buffers and liquidity counterbalancing capacity, which reduce potential liquidity risk; new requirements for the management of concentration risk were approved.

In 2010, banks continued implementing the internal capital adequacy assessment process (ICAAP). They assessed the significant risk, calculated the capital requirement to cover it and presented information on the capital increase possibilities with regard to the bank's activity forecast on a continuous basis. The internal capital adequacy requirements set by banks in Lithuania are higher than the internal capital level required by the Bank of Lithuania. When this level is approached, solutions are searched for the increase of the capital or the reduction of the asset risk.

The Bank of Lithuania also continued the supervisory review and evaluation process (SREP) to find out whether banks manage their risks properly and their capital is sufficient to cover this risk, as well as to identify potential and existing problems and shortcomings in the internal control and risk management system.

In conjunction with the SREP, the central bank additionally continued to organise annual general and target on-site inspections of banks. During target on-site inspections, special attention was devoted to the management of individual risks and certain areas of bank activities. In 2010, much attention was paid to the issues related with the management of credit and liquidity risks and the improvement of internal management.

There were a number of regular meetings of the Chairman of the Board of the Bank of Lithuania and some members of the Board with heads of banks operating in the country. These meetings were held to find out about activity prospects of banks, to present to their management the Bank of Lithuania's position on the issues it considers the most urgent, to discuss inspection results and other problems related to bank activities.

The liquidity in the banking sector was constantly monitored. The Bank of Lithuania continued to collect additional daily information on the changes in the composition of assets and liabilities. Upon detecting any major changes in the composition of assets and liabilities, banks were requested to provide explanations and foresee measures to be taken to absorb potential liquidity risk.

To limit possibilities for liquidity risk to emerge, banks were presented with new requirements for building up liquidity buffers and liquidity counterbalancing capacities. Banks started building up liquidity buffers for at least one-week and for at least one-month survival period. Banks estimated their liquidity counterbalancing capacity based on the cash-flow forecasts to ensure permanent appropriate level of required liquidity.

To ensure more detailed regulation of risk management and greater transparency of the supervisory process, the legal acts of the Bank of Lithuania regulating ICAAP, SREP, requirements for the consolidation of financial group financial reporting and joint (consolidated) supervision, requirements for the supervision of foreign bank branches and cooperation with supervisory institutions of other EU Member States during the supervision of branches were supplemented. Moreover, the definitions of the new maximum exposure requirement and connected persons were tightened. It is expected to impose more restrictions on bank lending to connected persons and thus reduce the loan portfolio dependence on connected borrowers. To strengthen risk management processes in banks, special attention was paid to the concentration risk. The new requirements approved by the Bank of Lithuania aim at reducing the loan portfolio concentration and dependence of credit risk on certain clients, financial products, sectors of economic activity or geographical regions.

In order to tighten the requirements that credit institutions have to comply with when setting and paying variable remuneration and other payouts awarded on the basis of performance results to employees whose professional activity and decisions taken may have a material impact on the risk assumed by the credit institution, the Board of the Bank of Lithuania approved the new remuneration policy requirements for the staff of credit institutions, which provide for certain restrictions regarding the deferred and noncash portion of variable remuneration and the deferral period.

Taking into account the impact of the global financial crisis and the recommendations of the EU institutions to revise the requirements for conducting stress testing in banks, the Bank of Lithuania updated and supplemented the General Regulations for Stress Testing. Requirements were set for banks to diversify the sources of liquid funds, to perform liquidity risk testing taking into consideration potential stress scenarios and to prepare business continuity plans revised on the basis of the stress testing results.

To determine real resilience of the financial sector, all banks performed stress testing according to general Bank of Lithuania’s scenarios, which are sufficiently severe. The findings of the stress testing on 1 January and 1 July 2010 showed that the Lithuanian banking system is capable of withstanding potential financial shocks.

As the Bank of Lithuania started conducting the supervision of payment institutions, the supervisory infrastructure for these institutions was built. It comprises both the legal base (licensing, calculation of requirements, internal control, reporting, etc.) and the technical measures that ensure the submission of supervisory and financial reports and the performance of supervision.

As the credit unions of Lithuania continued to expand their activity and introduced an increasing number of various operations, the necessity emerged for more detailed regulation of the requirements for their financial accounting and financial reporting.

With regard to the above, the Board of the Bank of Lithuania approved the Policy Requirements for Financial Accounting and Financial Reporting of Credit Unions.

In implementing the provisions of the programme of the Republic of Lithuania for 2008–2012 on merging the financial market supervisory authorities, the Bank of Lithuania's staff took part in the drafting of various legal acts and participated in the commission formed by the Ministry of Finance of the Republic of Lithuania for the implementation of the concept of the merger of financial market supervisory authorities.

The IMF mission that visited Lithuania in May and October 2010 analysed Lithuania's macroeconomic and financial stability, gave their assessment of the general economic forecasts and the implementation of economic policy measures.

THE ACTIVITIES OF BANKING SUPERVISORY AUTHORITY IN 2010

The BoL is a part of the ESCB and participates in the preparation and adoption of decisions of the ESCB and EU institutions. It cooperates with international and foreign financial organisations in all major areas of its activity.

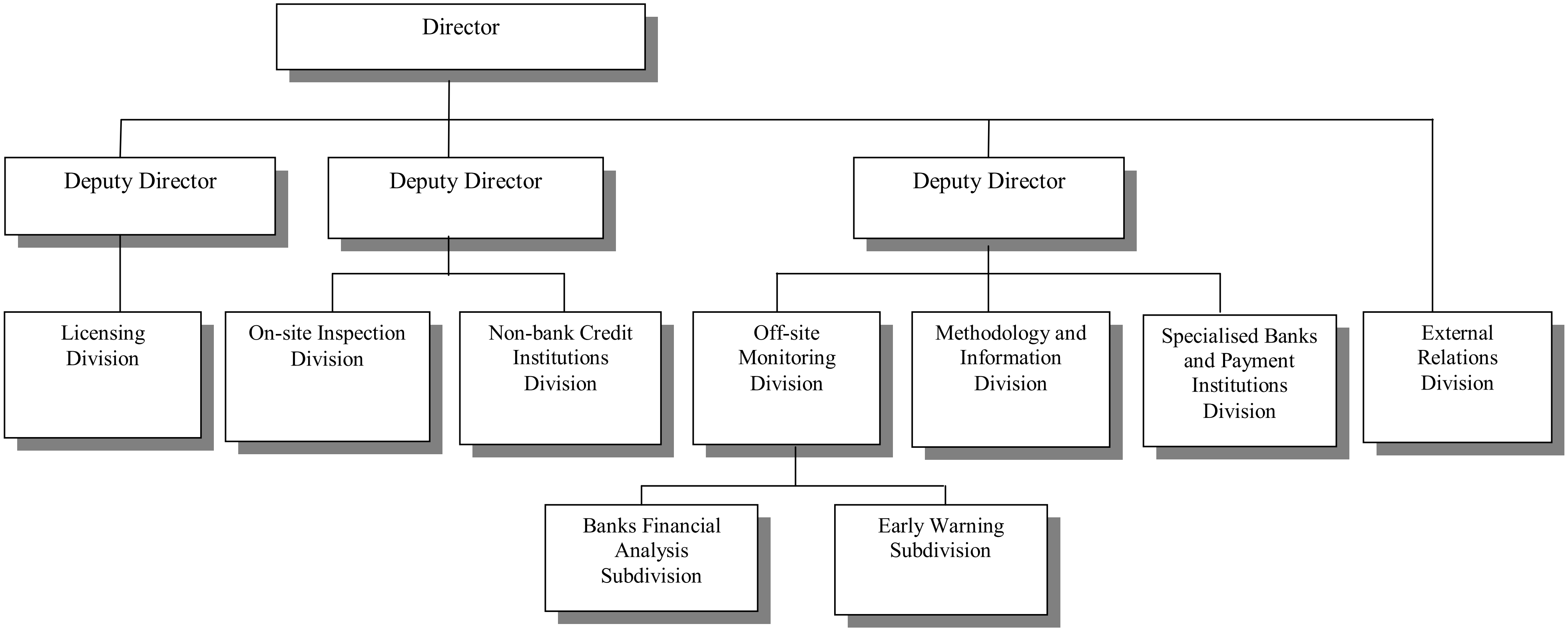
In Lithuania, over 80% of the banking market is controlled by foreign banks via their branches and subsidiaries operating in our country. Therefore the Bank of Lithuania, in implementing the supervision of banks operating in different countries within different bank groups closely cooperates with the financial sector supervisory authorities of the EU Member States. Cooperation is intensified through establishing colleges with the participation of representatives of the financial supervisory authorities of all parties concerned.

The Bank of Lithuania exchanged information on a regular basis with the supervisory authorities of other countries, organised joint inspections.

In 2010, the Bank of Lithuania, provided technical support to the national central bank of Belarus. Employees of the Bank of Lithuania introduced the representatives of the said bank to the supervision of the Lithuanian banking system, stress testing, implementation of the new requirements for the calculation of capital adequacy requirement, crisis prevention and preparation for the management of financial crises, credit risk management, problem credits, calculation of financial stability ratios, monetary and financial statistics and external sector statistics, risk management, internal audit, and the accounting policy of the Bank of Lithuania.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

THE STRUCTURE OF CREDIT INSTITUTIONS SUPERVISION DEPARTMENT OF THE BANK OF LITHUANIA AT THE END OF 2010



STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	9	9	9
Branches of foreign credit institutions	7	8	11
Cooperative banks*	68	68	69
Banking sector, total:	**84**	**85**	**89**

Ownership structure of the financial institutions
(at year-ends)

Type of financial institution	2008	2009	2010
Public sector ownership	-	-	-
Other domestic ownership	-	-	-
Domestic ownership total	15.1	17.1	21.1
Foreign ownership	84.9	82.9	78.9
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010
(at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	74.6	93.5	6380
Branches of foreign credit institutions	98.8	99.5	332
Cooperative banks	38.4	46.5	4
Banking sector, total:	**59.6**	**78.8**	**6716**

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

Type of financial institution	2008	2009	2010
Commercial banks	13.54	-48.42	-4.72
Branches of foreign credit institutions	-	-	-
Cooperative banks*	0,8	-5,2	-4.3
Banking sector, total:	-	-	-

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	81.3	80.9	79.9
Branches of foreign credit institutions	17.7	17.8	18.2
Cooperative banks*	1.0	1.3	1.9
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

*Equivalent in Lithuania – Credit Unions

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks**	12.90	14.15	15.64
Cooperative banks	16.81	18.61	20.16
Banking sector, total:	12.94	14.21	15.71

(* - for Basel I; ** - for Basel II)

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

Asset classification	2008	2009	2010
Loan portfolio*	4.55	19.30	19.50
- households*	1.94	5.64	8.08
Cooperative banks**	2.9***	22.7***	7.54***
Non financial sector	-	-	-
- households	**-**	**-**	**-**
- corporate	**-**	**-**	**-**

* share of non-performing loans in Commercial banks and branches of foreign credit institutions;
** share of non-performing loans in Cooperative banks;
*** due to accounting changes in 2009 and 2010, this ratio is non-comparable neither between 2009/2008, nor between 2010/2009.

The structure of deposits and loans in 2010 (%) (at year-end)

	Deposits	Loans
Households	58.3	43.4
Government sector	10.2	4.3
Corporate	28.8	47.4
Other (excluding banks)	2.7	4.9
Total	**100.0**	**100.0**

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

P&L account	2008	2009	2010
Interest income	1477.0	1215.7	939.8
Interest expenses	897.5	838.0	593.6
Net interest income	579.5	377.7	346.2
Net fee and commission income	201.3	188.7	195.8
Other (not specified above) operating income (net)	-31.0	-27.7	-22.3
Gross income	781.3	646.4	576.6
Administration costs	357.0	320.7	316.7
Depreciation	27.3	28.5	26.5
Provisions	3.4	40.4	-18.0
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	135.1	1154.8	209.9
Profit (loss) before tax	290.8	-1165.9	-92.5
Net profit (loss)	251.1	-1064.1	-81.1

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	2128.3	1575.1	553.2	-
Cooperative banks	43.7	37.7	6.0	-
Banking sector, total:	**2172**	**1612.8**	**559.2**	-

2010 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF MACEDONIA

MACROECONOMIC ENVIRONMENT

In 2010 the domestic economy started its gradual recovery, mainly driven by the strong positive impulse from the gradual revival of the global economy. GDP grew by 0.7 percent in 2010, after a contraction of 0.9 percent in 2009. This upturn has been driven primarily by recovery of exports, which have rebounded rapidly since mid-2009 and are now close to their pre-crisis peak. Exports upturn combined with the favorable conjuncture of the prices of main export products in world markets resulted in a intensification of the activity of the domestic export sector. Additional positive impulse for the domestic economic growth came from the increased credit support by banks, enabled by the accelerated deposit growth and favorable liquidity position of banks. The relatively favorable conditions on the labor market and the positive fiscal stimulus also contributed to the positive upturn of GDP. However, domestic consumption had an overall negative contribution (of -1.7 percentage points) to the annual GDP growth and did not create negative feedback pressures on imports.

The current account deficit has adjusted sharply and registered a deficit of 2.8% of GDP in 2010, which is a decline of some 4 percentage points of GDP compared to 2009. This rapid adjustment from the deficit of 12.7 percent of GDP in 2008 reflects improvement in the trade balance and strong growth in private transfers. The decreased trade deficit came as a result of the strong upward trend in export demand, contrary to the still relatively low level of domestic demand for imported goods. On the other hand, the stable macroeconomic environment in the country, absence of negative psychological pressures and the credible monetary policy created a positive climate of trust in the stability of the exchange rate. This climate supported the strong growth of private transfers, which "cover" over 90% of the trade deficit.

The favorable balance of payments position positively influenced the supply of foreign currency, which contributed to the absence of pressures on the FX rate, as one of the anchors of the domestic stability.

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

As of December 31, 2010 the **banking system in the Republic of Macedonia** comprised of eighteen banks and eight savings houses. Relative to the end of 2009 the number of banks remained unchanged[14] while the number of savings houses decreased by two. Banks maintained their prevailing role in the

[14] In January 2011 the number of banks reduced by one bank. According to the Decision by the Governor of the National Bank of the Republic of Macedonia no.5082 dated December 7, 2010 permission was issued for statute changes-merging of Starter Banka AD Kumanovo with Centralna Kooperativna Banka AD Skopje. On January 3, 2011 the merging was registered in the Central Registry of the Republic of Macedonia, and Starter Banka AD Kumanovo was deleted from the registry.

activities of depositary institutions, while savings houses' share has remained insignificant with only 1% of the total assets, 1.5% of total credits and 0.3% of total deposits in the banking system.

At the end of 2010, the **concentration of the banking system** as measured by CR5 and the Herfindahl index, remained high in all domains of banks' activities, but the trend is decreasing.

During the last several years, the banking system in the Republic of Macedonia, gradually yet in continuity, has been strengthening its role as economic life bloodstream, visibly developing its role and significance in the overall economy. The growth of the level of **financial intermediation** confirms the increased role of the banking system in the overall economy. The ratio of total banking system assets to GDP increased to 72.0% at the end of 2010. The increased level of financial intermediation is also evident through the continuous growth of the ratios of total loans and total deposits to GDP. At the end of 2010 they reached 44.0% and 50.3%, respectively.

2010 was more stable and less turbulent for the banking system. In 2010, the banks activities intensified, which corresponds to the recovery of the domestic economy and the positive signals of the monetary policy of the National Bank of the Republic of Macedonia (NBRM). The banks' assets increased by 13.7%, which is almost twice higher than in 2009. On December 31,2010, the total assets equaled Denar 305,290 million. The assets growth was mainly reflected in investments in low risk securities and loans to non-financial entities. In 2010 the banks significantly increased their CB bills and T-bills placements, thus by the end of the year the assets invested in these low-risk instruments were Denar 25,942 million and Denar 14,294 million, respectively. With such annual dynamics, the CB bills and T-bills placements caused the biggest share (44.1%) of the annual growth of banks' assets.

However, **lending to the nonfinancial entities** also registered intensified growth. As of December 31,2010 the loans totalled Denar 186,545 million. The recovery of the domestic economy and the monetary policy relaxation in 2010 contributed to the relaxation of the banks' lending terms, and consequently to the positive movements of the credit activity. In 2010 credits grew by 7.4% which is twice higher than the year before (when this growth was 3.5%). The non-financial entities credit growth conditioned around one third of the annual growth of total assets of the banks (in 2009 this contribution was 16%). The larger volume of the credit supply was enabled by the increase in the deposits, which mounted with faster dynamics in comparison with the loans.

In 2010, a growth rate of 13.5% was registered with the **deposits**, which is higher by three times relative to the preceding year. On December 31,2010, the total deposits reached Denar 213,270 million. Also, the depositors' propensity for saving in domestic currency, which began in the last quarter of 2009 remained in 2010.

Credit risk is the dominant risk in the banks' operations. In 2010, the growth of **nonperforming loans** registered a steady slowdown. The annual growth rate of the total nonperforming loans equaled 9.3% on December 31, 2010, which is by 29.6 percentage points less compared to December 31, 2009. This slowdown was registered in both corporate nonperforming loans and household nonperforming loans. The slower pace of nonperforming loans resulted from their exceptionally rapid growth in 2009, accompanied by an intensive growth of the on-balance sheet value of foreclosures, which in 2010 registered an annual growth rate of 60.7%. The share of the nonperforming credits of the nonfinancial sector in the total credits equaled 9.3% (in 2009: 9.1%). The coverage of the nonperforming loans with the calculated impairment and special reserve of the nonperforming loans equals 74.2% (in 2009: 70.9%). The average risk of the credit portfolio calculated as a ratio between the total impairment and the total exposure compared to the end of 2009 registered improvement by 0.4 percentage points and at the end of 2010 it equaled 6.1%.

At the end of 2010, the number of banks with dominant **foreign ownership** was fourteen, nine of which are subsidiaries of foreign banks. On 31.12.2010 foreign capital participated with 72.9% in the overall capital of the banking system of the Republic of Macedonia and it showed a marginal increase, compared with the end of 2009.

In 2010, the **liquidity** of the banking system of the Republic of Macedonia considerably improved relative to the previous year. At the end of the year, the liquid assets registered annual rise of 36.8%, i.e. Denar 24,822 million, which caused an upward dynamics in all liquidity indicators. The propulsive component of the liquid assets growth was the Denar liquid assets. Also, the share of the liquid assets in the total assets reached 31,0%. At the end of 2010, all liquidity indicators of the banks improved compared to 2009. The coverage of the households' deposits with liquid assets reached 62.6%, while the coverage of the short-term liabilities, 47%.

Currency risk and the interest rate risk have minor significance in the banks' operations. However, the use of the safeguard clauses by the banks (the use of the so-called adjustable interest rates and extending credits in Denars with FX clause), thus transferring these risks on their clients, emphasize the significance of the indirect credit risk in the total risk profile of the banks.

The banks maintain high **solvency and capitalization** rates. On December 31,2010, they equaled 16.1% (16.4% on December 31,2009) and 10.6% (11.4% on December 31,2009), respectively. The capital adequacy ratio is twice higher than the legally prescribed minimal level of 8%. The TIER 1 ratio (indicator between the basic capital and the assets weighted according to the risks) amounted to 13.4% on 31.12.2010 (in 2009: 13.8%). The leverage ratio, measured as a share of the equity and the reserves in the total balance and off-balance activities on 31.12.2010 amounted to 8.9%, compared to 9,7% at the end of 2009.

In 2010, the banking system of the Republic of Macedonia registered larger **profit** compared to the previous year. The profit realized in 2010 in the amount of Denar 2.307 million rose by Denar 631 million, i.e. by 37.7% compared to 2009. In the same time, the number of banks which showed loss almost halved, from seven banks at the end of 2009, to four banks to the end of 2010. The return on assets equaled 0.8% (in 2009, 0.6%), while the return on equity equaled 7.3% (in 2009: 5.6%). The improved profitability of the banking system was a result of the developments in the last quarter of 2010. Namely, in the last quarter of the year, as a result of the foreclosures (primarily with two banks), which resulted in releasing of considerable amounts of impairment, profitability of the entire banking system significantly improved.

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 NBRM is responsible for licensing and supervision of banks and savings houses in the Republic of Macedonia. Within the NBRM, the Supervision, Banking Regulations and Financial Stability Division performs the supervisory function. The General Manager of this Division is directly liable to the Governor of the NBRM.

The Supervision, Banking Regulations and Financial Stability Division encompasses three Departments: 1) Off-site Supervision and Licensing, 2) On-site Supervision, and 3) Financial Stability, Banking Regulations and Methodology. In addition, a Supervisory Committee chaired by the Division's General Manager, reviews the major supervisory and regulatory issues, for the purpose of uniform implementation of the legal framework and the internal supervisory methodology.

The competence of the NBRM is regulated with the Law on the National Bank of the Republic of Macedonia and the Banking Law. The Banking Law and relevant by-laws follow the provisions of the Capital Requirements Directive, as well as the principles and standards developed by the Basel Committee on Banking Supervision and the European Banking Authority.

The legal framework for banks was completed in 2008. However, in order to achieve further enhancement of the banking regulatory framework, in 2010 the following acts were prepared and adopted:

- Decision on the Manner and the Procedure for Implementation and Application of a Bank's Program for Prevention of Money Laundering and Terrorist Financing, which had replaced the previous by-law that regulated the prevention of money laundering and terrorist financing;
- Amendments to the Decision on the Terms and Procedure for Implementing the Rehabilitation Plan and the **Assets and Liabilities Transfer Plan** and the Procedures for performing the transfer of **assets and liabilities of** a **bank** under administration and for performing the sale of assets of a bank under administration; and
- Instructions for enforcing the Decision on managing the interest rate risk in the banking book, which prescribed in details the method of determining the interest rate risk exposure in the portfolio of banking activities, as well as the form of reporting to the NBRM regarding the exposure.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2010

The main focus of the National Bank of the Republic of Macedonia supervision in 2010 was:

1. Monitoring of the banks’ credit portfolio quality due to the deteriorated risk profile of the household and corporate sector.

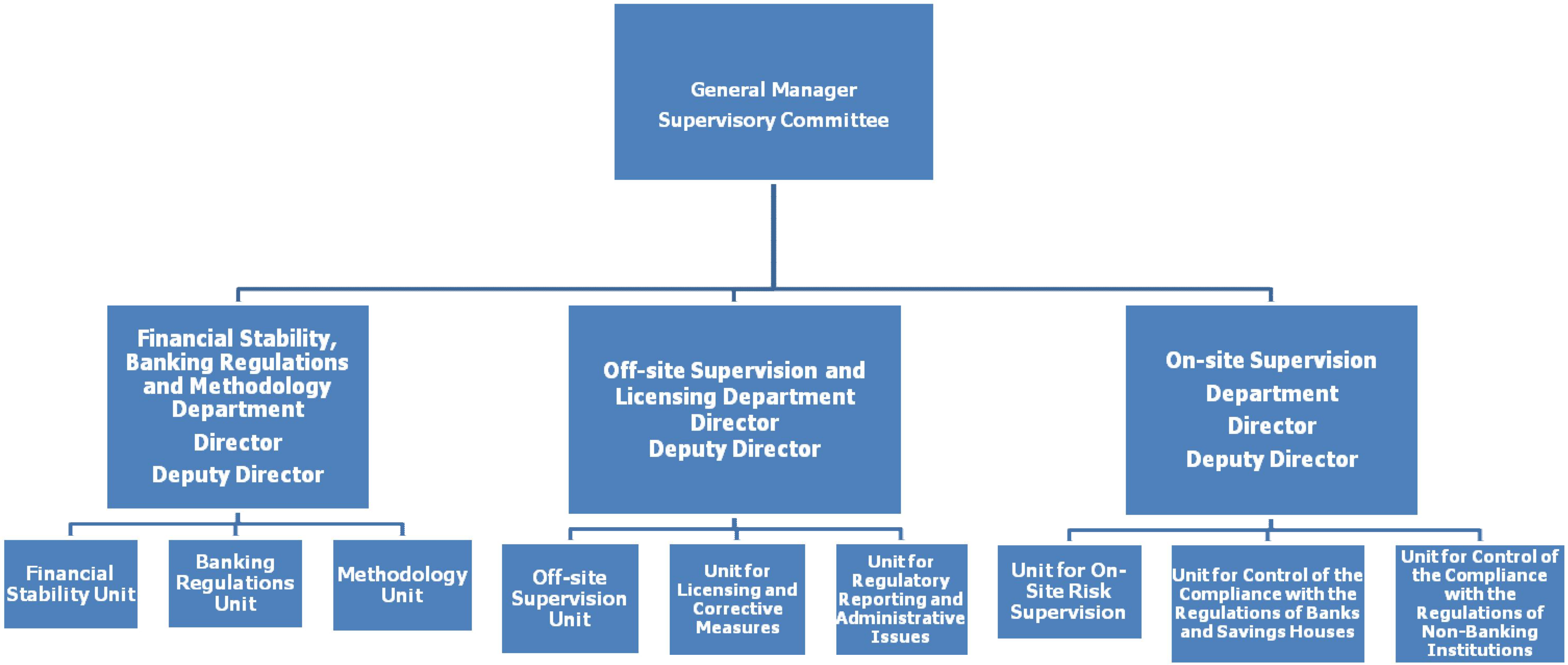
2. Assessing the appropriateness of the implementation of credit risk management regulation by the banks.
3. Further improvement of the Risk Assessment System, as a part of the overall activities for implementation of the risk-based supervision by NBRM.
4. Assessing the appropriateness of the implementation of the regulation on interest rate risk in the banking book that was enacted in 2010.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

The supervisory function of the National Bank of the Republic of Macedonia 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 actions. Within this framework, during 2010 the NBRM has performed the following activities:

- It has issued ten different types of licenses and approvals, among which the main activities were related to issuing approvals for: appointment of members of Board of Directors, amending and/or supplementing the Statute of the banks, appointment of members of Supervisory Board, etc. In 2010, an approval for status change - acquisition of one bank by other bank, was issued. In addition, NBRM had revoked the founding and operating license of two saving houses.
- Forty five on-site examinations of banks, saving houses and outsourcing companies in the Republic of Macedonia were performed. Twenty three of them were risk examinations, while twenty two were examinations of the compliance of the operation with the regulations. The goal of the conducted on-site risk examinations was to determine the safety, stability, level of risk and compliance with the regulations of the controlled institutions, through assessment of the system of established internal controls, the adequacy of the established risk management systems, as well as the effectiveness of the corporate governance system. The credit risk management, the liquidity risk, the established risk management system, the compliance with the corrective measures imposed by the NBRM and the risk management of inadequate banks' information systems were in the focus of the conducted targeted examinations. The targeted examinations were conducted with twelve banks, six saving houses and two outscoring companies.
- As part of its corrective action activities, NBRM imposed additional measures to two banks, and signed memorandums for compliance with the regulations with the Supervisory Boards of two banks. As a result to the determined weaknesses in the area of management of the credit risk, liquidity risk, strategic risk, operational risk and other risks, in 2010 regular corrective measures were undertaken, i.e. fourteen written recommendations to five banks and three saving houses and five recommendations to three banks and two saving houses.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

The strengthening of the cooperation with foreign supervisory bodies continued in 2010 with the signing of the Memorandum of Understanding with the Banking Regulation and Supervision Agency of Turkey. In this period the NBRM initiated signing of Memoranda of Understanding with the Austrian Financial and Market Authority and De Nederlandsche Bank.

COOPERATION WITH OTHER SUPERVISORY BODIES IN MACEDONIA

The collaboration of the domestic supervisory authorities in 2010 continued on a regular basis. Some of the previously signed Memoranda of Understanding were updated with new obligations for both contracted parities.

OTHER RELEVANT INFORMATION AND DEVELOPMENT

23rd Annual Conference of the Group of Banking Supervisors from Central and Eastern Europe

In the period from June 15 until June 17, 2010 in Ohrid, the NBRM of the Republic of Macedonia hosted the 23rd Annual Conference of the Group of Banking Supervisors from Central and Eastern Europe (BSCEE). The heads of the banking supervisory bodies from 18 countries from Central and Eastern Europe (Austria, Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Estonia, Lithuania, Poland, Russia, Slovenia, Slovakia, Serbia, Ukraine, Hungary, Croatia, Macedonia, Montenegro and Czech Republic) participated in the conference. In addition, representatives of the Bank for International Settlement (BIS), the European Central Bank and one international banking group, participated in the conference as guests and speakers.

In the working program of the Conference, the participants exchanged their experiences regarding two contemporary issues: (1) The lessons learned from the global economic crisis and the measures undertaken for strengthening the banking system resilience and (2) Liquidity risk standards, with a view on the national measures undertaken during and after the crisis.

Project - Strengthening macro and micro prudential supervision in EU candidates and potential candidates

For the purpose of strengthening macro and micro prudential supervision, in 2010 the ECB launched a multilateral project - "Strengthening macro and micro prudential supervision in EU candidates and potential candidates". This project covers the banking supervisory bodies of eight candidate countries or potential candidate countries for EU accession, covered by the IPA (Albania, Bosnia and Herzegovina, Croatia, Macedonia, Kosovo, Montenegro, Serbia and Turkey). It is composed of three interconnected components: regional training courses, national measures and technical simulation exercises focusing on cross-border cooperation. The main aims of the project relate to the strengthening of the resilience of the partner central banks to the international financial crisis, notably by building the capacity of their authorities to translate, when possible, best international standards into national practices which will occur both through regional and international level. At the same time, the project aims at creating the necessary technical prerequisites to strengthen regional cooperation among national authorities, including those of the European Union.

In 2010, the first part of the project, regional training courses, which pertained to training of the employees in the Division of Supervision, Banking Regulations and Financial Stability, was successfully finalized. Fifteen employees of the Division participated in the trainings which were focused on: 1) Home - host cooperation; 2) Macro - prudential supervision; 3) Micro - prudential supervision; and 4) Regulations.

Starting from end of 2010, as part of the second component of this project (national measures) NBRM and the Bank of Slovenia established a bilateral cooperation focused on improving the current risk-based supervisory approach. In June, 2011 the second part of this project was also successfully finalized.

The third component (crisis simulation) will be completed in 2011 Q4.

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	18	18	18
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	11	10	8

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

Type of financial institution	2008	2009	2010
Public sector ownership	1.2	1.4	2.3
Other domestic ownership	6.1	5.3	4.8
Domestic ownership total	7.3	6.7	7.1
Foreign ownership	92.7	93.3	92.9
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	66.0	77.2	1.578
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	**66.0**	**77.2**	**1.578**

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

Type of financial institution	2008	2009	2010
Commercial banks	12.5%	5.6%	7.3%
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	**12.5%**	**5.6%**	**7.3%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	98.6	98.8	99.0
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Other	1.4	1.2	1.0
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2008 (%)	2009 (%)	2010 (%)
CASH AND BALANCE WITH NBRM	10,8	12,0	11,4
NBRM BILLS	7,0	5,9	8,5
DEBT SECURITIES	4,0	5,2	6,1
PLACEMENTS TO OTHER BANKS	10,8	12,6	13,3
PLACEMENTS TO CLIENTS	61,5	58,5	55,1
ACCRUED INTEREST AND OTHER ASSETS	2,1	2,3	2,6
SECURITIES INVESTMENTS	0,5	0,4	0,3
FIXED ASSETS	3,3	3,2	2,7
NON ALLOCATED RESERVES FOR POTENTIAL LOSSES	0,0	0,0	0,0
TOTAL ASSETS	**100,0**	**100,0**	**100,0**
Liabilities	**2008**	**2009**	**2010**
DEPOSITS OF BANKS	4,8	6,7	6,0
SIGHT DEPOSITS	29,1	25,2	24,2
SHORT-TERM DEPOSITS UP TO ONE YEAR	36,4	36,2	34,9
SHORT-TERM BORROWINGS UP TO ONE YEAR	0,3	1,2	1,2
OTHER LIABILITIES	3,0	2,7	2,6
LONG-TERM DEPOSITS OVER ONE YEAR	6,7	8,6	10,8
LONG-TERM BORROWINGS OVER ONE YEAR	7,8	7,7	9,5
PROVISIONS FOR OFF-BALANCE SHEET LIABILITIES	0,4	0,3	0,2
OWNED FUNDS	11,5	11,4	10,6
TOTAL LIABILITIES	**100,0**	**100,0**	**100,0**

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks*	16.2%	16.4%	16.1%
Cooperative banks	/	/	/
Banking sector, total:	**16.2%**	**16.4%**	**16.1%**

(* - for Basel I; ** - for Basel II)

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

Asset classification	2008	2009	2010
Non financial sector	6,8%	9,1%	9,3%
- households	**5,3%**	**8,2%**	**8,1%**
- corporate	**7,7%**	**9,6%**	**10,0%**

The structure of deposits and loans of the banking sector in 2010 (%) (at year-end)

	Deposits	Loans
Households	63.7	37.1
Government sector	0.6	0.1
Corporate	24.8	58.9
Domestic Banks	0.6	3.0
Foreign banks*	5.3	0.3
Other (excluding banks)	5.0	0.5
Total	**100.0**	**100.0**

*The amount of foreign loans includes loans of nonresidents.

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

P&L account	2008	2009	2010
Interest income	16,641,301	19,130,949	19,535,305
Interest expenses	-7,542,357	-8,436,029	-9,138,386
Net interest income	9,098,943	10,694,920	10,396,919
Net fee and commission income	3,811,376	3,112,669	3,382,828
Other operating income	2,621,560	1,787,269	1,585,994
Gross income	15,531,879	15,594,859	15,365,741
Administration costs	-3,610,049	-4,064,471	-4,138,639
Depreciation	-897,883	-1,053,081	-1,150,002
Provisions*	-2,489,269	54,979	-93,090
Impairment on financial assets not measured at fair value through profit and loss/provisions on financial assets**	0	-4,254,278	-2,855,938
Other operating expenses	-4,653,807	-4,552,616	-4,787,786
Profit (loss) before tax	3,880,871	1,725,392	2,340,288
Net profit (loss)	3,410,426	1,675,660	2,306,926

* In 2009 and 2010, provision items include: impairment losses of non-financial assets, provisions for off balance sheet items and other provisions. In 2008, provision items include: impairment losses of non-financial assets, provisions for off balance sheet items, impairment on financial assets and other provisions.

** Presented on net basis

*** 1 EUR= 61.5050 MKD, as of 31.12.2010

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	614,318,897	511,295,512	103,023,385	0
Cooperative banks	/	/	/	/
Banking sector, total:	**614,318,897**	**511,295,512**	**103,023,385**	**0**

2010 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF MOLDOVA

MACROECONOMIC ENVIRONMENT

In 2010 the economy of Republic of Moldova has gradually recovered from the consequences of the global economic crisis. The GDP recorded a 6.9 % increase compare to the previous year mostly due to the significant recovery of the domestic demand. The household consumption rose by 9.0 percent in 2010, while the gross capital formation experienced a 18.7 % growth. Final consumption of general government recorded a modest increase (0.3 percent) and thus did not cause significant changes in GDP growth. The exports rose by 12.8 percent, stimulated by the economic recovery of Moldova's main trading partners. However, the export growth was surpassed by that of imports that rose by 13.7 percent compared with 2009, due to the increased domestic demand.

From the supply side, the positive developments in all sectors have helped the economy to emerge from crisis. The most significant contributions to GDP growth in the reference period are generated by the development of trade, transport and communications that have increased by 8.9 and 11.0 percent respectively compared with 2009. After several periods of negative development, a significant positive contribution from industry has been recorded in 2010, which grew by 8.1 percent, but this component was affected the most by the crisis and has not yet reached the level of 2008. Agriculture grew by 7.2 percent compared with 2009. Construction, after severe decline of 2009, with an increase of just 7.3 percent in 2010, is another sector that has not yet reached the level before the economic crisis.

In 2010 the labor market situation has deteriorated compare with 2009. The economically active population declined by 2.4 percent compared to the previous year. At the same time, the number of people employed in this period declined by 3.5 percent compared to 2009, which is determined by the decrease of population employed in agriculture, industry and construction. The unemployment rate has increased by 1.0 p.p. compare to 2009 and it amounted 7.4 % denoting a delay in the process of creating new jobs in Moldova's economy, despite the economic signals of the respective year on the economic recovery. The average wage of a worker in the national economy in 2010 amounted to 2971.7 MDL, increasing by 8.2 percent, while in real terms recorded an increase of 0.7 percent compared to the previous year.

The annual rate of inflation in December 2010 constituted 8.1 percent. On the other hand, the annual rate of core inflation was 4.4 percent in December 2010, with a difference of 3.7 percentage points compared with the CPI inflation rate, which reveals the increasing contribution of non-monetary factors in prices increase. Food prices (2.5 percentage points) have contributed the most to the formation of annual inflation rate in December 2010, as a result of weather deviations from the norm during the year and food price fluctuations on the world market. At the same time, the regulated prices had a major contribution (2.2 percentage points), as a result of changes in tariffs for services with regulated prices (gas, electricity, heating) made in January and May. The fluctuations in oil prices on the world market and exchange rate have led to fuel prices increase, which have contributed to annual inflation by 1.5 percentage points. The increase in core inflation has contributed with 1.9 percentage points to the formation of CPI inflation.

During 2010 the official nominal exchange rate of the national currency against the U.S dollar appreciated by 1.2 percent and against the EUR - by 8.6 percent. The real effective exchange rate of the national currency (REER), calculated as compared to December 2000 appreciated by 6.6 percentage points compared to the end of 2009. This change was determined mainly by significant nominal depreciation of foreign currencies of the countries from the region against the U.S. dollar such as Euro - by 8.1 percent, the Romanian leu - by 9.5 percent and the Hungarian forint - by 11.2 percent.

Exchange rate fluctuation of MDL in 2010 reflected mainly the changes in the amount of liquidity in foreign currency on the domestic foreign exchange market, following the variations in foreign exchange inflows and outflows.

DEVELOPMENT IN THE BANKING SYSTEM

On December 31, 2010 in Moldova there were operating 15 banks, licensed by the National Bank of Moldova, including three branches of foreign banks.

The total number of banking institutions constituted 1160, of which 293 are branches and 867 representative offices. During 2010, 11 branches and 65 representative offices were opened and 6 branches and 56 representative offices were closed.

Throughout the year 2010 the banking sector in Moldova noted the following trends:

Total assets of the banking system as of December 31, 2010 totalled 42302.9 million lei, increasing by 2366.5 million lei (5.9 percent) as compared to December 31, 2009. However, their weight in GDP has decreased from 66.1 to 58.9 percent.

The asset growth was determined both by the increase of banks' liabilities by 2002.3 million lei (6.1 percent) and the increase of equity capital by 364.2 million lei (5.3 percent).

In 2010, increases were recorded within the assets' structure by all items: net financial leasing and loans – by 3105.3 million lei (15.3 percent), net securities - by 598.6 million (9.9 percent), due from the NBM – by 440.7 million lei (22.7 percent). Simultaneously, the due from banks and net overnight placements decreased - by 1310.0 million lei (24.0 percent) as well as other net assets decreased - by 283.1 million lei (7.0 percent) and cash – by 185 million lei (8.5 percent).

Net credits held the highest share in total assets - 55.2 percent, by 4.5 percentage points higher than the end of 2009. In the context of distribution of risks and of destination of investment operations, loans to industry and trade held the highest share in the total loans portfolio – 51.6 percent, being followed by the loans to agriculture and food industry – 14.9 percent, loans for real estate, construction and development – 12.3 percent, consumer loans – 8.4 percent and other loans – 5.5 percent. The portfolio structure has not essentially changed compared to the previous year end.

The share of bad loans (substandard, doubtful and compromised) in total loans constituted 13.3 percent at December 31, 2010, or by 3.1 percentage points less compared to the end of 2009. Respectively, the reductions share for loan losses in total loans constituted 8.4 percent as of December 31, 2010, decreasing by 1.3 percentage points as compared to December 31, 2009.

Liquid assets totalled 14447.1 million lei, and decreased by 826.6 million lei as compared to the end of 2009, or by 5.4 percent. This decrease was due to the decline in net interbank credits and loans with the reimbursement term of up to 1 month – by 665.9 million lei (16.3 percent), cash and precious metals by 185.0 million lei (8.5 percent) and the deposits with the National Bank of Moldova – by 65.4 million lei (2.1percent).

Thus, the long-term liquidity (assets with the reimbursement term over 2 years/financial resources with the potential withdrawal term of over 2 years ≤1) accounted for 0.7 as of December 31, 2010.

The current liquidity (liquid assets expressed in cash, deposits with the NBM, state securities, and net interbank credits with the term of up to 1 month /total assets X100% ≥ 20.0%) equaled to 34.6 percent at the end of 2010.

Tier I Capital reached the level of 6758.0 million lei in 2010 and increased by 331.6 million lei (5.2 percent) as compared to 2009. The financial indicator for each bank individually matched the minimum set level. Tier I capital increase was due to the revenue gained during 2010 and due to the issuance of shares by five banks in the amount of 323.5 million lei at the expense of additional funds contributions account the underwriters of shares.

It should be mentioned that, according to the Regulation on Risk Weighted Capital Adequacy, since December 31, 2010 the amount of capital is established by the amount of 100.0 million lei. On December 31, 2010 all banks capital corresponded to the set amount.

The average risk weighted capital adequacy (ratio of total regulatory capital to risk weighted assets) is maintained at a high level - 30.1 percent (the minimum level in Moldova is 12.0 percent), indicating a high degree of safety of banks determined by the existence of a potential of making risky operations without affecting the capital.

During the analyzed period, the foreign investors maintained their activity in the banking sector, which is confirmed by the significant share of foreign investments in the banks' capital, which constituted 77.0 percent on December 31, 2010, with 0.6 percentage points less than at the end of 2009, as a result of share capital increase of banks. At the same time, the amount of foreign investment increased by 474.8 million lei (27.3 percent) and the domestic investment – by 160.8 million lei (32.0 percent).

As of December 31, 2010 the liabilities of banks accounted for 35013.0 million lei or by 2002.3 million lei (6.1 %) more as compared to the end of 2009. The deposits held the largest share of bank liabilities as of December 31, 2010 - 82.0 percent, increasing by 2.0 percentage points as compared to the end of 2009. In the total liabilities the deposits, the individuals deposits constituted 51.9 percent, deposits of legal entities - 27.9 percent, deposits of banks - 2.3 percent, other loans and other liabilities - 16.0 percent and 1.9 percent respectively.

For 2010, net banking income amounted to 219.1 million lei. Banks' income during 2010 originated mainly from the banks' basic activity (investments in interest-bearing assets). Respectively, interest related income constituted 3551.1 million lei, or 69.4 percent of total income obtained by banks.

For 2010, the banking system recorded a return on assets and shareholder equity of 0.5 and 3.0 percent respectively.

THE LEGAL AND INSTITUTIONAL FRAMEWORK OF BANKING OPERATION AND SUPERVISION, NEW DEVELOPMENTS. LEGAL COMPETENCE OF THE BANKING SUPERVISORY AUTHORITY IN MOLDOVA

The banking system of the Republic of Moldova is formed from National Bank of Moldova and 15 licensed banks. The National Bank has the right to license, supervise and regulate the activity of licensed banks in accordance with the Law on Financial Institutions No.550-XIII as of July 21, 1995.

The activity of the National Bank of Moldova, as a regulation and supervision body of the banks activity is based on the Law on the National Bank of Moldova, which establishes the composition, the main objective and the basic attributions of the National Bank of Moldova and its relations with the financial institutions.

For the purpose of supervision and regulation of the banks activity, the National Bank shall have the right to issue normative acts, to perform controls to these institutions, to examine the books, accounts and other documents and take any other action to maintain the stability of the banking sector.

During the 2010 the Law on Financial Institutions was amended. These amendments included new provisions regarding the prudential measures, procedures of constrained liquidation of a licensed bank, as well as new requirements for opening and closing the branches, secondary offices (internal structural subdivisions of the branches) and representatives, as well as outsourcing certain materially important activities by the banks from the Republic of Moldova.

As a result of the amendments in legislation, the National Bank perfected its normative acts in order to bring them according to the new provisions of the legislation. Also, the NBM are still perfecting the recommendations of the Basel Committee on Banking Supervision as well as the approximation with the Directives of the European Union. Prudential normative acts issued by the NBM are placed on its official web site and are available in official and English language in the compartment Legislation (www.bnm.md).

MAIN STRATEGIC OBJECTIVES OF THE BANKING AUTHORITY IN 2010

During 2010, the National Bank of Moldova promoted a continued coherent policy in the field of ensuring the stability and consolidation of the banking sector through:

a. the requirement to maintain minimum capital required, the amount of banks capital performing international transactions to be in accordance with EU standards;
b. overseeing the implementation by banks of certain adequate and effective internal controls, in order to contribute to the increasing of the competitiveness level of banks, and to minimize the risks related to its activity, including increasing the transparency level of their shareholders;
c. support the safety level of the banking system by promoting requirements related to risks diversification of the bank's active operations, forming provisions to cover these risks, maximum limits on

exposures to the risks related to the agreements concluded with the affiliated persons and granting the "large" credits in accordance with generally accepted international practice;

d. periodically examination of the information disclosed by banks and, if necessary, impose the necessary measures to ensure the completeness, timeliness and accuracy of them, fact that will help to increase the market discipline and credibility of the banking system.

ACTIVITY OF THE BANKING SUPERVISORY AUTHORITY IN 2010

During 2010 the improvement of prudential regulation and supervision of the banking activity continued.

It shall be mentioned that, for increasing the capacity of the banks to cover its losses from their financial activity, especially in global financial crisis were performed modification to the Regulation on risk-weighted capital adequacy, namely was increased the minimal requirement regarding Tier One capital to 200 million Lei and banks are going to conform to the new requirements by steps: starting with December 31, 2011 – 150 millions Lei and starting with December 31, 2012 - 200 millions Lei. Also, for ensuring the compliance of the provisions of paragraph (4) Art.28 of the Law on Financial Institutions was included provisions related to the obligation of banks to notify the NBM about their intention to distribute capital (payment of dividends, the acquisition by bank of shares, etc.), subsequently specifying the way of performing this notification.

In order to ensure the efficient functioning of the banking system by obligation to establish of an adequate internal control system by the bank has been awarded the status of Regulation to the Recommendation on the internal control systems within banks of the Republic of Moldova and were included new provisions regarding the corporative governing, effectuation of crises simulations for each type of risk, the externalization process of banking activities, the physical security of the bank's property, the independent and objective assessment of the pledge, the management and control of the risks the bank is exposed to, while performing its activity, the assurance of a continuous activity.

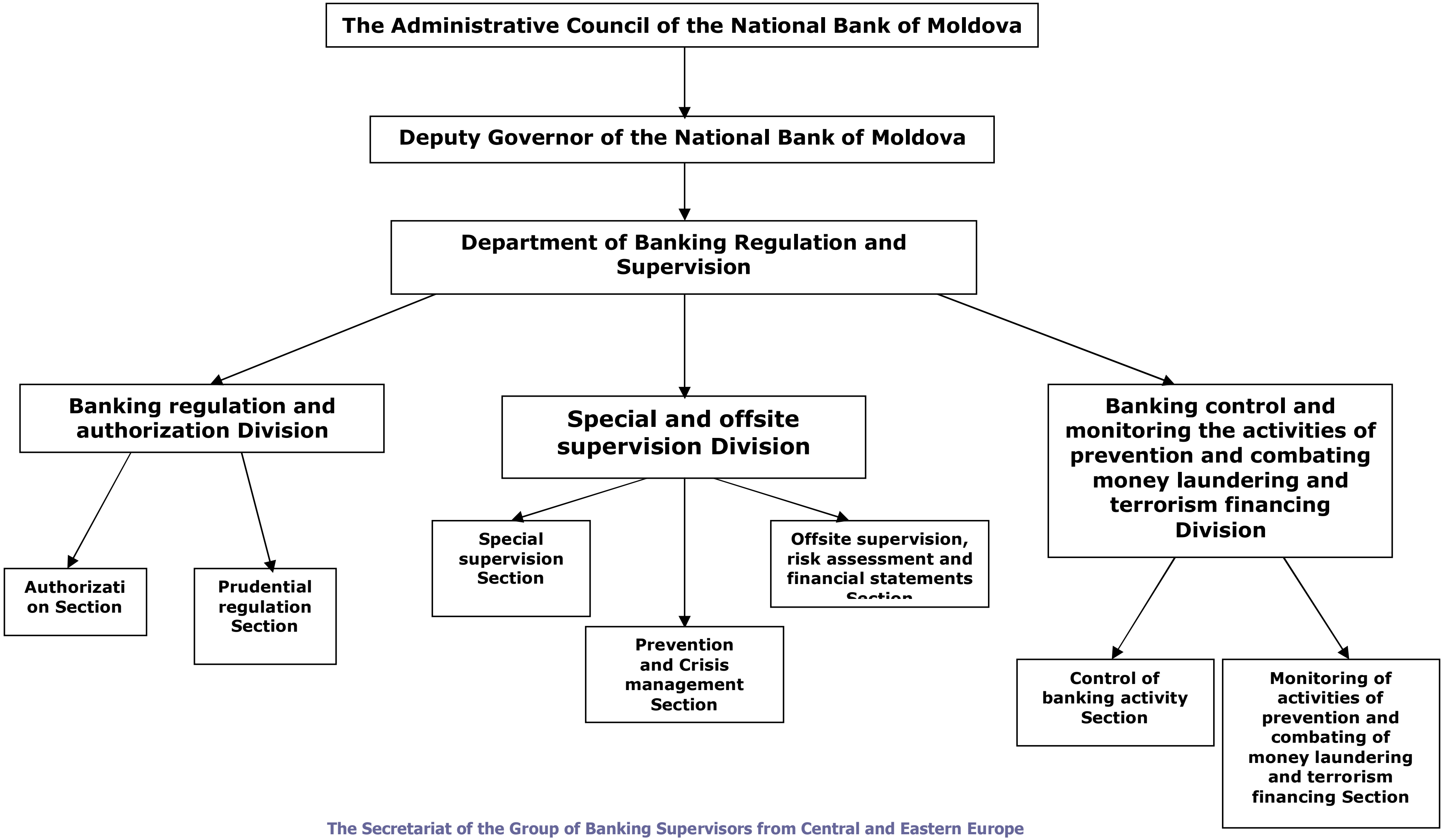
Subsequently, in a new version was elaborated the Regulation on requirements to bank's administrators, in order to promote the position of administrator of persons contributing in their activity to an efficient and prudent management of banks, as well as an adequate corporative governing was included provisions related to the improvement of the requirements to administrators, to the set of documents submitted to the NBM and in case of necessity performing the interviewing of the persons referred in the positions of administrators, as well as determining the remedial measures and sanctions, which may be applied to an administration in case of commitment by this of one or more infringements.

For improvement of the evaluation mechanism of assets subject to credit risk in order to form the allowances for asset losses was modified the Regulation on assets and contingent engagement classifications, allowance for assets losses and provisions for contingent engagement losses. As a result of this amendments were included new provisions related to the evaluation and classification of the credits attached to foreign currency, assets that are subject to seasonal factors, long cycle of obtaining profits, as well as assets in the form credits granted to government and assets which source are the funds obtained from financials international organizations and to the evaluation of the assets depending on the information hold by the banks of credit history bureaus.

Also, in a new version was elaborate the Regulation on branches, representatives and secondary offices of the banks establishing new condition for opening the branches, secondary offices and representatives of banks, including the compliance conditions of banks, the procedures for issuing the preliminary approval, as well as the procedure of informing on closing the respective subdivisions.

During 2010, in order to achieve the provisions of the Government Decision No.449 of June 02, 2010 on creation the National Committee for Financial Stability, as well as of the Supplementary Memorandum of Economic and Financial Policies (June 30, 2010), the National Bank of Moldova, within the technical assistance obtained from the International Monetary Fund (IMF) has elaborated the draft Memorandum of Understanding on Maintenance of Financial Stability. Subsequently, on February 28, 2011 the members of the National Committee for Financial Stability has signed the respective Memorandum providing the obligations and responsibilities of the authorities involved in managing the crisis situations.

ORGANIZATIONAL STRUCTURE OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL COOPERATION OF THE BANKING SUPERVISORY AUTHORITY

During 2010, the National Bank of Moldova collaborated with a number of international authorities, such as the World Bank (WB), International Monetary Fund (IMF), European Bank for Reconstruction and Development (EBRD) and the Banking Supervisors from Central and Eastern Europe (BSCEE) to provide information related to development of the domestic banking system.

Internationally, the NBM has concluded agreements with the banking supervisory bodies in other countries, including countries whose banks have bought shares in the domestic banking capital of Romania, Russia, Kazakhstan, Belarus to which development were taken into account the provisions of the Basel Committee for effective Banking Supervision document "Essential Elements of an Agreement of Cooperation between banking supervisors" (May, 2001). Currently, NBM negotiates the concluding of new agreements with the supervisory authorities from Germany, Italy, France and Austria.

During 2010, in the supervision and authorization purpose of the licensed banks, the NBM collaborated with supervisory bodies of Romania, Russia, Latvia, Slovenia, France, Czech Republic, Egypt, Bosnia and Herzegovina, Germany.

COOPERATION WITH OTHER SUPERVISORY AUTHORITIES OF MOLDOVA

In order to continue monitoring the risks related to the banks activity, the National Bank of Moldova is working with the various supervisory bodies in Moldova.

For monitoring and supervision of banks activity on the securities market and risks related to these activities, the National Bank of Moldova jointly with the National Securities Commission regulates the conditions, ways of issuance and circulation of securities issued by banks and establishes the ways of drawing, submitting and publication of specialized reports, as well as prospectuses of public offering of professional participants on the securities market.

In the country the NBM has concluded agreements with the Centre for Combating Economic Crimes and Corruption and the National Commission of Financial Market. Also, in order to monitor banks' activities in the filed of preventing and combating money laundering and terrorist financing, the National Bank cooperates with various state bodies in this field by informing and presenting the respective materials to the enforcement bodies.

OTHER INFORMATION AND RELEVANT TRENDS IN 2010

During 2010, the National Bank of Moldova received technical assistance from International Monetary Fund, from the High Courts of Justice in Luxembourg and from the Office of Technical Assistance, Department of the Treasury of the United States of America.

During the March 01-03, 2011 at the National Bank of Moldova were on a working visit an independent consultant of the International Monetary Fund and a coordinator of Technical Cooperation of the Netherlands Central Bank. The objective of the visit was to grant assistance in the field of banking regulation and supervision regarding the elaboration of Twinning draft in order to ensure the accordance of the Republic of Moldova legislation and regulations in the field of prudential banking supervision with the most important banking Directives of the European Union.

In the period September 2010 and March 18-25, 2010 the NBM received technical assistance from the IMF and the Monetary and Capital Markets Department concerning preparation for the management of crisis situations and urgent planning. Main recommendations of these missions were to make the authorities sign a Memorandum of understandings detailing the powers and responsibilities of the government, the NBM, the Deposit Guarantee Fund, the National Commission for the Financial Market. The Memorandum will stipulate in details the establishment of the National Committee for Financial Stability.

During the October – December, 2011 at the NBM was on working visit a financial sector expert at the Luxemburg High Courts of Justice and consultant in the banking activity and capital market within the project Support to the implementation of Moldova-EU agreements. The objective of the visit was to grant assistance to the NBM in the field of banking supervision for approaching European Directives with NBM activities, particularly as regards the implementation of Basel II. According to final report was presented general proposals related to the necessity of modification the domestic legislation in the context of Basel II, as well as the gradual transition to financial reporting for surveillance purposes covering the consolidated financial report and sub-consolidated financial reporting and which is based on IAS and IFRS (FINREP), accepted by the European Union.

During the November 5-12, 2010 for NBM employees and banking community has organized a seminar for the implementation of International Financial Reporting Standards (IFRS). The seminar was presented by banking consultant from the Office of Technical Assistance, Department of the Treasury, United States of America. In this seminar were presented topics related intangible assets, impairment of financial assets, investment property, the borrowing cost, non-current assets held to maturity and discontinuous operations, etc.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2008	2009	2010
Commercial banks	13	12	12
Branches of foreign credit institutions	3	3	3
Cooperative banks	-	-	-
Commercial banks	**13**	**12**	**12**

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

Type of financial institution	2008	2009	2010
Public sector ownership	2.2	1.7	3.1
Other domestic ownership	23.7	20.7	19.9
Domestic ownership total	25.9	22.4	23.0
Foreign ownership	74.1	77.6	77.0
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	2008	2009	2010
Public sector ownership	5.3	7.3	7.2
Other domestic ownership	46.0	47.9	50.3
Domestic ownership total	51.3	55.2	57.5
Foreign ownership	49.2	44.7	42.5
Financial institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	49.05	67.85	1061
Branches of foreign credit institutions	17.81	17.81	120
Cooperative banks	-	-	

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

Type of financial institution	2008	2009	2010
Commercial banks	21.19	3.75	8.81
Branches of foreign credit institutions	12.91	-22.17	-19.4
Cooperative banks	-	-	-
Banking sector, total:	**19.13**	**-2.51**	**2.61**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	75.13	77.83	82.19
Branches of foreign credit institutions	23.87	22.17	17.81
Cooperative banks	-	-	-
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2008	2009	2010
Cash	4.79	5.46	4.72
Due from banks and NBM, net	21.98	18.55	15.47
Net loans and financial leasing	60.22	50.69	55.17
Total securities, net	6.30	15.16	15.74
Other, net	6.71	10.14	8.90
Total assets	100	100	100
Liabilities	**2008**	**2009**	**2010**
Deposits by natural persons	43.76	41.23	43.00
Deposits by legal persons	19.55	20.06	23.07
Others	18.82	21.37	16.76
Shareholder capital	17.87	17.34	17.17
Total liabilities and shareholder capital	**100**	**100**	**100**

Solvency ratio of financial institutions

Type of financial institution	2008	2009	2010
Commercial banks	30.74	31.09	28.51
Branches of foreign credit institutions	36.67	35.71	37.37
Cooperative banks	-	-	-
Banking sector, total:	**32.06**	**32.10**	**30.0**

Asset portfolio quality of the banking system (%)

Loan classification	2008	2009	2010
Standard	63.33	45.21	44.21
Supervised	31.01	38.41	42.47
Substandard	4.09	9.66	8.89
Doubtful	1.44	6.41	3.56
Bad	0.13	0.31	0.87
Classified total	100	100	100
Specific Reserves/Total Loans	5.0	9.73	8.55

The structure of deposits and loans in 2010 (%) (at year-end)

	Deposits		Loans
Households	63.28	Credits to industry / trade	51.57
		Consumer credits	8.40
Corporate	33.75	Credits to agriculture and food industry	14.86
		Credits for real estate, construction and development	12.34
Government sector	0.21	Other credits	5.52
		Credits for road construction and transportation	3.54
Other	2.76	Credits for energy and fuel industry	3.61
		Credits to banks	0.08
		Credits to Government	0.08
Total	**100.0**		**100.0**

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

P&L account	2008	2009	2010
Total interest income, inclusive:	301.25	223.34	220.50
interest income on credits and financial leasing	262.76	201.06	190.98
interest income from securities	28.23	16.22	26.37
interest income from other assets	10.27	6.06	3.15
Total non-interest income	120.88	87.58	97.39
Expenditures	**2008**	**2009**	**2010**
Total interest expenditure	181.21	147.70	97.96
Total non-interest expenditure	128.89	109.99	146.63
Provision for Loan Losses	30.39	63.58	61.63
Total profit (loss) before taxes and extraordinary gain (losses)	81.64	-10.36	11.69
Total net income	82.71	-9.79	11.67

As on December 31, 2008 1 EUR = 14.7408 lei
As on December 31, 2009 1 EUR = 17.6252 lei
As on December 31, 2010 1 EUR = 16.1045 lei

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	335.86	332.84	3.02	-
Branches of foreign credit institutions	88.84	84.86	3.98	-
Cooperative banks	-	-		-
Banking sector, total:	424.70	417.70	7.00	-
Commercial banks	335.86	332.84	3.02	-

As on December 31, 2010 1 EUR = 16.1045 lei

2010 DEVELOPMENTS IN THE MONTENEGRIN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Montenegro went out from recession in 2010, but economic growth slowed down and faced numerous challenges. Measures of economic policy over past two years had partly mitigated the impacts of the crisis. In 2010 key drivers of the recovery were industrial production, tourism and forestry.

Price movement in Montenegro fully reflected recession adapting to the market in 2010. Reduced aggregate demand and lower absorption, than expected, negative shocks from the international market resulted in a very low annual inflation of 0.7%, measured by consumer prices. It was the lowest inflation rate since inflation had been statistically monitored in Montenegro. The annual core inflation amounted to 0.4%. However, in 2011 we expect growth in inflation, because there will be a transfer of the global market effects in form of rising prices of food and energy. Montenegro, a small and highly open economy and major importer of these products will not be able to avoid transmitting of these shocks.

Monetary policy has been countercyclical and main activities in CBM were focused on preventing the further accumulation of problems in the banking system. The banking sector is stable but is faced with numerous challenges, primarily in the form of growth in non-performing assets.

The negative trend from the two previous years in the movement of industrial production was stopped. There has been growth in overall industrial production by 17.5% compared to 2009. This is the result of production growth in the sector of electricity, gas and water by 51.1%, and production growth in mining and quarrying sector by 58.7%. The decline in production was recorded in manufacturing industry 3%, due to a number of problems that followed the specific areas within the overall manufacturing industry, especially metal working industry.

The tourism sector has proven to be flexible and competitive, after the negative impact of global economic crisis. That sector managed to achieve good results in 2010. The number of tourists, who visited Montenegro during the 2010, was higher by 4.6% compared to previous year, while the number of overnight stays increased by 5.5%. Therefore, tourism gave a positive impulse to the development and many other fields such as transport, telecommunications, trade and others.

Some segments of the traffic achieved growth in 2010 compared to the previous year. Transit of goods increased in rail and air transport by 49.9% and 46.1%, respectively, while the road transport recorded decrease of 7.1%. In the passenger transport there was an increase in air traffic by 26%, while the road and rail transport recorded a smaller number of passengers.

The annual increase in forestry output in 2010 amounted to 18.4%, while the construction recorded a 0.8% fall, as measured in effective working hours.

Budget revenues and expenditures in 2010 were influenced by recessive movement. The fiscal deficit was inevitable and it reached 2.8% of GDP. In addition, there was also an increase in external debt of 11.4% which was caused by Eurobond emission in September 2010. Total public debt in Montenegro increased from 38% to 42.0% of estimated GDP. It is still at the acceptable level, but there is a concern about its growth tendency.

The capital market is still in deep crisis. Compared to the previous years stock turnover fell by 86%, the index MOSTE fell by 18%, NEX PIF index achieved a decrease of 3.5% and NEX 20 index 0.5% decrease. However, given the fact that the Montenegrin economy is predominantly focused on the banking system as a source of funding, the crisis in the capital market did not have a major influence on the economy. The positive trend that marked the end of 2010 was merger of two stock-exchanges.

Since the crisis came on Montenegrin market with a certain time delay, difficulties in the labor market were present in 2010. Namely, there was an increase in the number of unemployed persons by 6.4% and reducing the number of employees by 7.1%.

The balance of payments recorded a slight improvement in 2010. Total exports in 2010 grew by 20.3%, while imports recorded a slight growth of 0.1% as a result of the stagnation in domestic demand. Key generator to the balance of payments imbalance was s a trade deficit, which amounted to 1.3 billion euro and indicated low level of competitiveness in Montenegrin economy. The deficit was recorded in sub-account of income (-21 million euro), whereas a surplus was recorded in sub-account of service (446 million) and current transfers (114 million). The current account deficit amounted to 774.6 million and was 13.6% lower in relation to the previous year.

In 2010 there has been a significant inflow of foreign direct investments (FDIs) which amounted to 542.4 million or 17.9% of GDP. The level of Net FDI inflows were lower than the level achieved in the previous year, but primarily as a result of the fact that in 2009 there was a sale of a minority block of shares and recapitalisation of Montenegrin electricity company. However, looking at the share of FDI in GDP Montenegro is still in the top European transitional economies.

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

Negative effects of the global financial crisis still influence the macroeconomic environment in Montenegro, thus affecting the banking system as well. In that respect, assets, loans and deposits declined annually.

- Banks' total assets amounted to EUR 2,944 million, as of 12/31/2010, and in relation to the same comparative period of 2009 recorded the nominal decrease of EUR 81,6 million, i.e. the decrease at the rate of 2.7%. Eight banks in the system recorded the growth of the balance sum in one year period. Total assets' share in GDP amounted to 92%. Four large banks incorporate 68.02% of total assets of the banking sector.
- The most important item in the aggregate balance of banks was bank loans amounting to EUR 2,2 million or 74.74%. Total loans in one year period recorded the decrease by the rate of 8.25%. Total loans' share in GDP amounted to 68.73%. In the loan portfolio structure long-term loans (over one year) make up 78.45% of overall granted loans in the system. The most important loan users are private companies (54.5%) as well as natural persons (37.1%). From the aspect of granted loans classification by sectors,

most loans in the banking system was granted to households to the amount of EUR 863.6 million (39.25%) but it appeared as net lender of funds to the amount of EUR 88.3 million. Trade sector was also a significant user of loans to the amount of EUR 503.6 million (22.89%), and simultaneously the largest net borrower with EUR 387.5 million. The highest net lender of assets was the finances sector amounting to EUR 119.1 million. Besides financing sector, energy sector was also important net lender of assets. At the system level, the level of loans exceeds the deposits level by EUR 410.1 million.

- Non-performing assets of banks (C, D and E) amounted to EUR 509.3 million and accounted for 17.3% in overall assets. At the aggregate level, non-quality assets increased by 47.76% in the one-year period. The level of criticized assets (B, C, D and E) was high and it represents 38.37% of assets. However, these assets in one-year period decreased by 1.96%. The share of criticized assets in capital and reserves is still high but in one-year period it recorded decline of 6.03 percentage points. Percentage of past due loans at system level amounted to 23.75% as of 12/31/2010. In relation to the annual comparative period this indicator increased by 0.89 percentage points. In the structure of past due loans, loans with maturity from 31 to 90 days made up 53.97%, while the loans with maturity from 91 to 180 days made up 32.94%. The structure of total past due loans shows the highest share of loans granted to private companies 66.5% and loans to households 26.15%.
- Total depositary potential of banks as of 12/31/2010 amounted to EUR 1.790 million. Total deposits' share in GDP amounted to 55.9%. In the previous year, the amount of deposits was the highest at end-2009 amounting to EUR 1.824,9 million due to significant inflow from the privatization Electric Company of Montenegro (EPCG). In one-year period, deposits declined by EUR 34.8 million or 1.9%. The most important depositors of banks were natural persons with the share of 53.18% as well as private companies with 24.58% of the share. Of total deposits in the system, 40.94% referred to demand deposits. Besides households, concentration of deposits was evident in finance, trade, energy and transport sectors, which together made up 27.28% of total deposits. Deposits of four large banks made up 70.76% of overall deposits.
- Total banks' capital as of 31 December 2010 amounted to EUR 310.9 million reporting a decrease of EUR 20.8 million (6.28%) in one-year period. The dominant share in the structure of total capital had foreign capital with 83.05 %, then follows private capital with a share of 14.73%, and state with 2.22% of the share. Observing the movements of these parameters in one-year period, we notice the decrease of share of state capital in total capital by 0.37 percentage points and in the share of private capital by 1.35 percentage points, whereas foreign capital increased by 1.72 percentage points. As of 12/31/2010 two banks were majority private owned, while other nine banks were majority (five banks) or 100% foreign owned (four banks). Banks with majority foreign capital controlled 88% of the banking market in Montenegro.
- Banking sector liquidity was satisfactory, mostly due to conservative lending policy conducted by systemically important banks as well as to the amendments of the Decision on Bank Reserve Requirement to be held with the CBM from the previous period, which is still in force, as well as support from the parent banks, in particular in the periods of the most evident

liquidity crisis. Liquidity improvement is confirmed by the growth of key parameters in relation to end-2009. Liquid assets to total assets ratio amounted to 19.11%, representing an increase of 3.85 percentage points in one year period. Maturity match of financial assets and financial liabilities at the aggregate level showed negative maturity gap in all periods from 16-365 days. Total cumulative gap was negative in the period from 90-365 days. Total cumulative gap at the system level amounted to EUR 851 million or 32.62% of total sources of funds. For comparison, at the end of 2009 it amounted to 29.03% of sources of funds.

- The 2010-end data showed loss of the banking system of EUR 81.7 million. Four out of eleven banks had negative financial result. The profitability of banks was affected by both biased and objective factors. Biased weaknesses in some banks, lead to the deterioration of loan portfolio quality and increase in loan delinquency, which as a result would require allocation of higher loan loss provisions. Objective factors refer to decreased lending activities in banks caused by deteriorated financial situation of borrowers, legal and natural persons, against the backdrop of the global financial crisis. Profitability indicators, ROA and ROE were negative as well, and declined in relation to the same period of the previous year. Aggregate interest rate spread fluctuated in one year period and it amounted to 4% as of 31/12/2010. Interest rates spread at the level of individual banks varied from 2.91% to 9.14%.
- As of 12/31/2010 banks in Montenegro operated with an expanded network of 188 organisational units and 321 installed ATMs. Total number of employees in the banking sector decreased by 3 in one-year period and it amounted to 2.290 employees.

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

The Parliament of Montenegro adopted the Law on the amendments to the Law on Banks at the end of June 2010. The amendments to the current Law on Banks improved the regulatory framework especially in the following areas:

1) The procedure in reference to the acquiring of the qualified participation at a bank is put into compliance with the most current EU Directive,
2) The framework of corporative governance has been improved through the following:
    - Through the exacting of the conditions that must be met by the members of the Board of Directors.
    - Through the introduction of the obligation in reference to the licensing of the executive directors and through the exacting of the duties and responsibilities of the executive directors through the daily performing of the business operations of the bank as a whole.
3) New solutions in reference to the supervisory authorizations of the Central Bank towards the bank- measures towards the banks have significantly reinforced the supervisory functions in comparison to the previous legal

framework, especially in the case of introduction of the interim administration at a bank. The interim administrator may introduce the temporary moratorium on the payments of the creditors during the duration of the interim administration, perform the blocking of the accounts of the debtors who are in default, perform the recapitalization of the bank and perform the purchase and assumption transactions.

The Central Bank adopted at the end of year 2010, for the reasons of putting into accordance with the Law on amendments to the Law on Banks:

- the Decision on closer conditions that must be met by the member of the Board of Directors of a bank and
- the Decision on amendments to the Decision on documentation that is submitted with the requests for issuing o f the approvals from the Law on Banks.

In the framework of the TWINNING PROJECT; "The improvement of the regulatory and supervisory capacities of the financial regulators" the work on the design of the following by-law regulations is in its final phase:

- the Decision on Capital Adequacy of the Banks,
- the Decision on the Large Exposures of the banks,
- the Decision on the amendments of the Decision on the reports that are submitted to the Central Bank of Montenegro,
- the Guideline for recognition of the external rating agencies.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2010

Key steps of the regulatory and supervisory actions of CBM in 2010 referred to:

- increased supervisory activities, with special focus on the banks of systemic importance, and more intensive monitoring of the risks to which the banks are exposed;
- improvement of the institutional regulatory frame;
- implementation of international standards and principles of effective supervision, particularly on supervisory control over the process of capital adequacy assessment, review of internal control, comprehensive risk assessment of banks and evaluation of qualitative functions of the board of directors in terms to eliminate uncontrolled risk taking;
- intensive cooperation with the regulatory and supervisory bodies in the rest of the financial system in Montenegro, as well as the country supervisors of parent banks operating in Montenegro, especially through joint planning and exchange of supervisory data and information in accordance with the signed memorandum of cooperation, aiming synchronization of supervisory activities at the national and global levels.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

The implemented supervisory activities in 2010 have presented the continuity of the process of diagnostic controls, which started in October 2009. On their basis, extraordinary direct controls of all banks in the system were done. The aims of mentioned controls were:

- to present the financial position of banks by gaining insight into the balance sheet and off-balance sheet exposure,
- to assess key risks and banks' vulnerability to negative events that may or have already had an impact on capital income and liquidity,
- to assess banks' ability to meet their obligations on time.

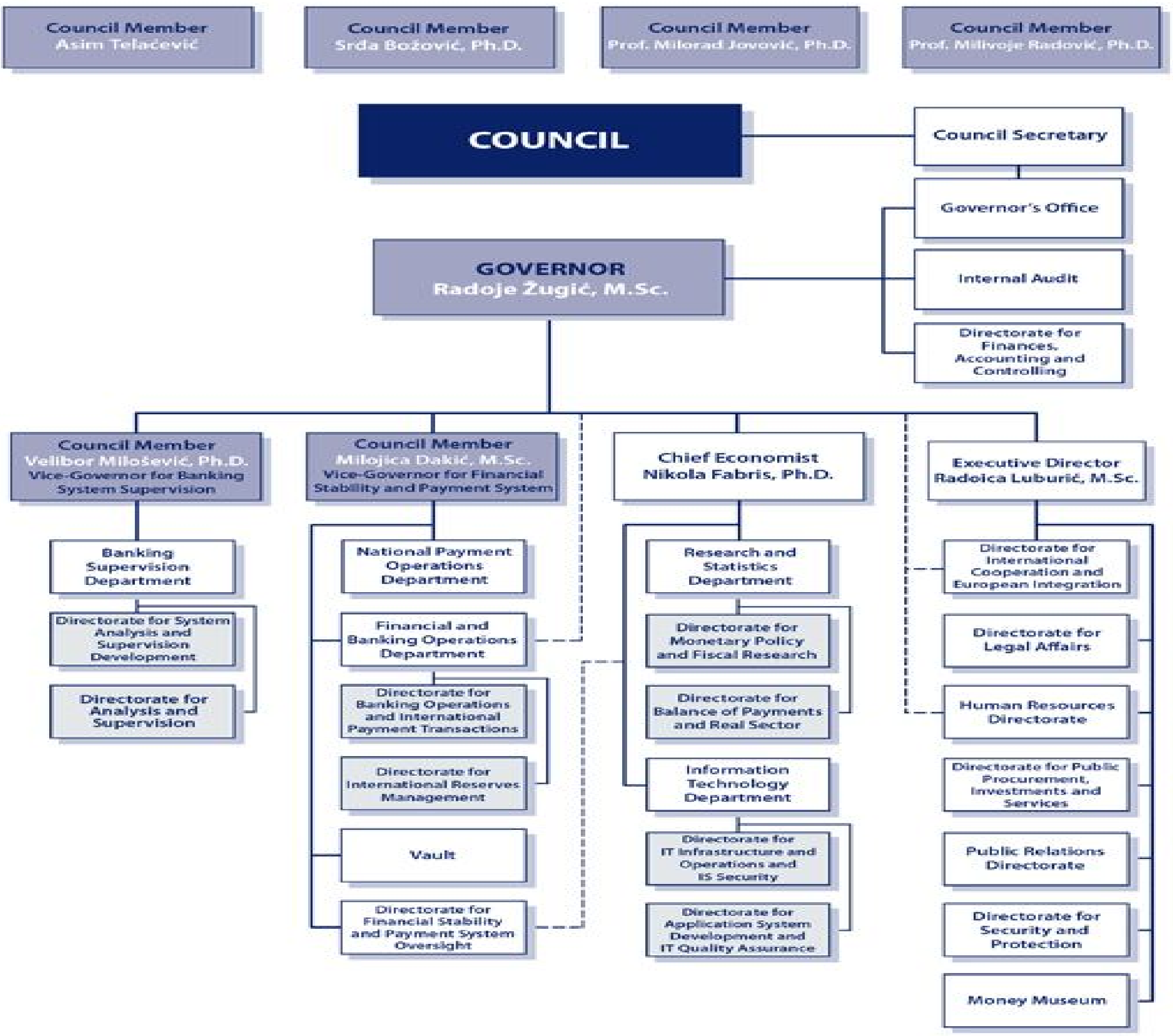
Supervision of the banking sector was conducted through direct and/or indirect examination, ordinary and / or extraordinary, full-scope and/or target examination, with a focus on intensive monitoring of systemically important banks, and banks that had been under the measures the Central Bank.

Central Bank in 2010 provided security and stability of the banking system creating a whole set of counter cyclical prudential measures. At the same time, trough supervisory activities in banks that had applied the bad banking practices in risk management, the Central Bank prescribed adequate measures and required adequate levels of liquidity and capital.

When analysing the sensitivity of banking sector on the crisis the results of stress testing showed the need to provide additional capital for four banks, while two other banks, although the diagnostic controls and stress tests did not required the need for additional capital, increased their capital.

In 2010 nine direct examinations were performed, including on full-scope and eight target examinations. All examinations included all systemic banks with an emphasis on credit risk, liquidity, capital adequacy and monitoring compliance with the regulations. Banks with low market share and lower degree of risk profile were continuously monitored by indirect examinations, through submitted reports on their business.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In attaining of the regulatory and the supervisory function of the Central Bank of Montenegro, the cross-border cooperation is a very important matter from the point of view of supervision on a consolidated basis and from the point of view of the improvement of the supervisory practices through the exchange of information and experience in the area of banking supervision.

On the basis of the concluded memorandums on understanding, the Central Bank especially attains cooperation with the supervisors of the banks that have subsidiary banks in Montenegro. The cooperation is being attained through the participation of the representatives of the Central Bank at the supervisory colleges that are organized by the supervisors of parent banks, and information is being exchanged in reference to the supervision of the banking groups. The Central Bank has concluded memoranda of understanding with all of the supervisory authorities that are supervising banks which are parent banks for the banks that are performing operations in Montenegro.

COOPERATION WITH OTHER SUPERVISORY BODIES IN MONTENEGRO

The Central Bank of Montenegro attains cooperation, besides the foreign supervisors, also with the organizations and institutions from Montenegro that is being performed on the basis of the signed agreements.

The Central Bank of Montenegro has concluded an agreement on cooperation with the Securities and Exchange Commission being the supervisor of the securities market, and with the Administration for prevention of money laundering and financing of terrorism and the Deposit Protection Fund.

A special type of cooperation with the supervisors of the financial system in Montenegro is being attained on the basis of the Law on the Financial Stability Council, which was adopted in June 2010. This Law established the Financial Stability Council, which consists of the Governor of the Central Bank who is the chairman of the Council, the Minister of Finance, the President of the Insurance Supervision Agency and the President of the Securities and Exchange Commission.

The aim of the establishing of the Financial Stability Council is monitoring, prevention and mitigation of the potential systemic risks in the financial system of Montenegro as a whole, in order of securing the maintenance of the stability of the financial system and avoiding the influence of factors which could lead to a wider financial crisis.

The Council collects and analysis the data and information that are of significance for the stability of the financial system and managing of the potential financial crisis: provides coordination and the exchange of data and information between the competent bodies: evaluates danger in reference to the financial system and determines the Plan on managing of the financial crisis at the level of the financial system as a whole (Contingency Plan), as well as the stress testing and the tests in reference to the simulation of the financial crisis.

In the framework of the Twinning Project “The Strengthening of the regulatory and Monitoring Capacities of the Financial Regulators”, the Central Bank of Montenegro, Securities and Exchange Commission and the Insurance

Supervision Agency are jointly working on the design of the Law in which the Directive 2002/47 on financial collateral arrangements will be implemented.

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Banks	11	11	11
Financial institutions, total	**11**	**11**	**11**

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

Type of financial institution	2008	2009	2010
Public sector ownership	-	-	-
Other domestic ownership	15	13	12
Domestic ownership total	**15**	**13**	**12**
Foreign ownership	85	87	88
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	57.39	76.87	1.479
Banking sector, total:	**57.39**	**76.87**	**1.479**

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

Type of financial institution	2008	2009	2010
Commercial banks	-6.90	-7.77	-27.27
Banking sector, total:	**-6.90**	**-7.77**	**-27.27**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks	15.04	15.75	15.85
Banking sector, total:	**15.04**	**15.75**	**15.85**

The structure of deposits and loans of the banking sector in 2010 (%) (at year-end)

	Deposits	Loans
Households	53.18	39.25
Government sector	6.89	2.19
Corporate	34.4	57.92
Other (excluding banks)	5.53	0.64
Total	**100.0**	**100.0**

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

P&L account	2008	2009	2010
Interest income	245,424	236,833	213,892
Interest expenses	135,336	116,465	100,191
Net interest income	110,088	120,368	113,701
Net fee and commission income	47,669	32,706	34,432
Other (not specified above) operating income (net)	-93,792 *	-91,382 *	-92,704*
Gross income	315,182	296,061	274,774
Administration costs	48,788**	51,273**	52,997**
Depreciation	-	-	-
Provisions	-	-	-
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-	-	-
Profit (loss) before tax	-17,809	-19,033	-80,850
Net profit (loss)	-19,688	-21,569	-81,677

Note: * Operating income, extraordinary income, extraordinary expenses, overhead costs and other operating costs

** Salaries and Contribution Expense

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	339,7	276,1	84,6	0
Banking sector, total:	**339,7**	**276,1**	**84,6**	**0**

2010 DEVELOPMENTS IN THE POLISH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2010 the Polish economy grew by 3.8%, which represents a higher rate than in 2009, i.e. 1.6%, but still lower than in 2008, i.e. 5.1%. The development was mainly stimulated by individual consumption and gross capital formation (mainly due to change in inventories), where the contribution to the economic growth totalled 1.9 pp. and 1.7 pp. respectively. Nevertheless, the contribution of investment was slightly negative and equaled -0.2 pp. The adverse tendencies observed in the wake of the economic and financial crisis thus partially reversed throughout 2010. In comparison to other European countries Poland turned out to be one of the leaders in terms of the economic growth.

The gradually rising GDP dynamics began to positively affect the labour market. The unemployment rate ceased to escalate, totalling 9.5% (according to the Eurostat) in the end of 2010. However, the figure remained higher than the year before, i.e. 9.0%, as well as compared to its low values of 2008. Currently the labour market in Poland is not as flexible as before the crisis, which means serious problems especially for young people seeking employment for the first time. In 2010 wages in the national economy grew at a moderate rate of 4.0% in nominal terms, which gives 1.5% in real terms.

The Monetary Policy Council (RPP) refrained from rising main interest rates throughout the entire 2010. Hence, the reference rate stayed at its historic low of 3.5%. Only the reserve requirement was increased from 3.0% to 3.5% as from the end of 2010. Consumer inflation in 2010 totalled 2.6%, which is close to the inflation target of the National Bank of Poland, i.e. 2.5%.

What posed non-negligible problems to the Polish economy was the performance of the public finance. In the end of 2010 the government deficit (according to the Eurostat) was equal to 7.9% of the GDP vs. 7.3% the year before, whereas the government debt reached the level of 55.0% of the GDP, compared to 50.9% in 2009. Although certain steps have already been taken by the government in those areas, improvement of the condition of the domestic public finance will be one of the main challenges for the Polish economy in coming years.

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

In 2010 the situation of the banking sector remained stable.

- The current situation as regards the capital base is good.
- The current situation as regards the short-term liquidity is good.
- The situation of medium- and long- term liquidity is unsatisfactory, because the interbank market does not function effectively in terms of transactions with due date exceeding one day and this is a lack of sources of medium- and long-term founding.

- There is a moderate increase in new loans, especially in mortgage loans, loans to budget and – to some extent – loans to individual enterprises. In other groups of loans stagnation is observed.
- Incomes increased because of interest expenses reduction, increase in fees and commissions and cost discipline.

The importance of banking sector in Polish economy rises systematically and in 2010 relation of its banking sector assets to GDP amounted to 81,9% compared with 78,7% in 2009.

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

In 2010 KNF continued work on regulation improving risk management in banks. This issue constituted the main objective of the supervision activity. The results of this work are following recommendations:

- Recommendation T *concerning good practices with regard to risk management of retail exposures.*

The main aim of this Recommendation is to improve the risk management of retail credit exposures to keep down credit losses. Recommendation also aims at reducing foreign currency risk. It underlines the substantial importance for banks to apply a conservative approach to the credit worthiness calculation process. Application of the Recommendation T standards by banks should allow for enrichment in the overall knowledge of customers by passing to them more detailed and comprehensive information.

- Amended Recommendation A *concerning risk management of banks' transactions in the derivatives market.*

This Recommendation introduces good practices concerning risk management due to derivatives (the value of which depends on price parameters connected with market risk) as well as specify rules which should be considered by banks while managing client relationships.

- Amended Recommendation I *concerning currency risk management in banks and the principles of conducting bank transactions exposed to currency risk*.

The aim of this Recommendation is to limit weaknesses with regard to the risk management process of foreign currency derivatives and foreign currency risk in banks.

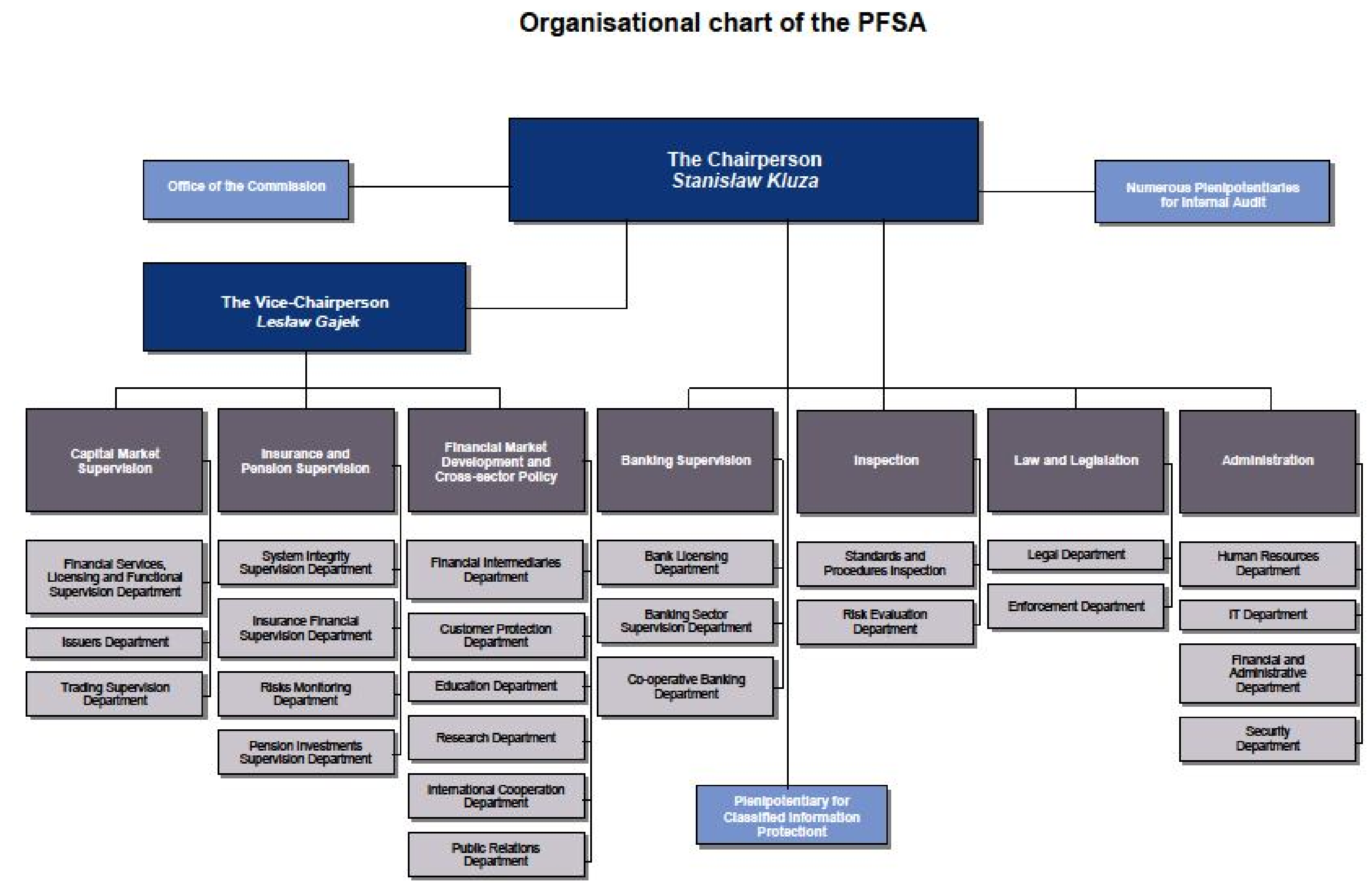
THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

In 2010 KNF carried out inspections in supervised entities – 55 complex inspections and 20 targeted inspections both in commercial and cooperative banks. Targeted inspections were focused on the areas of bank's activity considered to generate the highest risk. Inspections revealed some irregularities concerning credit risk management (most often) as well as liquidity risk management.

KNF also improved its off-site examination process, completing SREP (Supervisory Review and Evaluation Process) for banks, expected to be introduced in the beginning of 2011.

One of the important activities of KNF in 2010 was banking sector stress-testing, based on bottom-up approach. KNF also took part in CEBS (at present: EBA) stress-test exercise.

ORGANIZATIONAL CHART OF THE SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AURHORITY

In 2010 KNF together in other EU countries took part in work on following common issues aimed at mitigating risk of crisis:

- strengthening the European dimension of financial supervision,
- revision of the capital requirements directive (CRD IV) and deposit guarantee schemes directive,
- crisis management in banking sector on European scale,
- regulation of the rating agencies sector.

KNF developed cooperation in the Host Countries Forum, established on the initiative of KNF itself.

In 2010 KNF took part in discussion about BCBS proposal for new capital requirements regulations. KNF points out that EU has broadened original draft in the way that is unfavourable for local supervisor in term of liquidity risk management. KNF emphasizes the need of the efficient liquidity management on the solo basis and the effective supervision on the local market level rather than on the banking group level. It is especially crucial in case of threats to financial stability in the host country.

In 2010 KNF continued systematical cooperation with other supervisory authorities, especially as part of supervisory colleges.

COOPERATION WITH OTHER SUPERVISORY BODIES IN POLAND

KNF is an integrated supervisory agency, dealing with banking, insurance, pension funds and capital market supervision. However, it consistently cooperates with other governmental and self-regulatory institutions devoted to financial market issues, such as Ministry of Finance, Deposit Guarantee Scheme (BFG) or Polish Banks Association (ZBP) as well as with the central bank – NBP – that bear some responsibility in terms of market liquidity management and banks' data collecting. MoF, NBP and KNF cooperate with each other, in particular, in the Financial Stability Committee forum.

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	52	49	49
Branches of foreign credit institutions	18	18	21
Cooperative banks	579	576	576
Banking sector, total:	**649**	**643**	**646**

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

Type of financial institution	2008	2009	2010
Public sector ownership	17,3	20,8	21,5
Other domestic ownership	10,4	11,1	12,3
Domestic ownership total	27,7	31,9	33,8
Foreign ownership	72,3	68,1	66,2
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	33,0	43,9	
Branches of foreign credit institutions	3,7	4,1	
Cooperative banks	0,4	0,6	
Banking sector, total:	**33,0**	**43,9**	**571**

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

Type of financial institution	2008	2009	2010
Commercial banks	7,32	8,58	8,87
Branches of foreign credit institutions			
Cooperative banks	8,63	9,31	9,35
Banking sector, total:	**7,40**	**8,62**	**8,90**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	89,2	88,9	89,2
Branches of foreign credit institutions	5,4	5,3	4,7
Cooperative banks	5,4	5,8	6,1
Other			
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2008	2009	2010
Financial sector	10,3	8,1	8,2
Nonfinancial sector	56,6	60,6	60,3
Government sector	2,4	4,5	5,5
Other	30,7	26,8	26,0
Liabilities	**2008**	**2009**	**2010**
Financial sector	24,4	22,7	23,5
Nonfinancial sector	52,7	59,4	59,6
Government sector	5,6	5,5	5,1
Capital	9,3	10,8	11,2
Other	8,1	1,6	0,7

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks**	11,1	13,2	13,8
Cooperative banks**	13,1	13,4	13,6
Banking sector, total:**	**11,2**	**13,3**	**13,8**

(* - for Basel I; ** - for Basel II)

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

Asset classification	2008	2009	2010
Non financial sector	4,5	7,9	8,8
- households	**3,4**	**5,9**	**7,1**
- corporate	**6,1**	**11,2**	**11,9**

The structure of deposits and loans of the banking sector in 2010 (%) (at year-end)

	Deposits	Loans
Households	58,2	62,4
Government sector	14,6	8,3
Corporate	25,2	28,8
Other (excluding banks)	2,1	0,4
Total	**100.0**	**100.0**

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

P&L account	2008	2009	2010
Interest income	60 199	55 584	57 297
Interest expenses	30 111	29 208	26 371
Net interest income	30 089	26 376	30 925
Net fee and commission income	11 512	12 458	13 742
Other (not specified above) operating income (net)	7 503	9 381	7 428
Gross income	48 311	49 607	53 091
Administration costs	24 850	24 814	25461
Depreciation	2 339	2 544	2 532
Provisions	398	524	792
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	4 275	11 555	10 465
Profit (loss) before tax	16 787	10 170	14 302
Net profit (loss)	13 658	8 278	11 519

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	23 636,5	23 131,0	70,9	
Cooperative banks	1 659,7	1 659,7		
Banking sector, total:	**25 392,1**	**24 790,7**	**70,9**	

2010 DEVELOPMENTS IN THE ROMANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2010, real GDP has considerably slowed down the declining trend of the previous year (-1.3% against -7.1%). GDP evolution was driven by almost fourfold reduction in the rate of decrease in final consumption (up to -2.1 percent) and slower decline in investments up to -13.1 percent (approximately half of the variation recorded in 2009). GDP per capita was 40.6% in the euro area average, smaller than 2009, against the background of maintaining the external deficit to a moderate level and adjustment of the budget deficit to sustainable levels.

HICP inflation was higher in 2010 (6.1%) than that of the previous year (5.6%) but smaller than that of 2008 (7.9%). Romania's budget deficit decreased from 8.3% of GDP in 2009 to 6.4% in 2010. The authorities implemented fiscal consolidation measures in mid-2010, including an increase in the VAT rate from 19% to 24% and a temporary 25% reduction in public wages and a 15% reduction in social spending excluding pensions. In addition, the authorities also reduced public sector employment from 1.38 million at end-2009 to 1.27 million at end-2010.

DEVELOPMENT IN THE BANKING SYSTEM

As of 31 December 2010, the Romanian banking sector consisted of 33 local incorporated credit institutions and 9 branches of EU foreign credit institutions. Among the local credit institutions 26 entities have majority foreign capital, while other 7 credit institutions have majority domestic capital (2 state-owned credit institutions and 5 private-owned credit institutions). Consequently, foreign owned credit institutions held the largest share in the total banking system assets (85.1%, including foreign banks branches) followed by the domestic private-owned credit institutions with 7.5% and domestic state-owned credit institutions with 7.4%. The assets of the banking sector rose by 3.6% in 2010, to ROL 342 billion at the end of 2010. The banking assets in GDP added 0.3 percentage points, amounting to 66.6% at December-end 2010. Non-government loans grew by 4.7%, to ROL 209 billion at December-end 2010, accounting for 41% in GDP.

Notwithstanding the developments in 2010, the Romanian banking system is still sound, with solvency and liquidity ratios well above domestic prudential requirements. The trend of these ratios was supported by the growing capitalization through new cash contribution of the shareholders. At the end of 2010, the capital adequacy ratio stood at 15.02%, well above the regulatory threshold of 8% and the level of 2009. At the individual level, there are no banks with solvency ratio less than 10%; moreover about 18 banks are above the system average. Also, the liquidity ratio remained at a reassuring level in 2010, respectively 1.35 which is higher than 1 regulatory level. A valuable support in preserving the financial stability and confidence in the market was represented by the commitment of the parent banks of the 9 largest foreign subsidiaries to keep their exposure to Romania during the IMF and EU program. Thus, the banks involved in the European Bank Coordination Initiative have broadly maintained their exposure to Romania.

However, the economic downturn has increasingly impacted the quality of loan portfolios and credit demand. Non-performing loans (loans classified in loss category with debt service over 90 days) increased in 2010 and reached roughly 12% at December-end 2010. The slowdown in the growth of bank lending, together with the deterioration in the quality of assets they already hold, especially loans, finally affected the financial results. Furthermore, lower risk appetite, reflected in the adoption of more prudent lending standards and in low risk investments, have had a negative impact over profitability. The Romanian banking system reported losses at the end of December 2010 (121 million euro), generated to a large extent by the increased credit risk provisions.

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

The main changes to the regulation of credit institutions in 2010 with respect to the implementation of European law were the amendment of the legislation and related implementing regulations connected with the transposition of Directives 2009/111/EC (amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management), Directives 2009/83/EC and Directives 2009/27/EC (amending certain Annexes to Directive 2006/48/EC of the European Parliament and of the Council as regards technical provisions concerning risk management), Directives 2010/76/EU (referred to as the CRD III Directive).

The banking legislation regulating the procedure of special administration was amended in order to allow a quick and efficient intervention for banks in financial distress. The legal provisions increased the powers of the special administrator and its authority to implement a series of restructuring measures, such as the sale of assets by assuming liabilities and transfer of deposits. Also, in the context of the need for transposition into national law by 31 December 2010 of Directive 2009/14/EC amending Directive 94/19/EC on deposit guarantee schemes, amendments to the existing legal provisions were brought in order to increase the coverage to 100.000 euro; to eliminate of stand-by credit lines granted by credit institutions from the category of financial resources of the deposit guarantee scheme; to improve the eligibility requirements for the management board of the Deposits Guarantee Fund.

In order to transpose into national law of Directive 2009/110/EC (on the business of electronic money) NBR has participated in the issuing process with its area of competence, namely licensing, regulation and prudential supervision of electronic money institutions. The main aspects covered in the project refers to: establishment of new prudential regime applicable to electronic money institutions; regulation of payment and credit services performed by electronic money institutions; establishing the principle of proportionality, according to business risks, to ensure the supervision of electronic money institutions.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2010

The main objective of NBR was linked with the main goal which is to assure the stability of the Romanian banking system, attributable to its capacity to act as a monetary and supervisory authority. NBR acted to limit the impact of the international crisis on the local banking market. At that time the most likely way to affect domestic credit institutions condition appeared to be the liquidity channel. As a result, NBR has taken a number of important measures to manage developments in this field. Also, measures to strengthen banks capital positions and to maintain access to external finance have had a high priority.

Important measures have been taken in 2010 to facilitate rapid action in the area of bank resolution and to strengthen the options for bank restructuring and to strengthen the special administrator's ability to deal with banks in weak financial positions.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

NBR has been very dynamic in supervisory activities in order to protect the banking system against the negative impacts of the crisis. These included the control of liquidity levels, capital adequacy levels and the monitoring of the financial and economic condition of the banks.

In 2010, NBR conducted 63 on-site inspections at 30 domestic banks, including head offices and branches, 7 foreign bank branches, as well as at the Banca Centrală Cooperatistă- CREDITCOOP and its network. Also, apart from the regular off-site supervision activities (assessment of banks' financial standing and of the risks they assume in the pursuit of their business, monitoring on a continuous basis of the observance of prudential limits and regulations), particular importance was paid to the monitoring of capital adequacy, liquidity and the quality of the loans portfolios. Thus, NBR has requested some banks to submit solvency ratio on monthly basis instead of quarterly as rule provides; to increase share capital or to reach and maintain at least 10% level of solvency ratio. In conjunction with its supervisory measures to ensure bank capital adequacy, the NBR has also used stress testing techniques to assess the potential vulnerability of bank capital positions, with a view to ensuring that all banks remain adequately capitalized even in the event of adverse developments. With regard to liquidity NBR required banks to put in place alternative financing agreements and/or to diversify the financial resources; to purchase a portfolio of treasury bills representing a certain amount of the balance sheet liabilities; to set up liquidity risk management scenarios; to diversify financing resources in order to decrease high levels of concentration against any single counterparty; to improve the credit/deposits ratio.

NBR in the capacity of host supervision participated in the supervisory colleges devoted to cross-border groups of credit institutions. Within the working committees and their working groups operating within EU structures it was involved in the creation of EU regulatory measures for the financial market.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

BOARD OF DIRECTORS

GOVERNOR Mugur Isărescu

DEPUTY GOVERNOR
Cristian Popa

MONETARY POLICY DEPARTMENT
- Monetary Policy Analysis and Strategy Division
- Liquidity Management Division

MACROECONOMIC MODELLING AND FORECASTING DEPARTMENT
- Macroeconomic Forecasting Models Division
- Macroeconomic Assessment Models Division

FINANCIAL STABILITY DEPARTMENT
- Financial Institutions Division
- Financial Markets and Infrastructure Division
- Macroprudential Risk Division
- Banking Risk Division
- Payment and Settlement Systems Oversight Division

ECONOMICS DEPARTMENT
- Economic Analysis Division
- Publications Division
- Translations, Editing and Documentation Division

INTERNATIONAL RELATIONS DEPARTMENT
- European Union Division
- External Relations Division

Note: Colour patterns show the departments' co-ordination

FIRST DEPUTY GOVERNOR
Florin Georgescu

REGULATION AND LICENSING DEPARTMENT
- Financial Activities and Non-bank Financial Institutions Regulation Division
- Foreign Exchange and Accounting Regulation Division
- Licensing Division
- Prudential Banking Regulation Division 1
- Prudential Banking Regulation Division 2

SUPERVISION DEPARTMENT
- Inspection Division I
- Inspection Division II
- Inspection Division III
- Non-bank Financial Institutions and Payment Institutions Inspection Division
- Banking System Assessment, Methodology and Supervision Procedures Division
- Monitoring of International Sanctions Enforcement, Prevention of Money Laundering and Terrorist Financing Division

ISSUE, TREASURY AND CASH MANAGEMENT DEPARTMENT
- Issue Division
- Cash Management Division
- Central Vault Division
- Cash Processing Coordination Division

PAYMENTS DEPARTMENT
- ReGIS Management Division
- Financial Instruments Depository and Settlement Division
- Financial Messages Processing Division
- TARGET2 Division

ACCOUNTING DEPARTMENT
- Operational Accounting Division
- Internal Administration Accounting-Financial Issues Division
- Internal Administration Accounting-Fixed Assets Division
- Internal Accounting Rules and Preventive Financial Control Division

FINANCIAL CRISES MANAGEMENT UNIT

ASSETS AND INVESTMENTS DEPARTMENT
- Investment Division
- Movable Assets Division
- Immovable Assets Division

DEPUTY GOVERNOR
Bogdan Olteanu

STATISTICS DEPARTMENT
- Monetary and Financial Statistics Division
- Balance of Payments Division
- Direct Statistical Reporting Division
- Statistical Data Processing Division
- SIRBNR Data Management

IT DEPARTMENT
- IT Systems Division
- Network Administration Division
- IT Support Division
- Multimedia Support Division

LEGAL DEPARTMENT
- Legal Documentation and Advisory Opinion Division
- Contract Assistance and Disputed Claims Division
- European and International Law Division

TECHNICAL AND MAINTENANCE DEPARTMENT
- Construction and Electrical Equipment Division
- Equipment Maintenance Division
- Administration Division

PROCUREMENT DEPARTMENT
- Procedure Organisation Division
- Methodology and Contracting Division
- Planning and Monitoring Division
- Direct Procurement Division

BRANCHES

CHANCELLERY
- Chief Economist and Advisers' Group
- Governor's Control Office
- Board Secretariat Division
- Classified Information Division
- Protocol Division

MARKET OPERATIONS DEPARTMENT
- Monetary Policy Operations Division
- State Treasury Operations Division
- Foreign Reserve Management Division
- Back Office Division

COMMUNICATION DEPARTMENT
- Website and Electronic Publications Division
- Media Relations Division
- Institutional Image Analysis and Public Relations Projects Development Division
- Financial Education Division

SECRETARIAT
- Documents Registration Division
- Archives Division
- Library Division
- Museum Division
- Public Information Division
- Events Organisation Division
- Transport Division
- Cafeteria Division

HUMAN RESOURCES DEPARTMENT
- Organising and Planning Division
- Human Resources Management Div.
- Training and Career Development Division

INTERNAL AUDIT DEPARTMENT
- General Audit Division
- Analysis and Synthesis Division
- IT Audit Division

SECURITY DEPARTMENT
- Crisis Management& Business Continuity Division
- Internal Protection Division
- Special Transport Division
- Security Systems Division
- Emergencies Medical Services Division

TRAINING AND SOCIAL EVENTS FACILITY DEPARTMENT
- Training Support Division
- Social Events Division
- Maintenance Division
- Auxilliary Activities Division

INTERNATIONAL ACTIVITIES OF NBR

In the context of large presence on the Romanian market of the international financial groups, NBR acted to enhance cooperation and coordination with foreign supervisory authorities, especially with those from EU, both on bilateral and multilateral level. NBR actively involved in international cooperation participating in the activities related to the EU supervisory structure and working in the international organizations of financial supervisors and other international organizations.

International cooperation has been strongly reinforced once the supervisory colleges have been established. Cooperation and coordination within the supervisory colleges started to receive an increasingly importance for the NBR activity for reason that Romania is host country for 18 European cross-border banking groups. New multilateral cooperation agreements has been signed by NBR with home supervisors of three international banking groups (EFG Eurobank, Bayerische Landesbank and Piraeus Bank) that were added to the existing ones concluded to cooperate in view to supervise other 14 international banking groups (Crédit Agricole, Unicredit, Intesa Sanpaolo, Erste Bank, Raiffeisen Zentralbank, Volksbank, Société Générale, ING Bank, Banco Comercial Portugues, OTP, Alpha Bank, RBS, National Bank of Greece, Marfin Popular Bank).

The regular exchange of information, both quantitative and qualitative, facilitated the reduction of overlapping and contributed to the co-ordination between supervisors. Exchange of information focused on the groups and their subsidiaries financial condition, groups risk profile, their business strategy, main findings of the supervisory teams, coordination between foreign supervisory authorities and setting up of the on-site inspections plans, as well as other specific issues related to Basel II implementation. Also there is a regular exchange of experiences with foreign supervisory authority or regular consultation on bilateral basis. The NBR concluded a cooperation agreement with Bank of Spain in June 2010. There are a total of 12 bilateral cooperation agreements in which NBR is part. Accordingly, bilateral meetings were held as part of continued cooperation in the various areas of supervision and at various different levels.

In early 2010, NBR hosted a regional meeting of representatives of the supervisors from South-Eastern Europe countries held on two levels of decision, that of governors and directors of supervision departments. Participants discussed the latest developments in the macroeconomic performance of banking systems and the latest changes in the regulatory framework of the signatory countries. It was also reiterated the importance of efforts to achieve convergence of supervisory practices. In late 2010, Central Bank of Cyprus hosted the second meeting of supervisors in South Eastern Europe where discussed issues on a set of were statistical or supervision information to be regularly exchanged between supervisors in the region. Thus, it was agreed that each authority to assess the systemic importance of branches / subsidiaries belonging to a banking group in another signatory country of the agreement and the importance of the cross-border entities for banking groups. If is identified as being important or significant for local banking systems or for banking groups, it is necessary to provide quarterly information on the branches/subsidiaries by host country supervisors and on the banking group by the home country supervisors. As regards Romania, the central bank acts as supervisor of the host country for five subsidiaries/branches of Greek banking groups (Alpha Bank, ATE Bank, a member of the Romanian Bank National Bank of Greece, Bancpost, Piraeus Bank) and two banking groups from Cyprus (Marfin Bank and Bank of Cyprus). NBR has the quality of home supervision authority for one banking group which has a branch in Cyprus.

Romania continued to benefit from EU and IMF support by multilateral financial assistance package and from the commitment of the parent banks of the nine largest subsidiaries to maintain their exposure in Romania. The European Bank Coordination Initiative has played a key role in helping Romania withstand the peak phase of the economic and financial downturn. Throughout the programme period, parent banks have largely honored their exposure commitments to Romania at group level. Furthermore, parent banks also met their commitment to provide ex-ante additional capital for 2009 and 2010, so that the capital adequacy ratio of their subsidiaries has remained above 10% throughout the programme period.

COOPERATION WITH OTHER SUPERVISORY BODIES IN ROMANIA

In 31 July 2007, an agreement on the co-operation in the field of financial stability and financial crisis management between the Ministry of Public Finance, National Securities Commission, National Bank of Romania, Insurance Supervisory Commission, Private Pension Supervision 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 (NCFS). During its meetings in 2010, the members of the committee have discussed the recent developments at the European level regarding the prevention and management of financial crisis. In this context, the European Commissions documents regarding an EU framework for crisis management in the banking sector were analysed, along with the results of the public consultation on this matter. Furthermore, the latest debates, at the EU level, on burden sharing mechanisms among member states in cross border financial crisis as well as the principles regarding the organisation and functioning of cross border stability groups were examined.

The members of the committee have also analysed the recent developments in the Romanian financial system. The preservation of assets' quality at a manageable level and the broadly favorable developments in profitability led to a consolidation of the financial institutions' solvency and liquidity at adequate levels. In this context, the prospects of healthy financial sector development in Romania have been appraised as positive.

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	32	31	32
Branches of foreign credit institutions	10	10	9
Cooperative banks	1	1	1
Banking sector, total:	**43**	**42**	**42**

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

Type of financial institution	2008	2009	2010
Public sector ownership	5.2	7.3	7.4
Other domestic ownership	6.6	7.4	7.5
Domestic ownership total	11.8	14.7	14.9
Foreign ownership	88.2	85.3	85.1
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010
(at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	43.1	56.8	993
Branches of foreign credit institutions	87.0	95.9	3,303
Cooperative banks	-	-	-
Banking sector, total:	**40.0**	**52.7**	**871**

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

Type of financial institution	2008	2009	2010
Commercial banks	17.27	3.01	-2.44
Branches of foreign credit institutions	14.63	0.90	15.02
Cooperative banks	2.90	0.75	2.19
Banking sector, total:	**17.04**	**2.89**	**-1.73**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	94.2	92.4	92.8
Branches of foreign credit institutions	5.6	7.4	7.0
Cooperative banks	0.2	0.2	0.2
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2008	2009	2010
Financial sector	29.0	25.2	22.5
Nonfinancial sector	61.4	57.1	55.8
Government sector	5.3	14.1	18.1
Other	4.3	3.6	3.6
Liabilities	**2008**	**2009**	**2010**
Financial sector	31.7	30.5	29.1
Nonfinancial sector	52.7	55.3	56.5
Government sector	-	-	-
Capital	6.5	5.6	5.5
Other	9.1	8.6	8.9

Capital adequacy ratio of banks

Type of financial institution	2008**	2009**	2010**
Commercial banks	13.7	14.6	15.0
Cooperative banks	31.7	31.4	32.4
Banking sector, total:	**13.8**	**14.7**	**15.0**

(* - for Basel I; ** - for Basel II)

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

Asset classification	2008	2009	2010
Non financial sector	na	7.9	11.9
- households	**na**	**7.7**	**10.0**
- corporate	**na**	**8.0**	**13.6**

* Commercial banks and Cooperative bank

The structure of deposits and loans of the banking sector in 2010 (%) (at year-end)

	Deposits	Loans
Households	58.6	37.7
Government sector	0.0	22.7
Corporate	35.1	38.6
Other (excluding banks)	6.3	1.0
Total	**100.0**	**100.0**

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

Million RON

P&L account	2008	2009	2010
Interest income	25,077.7	30,542.2	26,723.7
Interest expenses	15,491.7	19,721.5	12,154.7
Net interest income	9,586.0	10,820.7	14,569.0
Net fee and commission income	5,191.9	5,112.9	3,965.3
Other (not specified above) operating income (net)	6,639.3	8,604.4	5,504.5
Gross income	**21,417.2**	**24,538.0**	**24,038.8**
Administration costs	11,075.6	14,675.9	14,535.0
Depreciation	852.3	1,000.5	1,054.5
Provisions	4,112.4	7,610.7	8,616.1
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	na	na	na
Profit (loss) before tax	**5,376.9**	**1,250.9**	**-166.8**
Net profit (loss)	**4,400.5**	**815.9**	**-516.4**

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	7,045.0	5,692.8	1,352.2	-
Cooperative banks	51.7	40.5	11.2	-
Banking sector, total:	7,096.7	5,733.3	1,363.4	-

Rate of exchange: 4.2848 RON/EUR

2010 DEVELOPMENTS IN THE RUSSIAN BANKING SYSTEM

MACROECONOMIC SITUATION IN RUSSIA

In 2010, the Russian economy was recovering after the global financial and economic crisis. Amid unstable economic recovery, the Bank of Russia monetary policy was aimed at supporting and expanding aggregate demand while keeping its strategic focus on measures to reduce inflation.

Production growth was mainly stimulated by larger exports of goods and services and higher investment and consumer activity. The growth in the number of employed in the economy resumed. The inflation rate remained at its 2009 level. The world prices of most commodities were observed to grow in 2010 and the market conditions for Russian exporters improved considerably, which had a positive effect on Russia's terms of trade with other countries.

Russia's external debt resumed growth in 2010, largely due to the increase in banks' debt, and totalled $488.7 billion as of January 1, 2011. The debt burden on the country's economy decreased from 37.9% of GDP as of the beginning of 2010 to 33.1% of GDP as of the beginning of 2011. The debt burden is not critical under internationally recognised criteria.

Net private capital outflow fell by a third, from $56.1 billion in 2009 to $35.3 billion in 2010, largely due to banks' efforts to raise capital while a year earlier banks' foreign liabilities were observed to decrease. Russia's international reserves grew by $39.9 billion to $479.4 billion as of January 1, 2011.

Russia's GDP rose by 4.0% in 2010 year on year (it fell by 7.8% in 2009).

Employment increased by 0.6% in 2010 (this indicator decreased by 2.2% in 2009). The total number of the unemployed in the reporting year fell by 10.9% to 7.5% of the economically active population (8.4% in 2009).

Accumulation of fixed capital formed increased by 6.1% in 2010 (it decreased by 14.4% in 2009). Investment activity intensified as the financial position of organisations improved and credit facilities became more affordable.

The growth of wages and pensions in 2010 contributed to the increase of household real disposable income (by 4.1%). The growth of incomes amid a better situation on the labour market and a rebound in consumer lending had a positive effect on the dynamics of household spending on goods and services. In 2010, household final consumption rose by 3.0% (it fell by 4.8% in 2009).

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

The growth of most key indicators characterising the role of the banking sector in the economy slowed down relative to GDP in 2010. The ratio of banking sector assets to GDP contracted from 75.9% to 75.2% over the year. The ratio of banking sector capital to GDP fell by 1.4 percentage points to 10.5%. Household deposits remained the main funding source for credit institutions in 2010: the ratio of their value to GDP increased by 2.5 percentage points to 21.8% (their share of banking sector liabilities grew to 29% as of January 1, 2011 from 25.4%

as of January 1, 2010). The ratio of deposits and corporate entities' other borrowings to GDP contracted by 0.7 percentage points to 13.4%. As in the previous year, loans prevailed in the structure of banking sector assets in 2010. The ratio of the total value of loans to GDP fell by 1.9 percentage points to 49.3%, while their share of banking sector total assets decreased by 1.9 percentage points to 65.5%. The value of loans to non-financial organisations and individuals as a percentage of GDP dropped by 1.1 percentage points to 40.4%. Investments in equity securities grew rapidly but their value as a percentage of GDP remained insignificant (1.6%).

LEGISLATIVE AND INSTITUTIONAL FRAMEWORKS FOR THE ACTIVITY OF CREDIT INSTITUTIONS AND BANKING SUPERVISION, MAIN CHANGES. SUPERVISORY AUTHORITY'S LEGAL COMPETENCE

In compliance with Federal Law No. 86-FZ, dated July 10, 2002, "On the Central Bank of the Russian Federation (Bank of Russia)" (hereinafter referred to as the Bank of Russia Law), the Bank of Russia is a body of banking regulation and supervision. Its main goals are to maintain stability of the Russian banking system and protect the interests of creditors and depositors. For these purposes, the Bank of Russia constantly supervises compliance by credit institutions and banking groups with banking legislation, laws on counteraction of money laundering and terrorist financing, Bank of Russia regulations and required ratios.

Pursuant to the Bank of Russia Law, to ensure the soundness of lending institutions, the Bank of Russia may establish the following prudential standards (also for the banking groups):

- maximum amount of property (nonmonetary) contributions to a lending institution's charter capital, as well as the list of types of property in nonmonetary form that may be contributed toward the pay-in of charter capital;
- maximum risk per borrower or group of connected borrowers;
- maximum amount of major credit risks;
- a lending institution's liquidity standards;
- equity (capital) adequacy standards;
- amounts of currency, interest-rate and other financial risks;
- minimum amount of reserves against risks;
- standards for a lending institution's use of its equity (capital) for acquiring shares (interest) in other legal entities;
- the maximum amount of loans, bank guarantees and sureties granted by a lending institution (banking group) to its participants (shareholders).

The Bank of Russia establishes the methodology for determining a lending institution's equity (capital), assets, liabilities and amount of risk on assets for each standard, taking into account international standards and consultations with lending institutions and banking associations and alliances. The Bank of Russia is empowered to establish differentiated standards and methods for calculating them according to types of lending institutions.

In order to exercise its banking regulatory and banking supervisory functions, the Bank of Russia conducts examinations of lending institutions (their branches), sends them binding orders for the elimination of violations that have been discovered in their operations, and applies the sanctions specified in the Bank of Russia Law with respect to violators.

In cases of a lending institution's violation of federal laws or the Bank of Russia's supporting regulations and orders, failure to provide information, or provision of incomplete or inaccurate information, the Bank of Russia has the power to demand that the lending institution eliminate the identified violations, impose a fine of up to 0.1 percent of minimum charter capital, or restrict the lending institution from engaging in certain operations for a period of up to six months.

The Bank of Russia has the power to revoke a lending institution's banking license on grounds stipulated in the Law on Banks. The procedures for revoking a banking license are established in Bank of Russia regulations.

At the same time, the Bank of Russia analyzes the performance of lending institutions (banking groups) in order to identify situations threatening the legitimate interests of their depositors and creditors and the stability of the Russian Federation's banking system.

Russian Federation banking legislation (including the Bank of Russia's regulations) in the area of banking supervision is being changed in order to maintain it's effectiveness in light of the development of the national banking system and regulatory practices, which take international banking supervision experience into account. Pursuant to Article 77 of the Bank of Russia Law, Bank of Russia cooperates with lending institutions and their associations and alliances, and holds consultations with them before adopting the most important regulatory decisions. To ensure the orderly development of the legislative base, the Russian Federation Government and Russian Federation Central Bank approved the Strategy for development of the Russian Federation Banking Sector in the Period up to 2015, which provides for improving banking regulation and supervision and enhancing protection of the interests and strengthening the confidence of depositors and other bank creditors.

The Bank of Russia is taking consistent steps to implement Basel II[15] in the Russian banking sector as the internationally recognised standard for capital adequacy assessment, including adjustments made for the development of internal risk management systems, supervisory process arrangements and information disclosures by banks. This work is phased to ensure the consistent introduction of various options available for the regulatory assessment of capital adequacy, ranging from simple (based on regulatory assessments) to more complex (based on internal bank risk assessments).

From July 1, 2010, amendments to the Bank of Russia regulations on the procedure of obligatory ratios and operational risk calculations came into force to implement a simplified standardised approach to credit risk assessment and the basic indicator approach to operational risk calculation under Basel II.

Amendments to the Bank of Russia regulations relating to the use of country-specific assessments in prudential supervision under the Basel II simplified standardised approach came into force to regulate the procedure for credit institutions to calculate the size of market risk and make loan loss provisions.

In 2010, the Bank of Russia drafted consultative documents to outline possible areas, deadlines and stages for implementing Basel II in the Russian banking sector, and also measures (including regulatory amendments) that are

[15] "International Convergence of Capital Measurement and Capital Standards. A Revised Framework. Comprehensive Version", Basel Committee on Banking Supervision, Basel, June 2006.

expedient for full-fledged implementation of Basel II. The documents were made available for comments to the banking community and a wide group of banking specialists.

In addition, other amendments were made to the regulatory framework of credit institutions to develop risk-based supervision, improve corporate governance, assess credit institutions' operations and apply measures of supervisory response and regulate other issues.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2010

In 2010, efforts to improve supervision of credit institutions focused on developing risk-based approaches, including measures to early identify negative changes in the activity of credit institutions and ensure timely supervisory response to shortcomings that were identified. Special importance was attached to the transparency of credit institutions and cooperative work of their management and owners. As part of these efforts, special attention was paid to the banks of the so-called second line of supervision (systemically important credit institutions). The supervisor also developed contacts with foreign banking supervisory authorities with regard to supervision of internationally active banks.

The intensification of supervisory procedures helped the Bank of Russia become more informed about the situation in banks, including systematically important institutions, and also raised the efficiency of supervisory decisions. In the process of supervisory work, the supervisor also paid attention to analysis of the financial standing of banks proceeding from consolidated approaches to the assessment of their operations, studied in detail operations involving member credit institutions of banking groups, as well as non-resident credit institutions, and examined the economic nature of transactions in relevant cases.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

In 2010, the Bank of Russia adopted regulatory acts to improve banking regulation and supervision, including the state registration of credit institutions, licensing of banking activities, off-site supervision, on-site inspections, the financial rehabilitation and liquidation of credit institutions, anti-money laundering and counter-terrorist financing.

When the Bank of Russia identified transactions that were conducted to hide real risk exposure, it took steps to specify banks' risk profile and exposure. To ensure the adequate recording of assets and liabilities in financial statements, preventive supervisory measures and, as necessary, enforcements were used.

The supervisor also paid attention to credit institutions' liquidity and conducted studies of the economic feasibility of raising corporate deposits at higher interest rates. The information that was received was taken into account to assess the future liquidity position and the quality of credit institutions' risk management systems.

Last year, the level of exposure to bank owner business risks was studied[16]. The data available from the Bank of Russia regional branches suggests that some credit institutions are highly exposed, including those that are systemically important. Following the studies, the supervisory process included measures to reduce the exposure to owner business risks within reasonable time limits. These efforts generally yield good results.

The Bank of Russia also paid enhanced attention to banks' operations with securities, because of the discovery of fraudulent securities and the securities portfolios of economically doubtful issuers. As it identified these in banks' balance sheet reports, it responded with corrective supervisory measures. Where fraudulent securities made up a considerable share of banks' assets and adequate reserves resulted in the actual loss of capital, the Bank of Russia took decisions on the revocation of banking licences.

To assess real foreign exchange risk and identify any signs of "constructed" hedging transactions, the supervisor analysed banks' off-balance sheet claims and liabilities. The Bank of Russia regional branches assessed the nature of transactions used by credit institutions with a net balance sheet position that was considerably in excess of 10% of capital to manage inherent foreign exchange risk. Analysis of data obtained exposed some instances with banks adjusting a net foreign exchange position on their books through forward transactions. These were entered with companies that were directly or indirectly related to bank owners or managers, which served as a ground for an additional assessment of these banks' foreign exchange risks. The results of these efforts were taken into account to improve the supervision of foreign exchange risks. Approaches to developing a system for the regulation of banks' foreign exchange risks are being discussed.

To protect the interests of depositors and creditors, the supervisor exercised additional supervision of banks demonstrating high rates of growth in deposits and setting interest rates that far exceeded those of the market. For this purpose, the Bank of Russia monitored regularly (every ten days) maximum interest rates on ruble deposits offered by ten credit institutions which attracted the largest value of personal deposits and posted the final results on its website.

Household deposits are the main source of funds for some banks and their aggressive policies to build up such deposits stem from liquidity problems, including those resulting from low asset quality. In this situation, raising household deposits will hide the real state of affaires, allowing banks to meet their current obligations. Nevertheless, these banks face increasingly larger strategic threats to their sustainability.

For this reason, the Bank of Russia defined quantitative parameters of changes to household deposits raised by banks which trigger analysis (to be performed by regional branches) of the economic feasibility of banks' policies for forming the sources of borrowed funds at the expense of such deposits. The supervisor also formulated approaches to analysis of credit institutions' interest rate policies, including asset quality assessment, and supervisory responses (Bank o Russia Letter No. 116-T, dated August 12, 2010, "On Assessing the Risks of Banks Which Actively Raise Deposits"). Supervisory action, including restrictions on the value of the interest rate, was taken against those credit institutions which extensively used such 'pyramids' to build up their businesses. These efforts allowed the Bank of Russia to suspend or arrest the growth of

[16] Bank of Russia Letter No. 04-15-6/1550, dated April 5, 2010, "On Efforts to Assess Owner-Related Banking Risks".

deposits by lowering interest rates, and draw the enhanced attention of the banks' owners to asset quality.

In 2010, banking regulation methodology was further improved, and incorporated some international approaches.

As part of efforts to increase the transparency of the banking sector, the Bank of Russia advised banks to disclose information on their capital and compliance with required ratios on the Bank of Russia website[17]. As of January 1, 2011, 930 credit institutions (92% of the total number of operating credit institutions) gave their consent to disclose these data.

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, the Credit Institution Licensing and Financial Rehabilitation Department, the Financial Monitoring and Foreign Exchange Control Department and the Main Inspectorate of Credit Institutions. The major tasks of these divisions are to provide methodological and organisational support to the Bank of Russia statutory functions of banking regulation and supervision within the framework of the entire supervisory cycle: from the licensing of credit institutions, the exercise of on-going supervision of their activities and the conduct of on-site inspections to their financial rehabilitation and the implementation of measures, if necessary, to liquidate financially unviable credit institutions.

The supervisory bloc is managed by the Bank of Russia Banking Supervision Committee, which is headed by the Bank of Russia First Deputy Chairman in charge of this area. The Committee is responsible for making decisions on banking regulation and supervision policies.

The Bank of Russia carries out its banking regulation and supervision policies through its regional establishments in the constituent entities of the Russian Federation (national banks and regional branches). As of January 1, 2011, there were 20 national banks and 59 regional branches operating in the Bank of Russia system.

INTERNATIONAL ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2010, the Bank of Russia continued its participation in the work of the Basel Committee on Banking Supervision (BCBS) and its working groups and sub-groups, by attending BCBS meetings held in March, July, September and November-December 2010. Bank of Russia representatives also took part in the activities of the following BCBS working groups: the Standards Implementation Group (operational risk, validation, and the development of standards monitoring procedures), the Policy Development Group (risk management and modeling, liquidity, the definition of capital, securitization and external ratings), the

[17] In accordance with Bank of Russia Letter No. 72-T, dated May 25, 2010, "On the Disclosure of Information by Credit Institutions Using Forms 0409134 and 0409135".

Macroprudential Supervision Working Group, and the Corporate Governance Group.

Within the framework of the BCBS Regional Group of Banking Supervisors from Central and Eastern Europe, the Bank of Russia took part in the group's annual conference, which took place in June 2010 in Macedonia. The conference discussed the lessons of the crisis and measures to strengthen the banking sector and financial stability.

Efforts were taken to draft information and materials on banking supervision for the Financial Stability Board (FSB) (as part of the cross-border crisis management group) and the G20 Group.

In 2010, FSB experts assessed the Russian financial sector's compliance with regulatory and supervisory standards in the area of international cooperation and information exchange, with the findings to be published in 2011.

As part of interaction with the International Monetary fund (IMF), the Bank of Russia took part in meetings with IMF experts within the framework of consultations on Article IV of the IMF Articles of Agreement (June and December 2010).

In addition, an IMF mission started implementing the Financial Sector Assessment Programme for the Russian Federation (stability module), with completion scheduled for the first half of 2011.

The Bank of Russia carried out interaction with the World Bank as part of the drafting of the Diagnostic Review of Consumer Protection and Financial Capability.

In 2010, the Bank of Russia, jointly with the Eurosystem (including the European Central Bank and the national (central) banks of European countries) continued to implement the EU-financed Programme of Cooperation on Banking Supervision and Internal Audit for 2008-2011.

In the process of implementing the Programme, the following documents were drafted and posted on the Bank of Russia website in 2010 as part of the banking supervision project under Basel II: a consultative paper on the prospects of applying the IRB-approach of Basel II Pillar 1 by Russian banks for supervisory purposes and relevant required measures (activity), an analytical paper on the compliance of internal credit risk management approaches of banks involved in the project with the minimum requirements of the Basel II IRB-approach. The Bank of Russia also prepared a document on the procedure for and the approaches to the implementation of Basel II Pillar 2 in the Russian Federation, which set forth a strategy for the staged introduction of this Pillar.

The Bank of Russia attaches great importance to interaction and information exchange with foreign banking supervisory authorities. In 2010, cooperation agreements (Memorandums of Understanding) were signed with the National Bank of Abkhazia, the supervisory authorities of Austria (the Federal Finance Ministry of Austria, the Austrian Financial Market Authority and the Austrian National Bank), the Financial Supervisory Authority of Norway (on supervision of Sparebank 1 Nord-Norge and its Russian subsidiary, joint stock commercial bank North-Western 1 Alliance Bank), and the Banking Regulation and Supervision Agency of the Turkish Republic. An updated Memorandum of Understanding was signed with the Financial and Capital Markets Commission of the Republic of Latvia.

In 2010, efforts were taken to agree on drat cooperation agreements (memorandums of understanding) with the banking supervisory authorities of 15 foreign countries.

In 2010, the Bank of Russia held meetings on topical issues of banking regulation and supervision with the supervisors from Austria, Hungary and Germany.

To coordinate efforts in cross-border supervision of banking groups, the Bank of Russia cooperates with foreign supervisors within the framework of multilateral supervisory colleges. Bank of Russia representatives took part in 2010 in the work of supervisory colleges for banking groups of Deutsche Bank (Germany), OTP Group (Hungary), VTB Bank (Austria), the Bank of China (China) and the Bank of Cyprus (Cyprus).

In addition, a supervisory college for VTB Group was set up (June 2010, the Bank of Russia) with the involvement of supervisory representatives from the host countries of the group's subsidiaries (Austria, Armenia, Belarus, Germany, Cyprus, Ukraine and France).

COOPERATION WITH OTHER SUPERVISORY BODIES

In 2010, the Bank of Russia developed cooperation with agencies, regulators and supervisors of financial markets within the framework of inter-agency agreements and arrangements that were reached with the Ministry of Finance, the Federal Financial Market Service, the Federal Insurance Supervision Service, the Federal Anti-Monopoly Service, the Federal Tax Service, the Federal Customs Service and other agencies.

STATISTICAL TABLES

Number of financial institutions
(at year-ends, %)

Type of financial institution	2008	2009	2010
Banks	1058	1007	955
Non-bank credit institutions	50	51	57
Banking sector total	**1108**	**1058**	**1012**

Share in Aggregate Banking Sector Registered Authorized Capital (%)
(at year-ends)

Type of financial institution	2008	2009	2010
Russian credit institutions including:	76,0	78,8	75,9
- public sector ownership	24,9	32,8	29,5
- other domestic ownership	51,1	46,0	46,4
Foreign-controlled banks (banks with non-resident interest in excess of 50%)	24,0	21,2	24,1
Banking sector total	**100,0**	**100,0**	**100,0**

Share in Aggregate Banking Sector Assets
(at year-ends, %)

Type of financial institution	2008	2009	2010
Russian credit institutions including:	81,3	81,7	82,0
- credit institutions controlled by state	38,0	40,4	41,0
- credit institutions controlled by residents	43,3	41,4	41,0
Foreign-controlled banks (banks with non-resident interest in excess of 50 %)	18,7	18,3	18,0
Banking sector total	**100,0**	**100,0**	**100,0**

Credit Institutions Asset Concentration
(Share in assets, %)

Type of credit institutions	Three largest credit institutions (by assets)			Five largest credit institutions (by assets)		
	2008	2009	2010	2008	2009	2010
Banks	40,8	41,9	41,8	46,5	48,1	47,9
Non-bank credit institutions	93,4	87,3	86,2	95,2	90,1	89,9
Banking sector total	**40,5**	**41,7**	**41,6**	**46,2**	**47,9**	**47,7**

Return on Assets (ROA) of credit institutions
(at year-ends, %)

Type of financial institution	2008	2009	2010
Banks	1,8	0,7	1,9
Non-bank credit institutions	1,9	2,2	2,2
Banking sector total	**1,8**	**0,7**	**1,9**

Return on Capital (ROE) of credit institutions*
(at year-ends, %)

Type of financial institution	2008	2009	2010
Banks	13,3	4,8	12,5
Non-bank credit institutions	57,6	50,8	31,2
Banking sector total	**13,3**	**4,9**	**12,5**

*Calculated as the ratio of the current years balance sheet profit to the average chronological value of assets (capital) over the accounting period

Share in Aggregate Banking Sector Assets
(at year-ends, %)

Type of financial institution	2008	2009	2010
Banks	99,32	99,64	99,61
Non-bank credit institutions	0,68	0,36	0,39
Banking sector total	**100,00**	**100,00**	**100,00**

Structure of Credit Institutions' Assets
(at year-ends, %)

	Type of financial institution	2008	2009	2010
1.	Money, precious metals and gemstones	3,0	2,7	2,7
2.	Account with the Bank of Russia	7,4	6,0	5,4
3.	Correspondent accounts with banks	4,4	2,9	2,5
4.	Securities acquired by banks	8,4	14,6	17,2
	of which:			
4.1.	Russian Federation sovereign debt securities	0,9	2,6	3,5
5.	Loans	71,2	67,5	65,6
6.	Other assets	5,6	6,3	6,6
	Total assets	**100,0**	**100,0**	**100,0**

Structure of Credit Institutions' Liabilities
(at year-ends, %)

	Type of financial institution	2008	2009	2010
1.	Banks' funds and profits	11,1	12,8	12,8
2.	Loans received by banks from the Bank of Russia	12,0	4,8	1,0
3.	Bank accounts	1,2	0,9	0,8
4.	Loans, deposits and other funds received from other banks - total	13,0	10,6	11,1
5.	Clients funds	52,6	58,2	62,4
	of which:			
5.1.	Deposits of legal entities	31,3	32,5	32,9
5.2.	Individuals deposits	21,1	25,4	29,0
6.	Debt obligations issued	4,0	3,9	3,9
7.	Other liabilities	6,0	8,7	8,0
	Total liabilities	**100,0**	**100,0**	**100,0**

Development of Off-balance Operations
(off-balance sheet positions/balance sheet assets (liabilities))
(at year-ends, %)

Type of financial institution	2008	2009	2010
Banks	21,52	17,96	18,41
Non-bank credit institutions	2,63	0,00	0,00
Banking sector total	**21,39**	**17,90**	**18,34**

Capital Adequacy Indicator
(at year-ends, %)

Type of financial institution	2008	2009	2010
Banks	16,8	20,9	18,8
Non-bank credit institutions	37,2	103,8	85,4
Banking sector total	**16,8**	**20,9**	**18,8**

Quality of Banking Sector Loan Portfolio
(at year-ends, as % of total loans)

Type of financial institution	2008	2009	2010
Standard loans	51,3	42,5	45,5
Non-standard loans	35,2	38,0	34,7
Doubtful loans	9,9	9,8	11,4
Problem loans	1,8	3,5	2,9
Bad loans	1,8	6,2	5,4
Loan loss provisions	**4,5**	**9,3**	**8,8**

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 2010
(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*	3,8	1,2
Legal entities	23,5	58,9
Individuals	46,9	18,7
Banks	8,2	7,7
Non-residents **	17,7	13,5
Total	100,0	100,0

* Including the Bank of Russia
** Including banks and other legal entities and individuals

Deposit and loan structure in 2010*
(at year-ends, %)

Loans, deposits and other funds raised by credit institution		Loans, deposits and other funds provided by credit institutions	
On demand	1,7	Long-term (over 3 years)	41,0
Less than 1 year	33,3	Mid-term (1-3 years)	25,8
Over 1 year	65,0	Short-term (less than 1 year)	33,2
Total	**100,0**	**Total**	**100,0**

* Excluding overdue debt,

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		
	2008	2009	2010	2008	2009	2010
Banks	32,3	27,7	24,2	28,4	25,3	22,8
Non-bank credit institutions	29,4	4,3	6,3	27,0	4,2	6,2
Banking sector total	32,3	27,6	24,1	28,4	25,3	22,7

Structure of Incomes and Expenses of Operating Credit Institutions (at year-ends, %)

	2008	2009	2010
1. Incomes, total	**100,0**	**100,0**	**100,0**
1.1. Interest income on funds provided to legal entities (without income on securities)	8,4	6,0	7,1
1.2. Interest income on loans to individuals	3,1	1,9	2,7
1.3. Incomes on securities	3,5	3,3	3,3
1.4. Incomes on operations with foreign exchange	62,3	72,0	62,5
1.5. Commissions received	2,8	1,5	2,3
1.6. Loss provisions recovery	12,8	11,5	18,2
1.7. Other incomes	7,1	3,9	3,9
of which:			
1.7.1. penalties, fines, forfeits	0,16	0,17	0,45
2. Expenses, total (without income tax)	**100,0**	**100,0**	**100,0**
2.1. Interest expenses on funds raised from legal entities (without expenses on securities)	3,7	3,0	2,8
2.2. Interest paid to individuals	2,0	1,5	2,6
2.3. Expenses on operations with securities	3,6	2,2	1,8
2.4. Expenses on operations with foreign exchange	62,4	71,9	64,0
2.5. Commissions paid	0,4	0,2	0,3
2.6. Expenses on loss provisions	15,8	14,9	19,7
2.7. Management expenses (including personnel expenses)	3,9	2,0	3,3
2.8. Other expenses	8,3	4,4	5,7
of which:			
2.8.1. Penalties, fines, forfeits	0,01	0,00	0,01

Structure of the Registered Authorized Capital and Equity Capital of Credit Institutions in 2010

Type of credit institution	Registered capital	/Total assets	Own funds	/Total liab.
	Mill. EUR	%	Mill. EUR	%
Banks	29 318,5	3,5	116 987,7	14,0
Non-bank credit institutions	91,1	2,8	331,4	10,2
Banking sector total	29 409,6	3,5	117 319,1	14,0

2010 DEVELOPMENTS IN THE SERBIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Though the spill-over of the global economic crisis to Serbia in 2009 led to a 3.5% contraction of its gross domestic product, tentative signs of recovery cropped up in 2010, but the level of macroeconomic movements did not reach pre-crisis level. According to the estimate of the Republic Statistical Office, the GDP growth in 2010 was 1.8%. The expected real economic growth for 2011 is 3%, mainly due to the better agricultural performance and high growth of processing industry.

In line with the Agreement on Inflation Targeting, which was concluded between the National Bank of Serbia (NBS) and the Government of the Republic of Serbia on 1 January 2009, the implementation of inflation targeting continued to be official monetary policy strategy in 2010. According to this Agreement, the estimated CPI index for 2010 is 6 ± 2%. In the first half of 2010, the consumer price growth was below the lower limit of the tolerance band, but it exceeded the target in the second half of the year. In October 2010, for the first time since the NBS began to target headline CPI inflation, y-o-y inflation overshot the upper bound of the target tolerance band. The growth persisted over the next two months and reached 10.3% by end of the year (vs. 6±2% target) and the core inflation reached 8.8%.

The NBS continued to implement monetary policy under a managed floating exchange rate regime in 2010. In terms of the analytical basket of currencies (euro and dollar), the dinar depreciated in 2010 by 10.5% and 3.1% in nominal and real terms respectively. In order to prevent high depreciation of the dinar, the NBS intervened in the Interbank Foreign Exchange Market by selling total 3.07 billion EUR, most of it in May, June and December.

In 2010, average wage growth reached 7.5% in nominal terms, but average wages declined 3.5% in real terms. The recession also reflected in the employment numbers, which continued down. Official statistics signal a further decline in employment numbers (by 86,000 persons or 4.6%), and the number of unemployed persons was 730,000 in 2010.

Serbia's public revenue for 2010 reached RSD 712.2 billion while RSD 812.5 billion were recorded on the expenditure side, so fiscal deficit equaled RSD 100.2 billion (3.4% of GDP). Share of public debt in GDP was 42.2%.

Current account deficit in Serbia was cca EUR 2.08 billion in 2010, which was reflected in current account deficit to GDP ratio of 7.2% and there was not any significant changes comparing to the level of 2009.

Year-end 2010, total foreign exchange reserves were EUR 11.7 billion, of which NBS foreign exchange reserves were EUR 10 billion.

Dinar-denominated reserve money reached RSD 188.2 billion by end-2010, down by 26% from end-2009, which reflects restrictive monetary policy in 2010. At end-2010, money supply M1 reached RSD 253.3 billion, up by 2% in nominal terms from end-2009 (decline of 11.1% in real terms). Money supply M2 equaled RSD 410.5 billion, up by 6% in nominal terms (decline of 14.8% in real terms).

The main challenges in 2011 relate to unemployment, fiscal and foreign trade deficit.

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

The banking sector, as the largest portion of the financial system of Serbia, successfully overcame spill-over of the effects of the global financial crisis. That was not only result of previously formed liquidity and solvency buffers, but also of timely support of parent banks and adequate measures of the NBS. Also, measures of the government of Republic of Serbia for alleviating negative effects of the global financial crisis in Serbia, have largely contributed to the stability and maintenance of confidence in the banking sector.

At the end of 2010, there are 33 banks operating in Serbia – 21 banks are in majority foreign ownership, 4 banks are in majority ownership of domestic natural persons and legal entities, while 8 banks are in majority ownership of the Republic of Serbia.

During 2010, few changes in banking sector's ownership structure have happened. Following acquisition by NKB banka Maribor from Slovenia, Credy banka switched from the category of state-owned to the category of foreign-owned banks. Following recapitalization by insurance company Dunav Osiguranje, Kosovsko-Metohijska banka Zvečan became a state-owned bank (previously privately-owned bank), while Metals banka Novi Sad had its capital increased by AP Vojvodina and DDOR Novi Sad so its majority owner became the Republic of Serbia. Banka Poštanska štedionica Beograd took over Privredna banka Pančevo.

Banking sector total balance sheet assets growth rate was 17.3% in 2010 together with RSD depreciation rate of 10%.

The nominal growth of banks' total credit activity (granted loans and deposits), that significantly reduced in 2009 (12.4% nominal growth), has accelerated in 2010 and amounts to 35.9%. The growth of loans to households and to enterprises is around 25%. To a significant extent, the growth of lending activity is a result of the government's stimulatory program (which is implemented through subsidized loans for liquidity and consumer loans as well as for investment loans, offered by banks) and measures introduced by NBS which are implemented mostly through changes in Decision on classification of balance sheet assets and off-balance sheet items.

At the end of 2010, the share of NPL's in total loans granted was 9.84% net (16,92% gross), while in absolute terms, their level reached EUR 1,370 million net.

Deposits recorded growth of 15.6% in 2010, mostly because of a growth in households' deposits (26.3% in 2010), whose share in the total bank funding sources amounts to 31.3% at the end of 2010. At the end of 2010 total FX household saving reached 7.1 bills. EUR (1,1 bill EUR more than in 2009).

Also, banks recorded growth in own funding sources (11.3% in 2010) which resulted in still high proportion of own fund to total liabilities side of balance sheet (19,7%).

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

Activities of National Bank of Serbia, as supervisor and regulator, in 2010 were with the aim of, on the one hand, obtaining and maintaining stability of banking sector and whole financial system, and on the other hand, amendments and supplements of existed regulatory framework modified according to macroeconomic environment and international standards of supervision.

The Law on Banks has been amended and supplemented to widen the set of central bank's instruments for dealing with crisis situations, to create additional legal grounds for enacting secondary legislation harmonized with Basel 2 standards and to remove deficiencies detected in the implementation of the Law.

The most important changes concerning introduction and implementation of receivership in a bank, the reasons and procedure for license revocation, the establishment of a bridge bank onto which a part or total assets and liabilities of a bank whose operating license has been revoked are transferred and the provisions regarding voluntary liquidation of a bank.

To widen the scope for the enactment of secondary legislation harmonized with Basel 2 standards, the grounds for issuing secondary legislation regarding the manner of calculating a bank's capital and capital adequacy ratio are supplemented in the sense that the NBS may now prescribe the terms and conditions for granting consent to the manner of calculating the bank's capital and capital adequacy ratio (i.e. for the use of different approaches, as well as for recognizing the eligibility of rating agencies) – pillar 1. The scope of authority of the bank's board of directors, executive board and audit committee is amended to accommodate the concepts of pillar 2 and to align the competences of the governing bodies accordingly (risk management strategy and policies, capital management policy). The Law further obligates banks to disclose data and information regarding their risk management strategies and policies, their capital and capital adequacy (pillar 3).

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2010

Finalizing of preparation for full implementation of Basel II standards is strategically important activity for Bank Supervision Department and the whole NBS in 2011. In 2010 the Working group for implementation Basel II standards prepared and officially presented to commercial banks drafts of the following bylaws:

- Decision on capital adequacy of banks, which implements Pillar 1 of Basel II;
- Decision on risk management of banks, which implements Pillar 2 of Basel II;
- Decision on disclosure of banks, which implements Pillar 3 of Basel II;
- Decision on supervision of banking group on consolidated level and

- Decision on capital adequacy reporting.

In the second half of 2010 and during 2011 the NBS has continued to amend and improve text of regulations. The changes were results of adjustment to newly changes in relevant EU regulation, as well as to take into account suggestions and comments of commercial banks, that actively participate in drafting of regulations. The final text of regulations was officially published in June 2011. The date of full implementation of new the regulation is 31 December 2011.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

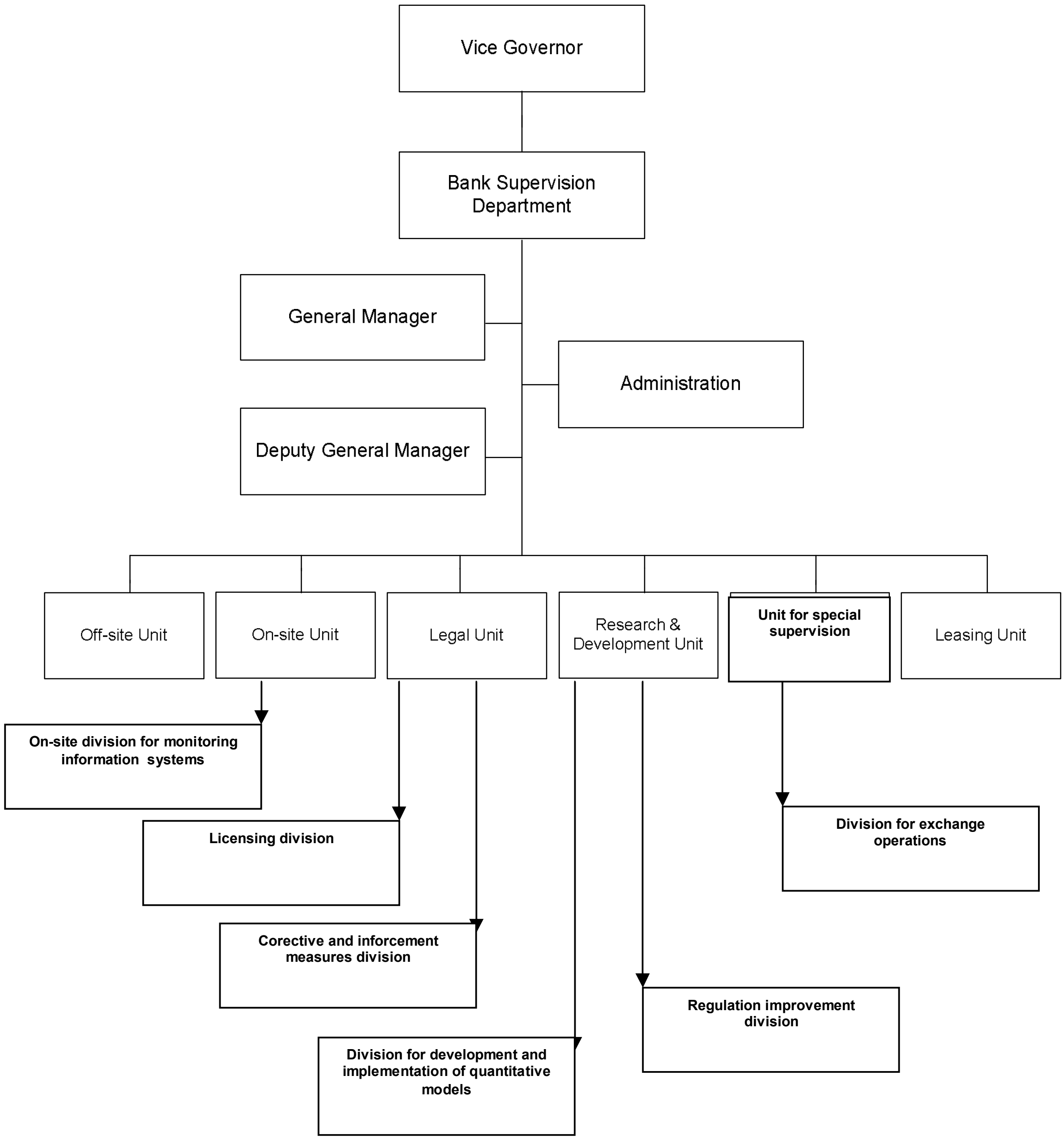
In 2010 the NBS continues to implement Financial Stability Support Program (FSSP) as a part of the IMF arrangement. Special measures of support are defined for those banks that meet prescribed conditions of the Program (25 out of 33 banks in total). Namely, in relation to the arrangement with the IMF, the National Bank of Serbia drew up special facilities tending to enable continuous access to sources of dinar and foreign exchange liquidity, to stabilize the forex market and maintain the quality of bank assets, as well as to reduce the outflow of foreign exchange and alleviate depreciation pressures.

Parent banks exposure limit toward Republic of Serbia has been decreased to 80% of December 31, 2008 level starting from April 2010. Previous limit was set at 100% of the December 2008 exposure. During 2010 parent banks exposure was stable. Total net exposure at the end of 2009 was 8,76 bill. EUR (8,17 bill.EUR without Raiffeisen bank) and at the end of 2010 7,96 bill. EUR (from July Raiffeisen bank was no longer participant of the FSSP).

The Financial Stability Support Program (FSSP) ceased to be effective as of 1. January 2011.

To estimate banking system's capability to preserve adequate solvency level in case of adverse macroeconomic trends the NBS regularly conducts stress tests. The last stress tests (September 2010) have shown adequate level of banking sector capital adequacy with no emergency recapitalization needs.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

The National Bank of Serbia, besides signed ten Memorandums of Understanding with foreign supervisory authorities and two multilateral agreements in previous period, is in the process of negotiating MoUs with FMA (Austrian supervisory authority), BaFin (Germany) and the Autorité de Contrôle Prudentiel (France), but has already established very successful cooperation with those supervisory authorities, since those authorities supervise parent banks that have its subsidiaries in Serbia.

Beyond signing Memorandums of Understandings, cooperation extended through:

- Participation at Supervisory Colleges organized by competent authority in Italy, Austria, Slovenia, Hungary, Greece and Belgium,
- Cooperation with foreign supervisory bodies (Croatian National Bank and Bank of Slovenia in preparation of Basel II related regulations),
- Participation in joint on-site exams,
- Sharing of information connected with granting the consent on appointment of members of Board of Directors and Executive Board of banks.

COOPERATION WITH OTHER SUPERVISORY BODIES IN SERBIA

Cooperation with other supervisory bodies in the country was already established. The NBS has signed Memorandums of Understanding with following domestic bodies and institutions:

- Association of Serbian Banks
- Deposit Insurance Agency
- Tax Administration of the Republic of Serbia
- Securities Commission
- Belgrade Stock Exchange
- Commission for Protection of Competition
- Administration for the Prevention of Money Laundering

The NBS successfully cooperates with all before mentioned supervisory authorities whenever there is a need for sharing information in accordance with MoUs signed.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

Given the scope and complexity of all duties that are expected from the NBS as banks` supervisor, activity at strengthening and improvement of supervisory capacity are currently in the course. Namely, the Bank Supervision Department was in 2010 in process of preparing comprehensive reorganization of all operations and activities and selection of new trainees. There is also continues process of employee’s training and education, mostly through the participation in international seminars.

Employees in Supervision Department were participants of two-year programme of the European Central Bank „Strengthening Macro and Micro-prudential Supervision". In 2010, program comprised micro-prudential supervision, macro-prudential supervision, home-host cooperation and regulation.

NBS has also continued cooperation with the ECB under the project "Strengthening of the Institutional Capacities of the National Bank of Serbia", approved from the EU Instrument for Pre-Accession Assistance (IPA). The aim of the project is to strengthen the institutional capacities and efficiency of the NBS. The project deliverables in the form of strategies, internal policies and economic models will allow the NBS to meet EU central banking standards.

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	34	34	33
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**34**	**34**	**33**

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

Type of financial institution	2008	2009	2010
Public sector ownership	16.0	17.5	17.9
Other domestic ownership	8.7	8.2	8.6
Domestic ownership total	24.7	25.7	26.5
Foreign ownership	75.3	74.3	73.5
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	31.4	45.1	629
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**31.4**	**45.1**	**629**

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

Type of financial institution	2008	2009	2010
Commercial banks	9.3	4.6	5.4
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**9.3**	**4.6**	**5.4**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions			
Cooperative banks			
Other			
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2008	2009	2010
Financial sector*	12,1	13,1	10,8
Nonfinancial sector**	54,7	50,7	54,1
Government sector***	2,4	7,8	11,0
Other****	30,8	28,4	24,1
Liabilities	**2008**	**2009**	**2010**
Financial sector	18,1	18,0	19,0
Nonfinancial sector	42,0	43,4	44,0
Government sector	4,2	3,8	3,2
Capital	23,6	20,7	19,7
Other	12,1	14,1	14,1

*Central banks, banks (domestic and foreign), insurance, leasing, voluntary pension fund and other fin.institution
** Enterprises and households, entrepreneurs and private housing with employed persons and registered farmers
*** Public enterprises and public sector
**** Foreign persons and other, including assets without sectorial structure (cash, fixed assets…)

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks*	21.9	21.4	19.9
Cooperative banks			
Banking sector, total:	**21.9**	**21.4**	**19.9**

(* - for Basel I; ** - for Basel II)

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

Asset classification	2008	2009	2010
Non financial sector			
- households	7,15	8,94	9,15
- corporate	14,97	20,88	21,85

The structure of deposits and loans of the banking sector in 2010 (%) (at year-end)

	Deposits	Loans
Households*	58,8	35,6
Government sector**	4,7	8,3
Corporate***	22,7	52,6
Other (excluding banks)****	13,8	3,5
Total	**100.0**	**100.0**

* Households, entrepreneurs and private housing with employed persons and registered farmers
**Public enterprises and public sector
***Enterprises
****Foreign persons, other financial institutions and other

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

P&L account	2008	2009	2010
Interest income	157,046	168,918	179,702
Interest expenses	61,855	68,393	71,315
Net interest income	95,191	100,525	108,387
Net fee and commission income	30,639	31,594	32,985
Other (not specified above) operating income (net)	22,460	17,947	17,439
Gross income	148,290	150,065	158,811
Administration costs	79,992	85,610	92,229
Depreciation	7,477	8,320	8,588
Provisions	0	0	0
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	26,082	36,110	32,596
Profit (loss) before tax	34,739	20,025	25,398
Net profit (loss)	32,104	17,696	22,622

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	3.857.596	4.317.099	853.320	0
Cooperative banks				
Banking sector, total:	**3.857.596**	**4.317.099**	**853.320**	**0**

2010 DEVELOPMENTS IN THE SLOVAKIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2010, the growth of the domestic economy was restored, what helped to stabilize the financial position of (parts of) non-financial enterprises. However, this revival was not displayed significantly in household income yet. The positive thing is the relatively short duration of the recession, compared with other euro zone economies. Despite of the difficult conditions, the functioning of the financial system in Slovakia was stable.

Real GDP grew in 2010 by 4% year on year. Low inflation, which was negative in the first months of the year, however, increased during the year. Restore of business confidence, together with the growth in corporate profitability was reflected in increasing investment demand. The credit activity to non-financial enterprises was also restored. The current account deficit fell slightly to 3.5% of GDP, maintaining the trade surplus. The level of private sector debt to foreign countries also decreased, where increasing of domestic economy's debt was determined by the public sector development. Gross external debt at the end of 2010 amounted to 74.8% of GDP. The share of short-term debt to total gross external debt decreased to 55.1%. Government deficit in 2010 was also very high and reached level of 7.9% of GDP, while public sector debt rose further. The introduction of the euro led to outflows of short-term deposits of non-residents from the accounts in banks in Slovakia.

During the crisis of confidence in sovereign states, Slovakia maintained the confidence of markets, and due to this reason it was financed under relatively favourable conditions and the government bond spreads development was not significantly adversely affected. Major rating agencies rated Slovakia at the level A + with the stable outlook.

DEVELOPMENT IN THE BANKING SYSTEM

Whereas 2009 was a year of crisis for the Slovak banking sector, 2010 can be viewed positively. This was apparent in several areas. First, banks strengthened their financial position. The profitability of the banking sector as a whole doubled in comparison with the previous year, although there continue to be relatively substantial differences between individual banks. The profitability growth was driven mainly by rising income from retail operations. Banks profited from the increase in lending and also from falling deposit costs. There was also growth in income from investments in debt securities, largely due to the increase in their volume. The growth in profits was most pronounced in the banking sector, which recovered from a substantial slump in profits in 2009. However, the level of profitability in 2010 remains far below the level in 2008.

In the banking sector, however, asset growth picked up again in 2010. Even so, asset growth in the banking sector remains far below the levels recorded from 2005 to 2008. The share of the assets of banking sector total to the GDP represented 83.06% to the end of year 2010. Banking sector comprised 75.2% of the whole financial market as at 31 December 2010.

A relatively new trend in the banking sector is the slight increase in the amount of non-resident deposits and in their share of total funds. Whereas it was foreign banks that increased their deposits in Slovak banks in the pre-2008 period, it was foreign non-bank customers that did so 2010. This change occurred mainly in the second half of the year.

Nevertheless, the financial sector reported growth, largely due to the increase in the financial assets and liabilities of Slovak households. Another positive aspect is that activity in the financial sector was at the same time not dependent on the supply of liquidity from the Eurosystem.

The degree of interconnection between the domestic financial and corporate sectors continued its trend decline in 2010. This was the case in both claims and liabilities of the corporate sector. The underlying trend is that the rest of the world has a gradually rising share of firms' total financial liabilities. There is a related drop in the extent to which domestic banks and leasing companies are lending to firms.

The improving economic position of households and firms was also reflected in a drop in costs related to the impairment of loans provided to these sectors. Loan-loss provisioning costs declined, particularly in comparison with 2009, but the extent of provisioning remains high compared to its pre-crisis level.

Banks also increased the amount of own funds earmarked for the coverage of unexpected losses. However, the overall capital adequacy ratio fell slightly in 2010, as lending to households picked up.

In 2010, the domestic banking sector became more heavily oriented on the household sector. The relatively sharp increase in new lending was most pronounced in housing loans. In the case of loans to households, the risk level eased as the financial position of households generally became stronger. It is positive for the stability of the banking sector that the amount of household financial assets deposited in banks continues to exceed the amount of loans that banks extend to households.

The amount of corporate financing provided by the domestic banking sector remained relatively flat in 2010 and only to a small degree reflected the economic recovery. On the positive side, the annual rate of change in the amount of loans stopped declining and recorded an increase in the last months of 2010.

While corporate lending stagnated, banks' investments in securities increased, with this trend being particularly marked in the first half of the year. There was growth in investments both in domestic government bonds and in foreign debt securities (where government bonds have the largest share)

Although 2010 brought about preconditions for an easing of credit risk in several segments of the corporate sector, the level of this risk in the Slovak banking sector remained significant, owing to the size of banks' exposures to firms, the relatively heavy concentration of loans and the high sensitivity of firms to macroeconomic developments.

The most significant of the market risks in the banking sectors is the risk of the effect of interest rate movements on the banking book.

The stability of the Slovak banking sector in 2010 was also confirmed by the results of stress testing. The sector as a whole reported stability in both stress scenarios.

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

General rules of procedure for financial market supervision in the area of banking, capital markets, insurance and pension savings, which is conducted by the National Bank of Slovakia, are established by the Act No. 747/2004 Coll. on Supervision of the Financial Market and on amendments to certain laws as amended.

The last amendment to the Act on Supervision of the Financial Market has resulted in changes to the Organizational Rules of the National Bank of Slovakia related to the Financial Market Supervision Unit (hereinafter "Supervision Unit"). From the 1st July 2010 is the Supervision Unit managed by the Executive Director of the Financial Market Supervision Unit and consists of three departments. One of the aims of the organizational change was that the new structure of the Supervision Unit reflected the structure of the supervision at the European level, the newly established European System of Financial Supervision. Particular areas of activity that Supervision Unit practiced in its management scope are linked to each other and together form one whole.

Considering the openness of the Slovak financial market, the active cooperation of the Supervision Unit with the regulators of other states as well as European institutions is essential, particularly in the form of mutual communication, exchange of information, experience and knowledge both on the European and the regional level.

In accordance with the Act on Financial Market Supervision, the Supervision Unit performs on-site and off-site supervision, manages proceedings and decides at the first instance as well as prepares drafts of generally binding regulations of the National Bank of Slovakia in the area of the financial market, in particular proposals for setting of prudential rules for safe operation and other requirements for the business of supervised entities.

Supervision Unit also focuses on early identification of risks of individual supervised entities, resulting from the activities carried out, as well as on the identification of the risks of the financial market as a whole. Each supervised entity is evaluated in terms of exposure to risks as well as from the perspective of established systems which manage these risks. Scope and focus of the supervision for the individual supervised entities is based on the assessment of their risk profile, applying the principle of the proportionality, taking into account the size of the entity, scope and complexity of the performing activities and the significance of the entity for the financial sector stability.

MAIN STRATEGIC OBJECTIVES IN 2010

The strategic objective of supervision of the financial market in Slovakia is to contribute to the stability of the financial market as a whole, as well as to its safe and smooth operation, in the interest of maintaining the credibility of the financial market, the protection of customers, and compliance with the rules of competition.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

Regulatory and Methodology area

In 2010, the Supervision Unit cooperated on drafting amendments to laws regulating the financial market environment in the Slovak Republic and issued a number of generally binding regulations governing the mentioned area.

In the area of banking it can be mentioned dealing with the problem of the credit risks calculation in banks by the expected loss models, respectively the creation of a legal framework for rational and efficient functioning of the consumer credits providing market in a harmonized internal market of Community by the Act on Consumer Credits and Other Credits and Loans for Consumers.

In 2010, the Green Paper on pensions was published by the European Commission in the area of retirement savings, to which NBS prepared a joint statement with the Ministry of Finance and the Ministry of Labour, Social Affairs and Family.

A recast version of Act on Collective Investment was prepared in cooperation with the Ministry of Finance in the area of securities market and NBS participated in the work related to AIFM and attributed to the work on PRIPs within the CESR and the Council of the EU.

In the area of insurance an intensive work proceed on the Solvency II project. One of the most important tasks in this project was to prepare the implementing regulations. In order to identify the impact of Solvency II on insurance undertakings, a quantitative impact study QIS 5 as well as an analysis of preparedness of insurance undertakings for a new regulatory capital requirements and requirements laid on the administration and management system of insurance undertakings were realised.

The Act on Financial Intermediation and Financial Counseling which entered into force in the 2010 in the field of financial intermediation, introduces a new system of intermediation and counseling regulation throughout the whole financial sector. Within the implementation of this Act into practice, the Supervisory Unit issued the methodological materials and implementing regulations with aim to help a smooth transition to the new regulation. During 2010, a system of organization of professional examinations and professional examinations with the certificate was put into practice too.

Area of banking supervision, supervision of the payment services provisioning and foreign exchange activity supervision

In this area, the Supervisory Unit issued in 2010 together 173 first instance decisions, of which 150 were administrative decisions related to area of banking. The largest part of the proceedings in this field (117 decisions) was to grant prior approvals to change the members of the board of directors, supervisory board, managers and authorised representatives.

Supervision performance schedule in banks was based on the assessment of risk profile of the individual supervised banks, as well as on the impact of financial and economic crisis on the banking sector and the resulting banking sector's main risks. The main priorities for the supervision performance in 2010 were therefore monitoring of credit risk, credit portfolios of banks, banks' liquidity and intra-group transactions.

In a given year, eight thematic on-site supervisions and two follow-up supervisions were started in banks, seven of which were formally completed by the end of 2010. In 2010, they were also submitted three requests for prior approval to use internal model for capital requirements calculation. Process of models assessment had been carried out and a joint decision with the supervisors of the parent banks was reached by the end of 2010. During 2010, nine applications for assessment of changes in models to calculate capital requirements for different types of risks were also submitted, two requests of which related to the change of internal model for operational risk calculation by the advanced approach, and seven applications for change in internal ratings based approach for credit risk measurement.

Area of supervision of insurance, pension savings and financial intermediation

In this field of supervision the Supervision Unit issued 369 first instance decisions in 2010. In the area of insurance, proceedings were conducted mainly in connection with the prior approvals to select a person to a board of directors' member, to amend a permission (extension) to conduct insurance business, to conduct reinsurance business and entry in the list of actuaries.

In the field of financial intermediation, proceedings related primarily to the granting a permission to operate as an independent financial agent, respectively as a financial adviser and to amend the authorization granted.

In the field of pension savings, proceeding were focused mainly to the change of the pension fund' statute, the prior approval for the election of a person proposed for a member of the Supervisory Board and prior approval to change the benefit plan.

In 2010, nineteen on-site supervisions were carried out together in regulated entities of the financial market in the area of the insurance, pension savings and financial intermediation, sixteen supervisions of which were aimed comprehensively. Comprehensive on-site supervisions in the insurance undertakings were focused to control of all the areas of activity, such as insurance contracts' administration, adjustment of insurance claims, creation and placement of technical provisions and accounting. On-site supervisions in the area of financial intermediation had been focused on the compliance with general binding regulations valid for the financial intermediation performance in Slovakia in the insurance or reinsurance sector and were based on on-site supervisions schedule, on clients' initiative and the requirements of other specialized units of the NBS.

Area of supervision of securities market and collective investment

229 first instance decisions were issued in this area in 2010, where majority of decisions in the collective investment sector related to the proceedings conducted in connection with the prior approval to change the statute of open-ended mutual fund, respectively specialised mutual fund, to the election of supervisory board member of the management company and to an authorization to create a mutual fund.

In the investment firms area, proceedings were conducted in particular in relation to the granting of the prior approval for the election of the board of directors' member and for the acquisition of qualifying holding in an investment firm; decisions issued in the area of public offer of securities concerned in particular the approval of securities prospectuses for mortgage bonds and the most of decisions in the area of takeover bids was related to the approval of the draft of mandatory takeover bid of issuer's shares.

In the field of securities market, eight on-site supervisions were carried out in 2010, seven of which were comprehensive - four on-site supervisions were carried out in investment firms and three on-site supervisions in management companies. In 2010, Supervision Unit performed also the supervision of the implementation of information obligations of issuers whose securities were admitted to trading on a regulated stock exchange market, within the off-site supervision.

Analytical activity of the Supervision Unit

Analytical work was performed at different levels of the organizational structure of the Supervision Unit in 2010. A significant part of it was the analytical work from the macro-prudential point of view, with the main output - the Slovak financial sector analysis, prepared on the semi-annual basis. Prepared analyses were focused mainly on the identifying the medium and long term risks for the financial sector' stability. This principle, within the macro-prudential analyses, is based on the detailed knowledge of the whole financial sector and individual institutions, as well as on the monitoring and analyzing trends and risks in the real economy and in the financial markets. Knowledge and connections of these areas enables early identification of threats for the Slovak financial sector stability. The focus of the thematic analysis reflected the recent developments in the financial markets and economies, particularly in terms of their impact on the financial sector stability.

Area of consumer protection

Financial Clients Protection Section, as the part of the Supervision Unit, is involved to the consumer protection area (its role in protecting of financial consumers is given by the wording of the National Bank of Slovakia Act and the Act on Supervision of the Financial Market), and handles submissions from customers of financial institutions that are subject of supervision of the National bank of Slovakia. In 2010, the Supervision Unit received a total of 799 complaints from the legal and natural persons, who were dissatisfied with the procedure of the financial service providers, and managed to settle 738 of them in that year, what represents 92.36% of managed submissions. The highest number of submissions (354) concerned the insurance sector (in particular the questions regarding the claims from compulsory Motor Third Part Liability insurance and the Unit linked insurance) and the banking sector (281 submissions), with the most often complains related to the change in fees and the interest rate policy of banks. In other areas, the most frequent subject matter of complaints were: in the capital market - remuneration for the provided services, in the field of supplementary pension savings - the amount of severance pay and in financial intermediation area - the method, scope and quality of information providing.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

- **Financial Market Supervision Unit**
  - BANKING AND PAYMENT SERVICES SUPERVISION DEPARTMENT
    - Licensing Section
    - Supervision of Banks with Advanced Risk Approach Section
    - Supervision of Banks with Standardized Risk Approach, Payment Services and Foreign Exchange Supervision Section
    - Enforcement Section
  - SECURITIES MARKET, INSURANCE AND PENSION SAVINGS SUPERVISION DEPARTMENT
    - Licensing Section
    - Securities Market and Pension Savings Supervision Section
    - Insurance, Financial Intermediation and Financial Advisory Supervision Section
    - Enforcement Section
  - REGULATION AND FINANCIAL ANALYSES DEPARTMENT
    - Banking and Payment Services Regulation Section
    - Securities Market and Pension Savings Regulation Section
    - Insurance Regulation Section
    - Macro-prudential Analyses Section
    - Financial Models and Information Support Section
    - Financial Clients Protection Section

INTERNATIONAL ACTIVITIES

In 2010, the Supervision Unit actively participated in creating a legal environment which allow the constitution of new regulatory bodies of the European Union on the macro and micro level from the 1st January 2011, particularly the European System of Financial Supervision, consisting of the European Systemic Risk Board and the European supervisor authorities for the area of banking, insurance and occupational pensions, and the securities and markets. The Supervision Unit of NBS collaborated with the Ministry of Finance on the stand of the Slovak Republic to the draft of European legislation regarding the new structure of supervision at the European level and employees of the Supervision Unit were involved in the discussions of working groups for financial services at the European Council. In addition, intensified cooperation and coordination within the groups V-4, V-6, respectively V-10 was realized on the senior management level.

Part of the activities of the Financial Market Supervision Unit is also the cooperation with the supervisory authorities of other countries, especially with the supervisors of the parent banks and insurance undertakings whose subsidiary banks, respectively insurance undertakings, are located in the Slovak Republic. Cooperation between supervisors is realized on a bilateral as well as on a multilateral level. In recent years, it was mainly colleges of supervisors for banking groups, respectively insurance groups. The Supervision Unit is a member of the eleven colleges of supervisors, nine of which are for banks and 2 for branches of foreign banks and a member of the eleven colleges of cross-border supervision of insurance groups in the EU.

In connection with the NBS obligations in relation to the international organizations, European Central Bank, EU committees etc., the staff of the Supervision Unit regularly participate in discussions of the various committees and established working groups.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY.

There are no other supervisory bodies supervising regulated entities of the Slovak financial sector, with the exception of the National bank of Slovakia.

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	17	15	15
Branches of foreign credit institutions	11*	13*	16*
Cooperative banks	-	-	-
Banking sector, total:	**28**	**28**	**31**

* As of the end of years two branches had not begun banking activities.

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

Type of financial institution	2008	2009	2010
Public sector ownership	0.8	0.9	0.9
Other domestic ownership	0.2	0.3	0.3
Domestic ownership total	10.0	1.2	1.2
Foreign ownership	99.0	98.8	98.8
Financial Institutions, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	58.7	77.3	14.18
Branches of foreign credit institutions	62.1	87.4	17.15
Cooperative banks	-	-	-
Banking sector, total:	**54.7**	**72**	**12.37**

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

Type of financial institution	2008	2009	2010
Commercial banks	17	15	15
Branches of foreign credit institutions	11*	13*	16*
Cooperative banks	-	-	-
Banking sector, total:	**28**	**28**	**31**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	93.3	92.9	93.1
Branches of foreign credit institutions	6.7	7.1	6.9
Cooperative banks	-	-	-
Other	-	-	-

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

Assets	2008	2009	2010
Financial sector	32.6	15.5	12.7
Nonfinancial sector*	47.7	55.3	56.7
Government sector	13.5	23.3	24.8
Other	6.2	5.9	5.8
Liabilities	**2008**	**2009**	**2010**
Financial sector	17.9	15.7	13.9
Nonfinancial sector	57.9	59.5	61.6
Government sector	5.9	3.7	3.3
Capital	9.7	12.0	12.4
Other	8.7	9.1	8.9

* Nonfinancial sector includes nonfinancial enterprises as well as households.

Capital adequacy ratio of banks (%)

Type of financial institution	2008	2009	2010
Commercial banks	11.44**	12.57**	12.68**
Cooperative banks	-	-	-
Banking sector, total:	**11.44****	**12.57****	**12.68****

(* - for Basel I; ** - for Basel II)

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

Asset Classification	2008	2009	2010
Non financial sector	3.21	5.50	6.07
- households	**4.03**	**5.23**	**5.12**
- corporate	**3.20**	**6.71**	**8.20**

The structure of deposits and loans in 2010 (%) (at year-end)

	Deposits	Loans
Household	59.4	46.3
Government sector	4.6	3.2
Corporate	35.3	49.8
Other (excluding banks)	0.7	0.7
Total	**100.0**	**100.0**

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

P&L account	2008	2009	2010
Interest income	3 103 796	2 338 752	2 264 837
Interest expenses	1 558 513	776 377	575 829
Net interest income	1 545 283	1 562 375	1 689 008
Net fee and commission income	430 868	381 629	419 562
Other (not specified above) operating income (net)	226 348	-55 927	-63 416
Gross income	2 227 746	1 910 246	2 065 011
Administration costs	1 041 959	961 896	957 595
Depreciation	162 387	159 078	150 976
Provisions	312 044	426 522	290 172
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	1 061 065	1 418 403	1 671 664
Profit (loss) before tax	686 109	340 581	646 411
Net profit (loss)	525 471	250 131	503 650

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	4 360 013 700	3 967 345 100	386 509 600	6 159 000
Cooperative banks	-	-	-	-
Banking sector, total:	**4 360 013 700**	**3 967 345 100**	**386 509 600**	**6 159 000**

2010 DEVELOPMENTS IN THE SLOVENIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

After a sharp decline in economic activity in 2009 Slovenia's economic growth in 2010 saw a recovery at 1.2%, but less than the euro area average, primarily as a result of the deepening crisis in construction and adverse developments in financial intermediation. Growth in value-added was positive in the vast majority of other sectors, the highest growth being recorded by sectors mostly dependent on foreign demand (8% in manufacturing, just under 6% in transportation, storage and communications). Growth in domestic demand remained negative, primarily as a result of the continuing decline in investment, while growth in private consumption was barely positive. Net exports accounted for just over two-thirds of overall GDP growth, primarily as a result of orders from Slovenia's main trading partners. As a result of the adverse situation on the labour market and public finance consolidation, the majority of economic growth will remain based on exports.

Because the labour market responds to economic activity with a lag, employment continued to fall in 2010. After falling by 1.9% in 2009, total employment fell by a further 2.2% in 2010.

Average inflation stood at 2.1% in 2010, up 1.2 percentage points on 2009, and 0.5 percentage points more than the euro area average. The largest contributions to the increase came from energy prices and higher excise duties. As a result of the weak recovery in activity and demand, core inflation remained low. Growth in unit labour costs slowed in 2010, which can be attributed to the effect of an increase in productivity as a result of a fall in employment.

Current account deficit declined (in 2009 to 1.5% and in 2010 stood at 1,1 % of GDP) primarily as a result of low domestic consumption, faster merchandise exports (up 10.2% overall in 2010 in volume terms) than the rise in merchandise imports, the surplus of trade in services and a decline in net interest payments to the rest of the world.

The general government deficit stood at 5.5% of GDP in 2010, down 0.5 GDP percentage points on the previous year. The persistence of a large general government deficit in 2010 was the result of low economic growth and further deterioration in the situation on the labour market. General government revenues increased to 2.8%, also due to raised excise duties. General government expenditure increased by 1.8% in 2010, less than the increase in general government revenues. The increase was significantly less than in previous years, primarily as a result of measures taken within the framework of the Economic Crisis Intervention Measures Act, which restricted growth in expenditure on wages, pensions and social transfers.

The general government debt was up again with the issue of long-term bonds of EUR 2.5 billion and stood at EUR 13,704 million at the end of 2010, or 38.0% of GDP, which is still behind the euro area average. The spreads of Slovenian 10-year government bonds over the German benchmark bonds showed no significant change after summer 2010, and stood at around 120 basis points. At the end of the year Standard & Poor's left its ratings for Slovenia unchanged at AA for long-term debt and A-1+ for short-term debt.

Fiscal consolidation with the timely and effective implementation of structural reforms is therefore vital for Slovenia – for its corporate competitiveness on the market, for maintaining a favourable position on sovereign debt markets and for achieving a long-term sustainable economic growth.

DEVELOPMENTS IN THE BANKING SYSTEM

At the end of 2010 there were 19 banks operating in Slovenia (of which eight were subsidiaries), three savings banks and three branches of foreign banks. There was no change in the number of credit institutions from the previous year. Regarding the ownership structure at the end of 2010 there were eight subsidiary banks and three branches of foreign banks that were under majority foreign ownership, one bank under full domestic ownership, and nine banks under majority domestic ownership. The proportion of total bank equity held by non-residents was up 0.5 percentage points in 2010 at 37.1%. Counting only non-residents that hold more than 50% of the equity in an individual bank, the figure is 27.8%. Government ownership as measured by equity declined slightly last year and stood at just over 20% at the end of the year.

The banking system's total assets declined by EUR 1.3 billion last year to EUR 50.3 billion and were at 140% of GDP. Total assets finished the year down 2.5%. The main reasons for the decline in total assets were the banks' continuing debt repayments to banks in the rest of the world, the repayment of funding obtained in Eurosystem long term refinancing operations and the withdrawal of government deposits. The banks were unable to fully replace this funding by means of securities issues. Last year's increase in household deposits at banks was significantly lower than those in the pre-crisis years. The banks adjusted to the decline in debt on the liability side of the balance sheet by reducing their investments in securities and investments at banks, and by curbing growth in loans to non-banking sectors. The banks' loans to non-banking sectors increased by just EUR 536 million in 2010. This primarily comprised loans to households, while the stock of corporate loans actually declined. There were notable differences in growth in loans to different sectors in 2010. Year-on-year growth in loans to non-banking sectors averaged below 2%. The average was negative for corporate loans (-0.6%), the rate ending the year at -2%. The average growth for household loans was relatively high, at more than 9%. The main factors in the decline in corporate loans were high corporate indebtedness and the related low creditworthiness, the rising cost of loan collateral and the maintenance of high premiums over reference interest rates. An additional factor in the decline in the stock of corporate loans was the banks' creation of large impairments. All the bank groups saw a decline in growth of loans, although the domestic banks maintained positive growth, while the banks under majority foreign ownership recorded negative growth. While reducing their corporate loans, the banks under majority foreign ownership also recorded an above-average increase in household loans in 2010. The banks primarily approved short-term loans to corporate, while for households it was long-term loans that prevailed, housing loans in particular. Year-on-year growth in housing loans stood at 23% at the end of 2010. The stock of consumer loans declined last year.

Banks in Slovenia maintained high nominal interest rates on corporate loans in 2010. Nominal interest rates on corporate loans in Slovenia were significantly higher than in the euro area overall. The spread on loans of more than EUR 1 million stood at around 2.7 percentage points last year. The main reasons for interest rates remaining high in Slovenia were the continuing adverse situation in funding in the rest of the world in combination with the increased credit risk due to relatively high indebtedness of Slovenian corporate, which led to banks' tendency to respond to increased impairment and provisioning costs by raising interest rates. Interest rates on consumer loans were lower in nominal terms and real terms than the comparable interest rates in the euro area overall. Interest rates on housing loans were 0.5 percentage points higher on average than the comparable interest rates in the euro area overall in nominal terms, a smaller spread than in 2009. Nominal interest rates on deposits of up to 1 year, which account for the majority of household deposits, were lower in Slovenia last year than the comparable rates in the euro area overall, having been higher the previous year. Interest rates on household deposits of more than 1 year at banks in Slovenia last year remained higher than at euro area banks overall. With the banks' funding in the rest of the world declining and the banks making repayments of liabilities to banks in the rest of the world and to the Eurosystem, deposits by non-banking sectors are the most important source of funding, particularly at the banks under majority domestic ownership.

The deterioration in the economic situation in 2010 had a significant adverse impact on the banks' performance. The banking system's pre-tax loss amounted to EUR 96.4 million in 2010. The banks were unable to reduce these losses by raising net interest income or cutting operating costs. Net interest income was up 11.3% on the previous year, while non-interest income was down 11.2%. The main factor in the decline in non-interest income was losses on financial assets held for trading, on which the banks recorded gains in the previous year. As a result, the banks' gross income only increased slightly last year. The banks' operating costs remained unchanged last year, labour costs even declined slightly. In 2010 the banks created EUR 806 million of impairments and provisions, up 61% on the previous year. The ratio of impairment and provisioning costs to gross income increased by almost 20 percentage points to 54.6%, compared with a pre-crisis level of just 11.4%.

The increase in credit risk continued last year, and was expressed in a significant deterioration in the quality of the banks' investments. Clients' arrears in settling their liabilities to banks increased significantly, particularly in certain sectors. The largest proportions of classified claims more than 90 days in arrears at the end of 2010 were recorded by the sectors of information and communication activities and construction, where the figure was just over 19%. The overall proportion of classified claims more than 90 days in arrears increased from 6.6% to 12.3%. At the same time the deterioration in the quality of investments was expressed in downgrading from the highest ratings (of A and B) to lower ratings, an increase in the proportion of non-performing claims and an increase in the coverage of claims by impairments. As a result of the pronounced increase in impairment and provisioning costs, the stagnation in lending and the decline in non-interest income, the banks' significantly increased income risk was seen in the banking system's losses. Interest rate risk increased slightly, but remained below its pre-crisis level. There was no significant change in the banking system's liquidity risk. The banks maintained relatively high stock of liquid assets. Secondary liquidity declined by EUR 0.8 billion, primarily as a result of adjustments on the investment side of the balance sheet to changes on the funding side, although at the same time the decline entailed secondary liquidity approaching the level typical of the pre-crisis period. The banks remain exposed to refinancing risk, which could increase if the financing conditions were to deteriorate.

Slovenia's banking system has so far maintained an adequate level of solvency, despite the adverse situation. The overall capital adequacy ratio stood at 11.3% at the end of 2010, while the Tier 1 capital adequacy ratio stood at 9.0%.

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

The financial market comprises three sectors and is supervised by three autonomous independent supervisory authorities: the banking sector (principally represented by banks and branches of foreign banks) supervision is under competence of the Bank of Slovenia (the central bank), The Securities Market Agency is responsible for the supervision of the capital market (principally represented by investment firms, management companies, the stock exchange, the central securities depository, issuers and investment service intermediaries) and the insurance sector with pension savings (principally represented by insurance companies, branches of foreign insurance companies and pension fund management companies) is supervised by The Insurance Supervision Agency.

According to The Banka Slovenia Act the central bank carries out supervision of credit institutions in order to maintain the stability and security of their operations and for the creation of confidence in the banking system, particularly among savers and depositors. In accordance with the statutory mandate the tasks of the Banking Supervision Department of the Bank of Slovenia include in particular the performance of licensing, authorisation and notification procedures for the work of these institutions, giving consent for members of boards of management to hold their offices in banks, and other authorisations and consents prescribed by The Banking Act, the performance of on site inspection in banks, collecting and analysing quantitative and qualitative information from supervised entities and other sources, cooperate with other supervisors in the country and outside, participate actively at international supervisory forums, working groups and colleges.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

Licensing

In 2010 the Bank of Slovenia issued a total of 14 authorisations and rejected one request for the issue of authorisation to hold office as a member of a bank's management board. The decision to grant or refuse an authorisation is taken by the Governing Board of the Bank of Slovenia. The majority of authorisations (eight) issued in 2010 were to hold office as a member of a bank's management board. Three authorisations were issued to provide additional financial services and one to provide mutually recognised financial services. The Bank of Slovenia also issued one authorisation in 2010 to acquire a qualifying holding in a bank and one to merge a legal entity with a bank. Fewer authorisations were issued in 2010 than in 2009, when 22 were issued, 15 of which were authorisations to hold office as a member of a bank's management board.

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 (mutually recognised) financial services may also provide these services in Slovenia. In 2010 the Bank of Slovenia received 22 notifications of the direct provision of banking or other mutually recognised financial services (compared to 28 notifications the previous year) and one notification of the expansion of mutually recognised financial services via an already functioning 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 the banks of third countries. Banks of third countries may only provide banking and other (mutually recognised) financial services via a branch, Bank of Slovenia authorisation being required to establish the branch. The Bank of Slovenia may request that the bank of a third country deposit a specific sum of cash or other eligible collateral in Slovenia, or provide other appropriate collateral as a guarantee for the settlement of liabilities from transactions concluded in Slovenia.

Examinations of banks and savings banks

In 2010 the Banking Supervision Department conducted regular on-site examinations of banks and savings banks, which are based on assessing the level of risks and the quality of the risk management control environment. Examinations of specific areas of risk were prevalent among the examinations conducted at banks and savings banks, practice having shown that shorter and thus more frequent and more detailed examinations of specific areas are more significant and more needed than comprehensive examinations (full-scope examinations).The greatest emphasis was placed on credit, liquidity and operational risks (in the scope of capital and strategic risk), in line with the development of macroeconomic conditions. Special attention was given to the ongoing monitoring of the implementation of measures and to follow-up examinations of the implemented measures.

The Banking Supervision Department also carried out specific examinations regarding compliance with legislation in the area of money laundering and terrorist financing, the ability of banks to provide data regarding guaranteed deposits and the readiness of banks to use loans as collateral for Eurosystem claims, and regarding other, more specific areas of banking operations.

In 2010 the Banking Supervision Department continued to systematically monitor the effects of the implementation of the new European capital framework at banks and savings banks with respect to the calculation of capital requirements in accordance with the rules of Basel II. Focus was placed on the quantitative portion of the internal capital adequacy assessment process, a detailed examination of the entire process and the calculation of capital requirements having been carried out at certain banks. To that end, examinations were also carried out of the readiness of individual banks for the introduction of the advanced approaches for calculating capital requirements for credit (IRB) and operational (AMA) risk and for controlling the proper functioning of these approaches and selected models at individual banks.

Based on authorisations from the Governor of the Bank of Slovenia, 39 examinations were initiated in 2010. The Banking Supervision Department carried out the following activities in the scope of examinations initiated in previous years:

- 35 on-site examinations by individual area of risk and the control environment,
- 32 follow-up examinations to verify implemented measures,
- 17 broader thematic examinations,
- participation in two examinations of banks and other financial institutions abroad, that are owned by Slovenian banks, and
- several examinations of the implementation of measures and several one-day examinations of a specific area of a bank's operations.

By the end of 2010 based on the examinations at banks and savings banks, the Bank of Slovenia had issued 9 orders to rectify breaches with 26 points, 95 warnings and several requests for reporting and the fulfillment of conditions for the issue of authorisations, and recommendations for improving operations. The majority of measures issued related to credit risk, followed by liquidity and operational risk, and the organisational structure and governance of banks. All of the aforementioned measures were discussed and approved by the Governing Board of the Bank of Slovenia.

In line with the Core Principles for Effective Banking Supervision, the Banking Supervision Department of the Bank of Slovenia maintains regular contact with the management of banks and savings banks through channels including regular annual meetings held at the completion of an examination and otherwise. The primary purpose of these meetings is to assess the performance and position of a particular bank or savings bank and to become familiar with its strategy for future development. The exchange of opinions and information between supervisors and the management of banks is also a prerequisite for timely and appropriate action in the event of operating difficulties. The Banking Supervision Department continued this practice in 2010, and conducted a number of interviews with the management of banks.

Changes to banking regulations

Two amendments to the Banking Act were adopted owing to changes in several EU directives. A significant portion of secondary legislation was thus amended in the form of regulations.

The majority of changes to secondary legislation in 2010 were the result of amendments to the Banking Act (Official Gazette of the Republic of Slovenia, No. 98/09; hereinafter: the ZBan-1D and Official Gazette of the Republic of Slovenia, No. 79/10; hereinafter: the ZBan-1E) and the new Consumer Credit Act (Official Gazette of the Republic of Slovenia, No. 59/10; hereinafter: the ZPotK-1).

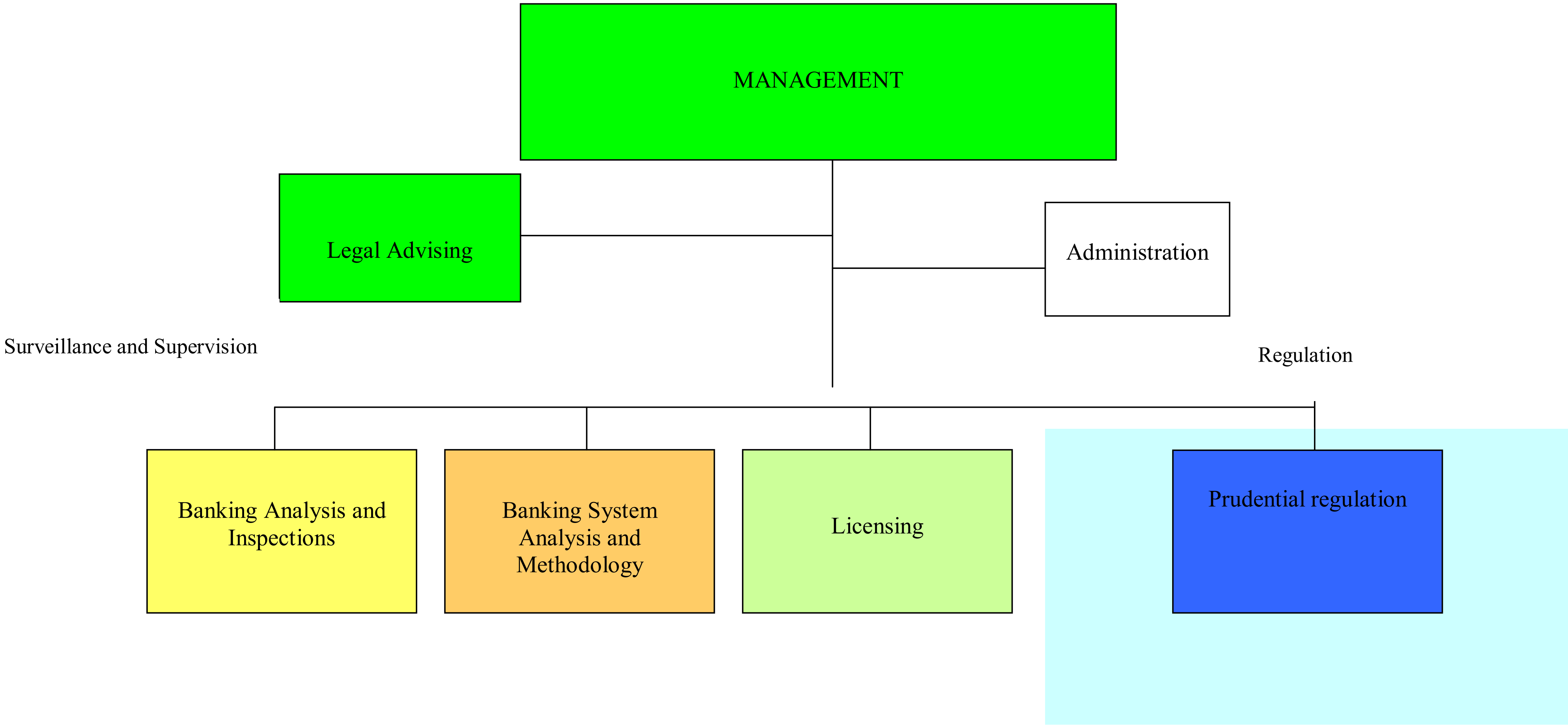
Changes in the area of deposit guarantees derive from harmonisation with EU Deposit Guarantee Directive which significantly increases the guaranteed deposit amount. With the required adoption of the Banking act and a new Regulation on the deposit guarantee scheme the guaranteed amount rose at the beginning to EUR 50,000 EUR (from EUR 22,000) and additionally to EUR 100.000 from the end of 2010 on. Harmonisation brought also a new definition of net deposit and changes regarding deposits excluded from the guarantee scheme. One of the main purposes of legislative changes was to ensure the conditions for the payment of guaranteed deposits in the shortest possible deadlines.

Crises always disclose systemic weaknesses and consequently results in new legislation with the aim to close grey areas. Following important changes of regulation were made during the year 2010:

- *Regulation on the calculation of capital requirements for credit risk using an internal ratings-based approach;*
- *Regulation on the recognition of external credit assessment institutions* was amended owing to Regulation (EC) No. 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (hereinafter: the EC Regulation), which also covers the use of credit rating for the regulatory purposes of credit institutions and other regulated financial corporations;
- *Regulation on the calculation of the capital of banks and savings banks, the Regulation on large exposures of banks and savings banks, the Regulation on the calculation of capital requirements for credit risk in securitisation, the Rules regarding the exposure of banks and savings banks to credit risk transfer* and *the Regulation on risk management and implementation of the internal capital adequacy assessment process* had to be adopted because of more significant changes brought out with so-called CRD II directive with regard to the treatment of own fund instruments, large exposures, securitisation and changes to liquidity risk management;
- *Regulation on the conditions to be met by credit intermediaries and the Regulation on reporting the effective interest rates of banks and savings banks* in accordance with the changed Consumer Credit Act.

Beside the aforementioned most important changes numerous other changes of regulations of more technical nature took place during 2010.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISION DEPARTMENT



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In its role as banking supervisory authority the Bank of Slovenia's important activity is the cooperation with foreign supervisors and the participation in numerous international supervisory forums.

Intensive cooperation with foreign supervisory authorities is based on signed multilateral and bilateral agreements (MoUs). The Bank of Slovenia has signed bilateral MoU with twelve foreign supervisory authorities, based on its provisions the detailed exchange of information and common examinations are carried out. In 2010 the Bank of Slovenia supervisors participated in two common examinations of the operations of subsidiary banks abroad, that are owned by Slovenian banks. Bank of Slovenia also always gladly responds to the invitation of foreign supervisors from the region to organise working meetings to exchange experiences, best practice and legal framework on supervision. In 2010 four such working meetings were held in Ljubljana with representatives from central banks of Montenegro, Kosovo and Serbia.

Lately is becoming more and more important a supervisory cooperation on the basis of multilateral agreements on the functioning of supervisory colleges for cross-boarder active banking groups with the aim to achieve more comprehensive and better coordinated supervision of these banking groups. The Bank of Slovenia participates in six supervisory colleges of internationally operating banking as a host supervisor responsible for a subordinate bank.

As a home supervisor the Bank of Slovenia is responsible for the organisation and management of the supervisory college for a Slovenian banking group being present with its subsidiaries mainly in South-East Europe. The last meeting of the college was held in October 2010 and attended by all supervisors of the countries where the bank has subsidiaries.

The Bank of Slovenia is actively participating at numerous expert groups and task forces operating under Committee of European Supervisors (since 2011 replaced by European Banking Authority) and European System of Central Banks. In 2010 experts from the Bank of Slovenia were intensively engaged to ECB project Strengthening Macro and Micro-Prudential Supervision in EU Candidates and Potential Candidates.

During 2010 representatives from the Bank of Slovenia was presented at the regular yearly conference of the Banking Supervisors from Central and Eastern Europe in Ohrid.

COOPERATION WITH OTHER DOMESTIC SUPERVISORY AUTHORITIES

Because of a joint concern and responsibility for the stability of the entire financial system and interdependence of financial institutions, cooperation between competent sector supervisory authorities (the Bank of Slovenia, the Securities Market Agency and the Insurance Supervision Agency) is of high importance. Cooperation is carried out on routine basis based on signed MoU and set by the Rules on mutual cooperation between supervisory authorities. Two level cooperation consists of Supervisory Coordination Body with the high level representatives presided over by the minister for finance, with cooperation from the Governor of the Bank of Slovenia and the presidents of the councils of experts at the Securities Market Agency and Insurance Supervision Agency. The operating level in the form of the Committee for Cooperation between Supervisory Authorities (hereinafter: the Committee), is in charge of implementing the tasks passed by the Coordination Body. The Committee members are the Vice governor, responsible for the banking supervision, the Director of the Banking Supervision Department, the Director of the Securities Market Agency and the Director of the Insurance Supervision Agency. Both forums conduct regular quarterly meetings. Permanent cooperation of supervisors takes place also in the area of identifying potential financial conglomerates with the Working Group for Financial Conglomerates.

Macroeconomic development with increased threats to the stability of financial system required to intensify cooperation between supervisory authorities. Supervisory authorities are required to inform each other if they identify any infringements that fall under the auspices of other authority. During 2010 the number of requirements between supervisory authorities to exchange confidential data, to conduct joint examinations and to exchanging information and findings of potential irregularities increased.

The Bank of Slovenia closely cooperates with the Office for Money laundering Prevention as being responsible for on-site examination of money laundering in banks. Banking supervision according to the law cooperates also with the Competition protection Office in case of its requirement to disclose available confidential information accessed at supervision of banks.

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	18	19	19
Branches of foreign credit institutions	3	3	3
Cooperative banks	-	-	-
Savings banks	3	3	3
Banking sector, total	**24**	**25**	**25**

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

Type of financial institution	2008	2009	2010
Public sector ownership	19,2	20,5	21,7
Other domestic ownership	39,7	40,1	40,1
Domestic ownership total	58,9	60,6	61,8
Foreign ownership	41,1	39,4	38,2
Banking sector, total	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	46,6	60,4	1 192,1
Branches of foreign credit institutions	100,0		7 519,4
Cooperative banks	-	-	-
Savings banks	100,0		4 652,8
Banking sector, total	**46,6**	**60,4**	**1 148,7**

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

Type of financial institution	2008	2009	2010
Commercial banks	8,08	3,83	-2,48
Branches of foreign credit institutions			
Cooperative banks	-	-	-
Savings banks	10,87	8,51	11,15
Banking sector, total	**8,09**	**3,85**	**-2,42**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	98,35	98,28	98,12
Branches of foreign credit institutions	0,99	0,95	1,02
Cooperative banks	-	-	-
Savings banks	0,67	0,76	0,87
Banking sector, total	**100,0**	**100,0**	**100,0**

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

Assets*	2008	2009	2010
Financial sector (banks)	8,6	11,1	9,5
Nonfinancial sector (non-banks)	69,2	64,2	66,1
Government sector	1,06	1,4	2,3
Other	21,1	23,3	22,1
Liabilities*	**2008**	**2009**	**2010**
Financial sector	37,9	30,7	30
Nonfinancial sector	39,6	38,2	41
Government sector	3,9	7,7	6
Capital	8,4	8,3	8,2
Other	10,2	15,1	14,8

*Classification of assets is just for loans, all other assets are in item "Other".

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks**	11,7	11,6	11,3
Cooperative banks	-	-	-
Savings banks**	11,7	11,7	10,2
Banking sector, total**	**11,7**	**11,6**	**11,3**

(* - for Basel I; ** - for Basel II)

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

a) impairments and provisions in impaired receivables:

Asset classification	2008	2009	2010
Non financial sector	3,0	3,7	4,9
- households (just citiziens without small entrepreneurs)	3,3	3,6	3,4
- corporate	3,5	4,7	6,6

b) share of non-performing loans:

Asset classification	2008	2009	2010
Non financial sector	1,8	2,3	3,7
- households (just citiziens without small entrepreneurs)	2,7	2,8	2,9
- corporate	1,8	2,6	4,7

The structure of deposits and loans of the banking sector in 2010 (%)
(at year-end)

	Deposits	Loans
Households	60,8	25,1
Government sector	12,9	3,4
Corporate	17,2	57,4
Other (excluding banks)	9,2	14,2
Total	**100,0**	**100,0**

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

P&L account	2008	2009	2010
	EUR thousands	EUR thousands	EUR thousands
Interest income	2 615 197	2 094 951	2 054 518
Interest expenses	1 670 635	1 162 766	1 016 725
Net interest income	944 562	932 185	1 037 793
Net fee and commission income	339 658	335 539	343 211
Other (not specified above) operating income (net)	75 936	157 587	93 415
Gross income	1 360 156	1 425 311	1 474 419
Administration costs	687 825	677 964	679 955
Depreciation	88 167	87 189	85 939
Provisions	-19 836	9 716	19 959
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	297 689	489 919	789 772
Profit (loss) before tax	306 311	160 523	-101 206
Net profit (loss)	**247 717**	**121 778**	**-98 114**

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	4 497 020	3 585 104	911 917	0
Cooperative banks	-	-	-	-
Savings banks	26 148	19 878	6 271	0
Banking sector, total	**4 523 168**	**3 604 981**	**918 187**	**0**

2010 DEVELOPMENTS IN THE UKRAINIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The 2010 macroeconomic situation in Ukraine was characterized by a reduction in the inflation rate as well as by GDP and industrial production growth.

In 2010, real GDP climbed by 4.2% versus 2009 to UAH 1.086 trillion. Industrial output rose by 11% and took place in all main types of industrial activity, while real effective household income was up by 16.2% (in 2009 declined by 8.5%).

The consumer price index (inflation index) for 2010 made up 109.1% against 112.3% in 2009, while the Producer Price Index stood at 118.7%.

The inflation rate for 2010 made up 9.1% (in 2009: 12.3%).

As of 1 January 2011, total direct foreign investment in Ukraine equaled about USD 45 billion, being 11.6% above the respective indicator for 2010-start.

DEVELOPMENT IN THE BANKING SYSTEM

As of January 1, 2011, 176 banks had the National Bank of Ukraine license to perform banking operations.

Foreign bank capital continues its way into the banking system of Ukraine, although at a slower pace and in smaller amounts than in the pre-crisis period.

In 2010, the number of banks with foreign capital went up from 51 to 55 entities (31.3% of the total number of banks operating in Ukraine), while that of banks with 100% foreign capital increased from 18 to 20 entities (11.4%).

The foreign capital in the registered authorized capital of Ukrainian banks augmented by almost 39% in 2010, amounting to UAH 59.2 billion as of 1 January 2011. The portion of foreign capital in the registered authorized capital of Ukrainian banks grew from 35.8% to 40.6%.

Foreign capital in Ukraine is represented by 26 countries. The largest portion in the total foreign capital falls on the capital of Russia (24.5%), Cyprus and France (11.1% each), Sweden (10.4%), Austria (10.0%), Germany (8.0%) and the Netherlands (5.9%).

Banking activity gradually picked up in 2010 as is evidenced by the following factors:

- The liabilities of Ukrainian banks increased by 5% to UAH 804 billion as of January 1, 2011 of which:
  - Deposits from economic entities grew by 25% to UAH 144 billion.
  - Household deposits advanced by about 29% to UAH 271 billion.
- The total loans granted by banks were up by 1% to UAH 755 billion. Loans to economic entities increased by 7% to UAH 508 billion, of which national currency loans were up by 13% to UAH 307 billion.
- The regulatory capital of banks augmented by 18.5% to about UAH 161 billion.
- Regulatory capital adequacy increased from 18.08% to 20.83%.

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

Banking in Ukraine is regulated by the following fundamental laws:

- On Banks and Banking;
- On the National Bank of Ukraine;
- On the Natural Person Deposit Insurance Fund;
- On Joint Stock Companies;
- On Prevention and Counteraction of Legalization (Laundering) of the Proceeds from Crime or Terrorism Financing.

Pursuant to the Laws On the National Bank of Ukraine and On Banks and Banking, banking regulation and supervision in Ukraine are conducted by the National Bank of Ukraine.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2010

In 2010, the National Bank of Ukraine took steps to stabilize the banking system of Ukraine, enhance bank capital, reduce debts on loans classified as negative, recommence lending to the real economy sector, streamline the legal basis and ensure appropriate supervision over banking activity.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2010

With a view of refining the legal framework for banking regulation and supervision, the National Bank of Ukraine has worked out:

- the draft Law of Ukraine *On Amendments to Some Ukrainian Laws (with respect to banking activity regulation)* as related to determining the real owners and controllers of a bank and laying down special requirements to them (regarding their financial standing, business reputation, etc) adopted by the Verkhovna Rada of Ukraine in February 2011;
- the draft Law of Ukraine *On Amendments to Some Legal Acts of Ukraine* regulating legal relations between creditors and financial service consumers;
- the draft Law of Ukraine *On Amendments to Some Ukrainian Laws (with respect to consolidated banking supervision)* as related to supervision improvement by introducing consolidated supervision over groups comprising financial institutions, including banks, as well as limiting risks to a financial institution arising from its belonging to such a group. The draft Law was adopted by the Verkhovna Rada of Ukraine in May 2011.

With the purpose of maintaining adequate bank capital and enhancing the banking system capability to cover risks and absorb losses and thus provide for stable activity, amended has been the Instruction on the procedure for regulating banking activity in Ukraine as related to setting a regulatory capital floor of UAH 120 million.

With a view of augmenting bank capital changed has been the approach to reflecting fixed asset revaluation in the regulatory capital of banks - only previous years' fixed asset revaluation results shall be included in the regulatory capital.

In order to augment capital, banks shall be allowed for a period up to January 1, 2012 to include paid-up unregistered contributions to the authorized capital in the core capital, while banks operational less than one year shall have the right to obtain funds as subordinated debt.

With a view of safeguarding banking system security and stability, approved has been the new Regulation on NBU emergency lending to Ukrainian banks, establishing the procedure of NBU emergency lending to solvent banks.

With the purpose of decreasing the amount of non-performing loans banks accumulated during the financial and economic crisis, approved has been the procedure for writing off bad debts against provisions.

ORGANIZATIONAL STRUCTURE OF THE BANKING SUPERVISORY AUTHORITY

In 2010, the following structural subdivisions within the National Bank of Ukraine were responsible for banking supervision:

- Bank Registration and Licensing Department;
- Department for Legal and Methodological Support to Banking Regulation and Supervision;
- Off-Site Banking Supervision Department;
- Bank Inspection Department;
- Department for Prevention of Legalization of Proceeds from Crime and Terrorism Financing through the Banking System;
- Department for Crisis Management and Open Market Operation Control;
- Bank Liquidation Office;
- Office for Legal Support to Banking Supervision.

Overall management of the said subdivisions was effected by the Banking Regulation and Supervision Direction and the NBU Deputy Governor in charge of banking supervision.

INTERNATIONAL ACTIVITIES OF THE BANKING SUPERVISION SERVICE

During 2010, the National Bank of Ukraine continued to work on improving and deepening cooperation in the area of banking supervision with foreign supervisory authorities. The main focus was on cooperation with the supervisory authorities of the countries whose banks have subsidiaries in the territory of Ukraine.

In 2010, the National Bank of Ukraine signed the Bilateral Memorandum of Understanding on cooperation in supervision over credit institutions with the Banking Regulation and Supervision Agency of Turkey as well as the Multilateral Agreement on cooperation and coordination of supervision over Marfin Popular Bank Group.

COOPERATION WITH OTHER SUPERVISORY AUTHORITIES

The National Bank of Ukraine, while performing banking supervision, cooperates with other supervisory authorities of the country, such as the State Commission for Financial Service Market Regulation of Ukraine and the State Government Securities Commission.

STATISTICAL TABLES

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

Type of financial institution	2008	2009	2010
Commercial banks	184	182	176
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**184**	**182**	**176**

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

Type of financial institution	2008	2009	2010
Public sector ownership	11.5	13.3	14.0
Other domestic ownership	37.4	35.9	39.0
Domestic ownership total	48.9	49.2	53.0
Foreign ownership	51.1	50.8	47.0
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2010 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	26.1	36.8	0.0468
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**26.1**	**36.8**	**0.0468**

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

Type of financial institution	2008	2009	2010
Commercial banks	8.51	-32.52	-10.19
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**8.51**	**-32.52**	**-10.19**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2008	2009	2010
Commercial banks	100.0	100.0	100.0
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2008	2009	2010
Commercial banks	14.01*	18.08*	20.83*
Cooperative banks	-	-	-
Banking sector, total:	**14.01***	**18.08***	**20.83***

(* - for Basel I; ** - for Basel II)

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

Asset classification	2008	2009	2010
Non financial sector	3.6	12.9	14.6
- households	**1.5**	**3.9**	**4.3**
- corporate	**2.1**	**9.0**	**10.3**

The structure of deposits and loans of the banking sector in 2010 (%) (at year-end)

	Deposits	Loans
Households	66.0	28.6
Government sector	1.0	1.2
Corporate	32.5	70.2
Other (excluding banks)	0.5	-
Total	**100.0**	**100.0**

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

P&L account	2008	2009	2010
Interest income	8,141	10,578	10,719
Interest expenses	4,681	5,816	5,808
Net interest income	3,459	4,761	4,911
Net fee and commission income	5,088	5,915	6,104
Other (not specified above) operating income (net)	-0,361	-0,519	-0,432
Gross income	11,292	12,490	12,943
Administration costs	2,640	2,465	2,748
Depreciation	0,242	0,271	0,302
Provisions	2,225	6,590	4,367
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	0,972	-3,417	-1,244
Net profit (loss)	0,673	-3,358	-1,232

Total own funds in 2010 (in EUR)

Type of financial institution	Total own funds (for CAR)	Tier 1	Tier 2	Tier 3
Commercial banks	15,218[18]	11,033	4,521	-
Cooperative banks	-	-	-	-
Banking sector, total:	15,218	11,033	4,521	-

[18] After supervisory deductions

MAIN GROUP EVENTS OF THE YEAR 2010

23rd Annual BSCEE Members' Conference

Ohrid, Republic of Macedonia, June 15 – 17, 2010

The Chairmanship of the BSCEE Group in 2010 was held by the National Bank of the Republic of Macedonia and Mr. Igor Davkov, General Director of the Division of Supervision, Banking Regulation and Financial Stability was entrusted the position of the Chairman. Therefore, the 23rd Annual BSCEE Members' Conference was hosted by the National Bank of the Republic of Macedonia, on June 15 - 17, 2010 in Ohrid.

The first day of the two days' Conference was devoted to *Lessons learned from the crisis and policies aimed at strengthening the resilience of the banking sector.*

Presentations were made by the representatives of the following institutions:

- National Bank of the Republic of Macedonia, *Lessons learned from the crisis and policies aimed at strengthening the resilience of the banking sector - Macedonian perspective.*
- Austrian Financial Market Authority, *Lessons learned and measures aimed at strengthening the resilience of the Banking Sector – the Austrian view.*
- Hungarian Financial Supervisory Authority, *Lessons learned from the crisis and policies aimed at strengthening the resilience of the banking sector – the HFSA case.*
- Czech National Bank, *Lessons learned from the crisis and policies aimed at strengthening the resilience of the banking sector - the experience of the Czech Republic and measures undertaken by the Czech National Bank.*
- Bank of Russia, *Lessons learned from the crisis: the CBR perspective.*
- European Central Bank, *Lessons learned from the crisis.*
- Societe Generale Group, *SG Group activities and policies aimed at strengthening the resilience of the Group during the turmoil.*
- Banking Agency of Republika Srpska of Bosnia and Herzegovina, *Issues concerning the influence of the global financial crisis on the national banking sector.*

The second day focused on the topic of *Liquidity risk standards and measurement - overview of the national measures during and after the crisis*.

Presentations were made by the representatives of the following institutions:

- National Bank of the Republic of Macedonia, *Macedonian measures during and after the crisis.*

- KNF - Polish Financial Supervision Authority, *Polish approach to the financial turmoil.*
- Bank of Albania, *Overlook of the Albanian banking system at the end of 2008.*
- Financial Stability Institute, *Liquidity Risk Standards and Measurement.*
- BSCEE Secretariat, *Report of the Secretariat.*

According to the decision taken by the BSCEE Members in voting, the Bank of Albania was appointed for the BSCEE Chairmanship in 2011. Therefore, the 24th Annual BSCEE Conference would take place in Albania.

Also by unanimous decision of the Member Countries, Poland has been appointed to hold the BSCEE Secretariat until December 2015 due to the fact that as of December 31, 2010 the present term of the BSCEE Secretariat in the KNF – Polish Financial Supervision Authority would come to its end.

FSI – BSCEE Regional Seminar

Ljubljana, Slovenia, June 1 – 3, 2010

The National Bank of Slovenia in cooperation with the Financial Stability Institute and the BSCEE Secretariat organized a regional seminar for the BSCEE member countries on *Stress Testing and Risk Management Techniques.*

XVI ICBS, Singapore, September 20 – 24, 2010

BSCEE Regional Meeting, September 21, 2010

On September 20 - 24, 2010 the XVI International Conference of Banking Supervisors was hosted by the Monetary Authority of Singapore and co-organized by the Basel Committee on Banking Supervision. During the Conference, on September 21, the BSCEE Regional Meeting took place and focused on two main Conference topics: *Towards a more resilient banking sector* and *A stable financial environment for sustained economic growth.*

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	*Otto-Wagner-Platz 5 1090 Wien Austria*	www.fma.gv.at
National Bank of the Republic of Belarus	*Nezavisimosty Ave. 20 Minsk 220008 Republic of Belarus*	www.nbrb.by
Federal Banking Agency of Bosnia and Herzegovina	*Kosevo 3, Sarajevo 4000 Bosnia and Herzegovina*	www.fba.ba
Banking Agency of Republika Srpska of Bosnia and Herzegovina	*Vase Pelagića 11 A 78000 Banja Luka Republika Srpska*	www.abrs.ba
Bulgarian National Bank	*1 Knyaz Alexander I 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	*Kuzman Josifovski Pitu, Blvd 1 Skopje, 1000 Macedonia*	www.nbrm.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	*Plac Powstańców Warszawy 1 00-950 Warsaw, 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.rs
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
BSCEE Secretariat	*Plac Powstańców Warszawy 1, 00-950 Warsaw, Poland*	www.bscee.org