BSCEE
Review
2011

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, Bosnia and Herzegovina), Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia and Ukraine. In 2011 the Central Bank of the Republic of Armenia has applied for membership and has been accepted to the Group. Armenia will officially join the BSCEE Group as the twenty third member in 2012.

The Chairmanship of the BSCEE Group rotates on annual basis. In 2011 Mr. Indrit Banka, Director of the Supervision Department in the Bank of Albania 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 2011. 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 24th Annual Members' Conference was organized by the Bank of Albania in Tirana on April 12 – 14, 2011.

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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2011 DEVELOPMENTS IN THE ALBANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

After a slowdown of economic growth during the second trimester of 2011, economic growth in Albania improved, reaching to an average annual growth of 3.1%. The trade and communication sectors are the main determinants of economic growth, while the performance of the industry sector has been volatile. On the other hand, the development of the construction sector has improved considerably during the second half the year. Indirect indicators suggest that the contributions of consumption and private investment to economic growth have been limited. Private consumption was slow due to the moderate rise in average wage and lower workers' remittances. However, by the end of 2011, the consumer confidence improved as development in the labor market is considered to be relatively positive. In December 2011, unemployment rate indicated 13.29% compared to 13.49% by the end of 2010 mainly due to an increase by 6.7% in annual terms of employment in the private sector. Remittances have declined by an average of 0.23% during 2011 as the second half of the year showed an improvement of remittances by 14% in annual terms compared to a decline of 11.3% during the first half. The contribution of the government consumption and trade balance to economic growth has also slowed down. By the end of 2011, government revenues increased by 1.8% on annual term compared to 3.8% increase of expenditures. As a result, the fiscal deficit widened by 20.2% on annual terms reaching to 3.5% of GDP with public debt peaking to 58.5% of GDP. As at end-2011, current account deficit was estimated at EUR 1,145 million or 11.98% of GDP, widening by about 0.08 pp versus year-end 2010. For the same stated period, trade balance deficit was estimated at EUR 2,106.96 million or 22% of GDP, narrowing by 1.5 pp compared to year-end 2010. This performance attributes to the dynamics of exports and imports. At an annual level, exports increased by 7.9% while imports of goods increased by 10.2%. As a result, by the end of 2011, exports coved 29.6% of imports compared to an average coverage of 36% during the year.

The average level of annual inflation during the second half of 2011 reached 2.9%, 1.1 percentage points lower than the first half of the year. Following well controlled financial pressures as well as aiming monetary stimulus to enhance the economic activity, the monetary policy lowered the repo rate by 0.25 pp in September and November to a level of 4.75%.

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

The banking system is the main financial intermediary in Albania and its role is growing. At end-2011, the assets of the banking system accounted for about 85% of the Gross Domestic Product (GDP), from about 81% at end-2010. During 2011, the banking system total assets increased at higher rates than in the preceding year. The banks' asset structure continued to be funded mostly by households' deposits and it focused on lending, primarily, to the private sector. In 2011, total assets were up ALL 129.54 billion or 13.08%.

At end-2011, loans accounted for about 50% of total banking system assets and its growth rates accelerated. The credit value increased throughout the quarters and reached the highest level in the last quarter of the year. Developments point to higher exposure of the banking system to credit risk, that is reflected in a higher non-performing loan ratio (18.76% comparing to 13.96% at the end of 2010). Loan portfolio quality deteriorated for loans to both businesses and households. On the other hand, the quality of the foreign currency loan portfolio was more problematic than the national currency one. Quality indicators for foreign currency loans and national currency loans were respectively 19.6% and 16.9%, from about 13.8% and 14.4% at end-2010.

The financial profit of the system dropped to All 0.71 billion from All 6.7 billion in 2010. The large increase of loan provisions was a determining factor for this result.

Deposits from households continue to be the main funding source for banks in Albania. During 2011, these deposits surged by 13%, although slightly down compared with a year earlier. Similar to 2010, foreign currency deposits were main contributors to this growth. Hence, the currency structure of the deposits is balanced.

At end-2011, Regulation "On liquidity management" was amended. The amendments consisted in the redefinition of some liquid asset components, increase of the minimum regulatory limit of liquid assets to short-term liabilities ratio to 25%, start of implementation of two separate limits for the national currency and foreign currency indicators to the minimum level of 20%. Banks responded immediately to the decision of the Bank of Albania by increasing their liquidity levels. At end-December, the liquidity ratio was 33.1%, compared with 30.6% a year earlier. All banks respected the new regulatory limit of this ratio. The increase of the total ratio is attributed entirely to the increase in the foreign currency ratio, a result of measures taken by banks to fulfill the new regulatory requirement by currency.

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.

Legal framework development

In the framework of improving and consolidating the legal and regulatory framework to achieve the main objectives that arise from the banking legislation, such as maintaining and guaranteeing financial stability of the system, the Bank of Albania in 2011 completed the drafting of the draft law "On some amendments to law no 9662, dated 18.12.2006 "On Banks in the Republic of Albania", which was approved by the Assembly of the Republic of Albania, by law no 10481, dated 17.11.2011. These amendments aimed at its further approximation with European Union directives in the field of banking and financial services as well as the best international standards and practices on handling and solutions for problematic banks (such as principles of the Banking Supervision Committee of the Bank for International Settlement and the International Monetary Fund on the legal, institutional, and regulatory framework for insolvent banks).

Regulatory framework development

In 2011, new regulations and amendments to some other regulations on banking supervision were finalized. They target alignment with Basel Committee standards, EU directives and best practices in the field of banking regulation and supervision.

New regulatory acts that were approved in this year on banking supervision are as follows:

- Regulation "On operational risk management", which sets out rules and qualitative requirements on operational risk management in the activity of banks and branches of foreign banks, non-bank financial institutions and savings and loan associations and their unions;
- Regulation "On minimum security requirements at premises where bank and financial activities are conducted", which sets out minimum security requirements for institutions that are licensed by the Bank of Albania to exercise banking and financial activities, for normal and secure operations.
- Regulation "On chartered auditors for banks", which sets out the criteria and procedures for the approval of the chartered auditor by the Bank of Albania, the audit content for the purposes of the Bank of Albania, as well as relations between the chartered auditor for banks and foreign bank branches and the Bank of Albania.
- Regulation "On credit risk management", which sets out the rules for the credit risk management in the activity of banks and foreign bank branches, the criteria for risk assessment and loan classification and other activities, as well as calculation of respective provisions.

Important amendments to existing legal acts include the following:

- Regulation "On consumer credit and mortgage credit for households" and Regulation "On transparency for banking and financial products and services" to strengthen the requirements by the supervisory authority mainly as regards transparency for fees and the methodology for their calculation; keeping the interest rate calculation methodology unchanged for the duration of the loan/s; periodic reporting from institutions about interest rates on deposits and loans; and, applicable fees on all products and services and their publication by the Bank of Albania, including maximum limits on compensation in cases of early loan/s pay back, etc;

- Regulation "On licensing and activity of banks and branches of foreign banks in the Republic of Albania", which includes the service of safety boxes, a financial activity that banks and branches of foreign banks in the Republic of Albania may conduct conform to stipulations of the Civil Code of the Republic of Albania;
- Regulation "On licensing and activity of non-bank financial institutions" on exemption of banks and branches of foreign banks from the requirements of this regulation for the approval of money transfer services, when the institutions have been licensed for payment and money transfer services;
- Regulation "On capital adequacy ratio" pertaining to the submission of requests for banks to weight the risk coefficient to 150 per cent of the credit in cases when crediting an entity outside the territory of their activity through a subsidiary, branch or agency. This is an activity that bears additional potential risks vis-à-vis crediting within the territory of the Republic of Albania;
- Regulation "On liquidity risk management" in relation to taking preventive measures against negative impacts from recent developments in the region on our country's banking system and stability;
- Regulation "On licensing, organization, activity and supervision of foreign exchange bureaus" pertaining to some corrections and additions to technical and other terms, which have risen during on-site inspections in these institutions.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2011

- *Methodological development*

During 2011, work already begun for the revision of the examination manuals was intensified by adopting the modern concepts of the supervisory process, based on European standards in this field, especially by improving risk assessment systems and by further structuring the criteria for the exercise of supervisory powers under Pillar II of Basel framework.

- *Human resource development*

Further development of human resources has continued even during 2011, including the recruitment of new staff in response to the needs of the organizational structure as well as enhancing the training for all staff, aiming that the adoption of new methodologies was associated with building of the necessary supervisory capacity for an effective supervision process.

- *Development of regulatory framework and approximation with Directives of European Union*

Continuous approximation with European standards in the area of regulation remains an important objective, in order to make way for a comprehensive harmonization of the developments in the banking sector, as well as in the supervisory area with the European experience. An important consideration in this regard has been paid for drafting the new regulation of capital adequacy as a major project initiated in 2010.

Bank of Albania has carefully followed the latest trends in the area of regulation in response to developments in global markets and has started to work on improving the framework on the bank governance, as a fundamental condition for ensuring a stable and healthy banking activity.

- *Cooperation with international authorities*

Work performed during 2011 on the implementation of the strategy of banking supervision was associated with an intensive cooperation with the Bank of Italy, in the framework of the twinning project, launched in the last months of 2010, regarding the areas predicted in this project, such as off-site and on-site supervision, regulation, reporting and information technology.

Meanwhile, the Bank of Albania has continued close cooperation with other institutions including the International Monetary Fund International and the World Bank in strengthening the overall framework of supervisory capacities to respond with flexibility effects that arise from developments in recent years in global financial markets.

Year 2011 was characterized by an increased cooperation with USAID, through financial sector development program in Albania, implemented through FSVC. It is worth noting that the cooperation with this institution is supposed to be long and extended in time, until 2015. Also, a wide range of topics to be treated - based on a detailed calendar - was identified through a proper analysis of the current staff needs for assistance.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

Banking supervision system in Albania, based in the legal and regulatory framework aims application and/or development of best policies and practices in the area of licensing, regulation and supervision of banking/financial services in the Republic of Albania, to ensure the stability of the entire banking system and reducing the risk of loss to the depositors.

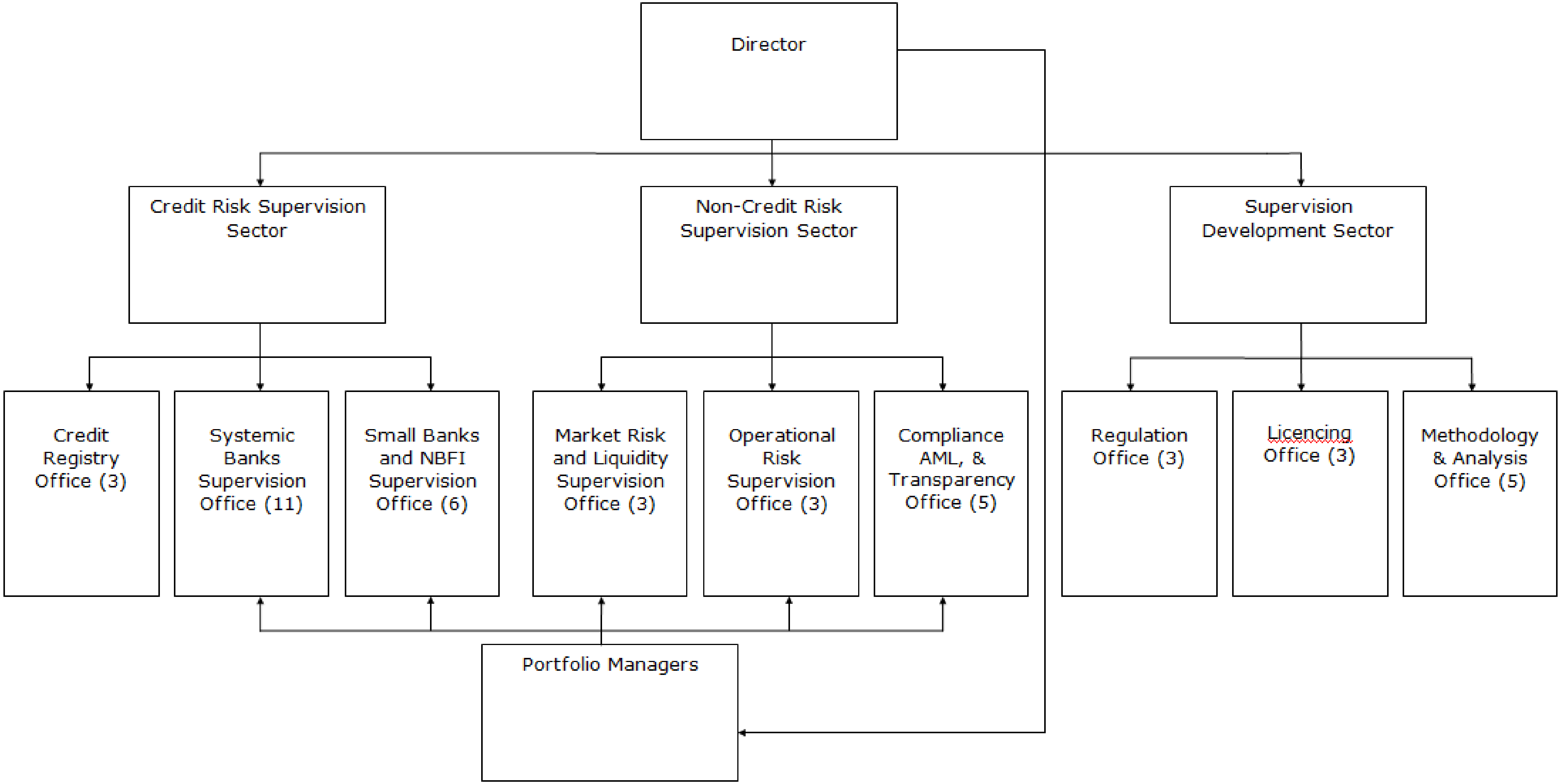
Licensing, as an integral part of banking supervision in 2011, was dynamic in response to banking and financial sector developments. Although, the number of banks that operate in Albania has remained unchanged, Bank of Albania has granted preliminary approval for the expansion of banks' network. Expansion of the banks' network within the country continued in 2011, although at low rates similar to those of previous years. During this year, 10 new bank branches and agencies were approved and started their activity. In addition, the Bank of Albania licensed two new non-bank financial institutions in response to their application to provide financial activities on payment services, money transfer and factoring.

During 2011 supervision department has strengthen the monitoring of the banks through

interweaving of off- site and on-site examinations. On site examinations performed in the during 2011, have primarily aimed at assessing the full risk profile of banks and other supervised institutions, without leave aside and examinations initiated as a result of the occurrence of specific phenomena in the licensed entities. So, in total were conducted six full and two partial examinations of banks.

During 2011, particular care was dedicated to continuous monitoring of the situation of financial markets, caused by the debt crisis in Europe, by performing deep analysis on potential impacts of this crisis in Albanian banking system.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

Cooperation with foreign authorities also continued during 2011. On the basis of cooperation agreements with several foreign supervisory authorities, the necessary information is provided to certain foreign banks that conduct banking activity in our country. Also following the initiative of the European Central Bank for the operation of colleges of supervisors of the largest European banking institutions, representatives of Bank of Albania has taken part in the meetings organized by the Bank of Greece. Meanwhile, cooperation with foreign authorities has also included meetings with institutions like the Embassy of the United States of America or participation in training activities organized by the Spanish Financial Intelligence Unit in cooperation with General Prosecution Office of the Republic of Albania.

COOPERATION WITH OTHER SUPERVISORY BODIES IN ALBANIA

During 2011 Bank of Albania has strengthen its cooperation with General Directorate for Prevention of Money Laundering, which is the competent authority for prevention of money laundering and terrorist financing in Albania. This cooperation is not limited to periodic reporting, regarding the implementation of the strategic document for the investigation of financial crime, but also includes joint on- site inspections of banks, joint activities in order to expand the supervisory capacity and exchange different professional experiences, training of other subjects etc.

On the other hand, cooperation with various institutions which monitor specific activities of the financial market, such as Financial Supervision Authority[1] and Competition Authority has continued to be effective during 2011. The cooperation has been focused in the exchange of information and data, in the compliance with the memorandums of understating that are signed with these authorities. Furthermore Bank of Albania has carried out three joint inspections with Financial Supervision Authority, regarding the insurance company and their relationship with supervision authority.

1 The competent authority for supervision of insurance companies.

STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
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	2009	2010	2011
Public sector ownership	0	0	0
Other domestic ownership	7.7	7.5	7.2
Domestic ownership total	7.7	7.5	7.2
Foreign ownership	92.3	92.5	92.8
Banking sector, total	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2011 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	61.6	78.4	0.18
Branches of foreign credit institutions	n/a	n/a	0.54
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**57.7**	**73.4**	**0.15**

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

Type of financial institution	2009	2010	2011
Commercial banks	7.79	11.32	6.94
Branches of foreign credit institutions	-15.47	-18.49	-63.20
Cooperative banks	n/a	n/a	n/a
Banking sector, total:	**4.58**	**7.58**	**0.76**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	87.88	89.10	90.4
Branches of foreign credit institutions	12.12	10.90	9.6
Cooperative banks	n/a	n/a	n/a
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	2009	2010	2011
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	**2009**	**2010**	**2011**
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	9.57	9.40	8.67
Other	n/a	n/a	n/a

Capital adequacy ratio of banks

Type of financial institution	2009	2010	2011
Commercial banks	16,1*	16,2*	15.6 *
Cooperative banks			
Banking sector, total:	16,1*	16,2*	15.6 *

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

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

Asset classification*	2009	2010	2011
Non financial sector	10.48	13.96	18.77
- households	8.21	11.77	15.84
- corporate	12.35	15.49	20.80

*share of non-performing loans

The structure of deposits and loans of the banking sector in 2011 (%) (at year-end)

	Deposits	Loans
Households	86.3	26.3
Government sector	2.5	3.6
Corporate	11.2	70.1
Other (excluding banks)	n/a	n/a
Total	**100.0**	**100.0**

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

P&L account *	2009	2010	2011
Interest income	62,892.89	69,332.68	73,324.06
Interest expenses	31,530.11	32,350.32	33,689.43
Net interest income	31,362.78	36,982.36	39,634.64
Net fee and commission income	4,640.85	5,353.33	6,110.92
Other (not specified above) operating income (net)	2,070.83	1,857.49	3,830.21
Gross income	38,074.46	44,193.17	49,575.76
Administration costs	21,770.48	23,491.22	24,490.67
Depreciation	n/a	n/a	n/a
Provisions	11,841.48	13,078.47	12,808.44
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	11,841.48	13,078.47	10,013.77
Profit (loss) before tax	4,486.80	8,029.12	2,262.07
Net profit (loss)	3,544.50	6,715.13	706.26

* In million ALL

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital*	Tier 1	Tier 2	Tier 3
Commercial banks	708.79	651.28	57.53	n/a
Cooperative banks	n/a	n/a	n/a	n/a
Banking sector, total:	708.79	651.28	57.53	n/a

*in million Eur

2011 DEVELOPMENTS IN THE ARMENIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2011 economic growth in Armenia reached 4.6 percent. Fastest recovery of the economic activity was seen in the second quarter of the year (in the third and fourth quarters the figures were 6.5 percent and 5.0 percent, respectively). The economic growth in the first half of the year was 2.7 percent. The growth has been driven mainly by increased outputs in industry and agriculture.

Chart 1: Economic growth rates, by sector

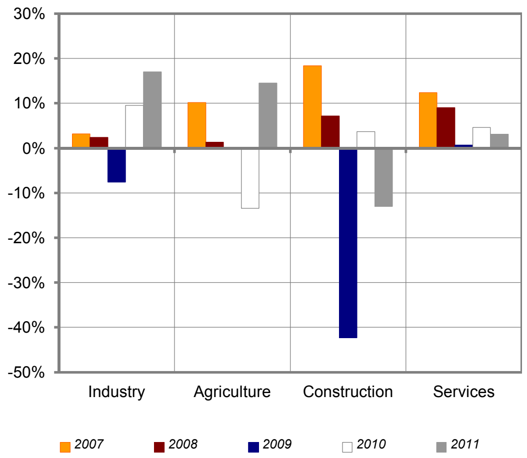
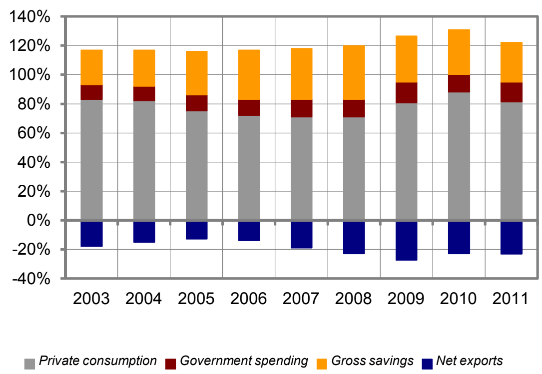


Chart 2: GDP expenditure components
(share in GDP)



Source: National Statistics Service of Armenia.

During the year industry reported 15.9 percent growth of value added driven by considerable increase of metals prices in global markets in the first half of the year and mounting industrial demand amid recovering global economy. The highest growth rates were reported in metal ore mining, food and beverage sub-branches, which seems to point to the recovering demand domestically and globally.

Agriculture reported 13.7 percent y-o-y growth of value added in contrast to non-favorable developments reported in this sector in 2010. The high growth was mainly determined by 26.6 percent growth in plant growing. The growth in animal breeding was 0.1 percent.

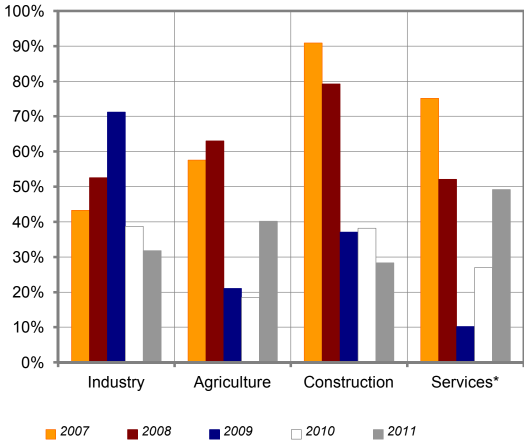
Construction further reported a decline, which amounted to 12.3 percent y-o-y. The volumes of construction by all sources of financing, except for state budget and local budgets, have decreased. The largest shrinkage was reported for volumes of construction financed by international loans (41.4 percent), resources of households (32.2 percent) and organizations (23.4 percent). The reduced volumes of construction financed by international loans were attributable to the accomplishment of some major construction projects and pending road construction projects. The persisting decline in residential housing points to the sluggishly recovering household incomes, as the largest part of the income pays consumption expenditures, still not creating an investment demand.

In 2011 the growth in services reached 3.7 percent y-o-y owing to increased volumes of retail trade (2.2 percent) and wholesale trade (5.5 percent), pointing out to some trends of recovering private demand and household incomes.

During 2011 the lending market remained active amidst positive developments and more optimism about economic environment. Strong lending growth fuelled a buoyant consumption by almost all sectors of the economy and households while stimulating aggregate demand and aggregate supply.

Commercial banks and credit organizations, while responding to the surveys conducted by the Central Bank, stated that they had further eased lending terms and procedures. The terms and procedures of lending were most affordable during the first half of the year, and the main contributing factors included increased competition among banks, easier access to financial resources and banks' plans to diversify loan portfolio. Reportedly, such sub-branches as trade, energy and communications were most conducive for lending, whereas construction and agriculture were considered less enticing in terms of loan viability.

Chart 3: Growth of lending to main sectors of economy



* Services include the total sum of indicators of trade and other service subsectors.

Source: National Statistics Service of Armenia.

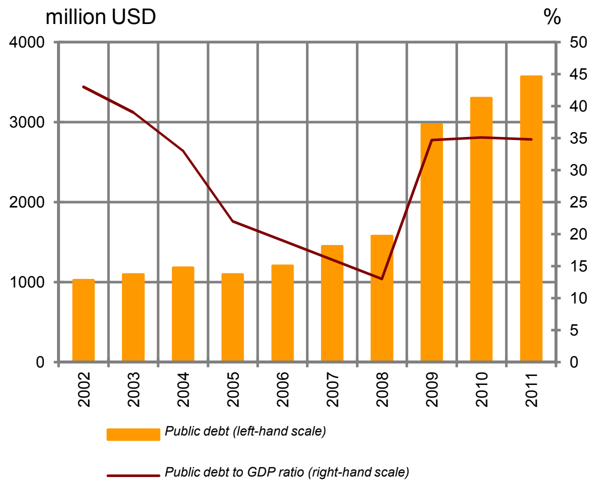
With a 36 percent increase in bank lending, the share of non-performing loans stayed almost unchanged relative to the previous year and it reached 3.3 percent at the end of the year. The largest share of non-performing loans was reported in agriculture (4.7 percent) and trade (4.2 percent).

The results of the survey conducted during four quarters of 2011 showed that the composite indices trended differently. In particular, Economic Activity Indicator has increased throughout the year, except for the fourth quarter when it dropped due to the falling of consumption sub-index as well as reduced propensity to invest (which is explained in part by a seasonal factor, i.e. holiday activeness). The falling path of Business Climate Indicator was determined by deteriorated estimation of risks expectation in almost all sectors of the economy.

In contrast to expectations of businesses about the changes, expectations of consumers were more optimistic. The Consumer Confidence Indicator has increased in the course of the first three quarters but tended to fall in the fourth mainly due to 10.7 percent drop in Future Conditions Index which was driven by negative expectations of households for future income, major purchases and employment.

By GDP expenditures structure, the real growth of consumption reached 3.1 percent, which was determined by some increment in real household incomes and economic activity as a result of rebounded inflow of private remittances and improved consumer confidence. Moreover, the growth of consumption was boosted up primarily by increased private consumption (2.4 percent) and public consumption (5.4 percent). Capital investment has reduced by 11.2 percent mostly due to the developments in construction. Private investment has decreased mainly in the second half of the year, which amounted to 5.5 percent, reflecting the EAI dynamics. Negative developments with public investment are mainly a product of a state budget deficit-cutting policy.

Chart 4: Public debt and public debt to GDP ratio



With exports growing faster over imports as well as reported growth of GDP, the contribution of net exports to GDP has been positive.

In 2011, relative to the previous year, the public debt has grown by 12.4 percent and reached USD 3708.9 million. The debt to GDP ratio was 36.2 percent, representing a slight increase in relation to the previous year. The debt sustainability indicators performed positively largely owing to faster growth rates of exports and economic growth over debt.

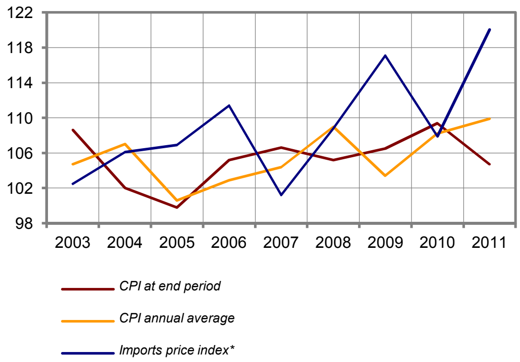
The structure of external public debt has incurred a change as well. During 2011 the share of concessionary loans in the structure of public debt further reduced to reach 57.6 percent. The share of loans with floating interest rate remained unchanged, 36.6 percent.

Table 1: Qualitative public debt indicators of the Republic of Armenia

Ratio	2005	2006	2007	2008	2009	2010	2011
Debt/GDP (limit 50%)	22%	19%	16%	14%	34.7%	35.1%	36.2%
Debt/Export	78% (less indebted)	80% (less indebted)	82% (less indebted)	90% (less indebted)	227% (moderately indebted)	182.1% (moderately indebted)	154.0% (moderately indebted)
Debt service/ Export	4.6% (less indebted)	4.2% (less indebted)	2.9% (less indebted)	3.1% (less indebted)	6% (less indebted)	5.0% (less indebted)	4.2% (less indebted)
Interest/ Export	0.9% (less indebted)	0.7% (less indebted)	0.6% (less indebted)	0.7% (less indebted)	2.0% (less indebted)	2.4% (less indebted)	2.1% (less indebted)

Surce: Ministry of Finance:
(Public Debt Report, 2011).

Chart 5: Consumer price and imports price



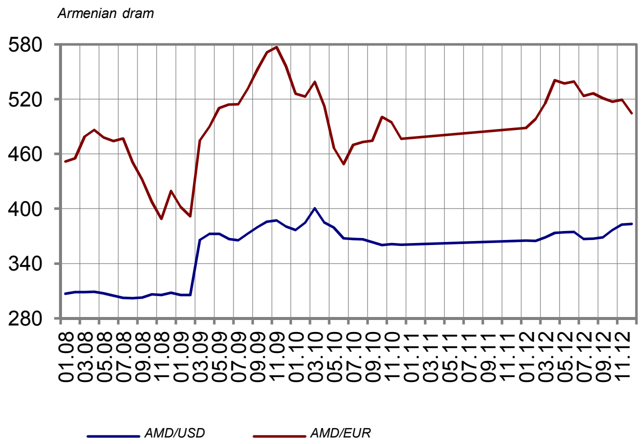
[*] The National Statistics Service of Armenia started a new methodology for calculation of imports prices in 2007; the 2002-2006 indicators have been estimated by the Central Bank based on the former methodology for calculation of imports prices.

Encouraging developments in the domestic economy in 2011 contributed positively to the state budget. There has been a reported increase in collection of revenues during the year: budget revenues have grown by more than 12.0 percent y-o-y and budget expenditures, by 3.0 percent. As a result, the budget deficit has reduced by 36.8 percent in relation to the previous year and amounted to AMD 109348.5 million (PIU funds inclusive). The growth of tax revenues was again high, 10.1 percent, and the fastest growth was reported on profit tax, 25.7 percent. In the expenditures structure, almost all expenditures items posted increases.

The budget deficit has reduced slightly as a result of surpassing revenues over expenditures and reached 2.8 percent of GDP from 2.9 percent recorded in the previous year.

In the first half of 2011 an inflationary environment persisted in Armenia, fuelled by high prices of food and raw materials in world markets as well as price increases due to steeply shortened supply of agricultural products. Starting from the second half, however, the inflation environment began to ease thanks to less external inflationary pressures, positive developments in agriculture and the lack of inflationary pressures driven by aggregate demand, making it possible to maintain the inflation indicator within the confidence band (4.7 percent).

Chart 6: AMD exchange rate versus



Based on the 2011 results, the average dram exchange rate versus the US dollar did not change, making up AMD 372.42 although the last quarter of the year saw a slight depreciation trend.

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

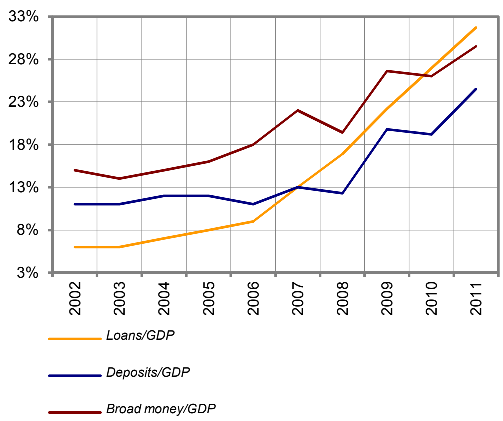
Armenian financial system, which overcame challenges with ease during the peak of the crisis, continued strong development in 2011.

Armenian banking system[2] holds 91.1 percent of the financial system assets. During 2011 banks were highly active in the lending market owing to trends in recovering real sector of the economy and increased remittances in the post-crisis period. Banks seeking to stimulate lending to legal persons, a stably performing AMD/USD exchange rate, and the launch of the Subsidized Agricultural Lending Program of the Government all further contributed to the active lending. The trend of faster growth in lending to legal persons over natural persons persisted during 2011.

In the period under review commercial banks further branched out while broadening the spectrum of quality services and products, thus increasing accessibility to the banking services and progressing with the banking culture.

During 2011 assets of banking system posted a rapid growth in line with the nominal GDP growth, pushing the ratio of banking system assets to GDP up by 9.6 pp to 54.1 percent at the end of the year (this indicator still lags behind the respective indicator of à number of CIS countries). Similarly, the ratio of banking system loans to GDP has risen by 6.3 pp to 31.6 percent, as a result of faster growing loans in relation to the GDP growth.

Chart 7: Financial intermediation



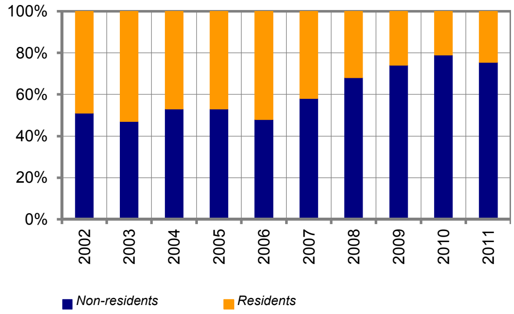
The ratio of bank-attracted deposits to GDP has increased by 5.3 pp and reached 24.5 percent at the end of the year. Also, the ratio of broad money to GDP has increased by 3.5 percent and amounted to 29.5 percent at the end of the year.

In the period under review statutory capital of the banking sector has increased by AMD 34.7 billion. As a result, the share of non-resident participation in the statutory capital has reduced by 3.8 pp to 75.1 percent at the end of the year.

Total capital of the banking sector has grown by 11.6 percent (AMD 37.0 billion) and total assets, by 32.4 percent (AMD 506.3 billion). The ratio of capital to assets, a.k.a. the leverage ratio, has dropped by 3.2 pp and amounted to 17.2 percent.

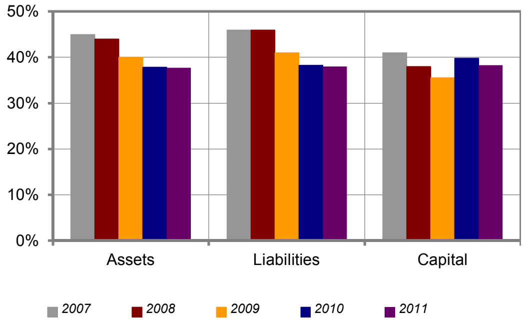
2 This refers to the 21 commercial banks functioning in the territory of the Republic of Armenia.

Chart 8: Foreign participation in Armenia's banking capital



Source: Central Bank of Armenia

Chart 9: Share of 4 largest bank assets, liabilities and capital in total banking system



The Herfindahl-Hirschman Concentration Index

	31.12.08	31.12.09	31.12.10	31.12.11
Total assets	0.07	0.07	0.07	0.07
Total liabilities	0.07	0.07	0.07	0.07
Total capital	0.06	0.06	0.06	0.06

Source: Central Bank of Armenia.

The Herfindahl-Hirschman Index of Concentration[3] for some balance sheet items (assets, liabilities, capital, loans, and deposits) of the banking system further denotes a low level of system concentration, which limits the likelihood of the impact of risk concentration on the financial stability.

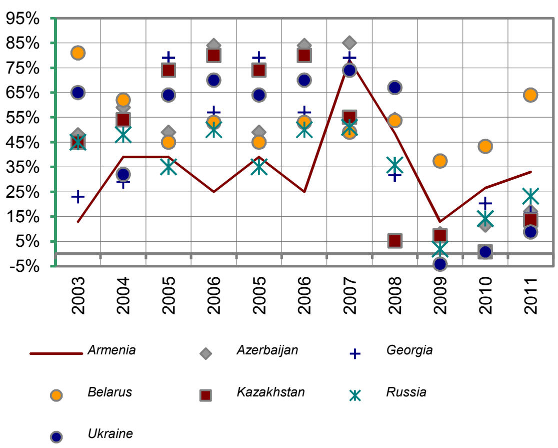
The shares of capital, assets and liabilities of 4 largest commercial banks have contracted by 0.2 pp, 0.3 pp and 1.5 pp and amounted to 37.7 percent, 38.0 percent and 38.3 percent, respectively.

Banking system financial risks and financial performance

Credit risk

During 2011 lending to the economy has grown by 36.2 percent (26.3 percent recorded in 2010). Despite a marked increase of the bank loans to GDP ratio in the period under review, it is still low and the number of potential borrowers is still great. This means that lending could expand while financial intermediation grow stronger on the back of economic growth, continued increase in household incomes and further easing of terms of lending.

Chart 10: Annual growth of loan portfolio



In 2011 the growth rate of lending exceeded the growth rate of total assets by 3.8 pp. As a result, the share of loans in total assets has increased by 1.6 pp and reached 58.6 percent at the end of the year.

Relative to the beginning of the year, the share of non-performing loans (classified as "watched", "substandard", and "doubtful") has grown by 0.3 pp and made up 3.4 percent in total loan portfolio. In the total loan portfolio structure, the share of non-performing

3 The Herfindahl-Hirschman Concentration Index varies between 0 and 1, characterizing the level of concentration (values near to 0 denote lower concentration).

Chart 11: Share of non-performing loans in total loan portfolio

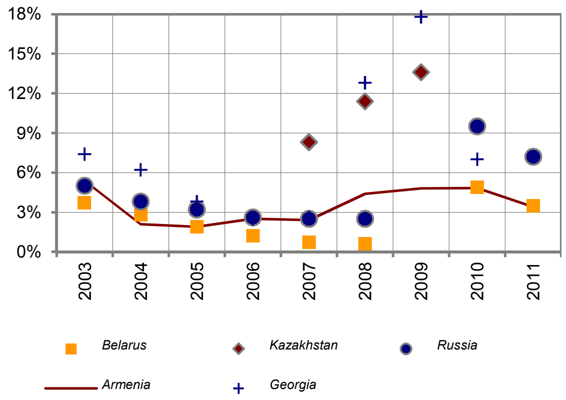


Chart 12: Volume of loans to the economy

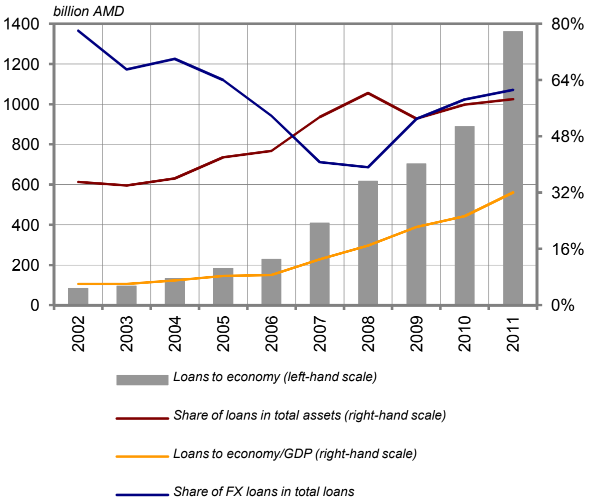
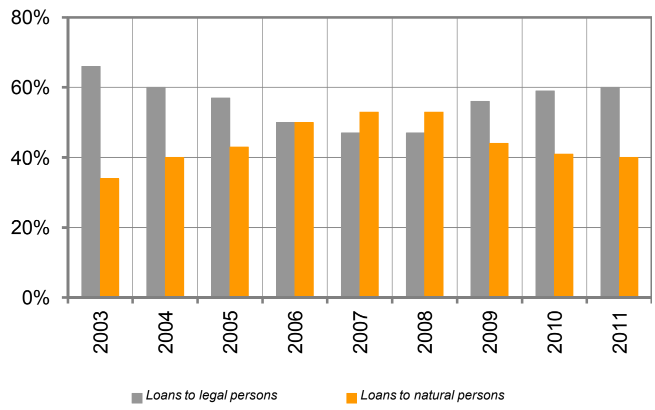


Chart 13: Share of loans to natural persons and legal persons in total loan portfolio



loans was relatively high in loans provided to *public catering (5.2 percent), agriculture (4.7 percent) and trade (4.2 percent).*

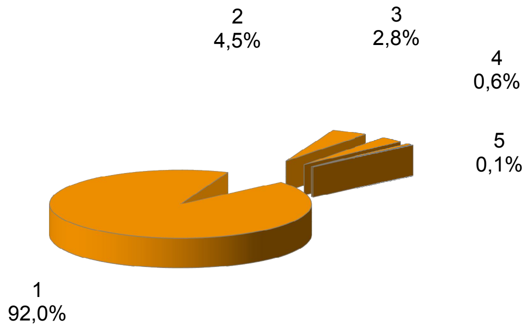
As calculated by the IMF methodology, the share of non-performing loans (classified as "substandard", "doubtful" and "loss") in total has dropped slightly and amounted to 5.3 percent at the end of the year.

In the period under review the share of loans to legal persons has grown by 1.4 pp in relation to the start of the year and reached 60.0 percent at the end of the year (back in 2009, another year of financial and economic crisis, banks had their lending policies redefined by prioritizing provision of loans to legal persons so as to ensure economic growth).

Relative to the start of the year, loan investments[4] have grown by 33.0 percent and reached AMD 1 trillion 362 billion at the end of the year. Moreover, all sectors of the economy posted growth in lending. The highest increases were reported in public catering and services, transport and communications and agriculture, by 65.7 percent, 60.0 percent and 49.2 percent, respectively. In the loan portfolio, loans to trade hold the largest share, 21.3 percent, followed by loans to processing industry, 11.7 percent, and mortgage loans, 8.5 percent.

4 The volume of loan investments varies from the volume of loans provided to the economy as it also includes loans to credit organizations, and deposits, lease, factoring and repo operations.

Chart 14: Risk weighted assets in bank capital adequacy ratio, as of 31.12.2011



1. Credit risk,
2. Interest rate risk,
3. Operational risk,
4. ²Foreign exchange risk,
5. Capital instrument price risk.

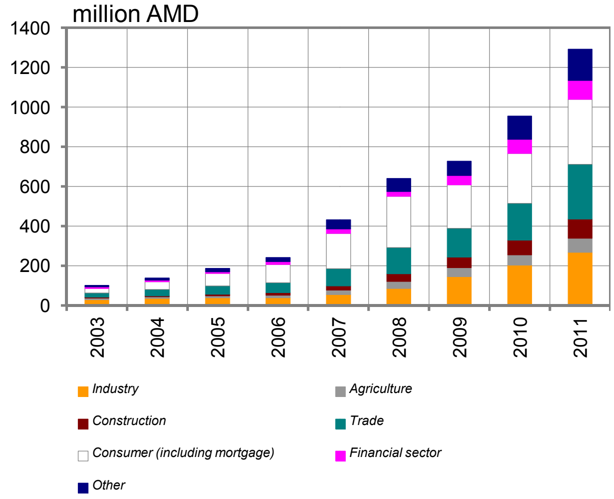
Source: Central Bank of Armenia.

The Herfindahl-Hirschman Concentration Index of loan investment by economic sectors remained unchanged, 0.11, pointing out to the moderate concentration of loans by sectors of the economy. However, the same indicator based on a bank average was 0.17 which denotes a relatively higher sectorial concentration of loans provided by some banks.

In the period under review the ratio of net provisioning against assets loss to total assets has increased by 0.3 pp and amounted to 0.9 percent at the end of the year.

The results of credit risk assessment test scenarios showed that the amount of potential banking system loss has grown a little in relation to the start of the year, due to faster growing rate of loan portfolio over that of total regulatory capital.

Chart 15: Balance of bank loans to residents, by



Liquidity risk

In 2011 the banking system liquidity trended down because of fast growing rate of loans provided by the banking sector. During the year, however, the level of liquidity has been roughly twice as high as the minimum requirement. Relative to the start of the year, the standard of total liquidity has fallen by 1.6 pp and current liquidity, by 10.7 pp, having reached, respectively, 27.9 percent and 120.8 percent at the end of the year[5].

The maturity gap analysis shows that there has been a noticeable variance observed for certain maturities of assets and liabilities. Specifically, the assets to liabilities ratio is 95 percent for up to 180-day maturity group (including demand resources), that ratio is 73 percent for 180-365-day maturity group, it reaches 180 percent for 1-3-year maturity group and the ratio amounts to 150 percent for over 3-year maturity group. Because a negative maturity gap has been reported for the 180-365-day maturity group, the banking system has plenty of time to adjust the gap as appropriate.

Foreign borrowings of commercial banks have grown by 62.7 percent and reached AMD 295.7 billion. The amount of funds attracted from international financial institutions has doubled, reaching 37.4 percent of total foreign borrowings.

The main lender countries to the banks included Russia (15.7 percent), Luxemburg (11.9 percent), Germany (7.2 percent), Netherlands (5.8 percent) and France (4.9 percent). The share of long-term loans amounted to 86.8 percent, which turns the likelihood of refinancing of those liabilities to almost zero. There has been a reported reduction in exposure to the concentration of banking system liabilities: during the year the share of major debt6 in total liabilities dropped by 0.4 pp to 27.7 percent.

Chart 16: Actual and regulatory banking system liquidity ratio dynamics

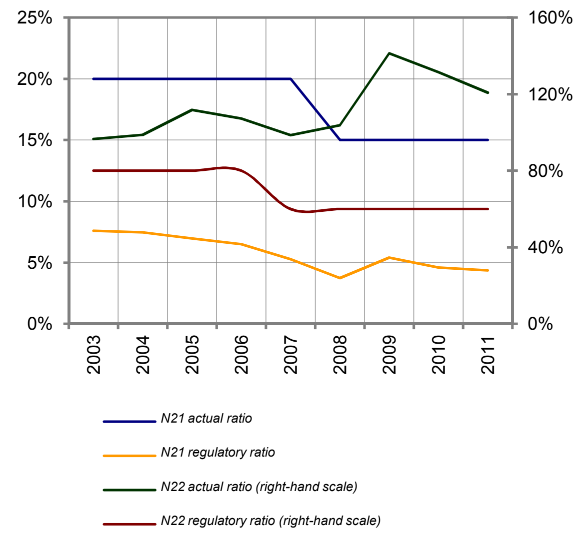
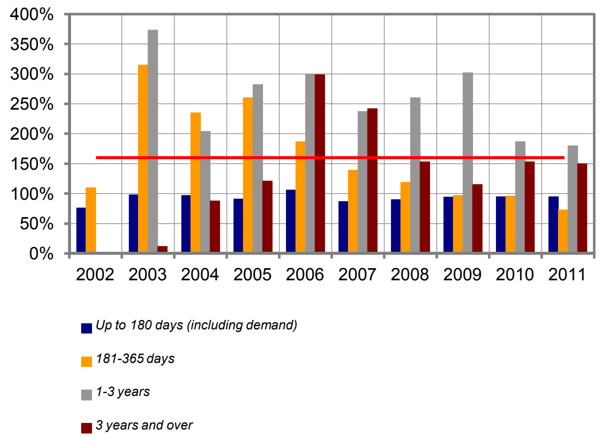


Chart 17: Assets to liabilities ratio by maturity baskets



Based on the stress-tests results no liquidity risks are observed, yet there is likelihood of breaching, by some banks, of the total liquidity and the current

5 The standard of total liquidity is calculated as a ratio of high liquid assets to total assets while the standard of current liquidity, as a ratio of high liquid assets to demand liabilities; the minimum requirement of these standards are, respectively, 15 percent and 60 percent.

6 This represents the sum of all liabilities to one person, which individually exceed the 5 percent margin of total liabilities of a bank, without taking affiliation into account.

liquidity. Nevertheless, in case of worst possible stress-scenarios, no liquidity problems will appear in the banking system, and the likelihood of emergence of risks undermining the financial stability remains low.

The results of the test show that the banking system total and current liquidity remain above their minimum thresholds.

Chart 18: Major liabilities to total liabilities ratio in the banking system

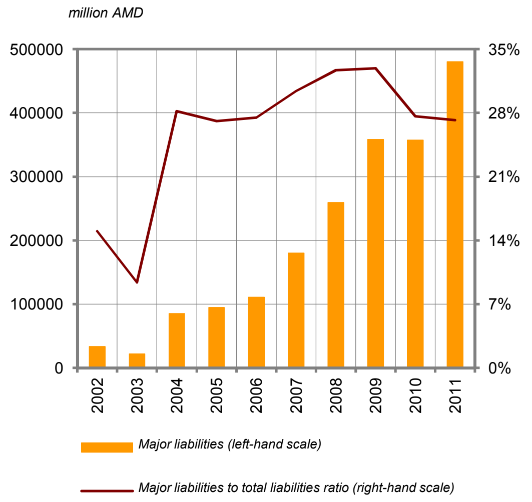
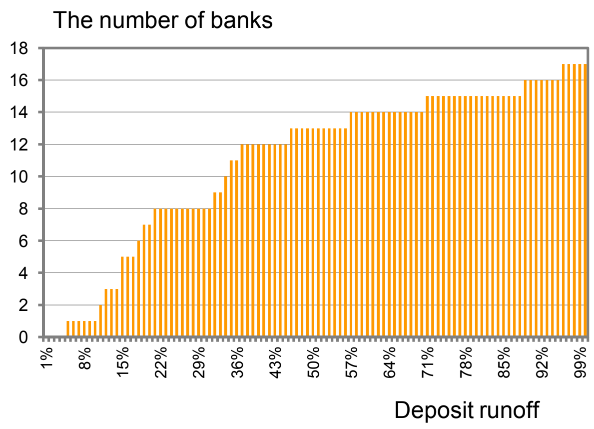


Chart 19: The number of banks in breach of total liquidity requirement in case of household deposit runoff



Market risks

Foreign exchange risk

During 2011 the Dram fluctuations against other currencies drove the banking sector to post revaluation gains which amounted to AMD 52 million. As a result of revaluation, 13 banks incurred losses and 8 banks reported profit. The banking system generated revenue of AMD 13.7 billion from foreign exchange transactions.

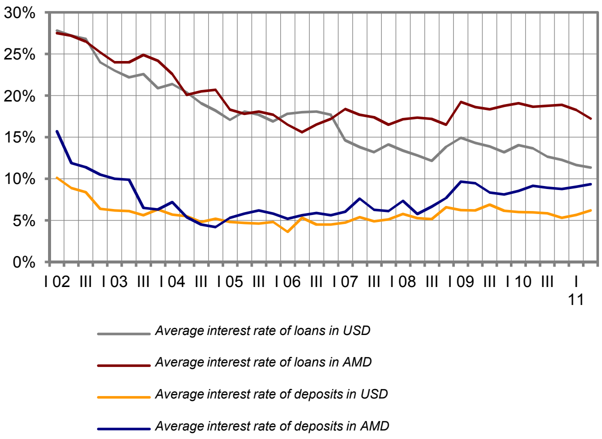
Relative to the beginning of year, the share of foreign currency loans in total loans has increased by 4.2 pp while the share of foreign currency deposits in total deposits has reduced by 0.9 pp, having reached 62.7 percent and 68.7 percent, respectively, at the end of the year. As of end-2011, commercial banks' Group 1 net position (inclusive of derivative instruments) has been a negative value, AMD 4.3 billion, which constitutes 1.3 percent of regulatory capital.

In case of worst possible stress scenarios reviewed in this stress-test, bank losses incurred as a result of foreign exchange risk are estimated to be insignificant, so the impact of such losses on the financial stability is weak.

Interest rate risk

In the period under review interest rates of both dram and foreign currency loans have dropped. Especially pronounced was the fall in interest rates of foreign currency loans, reflecting commercial banks' intention to spur up the demand for such loans, since foreign currency resources prevail in the structure of liabilities. Such interest rate falls were also fuelled by an increased competition among bigger banks, leading to the narrowing of the interest rate spread.

Chart 20: Average interest rates of bank deposits and loans



The gap of average weighted maturity of the present value of assets and liabilities is almost flat and resting around a half-a-year range. This signifies that possible fluctuations in market rates will not entail major losses in the banking system during 2012.

In case of worst possible stress scenarios, the share of commercial banks' losses in capital will neither be significant nor leave the system vulnerable to financial stability.

Price risk

In the period under review the price risk of the banking system was estimated to have been rather low. Relative to the beginning of the year, the share of available-for-sale and trading securities in total assets has reduced by 1.7 pp to 6.2 percent at the end of the year. Reported decrease of capital as a result of revaluation of available-for-sale and trading securities amounted to AMD 856 million (0.3 percent of capital).

Risks associated with real estate price volatility remained well manageable. Armenian commercial banks further originated mortgages at no more than 60-80 percent of the *loan to value* ratio while taking quite a strict approach in evaluating borrower credibility. Such restrictions are very effective as they hold back potential risks from real estate price volatilities.

Capital adequacy and profitability

The capital adequacy and profitability indicators of the Armenian banking system are strong enough in comparison with some East European countries. High level of profitability and capital adequacy of banks provide cushion for absorbing risks with its own resources. During 2011, as a result of brisker lending policy, the growth of risk weighted assets again outpaced the growth of regulatory bank capital thus driving the capital adequacy ratio of banking system down by 1.7 pp against the start of the year to 18.3 percent at the end of the same year (an established minimum requirement threshold is 12 percent).

Chart 21: Total capital adequacy by banks, as of 31.12.201[1]

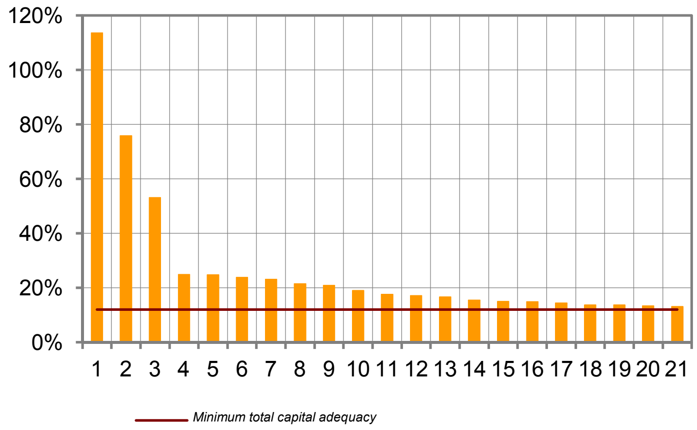


Chart 22: Profitability ratios in the banking system

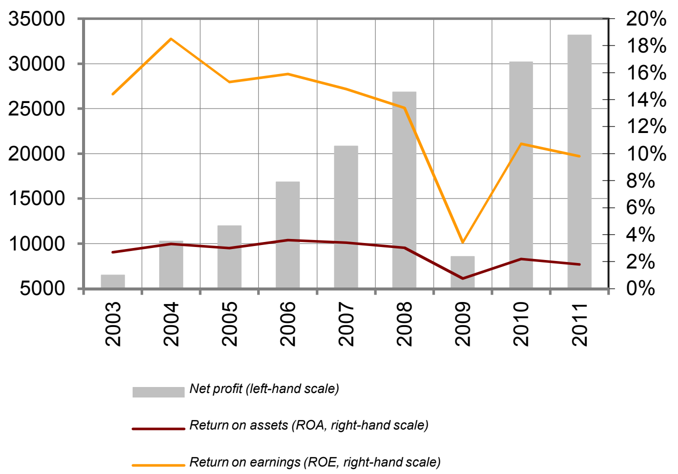
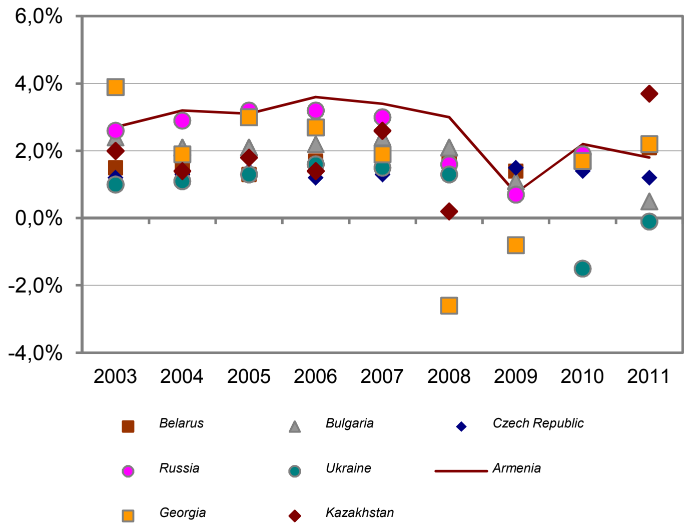


Chart 23: Banking system RoA in selected East European and CIS countries



During the year, 4 banks added a total of AMD 34.7 billion to the statutory capital. By individual banks, the capital adequacy ratio was above 12 percent. Commercial banks remained strongly capitalized; no violation of the capital adequacy requirement has been committed by commercial banks.

Profit and profitability indicators of commercial banks remained strong thanks to heightened activity in the lending market and to the absence of sharp fluctuations of the exchange rate of foreign currency.

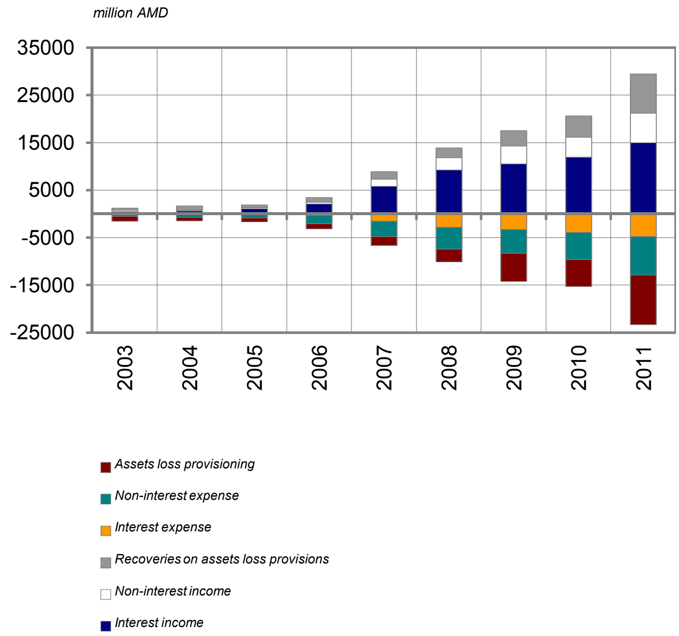
In 2011, relative to the previous year, the banking system's profit, calculated in accordance with Central Bank requirements[7], has grown by 9.9 percent to have amounted to AMD 33.2 billion. In the same reporting period, 19 banks posted profit and 2 banks posted loss. The profitability figures were as follows: return on assets, 1.8 percent; return on equity, 9.8 percent.

In the period under review, relative to the previous reporting period, gross revenues of the banking system have grown by 22.0 percent to have reached AMD 292.3 billion, and gross expenditures have grown by 24.3 percent to AMD 249.4 billion at the end of the year.

Overall, in the period under review, relative to the previous reporting period, the share of interest income and interest expense has

7 The main difference between the Central Bank and IFRS reporting modules is pertinent to the provisioning of standard assets.

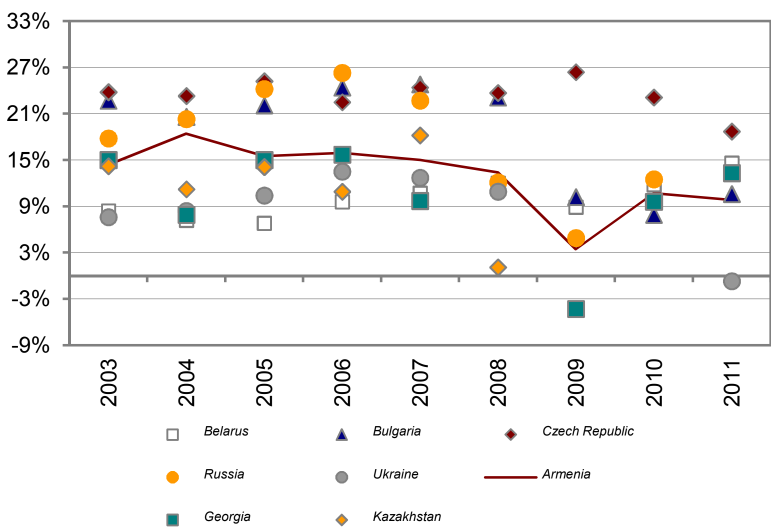
Chart 25: Banking system income and expense account



increased and the share of non-interest income, non-interest expense and provisions to and recoveries from assets loss reserve funds have decreased.

Profit of the banking system calculated in accordance with IFRS amounted to AMD 43.1 billion in 2011, and in this episode return on assets was 2.3 percent and return on equity was 12.7 percent.

Chart 24: Banking system RoE in selected East European and CIS countries



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

In the supervision and regulation framework stipulated by the law the Central Bank ensures one of its goals of securing stability, liquidity, solvency and soundness of the financial system, creating necessary conditions for development and sound performance of clearing systems, creating proper conditions for coordinated operation and future development of a fair, transparent and sustainable securities market, as well as protecting interests of the investors and consumers of financial services.

Modern developments in real and financial sectors call for the need for changes in the regulatory framework. In 2011 the Central Bank proceeded with enhancement of regulatory framework of financial sector.

Changes in the financial system regulatory framework

Legislative changes

In 2011 the National Assembly of Armenia adopted the following laws drafted by the Central Bank of Armenia Laws "On amendments in the law "On Income Tax"" and "On addenda in Civil Code of Republic of Armenia".

The purpose of those laws was to solve the taxation and legal issues arising during the confiscation of collateral.

According to the tax legislation in force prior to amendments, the transfer of the ownership of the collateral to the bank for further sale was considered as a sale by pledger, which created obligation of income tax payment.

The bank acting as a tax agent was obliged to pay the income tax at its own expenses, as the further sale of the collateral would cover neither credit liability nor the amount of mentioned income tax. Besides, the legislation didn't clearly define when the difference between the value of confiscated property and the credit liability is due to be paid to the pledger.

The adopted law defines new taxation mechanisms of natural persons' income rising from the out-of-court confiscation and further sale of the pledged property.

According to the law the income of the debtor is the positive difference between selling price of collateral and credit liability.

It is intended to have three possible options for defining **"the selling price of the property and selling moment (and hence moment for returning of excess amount)".**

1) **Option 1**- The pledged property is sold to third party during six month period from the day when the ownership of property was transferred to the bank. In this case as a sale price and moment of selling is considered *the sale date and price* of the property by the bank. When the sale price is unreasonably lower than the *market price of the property*, then the market price of the property is considered as the selling price of the property, except when the property was *re-sold to the previous owner or owner's legal successor*.

2) **Option 2**- The bank **did not sell** the property in six months from the day the property came into its ownership. In this case as a sale moment and price are considered the last day of six-month period and *the market price at that day*.
3) **Option 3**- According to a **contract preliminarily signed** by bank and pledger. In this case the parties can agree that in future in case of transfer of the ownership to the bank the sale moment and price is considered the day when the ownership passed to the bank and the market price at that day.

The above mentioned six-month period doesn't include the timeframe, when the collateral was arrested within the framework of civil, criminal, bankruptcy or administrative suite, where pledger or its successor took part.

Laws "On amendments and addenda in the law "On Insolvency"" and "On addenda in the law "On Compulsory Enforcement of Judicial Acts"".

The laws define that:

- The creditor with claims secured with collateral, guarantee or surety has the right to receive the fulfillment of secured claim regardless of moratorium. It means that financial organizations or any other parties have the right to receive fulfillment of their claims from collateral or means of the parties which provided guarantee or surety, without having to wait until the end of the insolvency process.
- At the same time, for the protection of interests of other participants of insolvency process two possible options were defined:
  - If the party exercises its right for early fulfillment from the collateral (without having to wait for the end of moratorium), then the party is not eligible (also in the future) to receive compensation above the value of collateral from other property of debtor,
  - If the creditor does not exercise the above mentioned right, then it receives the compensation after the moratorium, but from both collateral and other property of debtor.

Laws "On amendments in the law "On Circulation of Credit Information and Activities of Credit Bureaus" and "On amendments in the law "On Electronic Communication".

The presentation of the laws was conditioned by the adoption of Government decree No. 1768-N "On Approving Business Environment Improvement Program and Annulment of Government Decree No. 97-N January 21, 2010" on December 9, 2010.

According to amendments to the law "On Electronic Communication" providing credit information (debts for telephone bills) concerning their clients to credit bureaus by the telecommunication operators is not considered as publishing of private information.

As a result the telecommunication operators will have the right to provide information on their clients to credit bureau. But this information is not classified as mandatory information submitted to credit bureau. This means that providing information is possible only in case of existence of agreement between telecommunication operator and credit bureau having the telecommunication operator preliminarily warned their clients that their information might be provided to credit bureau.

After the adoption of law *"On amendments in the law "On Circulation of Credit Information and Activities of Credit Bureaus*" the credit bureau is obliged to include a note in credit report clarifying which parties provided information included in credit report taking into consideration the fact that now the credit bureau is collecting information not only about the customers of financial organizations, but also of other parties. In the credit report the bureau should mention that the presented information is based on the information provided by banks, credit organizations or for example from utility companies. If necessary, the Central Bank will define the list of information included in the credit report with the view of ensuring uniformity of the form and content of credit reports provided by all credit bureaus.

Law "On amendments and addenda in the law", "On Payment and Settlement Systems and Payment and Settlement Organizations", which defines the minimum total regulatory capital requirement, clarifies the terms and conditions of creation of payment and settlement systems and participation to those, clarifies the procedure of the foundation of payment and settlement unions, the procedures of the delegation of payment and settlement functions, the licensing procedure for payment and settlement organizations.

The law allows performing money transfers without opening a branch. The types of payment and settlement services were clarified, and definitions of latter were brought in compliance with EU legal requirements at the same time taking into consideration the characteristics of Armenian financial system. The issues related with taking actions against of payment and settlement organizations were regulated.

In 2011 the Central Bank of Armenia presented the following draft laws to the Government of Armenia:

Draft laws "On amendments in the law "On Central Bank of Armenia"", "On amendments in the law "On Administrative Violations"

The development of mentioned draft laws is conditioned by transfer of the functions related to the calculation of the balance of payment, international investment position and external debt to the Central Bank.

For the execution of the mentioned functions the related state bodies will assist the Central Bank. For compiling statistics on the balance of payments, international investment position and external debt the National Statistics Service (NSS) will provide the Central Bank with non-personal data.

After the adoption of laws the business entities (including non-financial entities) will be entitled to submit some of the statistical reports to the Central Bank formerly submitted to NSS.

Regulatory changes

In 2011 the Central Bank developed and revised the following regulations concerning banking activities:

1. Regulation No 1 "Registration and Licensing of Banks and Branches of Foreign Banks, Registration of Bank Branches and Representative Offices, Qualification and Registration of Heads of Banks and Branches of Foreign Banks", where the following changes were introduced:
   - In case of obtaining significant participation, in the documents presented to the Central Bank the significant participant should mention willingness or unwillingness to provide financial support in case of deterioration of bank's financial standing.

- During their future service the head and members of board of commercial bank can be invited to the Central Bank for additional interview at the Central Bank Board meeting with the view of examining the professional compliance.
- The head (employee) of bank's financial intelligence unit is considered as a managerial employee, and the qualification and registration procedures were harmonized with qualification and registration procedures of other managerial positions.
- The managers and employees subject to registration under the law "On Investment Funds" (in force from January 9, 2011) were included in the standard request form for the registration of managers and employees.
- It is intended to create unified electronic database by state bodies responsible for the registration of charters of legal entities, which can be used by all interested parties.
- Amendments and addenda were introduced to the list of the documents presented for registrations, licensing, and registration of branches and representative offices.
- Amendments and addenda were introduced to the list of documents and information presented to the Central Bank for receiving consent for obtaining significant participation.
- The list of the information and documents was defined, which the organization should periodically present to the Central Bank.
- Procedures were set up for the registration in line with the regulations, for providing, altering and returning of copies of registration certificates.
- An appropriate form was defined for opening accumulative account in the Central Bank intended for replenishment of the statutory capital.
- Qualification requirements are defined for the head and members of the liquidation commission, and in case of the delegation of those functions for the persons responsible for the fulfillment of the delegated functions.

As a result of those amendments, in case the financial standing of the bank deteriorates, it will be possible to use the additional financial resources provided by the significant participants and improve bank's financial standing. Besides, the registration procedures of the head (employee) of financial intelligence unit and other managers of the bank will be harmonized; it will be possible to ensure the requirements of the clauses of the law "On Investment Funds", and also procedure for registration of all managers and employees subject to registration by the Central Bank through unified petition.With the view of supporting the improvement of business environment in Armenia the procedure of submitting charters to various parties and bodies by the legal entities was eased. The amendments will allow ensuring efficient consolidated supervision through reports (information) periodically submitted to the Central Bank by financial organizations (the definition of the mentioned requirement was also conditioned by the necessity of complying to Basel principles).

2. Regulation No 2 "Regulation of Banking; Prudential Requirements for Banking", where the following changes were introduced:
   - The metal accounts are included in the calculation of foreign exchange risk, which is part of capital adequacy ratio.
   - For the standardized gold bars with no less than 999 proof 50 percent risk weight was defined.

- The funds attracted through metal accounts (except correspondent accounts) are subject to reserve requirement in Armenian dram.
- The banks are obliged to keep the whole 12 percent of attracted foreign exchange funds in Armenian dram as a result of changes to reserve requirement mechanism, which is aimed at fighting dollarization of the economy.
- The tangible assets, which were obtained for financial leasing or came into the ownership of the bank as a result of solution or ending of leasing contract, are reduced from the core capital of the bank in one year after the day of their registration in the balance sheet(formerly the period was six months).
- The funds attracted through overnight contracts signed at credit platform of NASDAQ-OMX (which are reflected in the correspondent account at the Central Bank) and deposits in the Central Bank with maturity more than three working days are excluded from the calculation of highly liquid assets.
- An exception was made from the requirement that the subordinate borrowings cannot be redeemed prematurely, for the cases when the whole amount (before the redemption date) is directed to the replenishment of statutory capital.
- As a result of changes in the accounting some of the articles of the "Chart of Accounts of Banks, Credit Organizations, Investment Companies, Investment Funds and Investment Fund Managers" (new chart of accounts) it was necessary to adjust the structure of the components of economic prudential ratios, which resulted in following changes:
  - In the structure of N1 prudential requirement from credit risk were excluded the securities obtained through repo agreements and differences of foreign exchange swaps, and were included securities sold through repo agreements, the interests receivable from foreign exchange swaps and differences from revaluation. The securities obtained through repo agreements and liabilities for capital tools obtained through repo agreements were included in interest and capital risks.
  - The securities obtained through repo agreements, which according to chart of accounts will be accounted in off-balance, will continue to be included in the highly liquid assets for the calculation of N2 prudential requirement. The repo agreements are not excluded from the total assets any more.
  - For the calculation of the foreign exchange prudential requirements in the structure of foreign exchange position without derivatives the off-balance (forward) part of foreign exchange swap will be included.

The purpose of those changes was to regulate the calculation of capital adequacy, liquidity and reserve prudential requirements, issues related to leasing activities, when the leasing contract is solved prematurely and the bank has to find a new leaser. The mentioned changes will allow increasing the efficiency of risk assessment and mitigation and supervision of financial institutions.

3. Amendments and addenda were introduced in Regulation No 3 "Banks' Reports; Submission and Publication of Banks' Reports", according to which the reporting forms and guidelines for filling them in were brought in compliance with the changes in Regulation No 2 "Regulation of Banking; Prudential Requirements for Banking". The sectoral structure of the indicators included in reporting Form No 6 "Report on credit investments, accounts receivables and investment securities" was changed. The purposed structure is

necessary for the precise calculation of financial intermediation in the GDP with FISIM method (Financial Intermediation Services Indirectly Measured). The sectoral breakdown used in the report was performed according to second edition of "Statistical Classification of Economic Activities".

4. The regulation "On Opening and Running of Unallocated Metal Accounts" was adopted by the Central Bank Board, which is aimed at defining the procedures of opening and running unallocated metal accounts, the allowed transactions with unallocated metal accounts and restrictions on such transactions. Particularly it was defined that:
   - The unallocated metal account is a demand or term account, which can be opened for individuals and legal persons. It is intended for accounting non-cash gold (only 999.5 and 999.9 proof), at the same time only the weight and proof of are stated.
   - The metal accounts are not considered as bank deposits and are not guaranteed.
   - For opening and running unallocated metal accounts the banks should obtain consent of the Central Bank through presenting appropriate internal legal acts and other documents.
   - The banks can withdraw or add funds to metal accounts through non-cash transfer of gold from metal account in the same bank or in other bank or through buying (selling) gold from bank. No other transactions can be carried out through metal accounts except those stated above, including lending on metal accounts, withdrawal or adding of non-financial funds from/to metal accounts.
5. In the regulation "On the Minimum Requirements Imposed on Financial Institutions in the Field of Combating Money Laundering and Terrorism Financing" amendments were introduced according to which the responsibilities of the head (employee) of the bank's financial intelligence unit cannot be delegated to the head (employee) of bank's internal audit.
6. New edition of Resolution N-39 "On Approval of the Procedure of Election of Independent Audit Company by Banks Operating in Republic of Armenia" was approved, which clarified the requirements imposed on the party conducting audit of financial and economic activity. In particular it was defined:
   - At least 5 years of experience in auditing of banks or insurance companies. Moreover, the requirement of the experience in auditing of banks or insurance companies does not apply to internationally recognized audit companies (10 best audit companies).
   - The audit company agrees to take part in trilateral meeting between bank, audit company and Central Bank for the discussion of the results of the external audit with the invitation of the Central Bank and by the agreement signed with the bank.
   - The same responsible auditor cannot conduct the audit of the financial and economic activity of the same bank, if he continually conducted the audit of financial and economic activity of that bank during the 3 financial years preceding the given financial year.
7. The regulation "On Providing State Registration Information of the Organizations Registered by the Central Bank to the State Revenue Committee", the purpose of which is to implement "one window" principle and also regulate the process of the providing of information to the State Revenue

Committee (SRC) by the Central Bank. The main principles of the regulation are:

- For issuing tax identification number (TIN) the Central Bank provides online the following information to SRC: the complete name of the organization, the legal type of the organizations, number of registration certificate, date of registration, location of registration, types of activities, the addresses of the locations of operation, the passport data and telephone numbers of the director and chief accountant, the method of the creation of the organization (through founding or reorganizing).
- After receiving the mentioned information SRC provides online to the Central Bank TIN of the organization and the name of tax office serving the organization.
- The Central Bank also provides to SRC information on giving consent of termination of the activity or liquidation of financial organization.

8. The Central Bank Board adopted regulation "On Merger of Banks", the purpose of which is to enable the Central Bank to assess the impact of the merger on the financial standing of the preserved organization and also to disclose possible risks and efficiently supervise the process. The regulation "On Merger of Banks" defines:
   - The scope of information, the terms, forms and procedures of its submission to the Central Bank for receiving preliminary consent for merger contract.
   - The documents and information presented for the approval of merger contract.
   - The procedure of presenting approved transfer deed and documents to the Central Bank for registering newly approved charter or the amendments and addenda to charter of preserved organization.
   - The procedure of publishing the merger announcement.

9. The "Requirements for the Voluntary Funded Pension Deposit's Contract" were approved by the Central Bank Board, the purpose of which is to ensure efficient operation of "voluntary funded pension deposit" pension scheme and the protection of depositors' rights in this field. The decree defines the minimum requirements for voluntary funded pension deposit's contract, in particular:
   - The bank stipulates in the contract the procedures and conditions of the deposit, the maturity, terms, conditions of calculation and payment of pensions/interests, as well as taxation principles and procedure of the transfer of pension funds or part of them to insurance company with the view of signing an annuity contract.
   - Non-payment of periodical payments by depositors is not considered as violation of contract and cannot lead to penalties, fines or any other consequence for the depositor.
   - The transactions with pension deposit are carried out in Armenian dram.
   - The pension deposit cannot be pledged as a guarantee for the execution of a liability.

10. The Central Bank Board approved the regulation "On the Forms, Submission Terms and Periodicity of the Reports Submitted to the Central Bank by the Banks in Liquidation Process", amendments and addenda were introduced to regulation "On Publishing Information on Activities of Liquidation Commission of the Banks and Credit Organizations in Liquidation Process" and to the "List of Documents Presented to the Central Bank for Receiving Preliminary

Consent for Liquidation of a Bank by the Decision of the Board and Liquidation Permission".

- The list of documents and information required for the preliminary consent for self-liquidation of banks and for permission for self-liquidation was clarified.
- The terms, procedures and forms of the reports submitted to the Central Bank by the liquidation commission (trustee) on the process of self-liquidation (liquidation).
- The list, publishing procedures and forms of the information published by liquidation commission on liquidation process were amended.

The above mentioned decrees ensure the completeness of the self-liquidation (liquidation) processes of the banks, which will contribute to the protection of rights and legal interest of the debtors as a result of self-liquidation (liquidation) process, disclosure of possible risks and their efficient supervision, and also to the transparency of the self-liquidation (liquidation) process carried out by liquidation commission.

11. The Central Bank Board approved "The Chart of Accounts for the Banks, Credit Organizations, Investment Funds and Investment Fund Managers operating in the territory of Republic of Armenia" and "The Application Instruction of the Chart of Accounts for the Banks, Credit Organizations, Investment Funds and Investment Fund Managers operating in Republic of Armenia", as a result of which:

- Instead of separate chart of accounts for banks, credit organizations and investment companies a unified chart of accounts was implemented.
- With the view of ensuring more precise and comprehensive classification of the accounts in banks' and credit organizations' chart of accounts the four digit accounts were substituted with five digit accounts.
- The securities obtained through repo agreements were moved to off-balance, as the risks and benefits of the securities obtained through repo agreement are not transferred to the party obtaining the securities, and according to IFRS the asset cannot be accounted in balance sheet, if the transfer of the risks and benefits of the asset did not occur.
- The foreign exchange swaps should be accounted in off-balance in accordance to the accounting principles of other derivative instruments.
- "Unrecognized interest income" was excluded, as according to IFRS the interest of the assets accounted in balance sheet should be accrued and recognized as income regardless whether the asset becomes classified or not.
- Following the requirements of IFRS that non-current assets for trade should be accounted separately from other assets, for those assets separate accounts were implemented in the chart of accounts.
- The accounting methods were changed for all those accounts that should be measured at amortized cost using effective interest rate method.
- Number of accounts were added, which lacked in charts of accounts in force, due to number of issues revealed in current chart of account.

Based on the fact that the charts of accounts of banks and credit organizations did not comply with the IFRS requirements new chart of accounts was introduced to address those incompliances. It is expected that as a result of changes the comprehensive implementation of IFRS compliant accounting at financial organizations will be ensured.

12. As a result of adoption of "The Chart of Accounts for the Banks, Credit Organizations, Investment Funds and Investment Fund Managers operating in Republic of Armenia" and "The Application Instruction of the Chart of Accounts for the Banks, Credit Organizations, Investment Funds and Investment Fund Managers operating in the territory of Republic of Armenia" number of legal acts were adjusted:
    - **Regulation No 3** "Banks' Reports; Submission and Publication of Banks' Reports", **Regulation No 15** "Reporting Forms of Credit Organizations, Their Submission and Publishing", **Regulation No 2** "Regulation of Banking; Prudential Requirements for Banking", **Regulation No. 14** "Regulation of Activities of Credit organizations; Prudential Standards for Activities of Credit Organizations". The guideline tables were excluded from Regulation No 3.
    - Regulation on "Classification of Loans and Receivables, and Loan Loss Provisioning in Banks operating in Republic of Armenia", which "Unrecognized interest income" was excluded from, as interest from non-performing assets should continue to be accrued and recognized as income, according to IFRS.

13. With the view of defining and regulating the process of changing the type of activities carried out credit organization (to be registered and licensed as a bank) arising from the provisions of the law "On Credit Organizations" the Central Bank introduced amendments and addenda to number of legal acts.
    - Regulation No 1 "Registration and Licensing of Banks and Branches of Foreign banks, Registration of Bank Branches and Representative Offices, Qualification and Registration of Heads of Banks and Branches of Foreign Banks",
        - For receiving preliminary consent for changing the type of activities the credit organization parallel to business plan should present to the Central Bank the calculation of prudential ratios for the last two months in accordance with Regulation No 2 and documents about the participants.
        - The preliminary consent of the Central Bank to the request assumes preliminary consent for receiving banking activity license and consent for significant participation in newly established bank.
        - For licensing purposes the credit organization should present to the Central Bank all documents indicated in Regulation No 1 required for licensing and registration, and all needed documents for branches and representative offices.
        - In case of sufficient statutory and total capital the presence of funds in accumulative account at Central Bank is not required.
    - Regulation No 8/03 "Information Disclosure by Banks, Credit Organizations, Insurance Companies, Insurance Brokers, Investment Companies, Central Depository and Money Transfer Clearing Companies":
        - The credit organization is required to publish information about the decision of changing the type of activities, on the date of receiving preliminary consent of the Central Bank and also publish the approximate date for applying for banking license.
        - The credit organization should publish this information in its own website, media, at own premises and through e-mail.

Reforms of the regulation framework come out of the necessity to provide solutions to the new challenges rising in light of the new developments in the financial system. The Central Bank identifies system risks and challenges affecting the sustainability and development of Armenian financial system, carries out research and proposes institutional and legal solutions thereto. The Central Bank keeps track of the trends and developments, as well as the new technologies emerging in global financial markets, and provides respective suggestions where their introduction and implementation is feasible.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2011

Individual departments (mainly Financial Supervision Department) of the Central Bank perform off-site and on-site inspections of the financial institutions aimed at identification of acceptable risk level for the financial system participants, combating money laundering and terrorism financing, protection of financial system consumer rights, compliance of financial system performance to regulatory framework and etc.

In 2011 on-site and offsite inspections of the Central Bank Financial Supervision Department focused on the following areas:

- internal control system,
- risk management system,
- integrity of corporate management principles,
- assessment of asset quality,
- transparency,
- IT sector,
- compliance with the requirements relating to safe and sustainable business operation,
- risk level of reinsurance,
- organization and control of Prospectus and/or Trade Prospectus registration procedures,
- control over protection of transparency, integrity and consistency of information subject to dissemination by reporting issuers,
- control over compliance of the business operations carried out by persons propounding public offerings of securities with the provisions of legislation,
- issues on prevention of operations by non-licensed entities,
- combat against money laundering and terrorism financing,
- quality of rendered services,
- consumer rights protection,
- other.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

In 2011, the Financial Supervision Department performed 235 on-site inspections.

Table 2. On-Site Inspections and Workload of the Supervisors

Indicators	2009	2010	2011
Number of Supervisors in the Financial Supervision Department	82	83	84
Total assets of commercial banks, credit organizations, insurance companies, securities market participants and pawn shops (annual average)	AMD 1.250 trillion	AMD 1.580 trillion	AMD 2.047 trillion
Average work load per supervisor of the Financial Supervision Department	AMD 15.2 billion	AMD 19.0 billion	AMD 24.4 billion
Number of inspections performed during the year, including:	539	380	235
Comprehensive inspections in banks	5	7	7
Targeted inspections in banks	29	24	13
Comprehensive inspections in credit organizations	3	6	6
Targeted inspections in credit organizations	3	2	1
Comprehensive inspections in insurance companies	4	3	3
Targeted inspections in insurance companies	4	8	-
Insurance broker companies	1	1	-
Insurance agents	-	-	38
Investment companies	8	4	4
Other participants of financial market(exchange offices, pawnshops, payments system organizations and other)	490	325	163

Compared with previous year, in 2011 the number of infringements relating to legislative issues dropped in total number of infringements identified during on-site and off-site inspections performed by the Central Bank Financial Supervision Department. Compared to the previous year, the number of penalties also decreased.

Table 3. Infringements of Financial Institutions and Penalties in 2011

Indicators	Commercial banks	Credit organizations	Insurance companies	Pawnshops	Payment system Companies*
Area of Violation					
Accounting	36	18	3		
Asset classification norms	20	9	4		
Legislation	364	133	191	76	2
Prudential standards	2	3	14		
Incompliance with instructions					
Reporting delays	5		4	7	
Inconsistent data	53	6	146	54	
Total regulatory capital		1	6		
Credit register	51	18			
Indicators	**Commercial banks**	**Credit organizations**	**Insurance companies**	**Pawnshops**	**Payment system Companies***
Penalties					
Revocation of License				2	
Fines imposed on organization	238	13	215	43	
Fines imposed on managers			5		
Penalty	1				
Warning	404	21	192	19	2
Revocation of manager's professional qualification license					
Termination of license				15	
Cessation					

* *Organizations implementing payment instruments, carrying out money transfers, processing settlement documents and performing clearing operations.*

ORGANIZATIONAL CHART OF BANKING SUPERVISORY AUTHORITY

Financial system supervision and regulation in the Central Bank is mainly performed through the following hierarchy (in the ascending order):

1. Structural Subdivisions. The main subdivisions responsible and assisting to supervision and regulation of financial system are: Financial Stability and Development, Financial System Regulation, Financial Supervision, Statistics, Legal and Financial Monitoring Center[8],
   - ✓ Standing committees: Implementation of the financial system supervision and regulation functions is supported by the Central Bank Council and Licensing and Supervision Committee.
   - ✓ The Central Bank Council is a consulting body under the Central Bank Chairman, members of which are the Central Bank Chairman, the Central Bank Deputy Chairman and heads of the divisions. As a rule, the Council regular sessions are convened once in every two weeks, but not less than once in a month. The Council sessions may be attended by the Central Bank Board members. The issues that will be discussed by the Council members during the session are in advance shared with the Central Bank Council.
2. Members of the Licensing and Supervision Committee are the Central Bank Chairman (Committee Chairman), the Central Bank Deputy Chairman (Committee Deputy Chairman), Head of the Central Bank Financial Supervision Department, Head of the Central Bank Financial System Stability and Development Department, Head of the Central Bank Financial System Regulation Department and Head of the Central Bank Legal Department. Licensing and Supervision Committee functions through sessions, which shall be convened upon necessity, but not less than once in a week.
3. The Central Bank Chairman is the highest rank official of the Central Bank. The Chairman is responsible for the fulfillment of the objectives of the Central Bank set forth by the "Law on the Central Bank of RA".
4. The Central Bank Board is the highest governance body of the Central Bank. The Board adopts normative and individual decisions. The Board is comprised of the Chairman of the Central Bank, his deputy and five members. A Board member of the Central Bank is responsible for carrying out duties reserved for him in the areas specified by the Central Bank Board. Sessions of the Central Bank Board shall be convened as a rule once in two weeks, but, no less than once a month.

Upon necessity working groups can be established within Central Bank.

8 For details of objectives and functions of departments responsible for financial supervision and regulation please visit the Central Bank website www.cba.am.

Chart 26: Organizational chart of Central Bank of Armenia

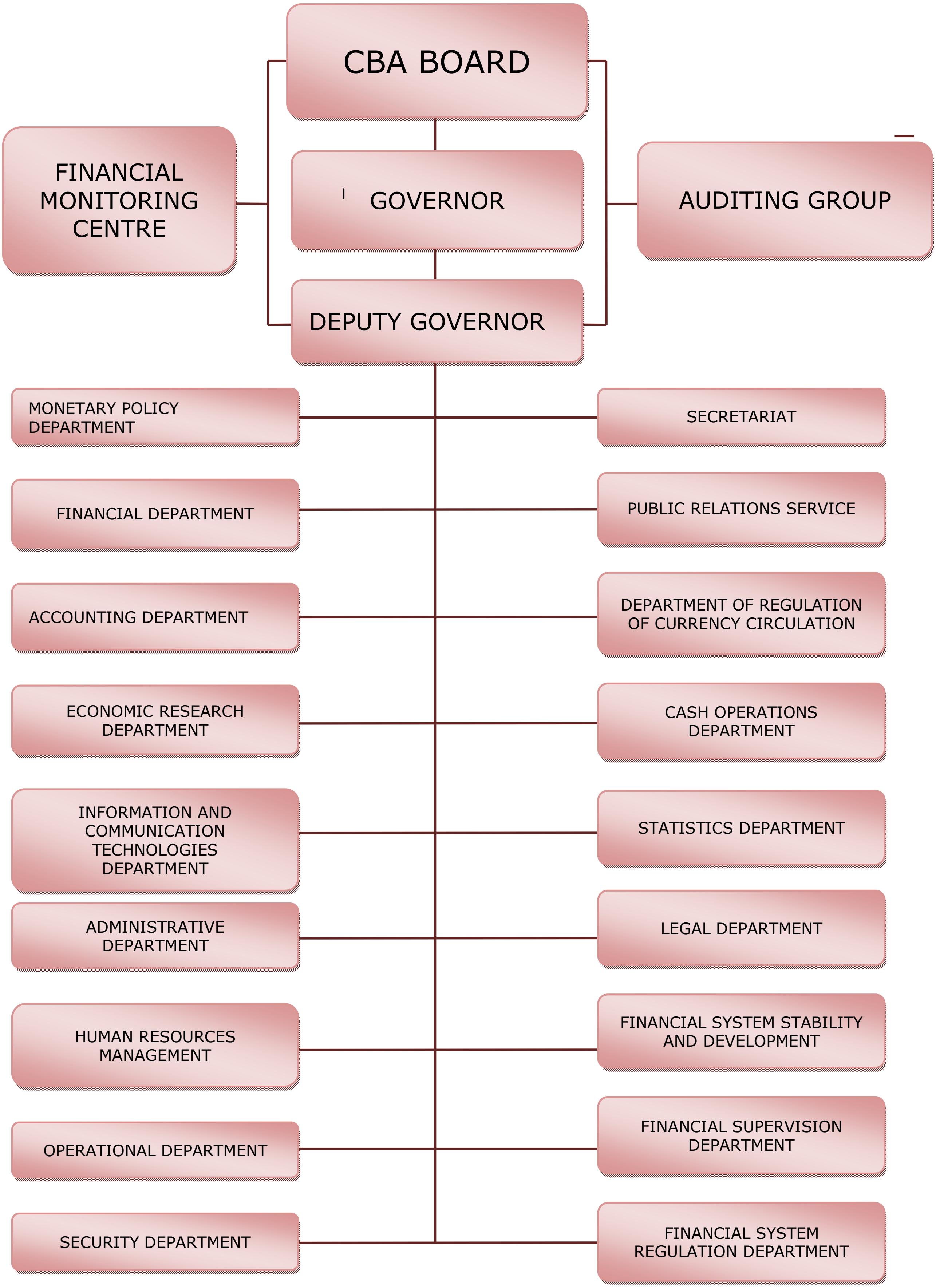


Chart 27: Organizational chart of Financial System Stability and Development Department

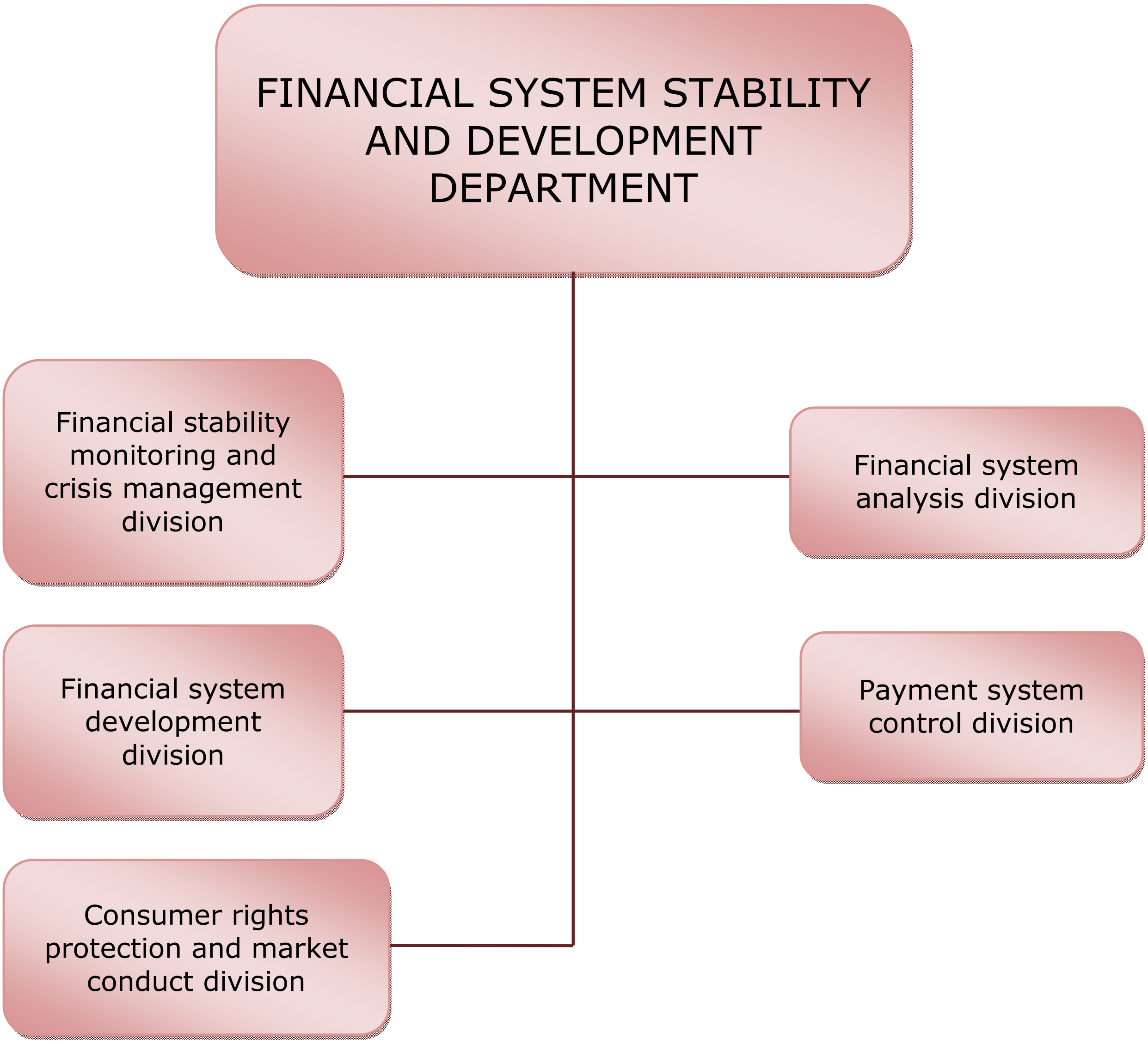


Chart 28: Organizational chart of Financial System Regulation Department

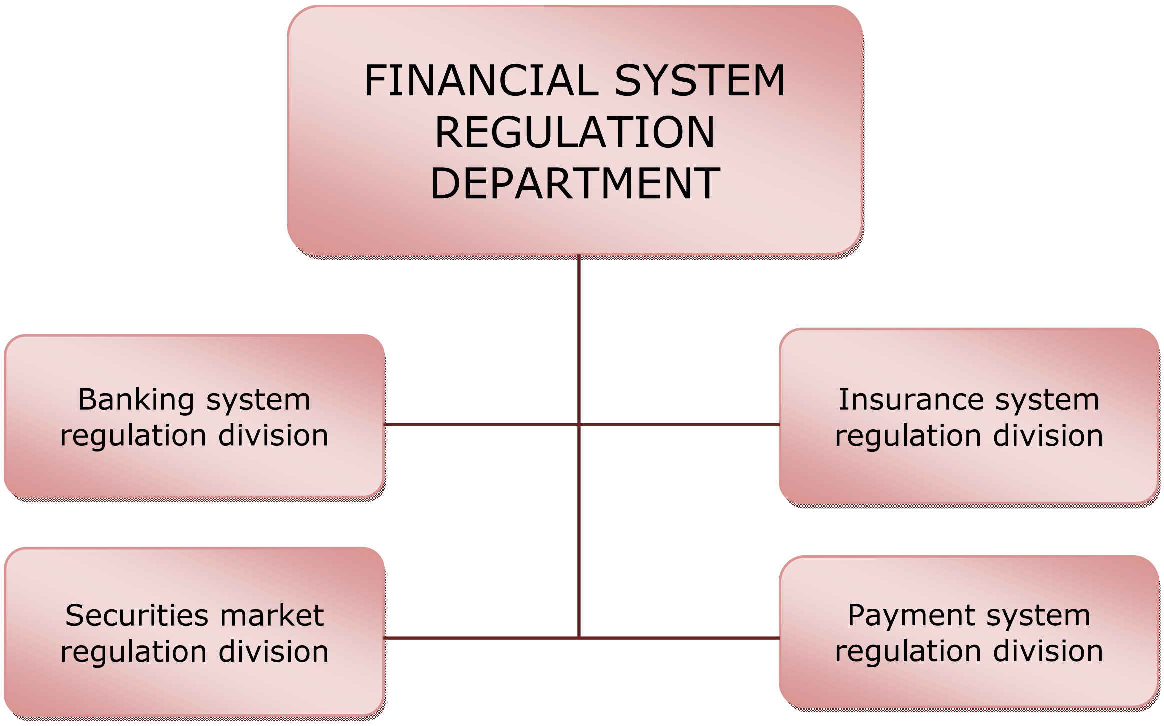
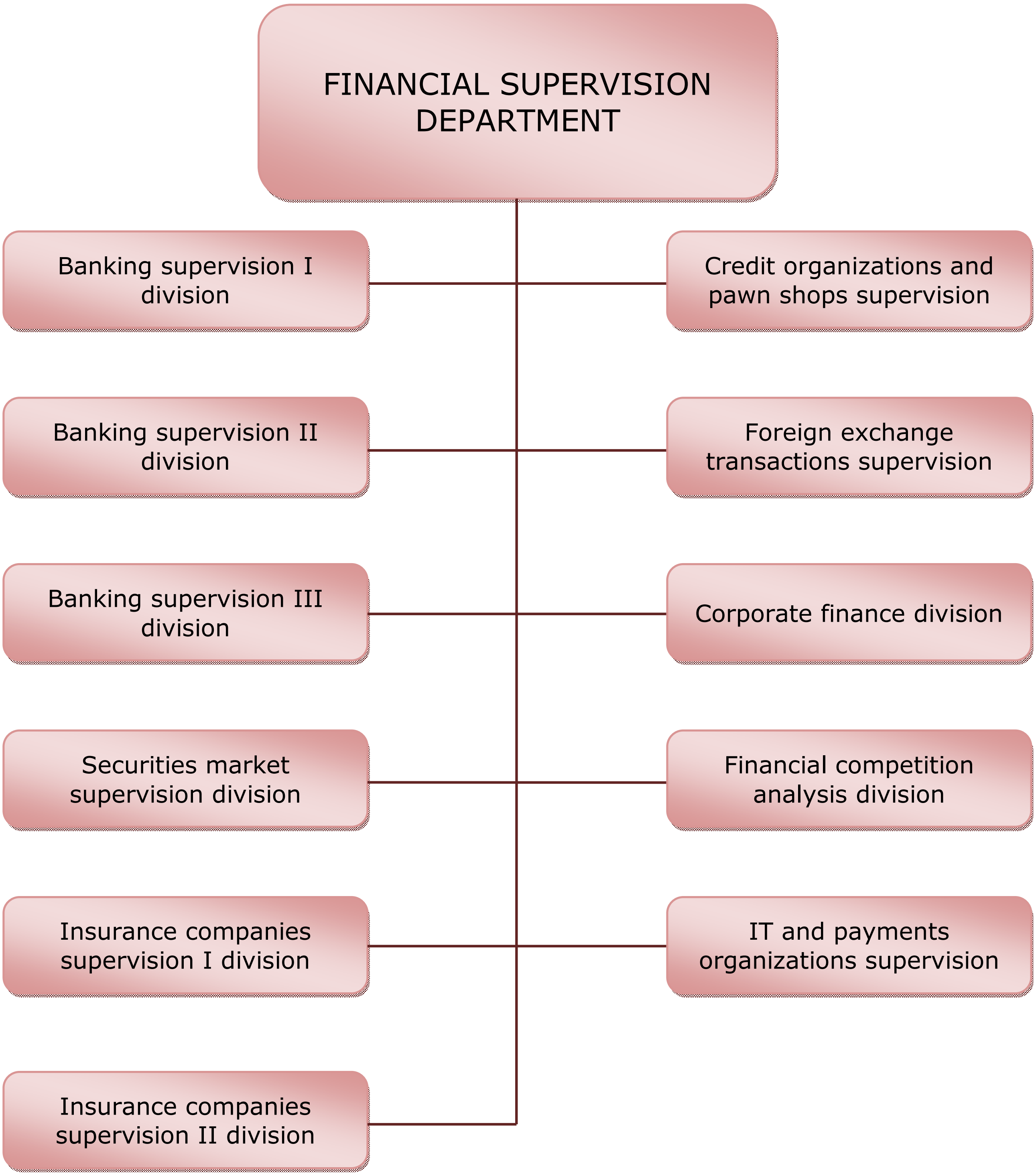


Chart 29: Organizational chart of Financial Supervision Department



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In 2011 Central Bank continued multilateral and bilateral cooperation with international and foreign organizations.

In 2011 the Central Bank continued cooperation with International Monetary Fund, Bank for International Settlements, Financial Stability Institute, Joint Vienna Institute, central banks of Switzerland, Russian Federation, Italy, Lithuania, France, Germany, Netherlands, Kazakhstan, Poland, Czech Republic, Austria, central bankers training center at Bank of England, International Organization of Securities Commissions and other institutions. Topics covered in training courses, conferences and seminars on exchange of work experience, conducted by the above mentioned institutions, related to financial stability and actual issues related to banking, insurance, securities market participant regulation and supervision. The Central Bank employees also visited central banks of other countries, in order to get acquainted with their experience.

The Central Bank in cooperation with Federal Reserve System of USA, central banks of Netherlands and France, German Bundesbank, Toronto Center of Canada, National Bank of Poland and also with Eurasian Economic Community organized 10 courses in Armenia including 6 regional courses, which were attended both by Armenian and foreign specialists. Within the scope of Eurasian Economic Community 4 courses were conducted on "Company ratings and credit register at central banks", "Accounting of capital investments and fixed asset renovation", "Study of money laundering and terrorism financing combating system" and "Internal audit and control in Central bank". USA Federal Reserve System conducted "Consolidated supervision" training and Toronto Center organized "Leadership" course.

The Central Bank employees participated in annual meetings, forums, banking and financial conferences, "round table" sessions, consultations, exhibitions and on-job seminars, where they presented reports and speeches.

It is worthwhile to mention the EGMONT group committee and working group meeting(Oranjestad, Aruba), European banking and financial forum (Prague, Czech Republic), "Mandatory private pension system reforms" international conference held by NASDAQ-OMX (Tallinn, Estonia), German-Armenian Fund's board meeting (Frankfurt, Germany), conference of members of Financial consumer protection and financial education network (Toronto, Canada), Meeting of the Central Bank Governors' Club of the Central Asia, Black Sea Region, and Balkan Countries (Istanbul, Turkey), meeting of European Council Anti-Money Laundering and Combat Against Terrorism Financing MONEYVAL committee (Strasburg, France),annual meeting of Governors and Deputy Governors of IMF and WB Netherlands subgroup countries (Limassol, Cyprus), board meeting of Interstate Bank (Moscow, RF), 11th board meeting of heads of securities supervision bodies of CIS countries (St. Petersburg, RF), 14th plenary session of Eurasian Anti-Money Laundering and Combat Against Terrorism Financing group (Moscow, RF), conference on "Corporate Governance of South-European banks" held by European Reconstruction and Development Bank (London, UK), annual meeting of the Bank of International Settlements (Basel, Switzerland), seminar discussion on "Financial Inclusion for Central Asia, the Caucasus, and South Asia" held by Asian Development Bank (Urumqi, PRC), discussion organized by Georgian National Bank on "Capital Market Development" (Tbilisi, Georgia), annual meeting of the International Monetary

Fund and the World Bank Board of Governors (Washington DC, USA), Annual meeting of central banks (Madrid, Spain), global forum of pension systems organized by International Organization of Pension Supervisors and Organization for Economic Co-operation and Development (Cape Town, South African Republic).

During 2011 within the scope of technical assistance by IMF and World Bank the Central Bank hosted number of missions on supervision and financial issues, monetary policy and statistics.

With the view of expanding business connections and negotiations the Central Bank hosted World Bank independent assessment group, Fitch Ratings experts, EBRD delegation, delegation of Chinese Development Bank for discussing possible directions of Chinese-Armenian cooperation and joint investment programs, delegation of Black Sea Trade and Development Bank for presenting 2011-2014 midterm strategy and business plan, delegation of French development agency led by South Caucasian regional manager Pascal Grangereau and other delegations.

During 2011 the Central Bank organized number of business meetings, working sessions, a "round table" and a conference. On 11-15 of July 2011 19th Plenary session of Egmont Group of Financial Intelligence Units was held in Yerevan. 290 delegates from 99 countries attended the session. On 20-23 of April 2011 President of the De Nederlandsche Bank Nout Wellink visited Yerevan, where he had a lecture on "Modern trends of supervision architecture within or outside the structure of the central banks". On 24th of May former Minister of Labor and Social Security of Chile Jose Piñera visited Central Bank with a lecture on pension reforms.

In 2011 the Central Bank continued the process of signing agreements and memorandums of understanding (MOUs) with other central banks within the framework of the intergovernmental committees.

On 4th of October 2011 Central Bank and German Federal Financial Supervisory Authority (BaFin) signed memorandum of understanding on "Cooperation in Banking Supervision".

On 18th of October in St. Petersburg, Russian Federation agreement on "Main principles of foreign currency regulation and foreign currency policy in CIS countries" was signed.

In 2011 preliminary works were carried out for signing memorandum of understanding between the Central Bank of Armenia and Financial Supervision Agency of Poland.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The Central Bank of Armenia is the mega-regulator of Armenian financial sector. It implements regulation and supervision of all financial organizations in the country.

For more information, please see:
http://www.cba.am/Storage/EN/publications/Fin-stab/fin_ham_zarg_11.pdf
http://www.cba.am/Storage/EN/publications/Fin-stab/fin_stab_11_eng.pdf

STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
Commercial banks[1]	22	21	21
Branches of foreign credit institutions	x	x	x
Cooperative banks	x	x	x
Banking sector, total:	**22**	**21**	**21**

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

Type of financial institution	2009	2010	2011
Public sector ownership[2]	0%	0%	0,37%
Other domestic ownership[3]	35,0%	32,5%	31,6%
Domestic ownership total	35,0%	32,5%	32,0%
Foreign ownership[4]	65,0%	67,5%	68,0%
Banking sector, total:	**100,0%**	**100,0%**	**100,0%**

Concentration of asset by the type of financial institutions in 2011
(at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	29,2%	46,2%	0,068
Branches of foreign credit institutions	x	x	x
Cooperative banks	x	x	x
Banking sector, total:	29,2%	46,2%	0,068

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

Type of financial institution	2009	2010	2011
Commercial banks	3,4%	10,3%	9,8%
Branches of foreign credit institutions	x	x	x
Cooperative banks	x	x	x
Banking sector, total:	3,4%	10,3%	9,8%

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	100,0%	100,0%	99,6%
Branches of foreign credit institutions	x	x	x
Cooperative banks	x	x	x
Other[5]	x	x	0,37%
Banking sector, total:	**100,0%**	**100,0%**	**100,0%**

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

Assets	2009	2010	2011
Financial sector	32,0%	24,7%	26,1%
Nonfinancial sector	54,8%	60,6%	60,7%
Government sector	8,2%	9,7%	8,1%
Other	5,0%	5,0%	5,1%
Liabilities	**2009**	**2010**	**2011**
Financial sector	23,0%	26,8%	29,7%
Nonfinancial sector	48,1%	43,9%	46,0%
Government sector	5,1%	5,2%	4,0%
Capital	21,0%	20,4%	17,2%
Other	**2,8%**	**3,7%**	3,1%

Capital adequacy ratio of banks

Type of financial institution	2009	2010	2011
Commercial banks**	28,4%	22,2%	18,3%
Cooperative banks	x	x	x
Banking sector, total:**	28,4%	22,2%	18,3%

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

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

Asset classification	2009	2010	2011
Non financial sector	4,80%	3,06%	3,38%
- households	5,76%	4,40%	3,47%
- corporate	4,57%	2,56%	3,34%

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

The structure of deposits and loans of the banking sector in 2011 (%) (at year-end)

	Deposits	Loans
Households	59,8%	35,1%
Government sector	x	x
Corporate	40,2%	60,0%
Other (excluding banks)	**x**	4,9%
Total	**100,0%**	**100,0%**

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

P&L account	2009	2010	2011
Interest income	211 579	282 985	351 868
Interest expenses	97 606	121 928	163 343
Net interest income	113 973	161 056	188 525
Net fee and commission income	28 530	40 062	46 140
Other (not specified above) operating income (net)	30 018	44 429	51 280
Gross income	172 520	245 548	285 945
Administration costs	96 479	127 161	144 814
Depreciation	13 440	16 938	18 789
Provisions	-	-	-
Net provisions on financial assets (loans, securities, other assets)	38 773	20 583	36 402
Profit (loss) before tax	23 882	80 863	85 923
Net profit (loss)	15 818	62 760	66 537

Source: OeNB, unconsolidated data in EUR bn.

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3[8]
Commercial banks	679 536	619 276	60 259	x
Cooperative banks	x	x	x	x
Banking sector, total:	679 536	619 276	60 259	x

1. Panarmenian Bank OJSC is not included. The latter was established in 2011 is an enterprise development bank whose the only shareholder is the Central Bank of Armenia. Data presented in tables don't include the Panarmenian Bank, except of table 2 and table 5.
2. Out of banks operating in the RA the only public bank is the Panarmenian
3. Include banks whose more than 50% of shares are owned by residents legal and natural persons.
4. Include banks whose more than 50% of shares are owned by non residents legal and natural persons.
5. Include only the Panarmenian Bank.
6. Households loans include consumer and mortgage loans. The share of non performing loans is calculated as the ratio of the sum of watched, substandard and doubtful loans to the sum of standard, watched, substandard and doubtful loans. Loans classified as loss, wich are provisionned fully were held-off balance sheet and are not included in the calculation.
7. Excluded leasing and factoring.
8. As of 30/12/2009 EUR/AMD=542.23
   As of 30/12/2010 EUR/AMD=481.16
   As of 30.12.2011 EUR/AMD=498.72

2011 DEVELOPMENTS IN THE AUSTRIAN BANKING SYSTEM

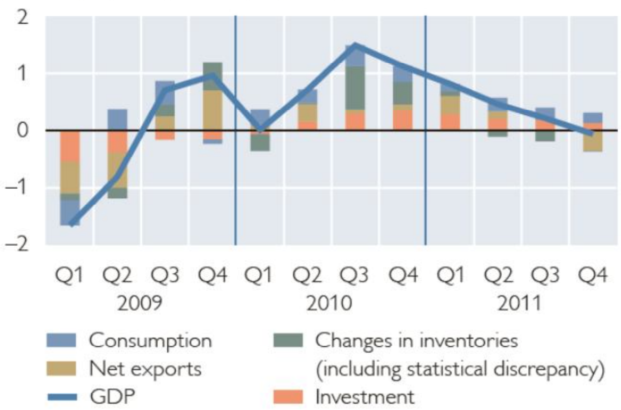
MACROECONOMIC ENVIRONMENT

The robust recovery of the Austrian economy recorded in 2010 continued well into the first half of 2011, resulting in a comparably high annual growth rate, which at 3% clearly exceeded the euro area average. While early in the year, economic growth mainly relied on exports and on the downturn in the inventory cycle, investment and domestic demand were the key drivers for the remainder of 2011. With the debt crisis intensifying, growth weakened considerably in the second half of 2011; in the fourth quarter, real quarter-on-quarter GDP contracted slightly.

The slowdown in growth recorded at the end of 2011 was mainly attributable to the weak international environment. Leading indicators point to a slight improvement in economic activity in the first half of 2012, both at a global level and in Austria, which means that a recession is unlikely. Nevertheless, growth in Austria is expected to come to no more than 0.7% in 2012, reflecting the external macroeconomic environment as well as fiscal consolidation measures. In line with the expected recovery of the international economy and the return of confidence, growth is assumed to accelerate to 1.6% in 2013 (OeNB economic outlook for Austria, December 2011).

Contributions to Real GDP Growth in Austria

Quarter-on-quarter growth in %; contributions to growth in percentage points (seasonally adjusted)



Source: Eurostat.

HICP inflation in Austria climbed from 2.2% to 3.7% from December 2010 to April 2011 and remained at high levels until December 2011 (3.4%). The acceleration of overall inflation until March 2011 mainly resulted from energy and food price developments, while later price increases were exclusively caused by rising prices for services. For 2011 as a whole, HICP inflation in Austria came to 3.6% and was thus above the euro area average and higher than the comparable rates in Germany and Italy. The OeNB expects inflation in Austria to decline markedly to 2.4% in 2012 and to decrease to below 2% in 2013.

The Austrian labor market performed extraordinarily well in 2011, posting excellent figures in international comparison. At 4.1% (Eurostat definition) for 2011 as a whole, the Austrian unemployment rate was the lowest among all EU countries; developments in youth unemployment were also relatively positive. Employment grew strongly in 2011, with changes in job vacancies being the only indicator of slight labor market deterioration in the course of the year. The sound economic recovery, favorable trends in employment as well as tax increases (petroleum tax) caused tax revenues to rise substantially in 2011.

Cuts in social transfers as well as the weak rise of public sector wages and pensions contributed to keeping expenditure growth relatively low. For this reason, Austria was able to achieve a better deficit ratio than that defined as its target in its 2011 Stability Programme, posting a general government budget balance of –2.6% of GDP. At the same time, the government debt ratio rose to 72.2%. As the euro area sovereign debt crisis intensified, the yield spreads of Austrian government bonds against the corresponding German bonds widened. Standard & Poor's downgraded Austria's long-term rating to AA+. These developments, together with the requirements related to the debt brake established in the fall of 2011, led the federal government to adopt a comprehensive consolidation package in the spring of 2012. This package envisages cumulative savings of EUR 26.4 billion to be reached by 2016; two-thirds of this volume are to be gained through measures on the expenditure side.

Austria recorded another large current account surplus of EUR 5.9 billion (2010: EUR 8.6 billion) in 2011. While trade in goods resulted in a deficit of around EUR 7 billion, services posted a EUR 14 billion surplus, which was attributable to the traditionally profitable travel and tourism industry as well as to other services categories. The balance on current transfers, which mainly reflects public sector transactions – such as EU contributions – closed with a deficit of around EUR 2 billion. Cross-border income produced a surplus of just under EUR 1 billion.

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

In the wake of the renewed tensions that gripped the international financial markets by mid-2011, the conditions underpinning the Austrian financial system have worsened progressively, thereby placing the country's financial stability at increased risk. A slight decrease in operating income paired with rising expenses that were driven (among other factors) by write-down requirements caused a significant decline in the profitability of Austria's banking sector in 2011.

After having increased during the first half of the year, capital adequacy ratios continued to improve slightly thereafter, although capitalization remained below peer levels.

Despite heightened macroeconomic and political risks, Austrian banks' subsidiaries in Central, Eastern and Southeastern Europe (CESEE) again accounted for a substantial share in the total earnings of their parent banks. Nevertheless, further improvements in efficiency are required and should be pursued.

Austrian banks' foreign claims on euro area countries which were most severely hit by the sovereign debt crisis was further reduced in 2011 and remained low by international comparison.

Despite the challenging international environment, Austrian banks' liquidity situation improved slightly in 2011, an outcome attributable to banks' early efforts to reduce their net funding gaps.

Although the level of new foreign currency lending was low in recent years, the substantial volume of outstanding foreign currency loans still constitutes a risk factor for domestic banks. While the measures implemented by the Swiss

National Bank have curbed the appreciation tendency of the Swiss franc for the time being, the volatile market environment is exerting pressure on the repayment vehicles often used to back foreign currency loans.

In light of the difficult environment they encountered in 2011 – a condition exacerbated by the continued uncertainty in international markets – Austrian banks must take steps to permanently strengthen their capital base, further improve their liquidity situation and enhance the sustainability of their business models. Published in March 2012 by the FMA and the OeNB, the "Supervisory guidance on the strengthening of the sustainability of the business models of large internationally active Austrian banks" was another decisive move in that direction.

In 2011 unconsolidated total assets of the Austrian banking system increased slightly in comparison to the previous year to EUR 1.014,3 bn. Due to a stronger rise of GDP the banking assets to GDP ratio reduced somewhat to approximately 337%.

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 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, 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 organization obligations. Further tasks include combating the unauthorized provision of financial services and taking preventive action against money laundering and terrorist financing. 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, authorization 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 analyzing 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.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2011

The FMA's main strategic objects in the field of banking supervision for 2011 were:

- The quality and effectiveness of the operative banking supervision are sustainably strengthened.
- The operative banking supervision is prepared for changes resulting from recent amendments to the Capital Requirement Directive.
- The FMA is actively contributing to the developments concerning the supervisory system at the European level.
- The cross border cooperation with other banking supervisory authorities in the context of Consolidating Supervision is further developed.
- Necessary measures concerning conclusions of relevant market developments are timely implemented.
- Measures concerning a strong crisis management are set and the implementation of the Recovery and Resolution Directive is prepared.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

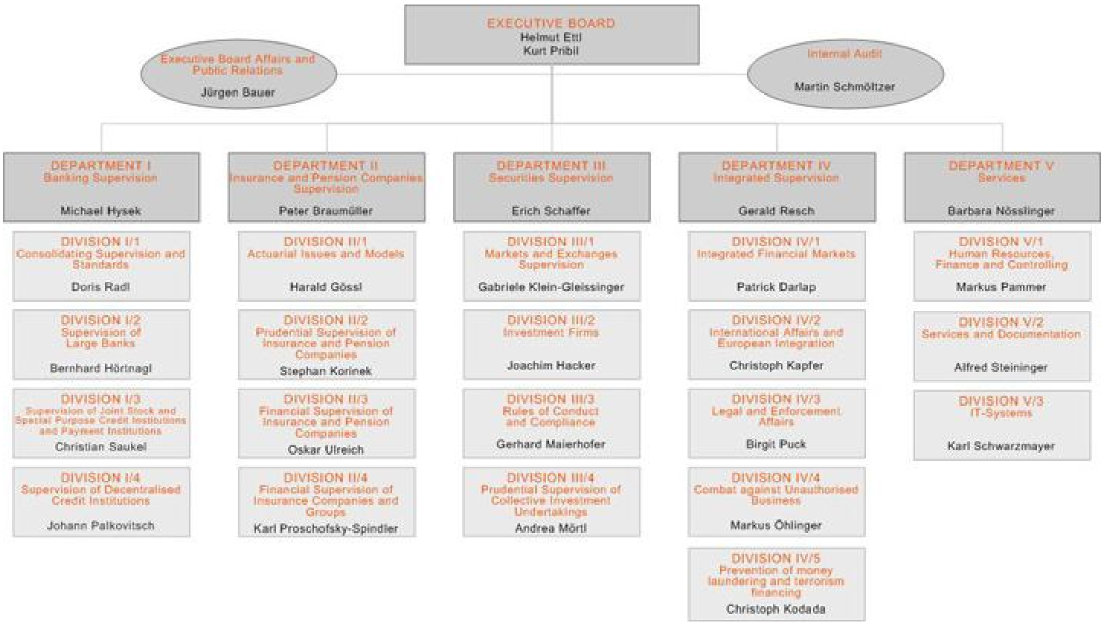
In 2011, the banking supervisory authority made use of its right to demand information from credit institutions in about 384 cases. Apart from these formal ad-hoc information requests the FMA based its decisions on various sources such as the credit institution's financial statements, the reports of 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 2011, the OeNB conducted 43 on-site inspections on behalf of the FMA.

As banking supervisor the FMA is also responsible for granting, extending or withdrawing licenses. In 2011 the FMA granted three new licenses, extended ten existing and revoked nine licenses.[9] Two license applications had to be refused due to formal deficiencies.

If there is a risk of a credit institution being unable to fulfill its obligations to its creditors and customers, the FMA may take appropriate measures. In particular, it may prohibit the distribution of capital or profit, appoint a government commissioner, dismiss the managers or prohibit the continuation of business operations. On one occasion in 2011, the FMA had to apply these measures.

9 Extending a license means to allow an existing credit institution to conduct additional banking business.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY AND COOPERATION WITH OTHER SUPERVISORY BODIES

The FMA consistently strives to nurture and further expand on dialogue with other supervisory authorities, particularly those in Central, Eastern and South-Eastern Europe. To this end, bilateral meetings were held in the various areas of supervision and at different levels. These meetings focused on such issues as the exchange of information on supervised institutions and groups engaging in cross-border activities. In 2011, meetings were held with banking supervisors from Hungary, Romania and Slovenia, and with insurance supervisors from Moldova, Romania and Macedonia.

Furthermore, the FMA was represented at the 24th annual conference of the Group of Banking Supervisors from Central and Eastern Europe (BSCEE) in Tirana, Albania. This event looked at the role of the banking system and banking supervision in terms of financial stability and at Basel III. The FMA was appointed as the chair of this conference for 2012, a role to be fulfilled by Michael Hysek, who heads the Banking Supervision Department.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

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.

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 is 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.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

<u>Sustainability package</u>

In November 2011, the OeNB and the FMA presented a principle-based set of measures that aims at strengthening the sustainability of the business models of the three largest internationally active Austrian banking groups. The guidance is based on the following three pillars of sustainability-enhancing measures:

1. Strengthening the self-reliance of subsidiaries.
2. Increasing the risk bearing capacity of large parent banks further.
3. Setting up of group recovery and resolution plans.

This balanced set of measures aims at strengthening financial stability both in Austria and in the host countries (above all in CESEE). It will promote sustainable growth and help avoid pronounced boom-bust cycles, thus strengthening the three Austrian banking groups' conservative and retail-focused business models.

<u>Foreign currency lending</u>

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 published an extension of the related FMA Minimum Standards in 2010. In 2011, on-site inspections focused on banks' compliance with these standards. Also, the FMA regularly monitors how the stock of foreign currency loans develops and if new foreign currency loans are extended to private households.

Moreover, the FMA published - jointly with the OeNB and the Austrian Federal Economic Chamber - an information folder concerning the risks involved in foreign currency loans.

STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
Commercial banks	213	207	197
Branches of foreign credit institutions	29	30	30
Cooperative banks	613	606	597
Banking sector, total:	**855**	**855**	**824**

Source: OeNB, unconsolidated data.

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

Type of financial institution	2009	2010	2011
Public sector ownership	10.5	11.5	10.6
Other domestic ownership	68.3	68.7	68.1
Domestic ownership total	78.8	80.2	78.7
Foreign ownership	21.3	19.2	21.3
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	39.6	49.2	729.6
Branches of foreign credit institutions	70.3	77.2	3,447.5
Cooperative banks	39.8	55.1	823.4
Banking sector, total:	**28.9**	**36.5**	**390.5**

Source: OeNB, unconsolidated data.

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

Type of financial institution	2009	2010	2011
Commercial banks	0.1	4.8	-0.1
Branches of foreign credit institutions	n.a.	n.a.	n.a.
Cooperative banks	-0.1	6.6	4.3
Banking sector, total:	**0.1**	**5.8**	**1.6**

Source: OeNB, unconsolidated data.

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	64.2	62.3	61.3
Branches of foreign credit institutions	1.1	1.2	1.2
Cooperative banks	34.7	36.6	37.5
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	2009	2010	2011
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	**2009**	**2010**	**2011**
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	2009	2010	2011
Commercial banks**	12.2	13.2	13.4
Cooperative banks**	13.7	13.4	13.7
Banking sector, total:**	12.8	13.2	13.6

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	2009	2010	2011
Non financial sector	4.2	4.7	4.5
- 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	71.6	40.8
Government sector	4.1	9.3
Corporate	16.8	42.4
Other (excluding banks)	7.6	7.6
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	2009	2010	2011
Interest income	32.8	26.9	28.2
Interest expenses	24.0	17.8	18.6
Net interest income	8.8	9.1	9.6
Net fee and commission income	3.6	4.0	3.8
Other (not specified above) operating income (net)	5.5	6.6	5.8
Gross income	17.9	19.7	**19.2**
Administration costs	9.5	9.7	**10.0**
Depreciation	0.6	0.6	0.5
Provisions	8.5	3.3	5.7
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	0.4	4.8	2.2
Net profit (loss)	0.04	4.2	1.2

Source: OeNB, unconsolidated data in EUR bn.

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	51.8	40.7	12.7	0.9
Cooperative banks	36.3	28.1	9.5	0.3
Banking sector, total:	**88.1**	**68.8**	**22.2**	**1.1**

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

2011 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF BELARUS

MACROECONOMIC ENVIRONMENT

In 2011, worsening external imbalances in the beginning of the year had a key influence on the economic development of Belarus, resulting in the continued high domestic demand under the influence of a number of adverse external factors, including an increase in import prices on natural gas.

Current external economic imbalances contributed to the development of instability in the domestic foreign exchange and deposit markets, a significant reduction in the national currency exchange rate, and acceleration of inflation processes.

GDP increased in comparable prices by 5.3% on the previous year (in 2010 – by 7.6%). Inflation in the consumer market stood at 8.7%, compared with 9.9% in 2010.

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

As at January 1, 2012, the banking sector of the Republic of Belarus included 31 operating banks and 138 branches. Foreign banks ran 9 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, 2012, the non-residents' share in the aggregate authorized capital of the Belarusian banks amounted to 14.54% (in 2011 – by 24.22%). The share held by the State Committee on Property of the Republic of Belarus in three banks exceeded 50% of the authorized capital.

In 2011, the banks' aggregate authorized capital grew by 130%, amounting to BYR27.65 trillion as at year-end 2011 or EUR2.6 billion in equivalent.

In the period under review the banking sector's assets increased by 103.4%, amounting to BYR257.4 trillion (EUR24.0 billion in equivalent) and the assets/GDP ratio rose from 59.7 to 66.2%.

In 2011, the banks' profits amounted to BYR3.1 trillion, exceeding 1.8 times the profit made in 2010. The banking sector yielded return on assets[10] to the tune of 1.65% (as at January 1, 2011 – 1.7%) and return on the regulatory capital to the tune of 14.9% (as at January 1, 2011 – 11.8%).

10 Profit after taxation is used in the calculation of this indicator.

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

In the year under review, the work on improving the regulatory legal framework that regulates the banking supervision sphere, bringing it into line with international standards, legislation requirements, and practical application experience continued.

Amendments and modifications to the regulatory legal acts of the National Bank regulating the formation of special reserves and secure functioning requirements were introduced. Additional restrictions on banks' participation in the authorized capital of commercial organizations were imposed. Uniform amounts of secure functioning requirements for operating and newly established banks were defined.

Pursuant to recommendations on the methodology for conducting inspections of banks and non-bank financial institutions by the National Bank and risk level assessment, the procedures for performing inspections in all significant aspects were improved, as well as new directions of the above-mentioned activities were defined. The mechanism of assessing the level of each risk, capital adequacy, profitability (income), and the quality of bank's management based on the assessment of quantitative and qualitative influence factors was developed.

The procedures for implementing measures to improve the financial condition or reorganization taken by banks and non-bank financial institutions were updated and brought into line with practical experience and prevailing economic situation in the country.

Recommendations on organizing the risk management system in banks given the international best practices, generalized in the documents of the Basel Committee on Banking Supervision, the European Banking Organization, and other quality standards for risk management were drawn up.

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:

- development of secure functioning requirements and other prudential requirements for the banks to ensure the banking system's stability and soundness;
- 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. Natural persons' deposits guarantee fund 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 2011

In 2011, goals and objectives of banking supervision were determined by the need to ensure a stable functioning of the banking sector and protect the interests of depositors and other banks' creditors. Their implementation was associated with the improvement of prudential requirements and supervisory procedures, increase in the level of all components of the supervisory process (pre-supervision under the state registration of banks and banking licensing, the current supervision, including off-site and macroprudential supervision, and inspection).

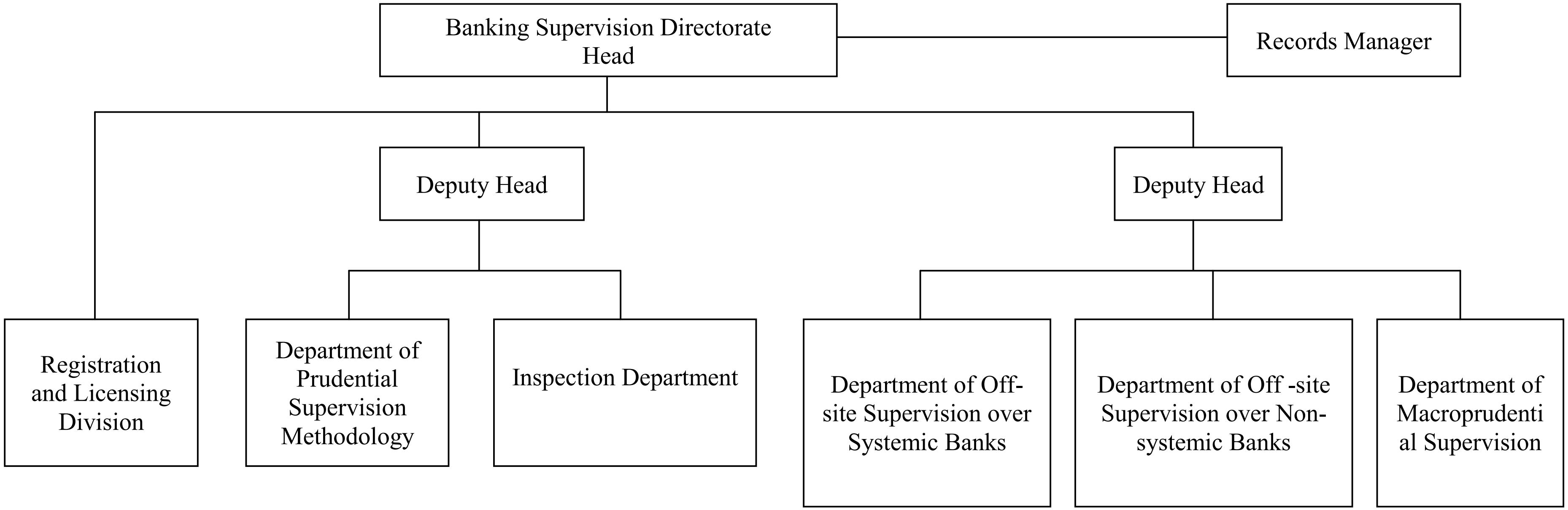
THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

In the year under review, the banking sector was faced with an adverse impact of a significant reduction in the exchange rate of Belarusian ruble, a sharp acceleration of inflation, the uncertainty in the domestic foreign exchange market, the outflow of the households' funds in the national and foreign currencies, monetary policy tightening, growth in the proportion of clients' problem assets, as well as the decrease in the international ratings. These factors greatly complicated the conditions of banks' activities and their compliance with the secure functioning requirements.

Continuous monitoring of the negative tendencies and increased risks of banks' activities was carried out as part of the off-site supervision. For the purpose of identifying the reasons, grounds, and circumstances contributing to the breaches of prudential requirements, working meetings with the banks' executive bodies were held, measures of supervisory response were taken, necessary recommendations were submitted to the banks' supreme management bodies (supervisory boards). The cooperation of the National Bank with audit organizations and the Association of Belarusian banks was reinforced.

In 2011, the National Bank conducted 21 unscheduled inspections of banks and their structural units on various aspects of banking activities. Based on the results of inspections the acts, which reflected the violation of legislation regulating banking activities, and statements on the level of risks assumed by banks, the adequacy of internal control system, and the quality of bank management were drawn up. Recommendations to remedy the deficiencies revealed, instructions to eliminate violations were submitted to banks, as well as measures stipulated by legislation on administrative offenses were applied in case of necessity.

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 2011, 16 bilateral agreements with foreign banking supervisory authorities were in force.

In the year under review, the National Bank was aided, in the course of technical assistance from the IMF, in the development of risk-oriented supervision.

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	2009	2010	2011
Commercial banks	32	31	31
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total	**32**	**31**	**31**

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

Type of financial institution	2009	2010	2011
Public sector ownership	72,4	71,7	84,5
Other domestic ownership	1,2	1,0	0,9
Domestic ownership total	73,6	72,7	85,4
Foreign ownership	26,4	27,3	14,5
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	69,22	79,42	21,94
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**69,22**	**79,42**	**21,94**

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

Type of financial institution	2009	2010	2011
Commercial banks	8,93	11,77	14,87
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**8,93**	**11,77**	**14,87**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
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	2009	2010	2011
Claims on general government	4,8%	4,1%	5,5%
Claims on economic entities*	60,4%	54,9%	48,1%
Claims on natural persons	19,3%	17,9%	12,6%
Claims on the National Bank	4,2%	14,8%	22,2%
Claims on banks	3,7%	2,7%	3,0%
Claims on non-residents	4,9%	3,5%	7,3%
Other assets	2,6%	2,1%	1,3%
Liabilities	**2009**	**2010**	**2011**
Central government funds	11,7%	8,7%	4,6%
Local government funds	2,8%	2,5%	2,5%
National Bank funds	10,2%	21,9%	7,3%
Economic entities' funds*	19,8%	18,1%	26,1%
Natural persons' funds	21,8%	18,0%	19,5%
Banks' funds	4,3%	2,9%	3,1%
Funds received from non-residents	12,2%	13,5%	19,3%
Other liabilities	17,2%	14,5%	17,6%

* 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	2009	2010	2011
Commercial banks	19,8%**	20,5%**	24,7%**
Cooperative banks	-	-	-
Banking sector, total:	**19,8%**	**20,5%**	**24,7%**

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

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

Asset classification	2009	2010	2011
Non financial sector	4,49%	3,71%	3,68%
- households	5,60%	4,80%	4,59%
- corporate	0,99%	0,52%	0,47%

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

	Deposits	Loans
Households	40,3	20,6
Government sector	14,6	0,7
Corporate	42,0	75,3
Other (excluding banks)	3,1	3,4
Total	**100,0**	**100,0**

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

P&L account	2009	2010	2011
Interest income	2098,2	2640,3	2126,7
Interest expenses	1428,6	1607,7	1481,5
Net interest income	669,6	1032,6	645,2
Net fee and commission income	350,5	451,4	280,5
Other (not specified above) operating income (net)	-602,7	-753,9	-415,7
Gross income	238,6	364,0	364,6
Administration costs	175,0	163,4	140,4
Depreciation	3135,3	4073,6	7517,0
Provisions	353,7	529,5	349,1
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	89,7	98,4	63,2
Profit (loss) before tax	264,0	431,1	285,9
Net profit (loss)	2098,2	2640,3	2126,7

Total own funds in 2010 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	3464,53	2865,03	607,14	0,06
Cooperative banks	-	-	-	-
Banking sector, total:	**3464,53**	**2865,03**	**607,14**	**0,06**

2011 DEVELOPMENTS IN THE BANKING SYSTEM OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

MACROECONOMIC ENVIRONMENT

According to the preliminary estimates[11], the nominal value of the GDP for Bosnia and Herzegovina (B&H) in 2011 was 25.950 billion KM, which represents a nominal increase of 5,6%, compared to the year 2010. According of estimate by Central Bank of Bosnia and Herzegovina GDP/ per capita in 2011 amounted to 6.758 KM for Bosnia and Herzegovina. An analysis of the composition of the Industrial Output Index in B&H, December 2011[12], relative to December 2010, reveals that all three sectors that comprise industrial production – mining, manufacturing industry and supply of electric power, gas and water – recorded output increases by 4,9% , 6,5% per cent and 16,3%, respectively.

The annual rate of inflation recorded in December 2011 in B&H was 3,1% and it was 40 basis points higher than the annual inflation in the Euro area, and 10 basis points higher in comparison with the EU27. In neighboring countries, the annual inflation rate was mainly lower than in BH, except in Serbia, where inflation of 7.0 per cent was recorded. Inflation rate was lower by 1.1 percentage point in Slovenia, 1.0 pp in Croatia and by 0.3 pp in Macedonia and Montenegro, respectively.

The composition of the Consumer Price Index in B&H shows that the price levels in December 2011, in annual terms, were caused both by increases in prices of goods and also of services. Namely, prices of goods increased by 2.8 per cent, and service prices by 3.2 per cent. Consumer Price Index in B&H indicated that the price level in December 2011, in annual terms, were recorded for alcoholic beverages and tobacco – 8.9 per cent, transportation by 6.9 per cent and in communication-related services – by 5.3 per cent. The average net wage, relative to September 2011, was 14 KM, or 1.7 per cent, greater in FBH, 13 KM, or 1.6 per cent in RS and 14 KM, or 1.7 per cent in Brcko District. The average December 2011 net wage in annual terms in FBH, RS and Brcko District was 0.9 per cent, 2.1 per cent and 2.9 per cent higher, respectively.

The number of employees in B&H in December 2011 amounted to 693.734 persons; out of that number 439.743 are employed in the FB&H, 237.923 in RS and 16.338 people in the Brcko District.

The ceiling for insured deposits scheme under the auspices of the Deposit Insurance Agency was 35,000 KM and it applied exclusively to physical persons, with 25 banks participating in the deposit insurance.

As of end-Q4 2011, total deposits were 13 billion KM, which constituted an increase of 185.6 million KM or 1.4 per cent in comparison with the preceding quarter, while the increase was 470 million KM, or 3.8 per cent in annual terms. In terms of currency structure, deposits in KM accounted for almost entire deposit increase, so the share of these deposits rose to 53.5 per cent in

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

12 For all statistic macroeconomic environment in B&H, source is - Central bank of B&H, Bulletin 4, 2011 (January - December)

December 2011. Deposits of the government sector were 1.46 KM billion and their share in total deposits was 11.2 per cent, which was 1.3 percentage points lower relative to the end of the preceding quarter. Total deposits of the nongovernmental sector were 11.53 KM billion in December 2011 and increased by 280.5 million KM, or 2.5 per cent relative to the preceding quarter, while in annual terms these deposits increased by 672.8 million KM, or 6.2 per cent.

The spread between lending and deposit interest rates of commercial banks in BH was 7.26 percentage points in December 2011, which was 17 basis points lower relative to September. In December 2011, the difference between lending interest rates of commercial banks in BH and twelvemonth EURIBOR was 5.53 percentage points, which was 8 basis points lower relative to the end of the preceding quarter, and this was due to the decline of lending interest rates in BH, as well as to the declining interest rates in the Euro area.

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

The performance of the banking sector of the Federation of BiH in 2011, as in the previous two years, was under the impact of the global economic crisis and recession, and positive changes in the first half of year slowed down due to the events in the euro zone, the escalation of the debt crises, which also had an effect on the slowing down of the economic growth and the deterioration in the macroeconomic conditions in BiH. Although, the growth and the development of the banking sector is stagnating, and foreign financing sources have a decreasing trend, it is estimated that the stability, security and the liquidity of the entire system are satisfactory, and in 2011 recorded are some positive changes, of which the most important are: reviving of the credit activities and a slight increase of loans, continuous increase of citizens saving deposits, improvement of profitability in the majority of banks and consequently the strengthening of capital base, and slowing down of the negative trends in the asset quality segment.

As of 31.12.2011, there were 19 banks (18 banks with majority private ownership and one bank with majority state ownership) with banking license issued in the Federation of BiH, of which two banks were under provisional administration. As of 31.12.2011, the number of employees in banks slightly decline (0,2%) in comparison to the end of 2010.

Aggregate balance sheet of the banking sector, as of 31.12.2011, amounted to 15,2 billion KM, 1% or 115 million KM higher than at the end of 2010. Capital of banks in the Federation of BiH, as of 31.12.2011., amounted to 2,1 billion KM. In 2011, capital increased by 3% or 63 million KM in comparison to 2010, while the changes in core and supplementary capital influenced the changes in the structure of regulatory capital. The core capital increased by 5% or 85 million KM, and participation from 76% to 80%, supplementary capital decreased by 4% or 22 million KM which caused the decline of the participation from 24% to 20% . The core capital growth is a result in most part of the inclusion of the realized profit for 2010 in the amount of 49 million KM in the retained profit and reserves. Capital adequacy rate of the banking system, as of 31.12.2011, was 17,1%, which is still much more than the minimum prescribed by the law (12%), representing satisfactory capitalization of the entire system very strong basis and foundation to preserve its safety and stability.

Further strengthening of capital base will be priority task in majority of banks as it has been the case so far, especially in the largest banks of the system, which is necessary to strengthen stability and safety of both banks and the entire banking system, especially due to changes in business and operating environment under which banks in the Federation operate, because of the global financial crisis expansion to the area of our country and adverse effects this crisis may have on the banking sector and the entire economy of BiH.

As a concenquence of the indirect impact of the crises on real sector, in banking sector there has been a deterioration of the loan portfolio and increase of the reserve expenses for loan losses, which had a significant impact on the downfall of the profitability of all banks.

The main focus of all of the Agency's efforts have been directed towards capital strengthening of banks, improvement of their credit policies and their consistent implementation in practice, raising prudency at maximum possible level in terms of credit risk management that is still very dominant in our environment, as well as liquidity risk, as well as to strengthen capacities for potential crisis management. Along with the mentioned, the Agency has been continuously giving incentives to banks, especially those that are dominant in the system to strengthen their financial potentials and through additional special support by their foreign parent-banks.

The slight credit growth from the last three quarters of 2010 continued in 2011, which is encouraging and is an indicator of the intensifying of the credit activities of banks. After the growth of 4% or 432 million KM, as of 31. 12. 2011 the loans reached the amount of 10,4 billion KM. In the structure of banks' balance sheet liabilities from the aspect of the most significant balance sheet categories, deposits in the amount of 11,05 billion KM and participation of 72,8% are still the dominant source of financing for banks in the Federation of BiH. The structure of assets, as well as the structure of sources, had slight changes related to two key assets items: increased participation of loans from 66,2% to 68,6% and a decrease of cash funds from 29,5% to 28,8%.

According to the data from the financial report which shows the success of the banks performance, that is the income statement for 2011, at the level of the banking sector in the Federation of BiH realized is a positive financial result – profit in the amount of 84 million KM.

Liquidity of the banking system in the Federation of BiH 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 FBiH 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. It may be concluded that the liquidity of the banking system of FBiH is still assessed as satisfactory.

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

1. Decision on changes and additions to the Decision on the minimum standards for managing the banks' capital („Official Gazette of the Federation", number 70/11);
2. Decision on changes and additions on minimum standards for managing the credit risk and banks asset classification („Official Gazette of the Federation", number 70/11 and 85/11);
3. Revised text of the Decision on minimum standards for managing the credit risk and banks asset classification („Official Gazette of the Federation", number 85/11);
4. Decision on changes and additions to the Decision on minimum standards for managing the banks risk concentration („Official Gazette of the Federation", number 46/11 and 70/11);
5. Decision on changes to the Decision on reporting forms which the banks submit to the Banking Agency of the Federation of BiH („Official Gazette of the Federation", number 70/11 and 01/12);
6. Decision on changes and additions to the Decision on minimum volume, form and content of the program and reports about economic and financial audit of the banks („Official Gazette of the Federation", number 85/11);
7. Decision on changes to the Decision on temporary measures for restructuring of the credit liabilities of the individuals and legal entities in the banks („Official Gazette of the Federation", number 01/12);
8. Decision on the minimum standards for managing the externalization („Official Gazette of the Federation", number 01/12);
9. Decision on minimum standards for managing the information systems in the banks („Official Gazette of the Federation", number 01/12);
10. Decision on changes to the Decision on unified manner for accrual and reporting of the effective interest rate on loans and deposits („Official Gazette of the Federation", number 46/11);
11. Decision on changes and additions to the Decision on determining the fees of the Banking Agency of the Federation of BiH („Official Gazette of the Federation", number 46/11);
12. Decision on changes to the Decision on conditions and procedure in issuing the license for operations and other approvals to the macro credit organizations („Official Gazette of the Federation", number 46/11);
13. Decision on fees which the microcredit organization pay for performance to the Banking Agency of the Federation of BiH („Official Gazette of the Federation", number 46/11);
14. The Decision on the changes to the Decision on conditions and procedure for issuing and revoking the approval to the leasing company („Official Gazette of the Federation", number 46/11);
15. Decision on changes and additions to the Decision on fees which the leasing companies pay to the Banking Agency of the Federation of BiH („Official Gazette of the Federation", number 46/11);

16. Decision on changes and additions to the Instructions for licensing and other approvals of the Banking Agency of the Federation of BiH („Official Gazette of the Federation", number 46/11);
17. Revised version of the Guidelines for licensing and other approvals of the Banking Agency of the Federation of BiH („Official Gazette of the Federation", number 46/11);
18. Changes and additions to the Guidelines for changed manner for establishing, recording and reporting the reserves for loan losses (December 2011);
19. Manual for supervision of the leasing companies (December 2011);
20. Manual for offsite examiners (January 2012).

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 2011

Banking Agency of the Federation of BiH (hereinafter: FBA), in 2011, 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 home country supervisors of the investors present in the banking sector of the FBiH, and other countries in order to have more effective supervision,
   - continue improving cooperation with the Banks Association in all banking performance segmentsorganization of counseling and professional assistance in the area of implementation of banking laws and regulations, advancement of cooperation in regard to professional development, proposed changes of all legislative regulations.
4. Work on continuous education and training of staff.

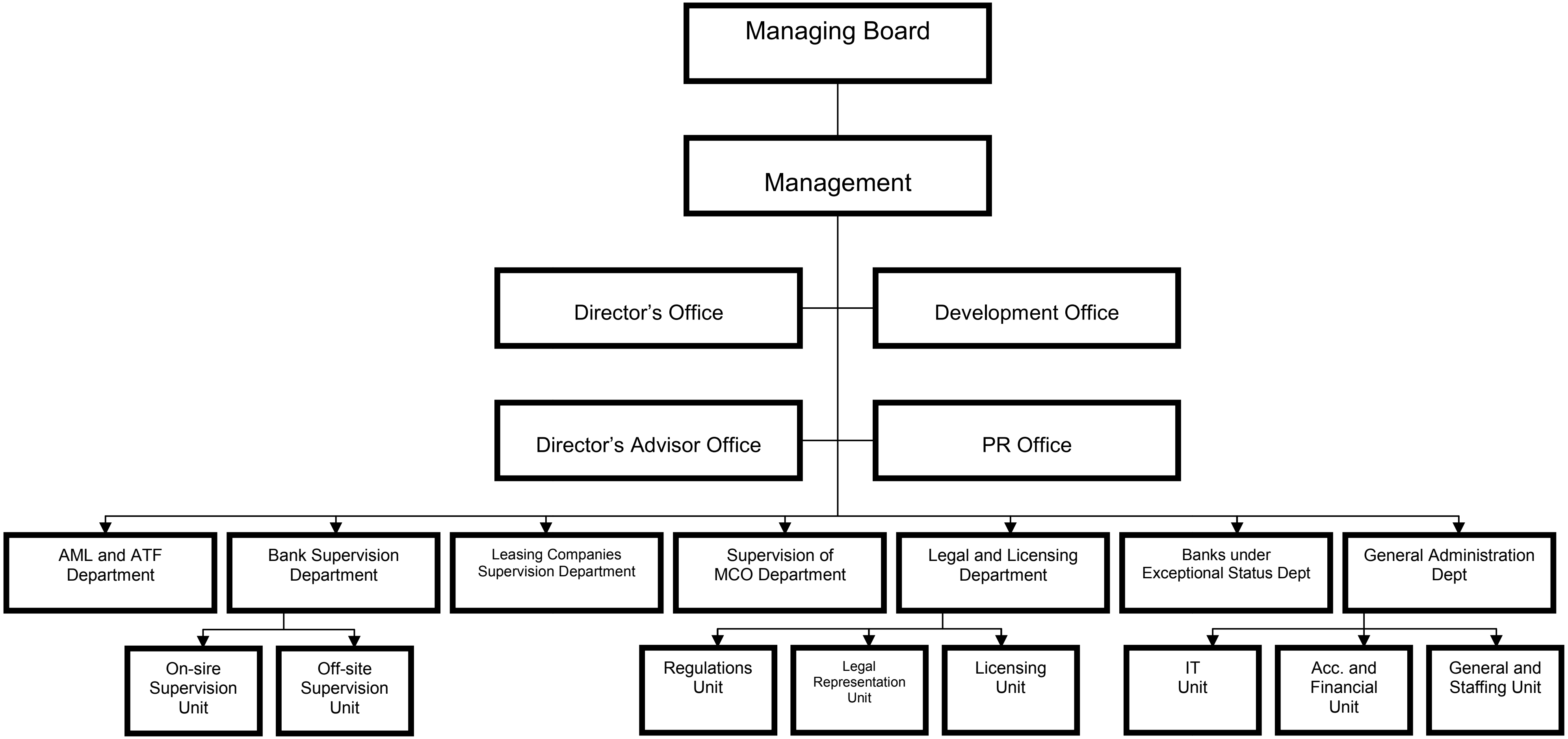
THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

The FBA, in 2011, among other things, implemented the following activities:

1. continuous monitoring through a continuous process of on-site and off-site examination, monitoring of financial condition of banks in order to synchronize and coordinate activities to preserve the stability of banking sector;
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;
6. the focus of supervision was on dominant risk segments such as credit risk, capital risk, and liquidity risk;
7. further cooperation with domestic and foreign global and other institutions, as the International Monetary Fund (IMF),European Central Bank (ECB), the World Bank, Group of Banking Supervisors of Central and Eastern Europe (BSCEE) and others, as well as with supervisory authorities from home countries of parent banks that in the FBiH have their banks-subsidiaries;
8. in cooperation with the IMF, Central Bank of Bosnia and Herzegovina and the Banking Agency of the Republic of Srpska, continued implementation of the project "stress tests" for assessing resistance to crises of banking system, as well as conducting mentioned project at "micro level" in order to receive aggregate data for banks capital and financing needs, individually through banks.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

Within the bilateral cooperation, in the reviewed period the FBA realized cooperation through a regular exchange of information and bank supervision – members of the foreign banking groups which have subsidiaries in both entities in BiH, with the banking regulators: Slovenia (participation in the supervisory colleges); Turkey (through regular exchange of information on the quarterly bases, information on the banking groups and their subsidiaries in FBiH, as well as the annual reports about the supervisory reviews and evaluation process); and Croatia (regular exchange of information with the National bank of Croatia).

The FBA participated, as beneficiar, in Project called „Strengthening macro and micro-prudential supervision in EU candidates and potential candidates". The Program has successfully completed by the end of 2011, in terms of exchange of experience, knowledge, and cooperation in field of banking supervision between the Program user, and the central banks of Euro system.

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 participation and cooperation in the Project of the World Bank BiH in regard to consumer protection – users of the financial services, with their expert advice performed was the Diagnostic review of the consumer protection and financial literacy in the banking services and the micro financing sector in BiH. Based on that, performed was a comparison with the good practices in the EU and other countries, and given were key findings and recommendations. There followed a financial literacy in BiH survey. In compliance with the Action plan and its revision continued are the activities of the authorized institutions included in the implementation of this project, which covers, among other issues, the development of the new legislation, which would define the consumer protection segment – users of the financial services.

STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
Commercial banks	20	19	19
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:			

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

Type of financial institution	2009	2010	2011
Public sector ownership	1,1	1,1	2,4
Other domestic ownership	5,0	7,0	10,3
Domestic ownership total	5,61	8,1	12,7
Foreign ownership	93,9	91,9	87,3
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2011 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	59,75%	74,55%	1.544
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:			

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

Type of financial institution	2009	2010	2011
Commercial banks	0,00	-6,15	4,77
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:			

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
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	2009	2010	2011
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	**2009**	**2010**	**2011**
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	2009	2010	2011
Commercial banks	16,1*	16,2*	17,1*
Cooperative banks			
Banking sector, total:			

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

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

Asset classification	2009	2010	2011
Non financial sector			
- households	**39,2**	**43,6**	**69,61**
- corporate	**35,2**	**39,0**	**71,70**

The structure of deposits and loans of the banking sector in 2011 (%) (at year-end)

	Deposits	Loans
Households	56,2	48,5
Government sector	7,2	1,2
Corporate	29,2	49,8
Other (excluding banks)	**7,4**	**0,5**
Total	**100.0**	**100.0**

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

P&L account	2009	2010	2011
Interest income	918.692	856.528	866.684
Interest expenses	396.702	325.773	294.557
Net interest income	521.990	530.755	572.127
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	**816.015**	**859.328**	**888.667**
Administration costs	**248.716**	**242.690**	**250.783**
Depreciation	n/a	n/a	n/a
Provisions	237.596	386.102	189.809
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	6.396	-94.219	98.996
Net profit (loss)	807	-102.976	83.632

*In thousands of KM

Total own funds in 2011 (in EUR)

Type of financial institution	Total own funds (for CAR)	Tier 1	Tier 2	Tier 3
Commercial banks	1.067.186	847.250	239.230	
Cooperative banks				
Banking sector, total:				

2011 DEVELOPMENTS IN THE BANKING SYSTEM IN REPUBLIKA SRPSKA OF BOSNIA AND HERZEGOVINA

MACROECONOMIC ENVIRONMENT

Economic movements in 2011 were more dynamic than in the two preceding years and therefore trend of economic recovery after the 2009 recession may be said to have continued. The positive dynamic that started 2010 was maintained in the first half of the year, and at that time there were prospects for achievement of even higher growth rates. However, a number of internal and external factors negatively affected growth in the second half of the year. Internally, the lack of fiscal policy coordination was caused by delays in adoption and execution of the budgets, which negatively impacted confidence inimplementation of economic policies and discouraged market participants from more extensive economic activities. Externally, mid-year there were negative shocks related to dangerous financial turbulences in the Euro Area, and oil prices suddenly rose at the same time. With regard to net external demand, the positive impulse to the GDP, as had been the case in 2009 and 2010, did not materialize. Despite continued rise in exports during the year, imports of goods (and services) increased considerably more in absolute terms, which constituted a negative contribution to the overall GDP. In this way, economic growth was again structured as before the crisis, with exclusive reliance on domestic demand. With respect to personal consumption (on the basis of available indicators – retail sales and final consumption for calculation of VAT), a recovery occurred and it was estimated that, following two years of stagnation, personal consumption again approached the level attained in 2008. Due to implementation of restrictive measures in terms of budgetary expenditures, the government sector could not contribute more to total economic activities. Yet it was evident that implementation of some externally financed capital investments intensified in 2011, along with an increased inflow of foreign direct investments, all of which should contribute to a general increase in investment.

On the output side, available data suggests an increase in industrial output which was simultaneously a foundation for other service activities. The construction sector also exhibited signs of consolidation, after serious losses and reduced activities during the recession. However, agriculture was severely affected by unfavorable weather conditions (draught), which resulted in considerable damages and economic losses. The estimated real 2011 GDP growth was 1.6 per cent, which was lower relative to earlier expectations and forecasts of over 2 per cent. The causes of lower growth were shocks which unexpectedly impacted the domestic economy, but also the lack of an adequate reaction and insufficient adjustment. Unlike previous years, in 2011 the economy was exposed to more pronounced inflationary pressures, which also negatively affected overall economic activities. Such inflationary trends were taken into consideration for estimation of real growth.

DEVELOPMENT IN THE BANKING SYSTEM

Basic indicators of the banking sector operation as of 31.12.2011:

- Total balance sheet amount was KM 6,638.7 million with growth rate of 11% if compared to 31.12.2010.
- Cash funds (KM 1,180 million) were 20% out of total assets. Out of total banks' cash funds an amount of 20% was in accounts abroad. They were mainly free cash funds not placed into loans mostly because of problems that banks had in finding quality clients and projects in the domestic banking market, while banks could use them for current liquidity when needed.
- Total gross loans (KM 4,149.4 million) increased by 5%, and loans to citizens by 4% if compared to 31.12.2010.
- Share of past due loans in total loans was 6.68%, which was a decrease by 1.97 percentage points in comparison with the year 2010.
- Share of NPLs i.e. non-performing loans (loans classified into higher risk categories) in the total loan portfolio decreased from 17.14% to 11.46%. The NPLs level calls for an additional attention and prudence. Positive trend of capital strengthening in RS banks in 2011, and growth of capital planned in 2012 should be a guarantor of keeping RS banking sector secure.
- Total reserves calculated for coverage of potential credit and other losses under regulatory requirement decreased by 13% if compared to the previous year, while rate of coverage of classified assets by reserves amounted to 8.7% (as of the end of 2010 it was 10.6%).
- Deficient amount of reserves considering regulatory requirement, representing balance between reserves under regulatory requirement and value correction and reserves under IAS, amounted to KM 15.2 million.
- Deposits (KM 4,009.2 million) were a basic source of funding of banks' operation, and their share was 70%. In 2011 deposit decreasing trend from 2009 and 2010 was stopped and the level of deposits recorded an increase of 6% in comparison with the end of 2010.
- Based on deposit maturity structure an amount of 56% represented short-term deposits with a growth rate of 6%, while an amount of 44% were long-term deposits with a growth rate of 6% if compared to the end of 2010. Trend of growth in citizens' deposits continued in 2011, and as of 31.12.2011 the amount was larger by 14%.
- Share of citizens' deposits in total deposits increased from 39% to 42%.
- Total capital (KM 78.3 million) increased by 10% in comparison with the amount as of 31.12.2010.
- Based on the ownership structure, shareholders' capital was 98% private, while share owned by Republika Srpska amounted to 2%. In the private capital structure share of foreign capital amounted to 83%, while domestic capital amounted to 17%.
- Core capital (KM 592.3 million) increased by 5% in comparison with the previous zear, and the law defined a parameter to measure a maximum exposure of banks to loan and other risks concentrations.
- Banking sector of Republika Srpska was liquid and able to meet all its obligations in due terms. All banks met prescribed requirements for liquidity maintenance.

- At the level of the total banking sector a positive financial result was achieved in an amount of KM 58.3 million (as of 31.12.2010 a loss of KM 21.3 million was generated).
- Nine banks generated net profit in a total amount of KM 58.9 million, while one bank had a current loss in an amount of KM 0.59 million.

The Agency has kept requesting from banks not to allocate profit to dividend payment, but to use it to strengthen their own capital bases.

Total assets to GDP: 0,80.

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

In April 2011 the Law on Modifications and Amendments to the Law on Banking Agency of Republika Srpska came into force, by means of which an Ombudsman for Banking System was established within the Agency as an autonomous and independent organizational unit with a goal to efficiently promote and protect rights and interests of physical persons being beneficiaries of financial services.

Coming into force the Law on Accounting and Audit of Republika Srpska with supporting regulation introduced an obligation to implement International Accounting Standards (hereinafter: IAS) and International Financial Reporting Standards (hereinafter: IFRS) in business records maintenance and financial report development. Also, banking regulation reform already commenced under the Strategy for implementation of "International Agreement on Capital Measurement and Standards" (Basel II) contributed to the decision to accept, as a transitional solution, a partial modification of the Agency's regulation and reporting basis. The goal of such modifications was to create preconditions for a more complete implementation of IAS and IFRS keeping regulatory requirements for credit and other losses provisioning. The modifications were applied as of 31.12.20012 and should be applied further on continuous basis.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2011

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 commited 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:

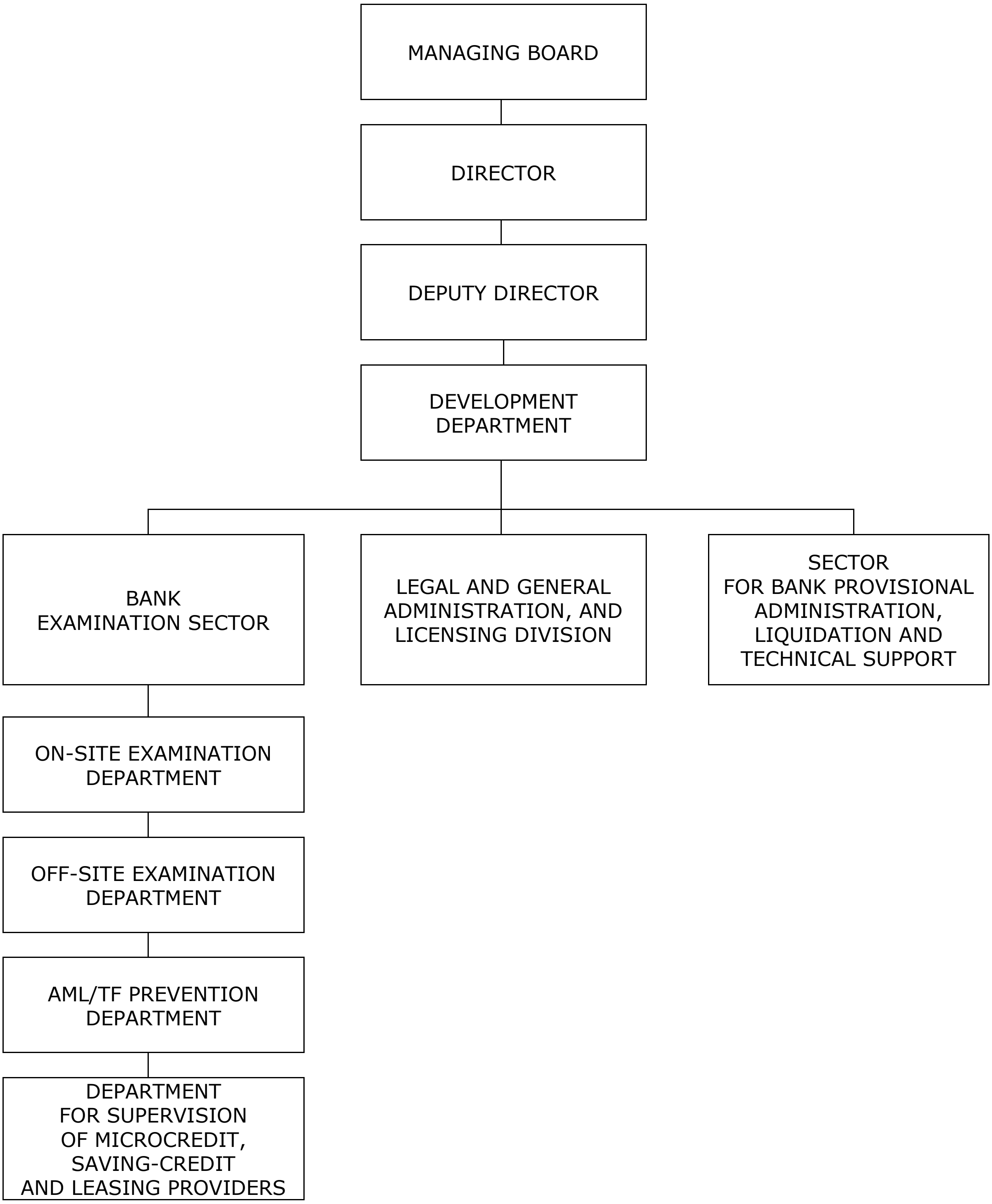
- Introduction of „ International Accord on Capital Measurement and Standards „ – Basel II through the project of technical assistance to BiH financial sector - Partnership for Advancing Reforms in Economy – PARE, under auspices of USAID. In 2009 a working group, consisting of representatives of entity 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).

ACTIVITIES OF THE RS BANKING AGENCY IN 2011

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 2011 Supervision Plan the Agency performed overall and targeted on-site examinations of financial organizations.

Agency also established Ombudsman for protection of financial services users.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2009	2010	2011
Commercial banks	10	10	10
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Commercial banks	10	10	10
Financial institutions, total	10	10	10

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

Item	2009	2010	2011
Public sector ownership	-	-	-
Other domestic ownership	3,6	4,7	5,2
Domestic ownership total	3,6	4,7	5,2
Foreign ownership	96,4	95,3	94,8
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
Commercial banks	62,1	82,3	1.608
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Financial institutions, total			

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

Type of financial institution	2009	2010	2011
Commercial banks	3,4	-4,6	8,2
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Financial institutions, total			

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	94,5	95,5	95,8
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Other*	5,5	4,5	4,2
Financial institutions, total	**100.0**	**100.0**	**100.0**

*Microcredit organizations and Leasing

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

Assets	2009	2010	2011
Financial Sector	27	25	22
Nonfinancial Sector	62	61	59
Government	5	6	13*
Other	6	8	6
Total:	**100.0**	**100.0**	**100.0**
Liabilities	**2009**	**2010**	**2011**
Financial Sector	31	30	20
Nonfinancial Sector	38	42	39
Government	18	11	25
Capital	9	13	14
Total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2009	2010	2011
Commercial banks	15,8*	16,9*	17,3*
Cooperative banks	-	-	-
Financial institutions, average			

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

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

Asset classification	2009	2010	2011
Non financial sector			
- households	**37,4**	**53,4**	**60,5**
- corporate	**28,0**	**45,8**	**52,3**

The structure of deposits and loans in 2011 (%) (at year-end)

	Deposits	Loans
Households	51,2	39,6
Government sector	24,6	13,2
Corporate	14,7	46,5
Foreign	9,5	0,7
Other (excluding banks)	51,2	39,6
Total	**100.0**	**100.0**

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

P&L account	2009	2010	2011
Interest income	166.972	158.711	166.190
Interest expenses	72.018	64.362	62.863
Net interest income	94.955	94.349	103.327
Net fee and commission income	-	-	-
Other (not specified above) operating income (net)	-	-	-
Gross income	315.204	233.905	229.053
Administration costs	92.488	98.721	104.078
Depreciation	-	-	-
Provisions	-	-	-
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	59.695	69.806	20.073
Profit (loss) before tax	12.114		34.131
Net profit (loss)	8.569	(10.898)	29.812

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	396.348	302.836	101.277	7.765
Cooperative banks	-	-	-	-
Financial institutions, average	396.348	302.836	101.277	7.765

2011 DEVELOPMENTS IN THE BULGARIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2011 real GDP increased by 1.7 per cent on a yearly base. Net exports had a major contribution to the growth. During the year growth rate in exports of goods and services remained high in real terms, rising in total by 12.8 per cent. Imports of goods and services accelerated in real terms from 2.4 per cent in 2010 to 8.5 per cent in 2011.

Household demand contracted by 0.6 per cent in real terms in 2011 after the relative stabilization of consumer demand in 2010. The unfavourable international environment had an adverse effect on expectations for economic recovery and especially for improving labour market conditions. The data confirmed these concerns: the economy started to slow, while employment continued to fall. These were the main factors for the subdued household consumer spending.

The downward trend in fixed capital investment (in real terms) continued over 2011. Investments in fixed assets (gross fixed capital formation) decreased in real terms by 9.7 per cent (contributing negatively to the real GDP growth of 2.2 percentage points).

Gross value added produced in economy went up by 1.8 per cent in real terms. Industry in which value added posted a growth of 9.1 per cent had the major contribution. Weak domestic demand had a negative effect on services. After growing by 4.4 per cent in 2010, value added in the services sector fell by 0.1 per cent in 2011. A more significant decrease had retail, transport, hotels and restaurants and culture, sports and entertainment sectors. The information services and professional activities, and scientific research, administrative and ancillary activities sectors, which were relatively less affected by the global crisis, contributed most to the value added growth.

In 2011 labour market situation of the total economy continued to deteriorate. Employment fell by 4.2 per cent against a drop of 4.7 per cent in 2010. While in 2010 industry jobs fell most significantly, in 2011 those in services (mainly retail, transport, hotel and restaurant) had a more significant drop, and the rate of decrease in employees in the industrial sector moderated.

The unemployment in 2011 slightly increased on 2010, though it remained at a relatively stable level of 11.2 per cent.

International energy and food price dynamics which had a sizeable effect on inflation in 2010 continued to play a key role for the consumer price rises in Bulgaria in 2011[13]. Average annual inflation was 3.4 per cent (3.0 per cent in 2010), and end-year inflation declined to 2.0 per cent (4.4 per cent a year earlier).

In 2011 the total current and capital account balance was in surplus of EUR 855.3 million (2.2 per cent of GDP) against EUR 84.9 million deficit (-0.2 per cent of GDP) in 2010. The fall in trade deficit contributed most to this improvement. In 2011 the deficit totalled EUR 1974.6 million, a nominal decrease of EUR 789.0 million on the previous year.

13 Analysis based on HICP data.

In 2011 the nominal growth rate of exports (30.0 per cent) continued to outpace that of imports (21.2 per cent), resulting in a decrease in negative trade balance. All commodity groups contributed to the export growth. All import groups (by use) also grew positively.

Preliminary balance sheet data show that the positive direct investment inflow into Bulgaria in 2011 came to EUR 1341.2 million (3.5 per cent of GDP), from EUR 1208.5 million (3.4 per cent of GDP) in 2010. The relatively low net figure over the last two years reflected fewer attracted funds and intercompany loan repayments.

The balance of payments financial account deficit grew to EUR 1194.3 million in 2011. Transactions of resident banks, which increased their foreign assets by EUR 695.8 million and reduced their external obligations by EUR 1204.5 million over the review period contributed most significantly. Increased household propensity to save and reduce consumption coupled with confidence in banks significantly boosted deposits. Enjoying high liquidity, banks further cut their gross external debt by EUR 1202.5 million (its share of total gross external debt falling from 18.5 per cent in December 2010 to 16 per cent in December 2011).

Gross external debt fell in 2011 by EUR 1666.8 million and amounted to EUR 35.4 billion (91.9 per cent of GDP) as of December.

As a result of all external current, capital and financial transactions, the BNB international reserves rose by EUR 158.7 million in 2011 (valuation adjustments excluded). Given the change in the international foreign reserves on the BNB Issue Department balance sheet, including revaluation adjustments, they rose by EUR 372.1 million.

DEVELOPMENT IN THE BANKING SYSTEM

Major financial indicators of credit institutions and the banking system remained stable. In 2011 the capital base and liquid assets increased and the profit amounted to EUR 242 million. Growth was reported in attracted funds, loans and assets of banks. The increased non-performing exposures against the background of slow credit growth limited banks' opportunities to generate additional revenue from core operations. In 2011 the major factors behind lower return from operations were lower interest income from loans and financial instruments unlike the previous two years when the major reason was the high impairment costs incurred.

Asset quality

In 2011 the quality of assets continued to worsen at a much slower growth rate than that reported in 2010. The annual growth of classified exposures was limited to 13.7 per cent, with the classified portion of corporate loans increasing by 13.0 per cent. The economic situation impacted also the quality of household exposures. In 2011 the total amount of non-performing loans (over 90 days) rose by 30.2 per cent and their relative weight in the gross loan portfolio of the banking system (excluding those to credit institutions) reached 14.97 per cent[14]. The net non-performing loans (over 90 days) to net loans ratio[15] increased to 9.6 per cent. The ratio was calculated by reducing the gross value of these loans by impairment costs.

By the end of 2011 the amount of provisions accumulated in the banking system in the form of impairment costs and specific provisions for credit risk was adequate. The amount of impairments on loans under the International Accounting Standards, specific provisions for credit risk and capital surplus (i.e. the capital in the system over the required regulatory minimum) came to 103.5 per cent of the gross value of non-performing loans past due over 90 days. Assessing the the amount of provisions and coverage degree it should be taken into account that the banking system and individual credit institutions maintain high the level and quality of collateral on extended loans which affect the amount of impairment costs and specific provisions for credit risk.

Profitability

In 2011 banks' profitability was impacted by credit risk. By the end of 2011 the banking sector reported an audited profit of EUR 242 million: down by EUR 64 million (21.0 per cent) compared with 31 December 2010. As a result the ROA went down to 0.63 per cent. The return on balance sheet equity and reserves (ROE) followed a similar dynamics and by the end of 2011 amounted to 4.93 per cent. The results for 2011 reflect the lower level of net interest income (by EUR 24 million or 1.6 per cent on the previous year) due mainly to lower income interest on problem and newly extended loans. On the other hand, higher interest income reported on individual portfolios of financial instruments failed to offset the lower interest income from banks' core operations. Interest expenditure remained close to that reported by the end of 2010: EUR 1.1 billion.

Solvency

The amount and quality of the capital position remained at levels providing possibilities for expanding the banking intermediation. Total capital adequacy of the banking sector reached 17.55 per cent by end-December, a value more favourable than that reported a year earlier. Tier one capital, the most qualitative part of own funds, strengthened and by the end of 2011 the tier one ratio reached its peak since the start of the crisis (15.73 per cent). The increased equity was a result of the effect of two groups of factors: the sustained ambition of credit institutions to maintain higher minimum level of primary capital and to adhere to a more conservative policy in distributing profit (dividends), as well as to continued proactive supervisory requirements. These factors were a prerequisite to increase the system's capital surplus.

Liquidity

Within 2011 the liquid assets ratio ranged between 24–26 per cent, with low lending growth being among the factors behind the maintenance of adequate liquidity. The annual growth rate of liquid assets exceeded that of liabilities and by the end of the period liquid assets ratio rose to 25.53 per cent. Liquid assets

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14 Mechanical comparison should be avoided in international analysis of the relative weight of loans past due over 90 days indicator in the banking system gross loan portfolio. It should be considered in the context of the structure of balance sheets of individual banking systems. For example, there are no sizeable portfolios of instruments for trade which are sensitive to market impairment (including also those triggered by debt crisis) in the structure of the Bulgarian banking system balance sheet. In contrast to some European banking groups and systems banks in Bulgaria did not suffer losses from these portfolios. Concurrently, EU leading banks maintaining a low share of non-performing loans incurred losses from debt securities which then required their recapitalisation.

15 The ***non-performing loans (over 90 days) to credit portfolio*** ratio reports the gross value of loans, i.e. it includes the risk that has been already reported in the income statement through impairment.

increased by EUR 0.7 billion (9.4 per cent) to EUR 8.6 billion in the review period.

Market structure

In 2011 the number of credit institutions in Bulgaria increased from 30 to 31. Banking system's assets grew by EUR 1.5 billion (4.1 per cent), with their growth rate matching that of attracted funds. The assets of the five largest banks comprised 51.8 per cent of system's balance sheet figure by end-2011. The ratio of banking sector assets to GDP for end-2011 was 101.9%.

Foreign presence

On an annual basis, the share of EU subsidiaries decreased to 69.6 per cent. Concurrently, domestic banks continued to be more active market participants and in 2011 they increase their market positions by 4.2 percentage points to 23.5 per cent of banks' assets. The shares of the remaining institutions (banks outside EU and foreign bank branches from and outside the EU) did not experience significant changes.

Products and distribution channels

For end 2011 there are 51 points of sale (branches, offices, representative offices and remote workstations), 75 ATMs and 879 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

The Bulgarian National Bank (BNB) is responsible for the supervision of credit institutions and maintenance of the banking system stability in Bulgaria. The cornerstones in its supervision policy are the protection of depositors' interests, and saving the capacity of credit institutions in providing credit to domestic business and consumers. Within these policy landmarks and trying to off-set effects from recent sovereign debt crisis, in 2011 the Banking Supervision Department continued also harmonisation of the national legal framework to changing prudential requirements in EU, and convergence of practices in the supervision of banks.

At the beginning of the year, amendments to Ordinance No 9 on the Evaluation and Classification of Risk Exposures of Banks and the Allocation of Specific Provisions for Credit Risk were adopted, in order to alleviate capital burden on banks, without adversely affecting accrued to date and required future capital buffers. In the second half of 2011, it was worked out and introduced a package with legislative amendments arising from the EU Capital Requirements Directive (so-called package CRD III), in force as of 31-December-2011. The amendments affected Ordinance No 8 on Capital Adequacy of Credit Institutions and imposed relevant update of reporting templates of credit institutions (COREP).

The regulatory framework was further updated taking into account amendments to the said CRD or particular guidelines, issued by the European Banking Authority (EBA). Since the beginning of 2011 updated national guidelines on stress testing and management of concentration risk with banks are in force which should be further taken into account under the Supervisory Review Process. As regards the corporate governance framework, guidelines on remuneration were introduced. They define certain reference points and application requirements to be considered in remuneration policy of banks that as a matter of fact should be risk- and result-oriented for a longer term. Moreover, the EBA recommendations on Liquidity Cost Benefit Allocation (LCBA) were adopted. They provide principles to credit institutions for working out or improving current practices or already available allocation mechanisms for costs and benefits associated with liquidity and liquidity risk management. As the Bulgarian banking system is dominated by foreign subsidiaries and branches, implementation of the LCBA-guidelines should be examined in the context of cross-border effects and financial stability.

In response to recommendations issued by the European Systemic Risk Board (ESRB) regarding observed practices of foreign currency lending across the EU, at the end of the year BNB prepared and sent to banks clarifications on their application, taking into account economic and financial conditions in the country. The said recommendations should raise banks' awareness on risk implications with foreign currency lending that turned out to be a problem for some EU member states, and that emphasise on improving lending in foreign currency, particularly to unhedged borrowers, as well as on related aspects of liquidity management.

During the year, amendments to the supervisory reporting framework were made, that will require more detailed information on banks' condition. The update was focused on capital adequacy, reporting on large exposures, liquidity monitoring and liquidity risk management. Changes of reporting undertaken should address further needs of harmonisation in financial information for supervisory purposes at EU level.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2011

The strategic objectives of the Banking Supervision are:

- effective micro-prudential supervision of credit institutions and the broader macro-prudential goal of maintaining stability of the banking system;
- assessment of the strength and resilience of banks and the banking system to identify emerging risks for individual firms and the broader impact on financial markets and the financial system as a whole;
- to verify compliance with the specific banking provisions for which it is responsible, among which should be highlighted, along with those relating to the financial situation and solvency of the institutions, those relating to customer protection and transparency vis-à-vis the market;
- to strengthen operative banking supervision and cross-border cooperation within supervisory colleges; to deliver timely and well reasoned risk assessments on local bank subsidiaries within the joint risk assessment and decision process related to EU banking groups presented in Bulgaria;
- participation in the work of European Banking Authority, implementation of EU directives, guidelines and recommendations in order to ensure the harmonized interpretation and application of EU legislation.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

During 2011, BNB's efforts in on-going banking supervision were placed in streamlining regular of-site monitoring of banks and on-site inspections for delivering timely and well reasoned assessments. In the main, they were aimed at updating individual financial and risk profiles, and to evaluate management of credit institutions.

During the on-site inspections particular attention was paid on the management of credit and liquidity risk, and assessment of the level of capital adequacy. During the year, mostly full-scope supervisory inspections were carried out, including evaluation of market and operational risk, and some particular Pillar II risks, e.g. concentration risk, interest rate risk in banking book. Sixteen inspections were conducted during the year. Outcomes of the supervisory reviews show that banks have a satisfactory credit and liquidity risk management. Credit institutions demonstrated viability, backed by well preserved solvency and liquidity buffers.

Four of the supervisory inspections carried out during the year were devoted to examination of internal capital adequacy assessment process (ICAAP) with banks, which were assessed as satisfactory.

Main priority in the area of macro-prudential analysis was the assessment of the resilience of the banking sector in terms of the recent sovereign debt crisis in EU. For this purpose, on-going monitoring of financial or regulatory parameters of the system as a whole, and of individual credit institutions was performed during the year. Main focus of supervisory macro analysis was identification of possible early risks' symptoms or cross-border spill-over effects. Complementary data were collected on the financial situation of certain foreign parent institutions or banking groups domiciled in countries experiencing fiscal or sovereign debt problems, and that carry out business in Bulgaria.

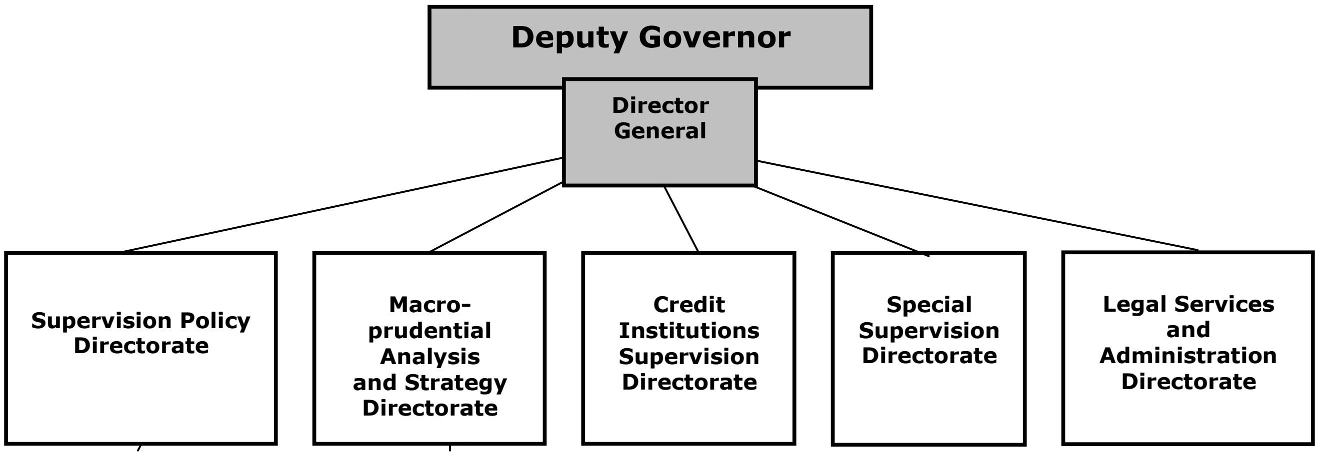
Based on the EBA common framework for sustainability of banks to shocks, a national stress test was conducted (April-June 2011). Although credit institutions in Bulgaria did not fall within the scope of the pan-European stress test, resilience of the system and banks to credit risk was tested using the "top-down approach". The assessment of the sensitivity was focused on interest rate and market risks by implementing the "bottom-up approach". Joint application combines specific advantages of both approaches and utilizes to facilitating dialogue with institutions on credit risk, which is the main risk for the system. During the year, also stress tests on liquidity of credit institutions were carried out, which together with stress test exercises on credit risk were in aid of the countercyclical policy of BNB.

Besides of banks, *also monitoring of non-banking financial institutions* was carried out. Within the registration procedure and the established reporting framework, financial data of leasing companies, factoring and other lending firms were observed in the context of financial stability. As a whole, condition of this particular segment of credit market is corresponding with the trends in the banking sector.

In 2011, BNB supervisory staff was carrying out further oversight activities in monitoring and assessing adherence of credit institutions and non-bank financial institutions to rules and practices of combating money laundering, terrorist financing and financial crimes. Certain requirements for supervision of cash payments were improved in order to strengthen this type of control done by BNB.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

Banking Supervision Department



INTERNATIONAL ACTIVITIES

The published draft proposal for a new regulatory package (so-called CRD IV), introducing the new capital framework (Basel III) for banks in EU, launched a series of discussions at European level, which required active exchange of expert opinions. BNB representatives continued their participation in EC- and EU-Council committees and working groups, and contributed to the elaboration of the EU legal acts, of which the amendments to above mentioned CRD were of main importance. Also for purposes of convergence, in 2011 the BNB staff was actively collaborating with colleagues from other national supervisory authorities and supported the joint efforts with the European Supervisory bodies to develop common supervisory standards and countercyclical measures, aimed at maintaining a safe and adaptive banking sector, for sound credit institutions and banking groups.

BNB was exchanging regular information within the work of the relevant standing committees and working groups of EBA and ECB for monitoring financial stability in the EU, where strengthening the financial stability mechanism is an important objective.

With regards to the supervision on cross-border banking groups, BNB continues participation in supervisory colleges. During 2011, BNB was attending to work at 11 colleges of line supervisors. In general, exchange of supervisory information was sufficient but there is still space for improvement, e.g. to discuss and assess in advance decisions or measures to be imposed that might have cross-border effects. Under the coordination of consolidating authorities, joint risk assessments of banking groups with subsidiaries operating in the country, were performed. Upon these assessments, joint decisions on the capital adequacy on consolidated level were reached, topical issues and lessons learnt from supervision of cross-border banking groups were discussed, and follow-up actions for further cooperation were outlined.

Within the EU supervisory cooperation, steps were undertaken for convergence of supervisory practices in preventing money laundering, terrorist financing and fraud. In order to improve efficiency and effectiveness of measures, significant work was done in several areas: i.e. drafting a document for supervisory cooperation for monitoring on group level with regard to measures undertaken against money laundering; training of banks and financial institutions; amendments of Directive 2005/60/EA on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

During 2011 BNB was providing technical assistance to supervisory authorities in non-EU-countries. Last November, the two-year EU-funded Twinning project with financial supervisory authorities of Montenegro as beneficiaries was successfully completed. This really comprehensive project was led by the Bulgarian National Bank, in cooperation with the Financial Supervision Commission of Bulgaria and De Nederlandsche Bank. Project outcomes should contribute to the preparation of Montenegro for the negotiation process with the EC.

BNB participated also in the three-year programme of technical cooperation with the Central Bank of Egypt, from 2009 to 2011 and under the leadership of ECB, which was focused on the effects of the implementation of the Basel II capital framework. There were two study visits of Egyptian experts to BNB, which were aimed at addressing certain topical issues of implementation associated with supervisory capital requirements and future changes in the capital framework incorporated in the Basel III accord.

COOPERATION WITH OTHER SUPERVISORY BODIES IN BULGARIA

In order to meet its commitments and following the tasks pertaining to the function of the Financial Stability Advisory Council, in 2011 the BNB was supporting periodical meetings of the Minister of Finance, the Governor of BNB and the Chair of the Financial Supervision Commission. Upon Council's agenda, relevant information and reports on the financial stability in the country were delivered, as well as on the condition of the financial sector and on cross-border effects observed at EU-level.

BNB continued also cooperation and communication with other national authorities engaged in the fight against financial crime and money laundering, especially at the Multidisciplinary Task Force for Prevention of ML and TF, or some other multidisciplinary working groups and ad-hoc temporary working groups. The active collaboration and exchange of information with respect to cross-border financial crime between the institutions provided greater efficiency in preventing and detecting transactions involving dirty money.

There was an intense cooperation between BNB and other relevant national institutions for elaborating the National Strategy on measures for preventing money laundering in the Republic of Bulgaria during 2011-2015, as well as a large-scale project for strengthening the analytical capacity of administration with regards to euro funds corruption risk. The National strategy includes an up-to-date assessment of national environment and formulates a number of measures, i.e. within the international cooperation and information exchange, monitoring and effective decision-making, legislation elaboration, increasing prevention effectiveness, effective investigation, access to necessary information and property confiscation.

During the year, BNB and the Deposit Insurance Fund in Bulgaria (DIFB) collaborated on issues of discussion at EU level regarding improvements sought in the EU framework on Deposit Guarantee Schemes. Bearing in mind recent trends on credit markets, and as usual, supporting the activity of the DIBF; further efforts were placed in order to update regularly exchanged information.

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2009	2010	2011
Commercial banks	24	24	24
Branches of foreign credit institutions	6	6	7
Cooperative banks	-	-	-
Banking sector, total:	**30**	**30**	**31**

Ownership structure of banks on the basis of assets total

Type of financial institution	2009	2010	2011
Public sector ownership	1.27	1.86	2.44
Other domestic ownership	14.60	17.41	21.06
Domestic ownership total	15.87	19.27	23.50
Foreign ownership	84.13	80.73	76.50
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
Commercial banks	35.41	51.77	95.46
Branches of foreign credit institutions	3.83	4.53	4.54
Cooperative banks	-	-	-
Banking sector, total:			**100**

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

Type of financial institution	2009	2010	2011
Commercial banks	8.95	6.55	4.93
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**8.95**	**6.55**	**4.93**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	94.9	95.17	95.46
Branches of foreign credit institutions	5.1	4.83	4.54
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	2009	2010	2011
Cash in hand, balances with central banks	9.02	9.94	9.92
Loans and advances to credit institutions	10.45	10.39	10.83
Loans and advances to customers	71.09	68.84	67.73
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	6.68	8.06	8.60
Tangible assets and Intangible assets	2.23	2.12	2.06
Residual assets	0.52	0.65	0.84
Total assets	**100.00**	**100.00**	**100.00**
Liabilities	**2009**	**2010**	**2011**
Amounts owed to credit institutions	20.33	17.95	12.74
Amounts owed to customers	61.31	63.93	69.31
Debts evidenced by certificates	0.85	0.81	0.67
Residual liabilities	1.53	1.08	1.15
Provisions	0.10	0.10	0.11
Subordinated liabilities	2.56	2.53	2.54
Equity (including valuation adjustments)	12.25	12.77	12.86
Profit or loss for the financial year	1.06	0.81	0.62
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.

Capital adequacy ratio of banks

Type of financial institution	2009	2010	2011
Commercial banks	17.04**	17.39**	17.55**
Cooperative banks	-	-	-
Banking sector, total:	17.04**	17.39**	17.55**

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

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

Asset classification	2009	2010	2011
Net Non-performing loans past due over 90 days (excl. those to credit institutions) as a % of net loans (excl. those to credit institutions)	4.14	8.02	9.60

Note: Total loans of banks are Net loans (gross loans minus impairment expenses).

The structure of deposits and loans of the banking sector in 2011 (%) (at year-end)

	Deposits[6]	Loans[7]
Households[1]	47.7	27.2
Government sector[2]	2.8	0.9
Corporate[3]	21.1	48.1
Foreign[4]	19.2	10.8
Other[5]	9.2	13.0
Total	**100.0**	**100.0**

[1] Data refer to ESA'95 sectors S.14 Households and S.15 Non-profit institutions serving households.
[2] Data refer to ESA'95 sector S.13 General government (S.1311 Central government, S.1313 Local government and S.1314 Social security funds).
[3] Data refer to ESA'95 sector S.11 Non-financial corporations.
[4] Data refer to ESA'95 sector S.2 Rest of the world.
[5] Data refer to ESA'95 sector S.12 Financial corporations (monetary financial institutions, other financial intermediaries, financial auxiliaries, insurance corporations and pension funds).
[6] In accordance with the requirements of Regulation ECB/2008/32, in the liability side, instrument *deposits* also includes loans and repurchase agreements.
[7] In accordance with the requirements of Regulation ECB/2008/32, in the asset side, instrument *loans* includes also claims on deposits and repurchase agreements.
Source: Other monetary financial institutions

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

P&L account	2009	2010	2011
Interest income	2,633,280	2,592,565	2,572,113
Interest expenses	1,183,238	1,101,200	1,104,396
Net interest income	1,450,042	1,491,365	1,467,718
Net fee and commission income	375,734	388,186	401,789
Other (not specified above) operating income (net)	16,025	19,768	24,283
Gross income	1,938,858	2,012,102	2,003,886
Administration costs	861,768	865,598	887,673
Depreciation	114,641	116,069	115,921
Provisions	-8,738	5,913	10,003
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	547,444	680,999	711,964
Profit (loss) before tax	428,514	344,955	279,296
Net profit (loss)	384,475	306,573	242,277

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	4,711,853	4,221,899	489,957	-
Cooperative banks	-	-	-	-
Banking sector, total:	4,711,853	4,221,899	489,957	-

2011 DEVELOPMENTS IN THE CROATIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Gross domestic product of the Republic of Croatia held steady in real terms in 2011, after falling by 1.2% in 2010 and by even higher 6% in 2009. Of all the other Central and South Eastern European countries, Croatia's economic dynamics in the period after the breaking up of the crisis was the worst, as seen in particular in Croatia's slower exports of goods compared to these other countries. Total economic activity held steady in 2011. The labour market was marked by further unfavourable developments, with falling average employment and rising unemployment rate. The average administrative unemployment rate in 2011 reached 17.8%, and the internationally comparable Labour Force Survey unemployment rate stood at 13.5%. Nominal gross and net wages rose in 2011, while real wages fell slightly.

Import prices pushed inflation up. However, its growth was slowed down by weak growth and unfavourable expectations related to economic developments, reduced employment and unemployment growth. Import pressures on prices were due primarily to an increase in the prices of energy and raw materials on the global markets. The average annual rate of consumer price inflation in Croatia rose from 1.1% in 2010 to 2.3% in 2011. Inflation acceleration was particularly evident in food products.

Current account deficit narrowed slightly, mostly due to good results in tourism. The negative balance on an annual level thus stood at EUR 0.4bn (-1.0% of GDP). The weakening of economic activity, coupled with a fall in the current account deficit diminished the need for foreign financing. However, net capital inflows (changes in international reserves excluded) stood at EUR 1.7bn, which is an increase of 27.5% compared to 2010. The largest share of direct equity investment involved debt to equity transactions of several foreign-owned companies, while investments into new projects fell by one third from the previous year. The debt to equity conversion had a significant impact on the gross external debt balance, that fell by EUR 0.7bn and stood at EUR 45.7bn or 99.6% of GDP. However, if the said transactions and cross-currency changes are excluded, the debt rose by EUR 0.7bn with the banks and the central government increasing foreign liabilities the most. Private non-financial companies also increased their debt, while public enterprises and non-banking financial institutions reduced their liabilities towards foreign creditors.

Unfavourable developments in public finance continued for the third consecutive year. The government ensured almost the entire amount needed to finance the deficit through new borrowing, thus boosting further fast growth in general government debt that reached HRK 156.0bn (45.7% of GDP) last year. Worsening of foreign investors' risk perception regarding Croatia in 2011 and the widening of the negative gap in relation to new EU member states negatively influenced the price and availability of foreign financing. Further increase in the global risk premium led to further worsening of the conditions for foreign financing for Croatia.

In 2011, the central bank continued to pursue the policy of stable nominal exchange rate of the kuna against the euro, as the main precondition for creating low inflation in Croatia and for maintaining total financial stability. In addition to maintaining the stability of the exchange rate, in 2011 the CNB also supported high monetary system liquidity in an effort to ensure more favourable conditions for financing and faster recovery of the domestic economy. Poor demand and absence of investments, coupled with the growth in the share of irrecoverable loans and steady large demand of the government for financing, weakened the prospects for any considerable recovery in loans to companies and households.

DEVELOPMENTS IN THE BANKING SYSTEM

At the end of 2011, there were 37 credit institutions operating in the Republic of Croatia: 31 banks, one savings bank and five housing savings banks. Compared to the end of 2010, the number of credit institutions fell by one as a result of compulsory winding up proceedings initiated in one bank and withdrawal of this bank's authorisation. Banks accounted for 98.1% and savings banks for 1.9% of the total assets of credit institutions. The total assets of credit institutions stood at HRK 414.8bn and accounted for 121.6% of GDP. There were 21 majority foreign-owned credit institutions at the end of 2011 which accounted for 90.8% of the total assets of all credit institutions. Three credit institutions were in majority state ownership and their assets accounted for 4.5% of the total assets of all credit institutions. The remaining 13 credit institutions were in majority ownership of domestic shareholders and their assets accounted for 4.7% of the total assets of all credit institutions. At the end of 2011, credit institutions employed 22,305 persons.

A slight heightening of credit activities led to increased dynamics of assets growth and had a favourable impact on the business results of banks in 2011. Compared to the pre-crisis period, the rate of assets growth was relatively low, and so were indicators of return, reflecting uncertainties in the environment and further growth in credit portfolio losses. Exchange rate effects excluded, bank assets grew by 2.5% in real terms with bank assets of large banks growing the fastest, as a result of an increase in the sources from majority foreign owners. Of the domestic sources, household deposits were the only category that rose, though at a much slower rate compared to the previous year. The increase in corporate loans had a key impact on total loans growth, with the largest share of these loans being used for working capital and existing liabilities financing. The household sector was again very cautious as regards consumption and borrowing, with the loans to that sector falling for the third consecutive year. The level of new credit activity was not sufficient to halt deterioration in the quality of loans. As a result, the share of partly recoverable and fully irrecoverable loans rose to 12.4%, while the banks' risk aversion remained elevated. In search of less risky clients, the banks turned increasingly to government units and public enterprises as well to other big clients.

Heightened credit activity led to stabilisation in net interest income and an increase in bank profit. Lower expenses on loss provisions, as the main generator of profitability growth, also boosted profits. The return on assets rose to 1.2% and the return on capital to 6.9%. The ability of capital to cover potentially increased operational risks increased additionally from the previous year. The capital adequacy ratio rose to 19.6% as a result of a significant decline in the average weight for credit risk and the ensuing lower capital requirements for credit risk. The average weight for credit risk declined as a result of an increase in the share of low-risk exposures to central governments and central banks, with a considerable share of this increase being attributable to increased use of credit risk mitigation techniques, particularly the use of government guarantees.

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, the fundamental acts governing the conditions for the establishment, operation and dissolution of these institutions, as well as supervision of their operation. The main objectives of supervision exercised by the CNB are to maintain confidence in the Croatian banking system, and 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 laws and regulations governing the carrying out of financial activities, their own rules, and professional standards and rules. 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.

The CNB exercises supervision of credit institutions by:

- collecting and analysing prescribed reports and other reports and information;
- ongoing monitoring of the lawfulness of operation of credit institutions, by carrying out on-site examinations of credit institutions' operations; and
- imposing supervisory measures in order to take actions at an early stage to improve the safety and stability of credit institutions' operation and to eliminate any detected illegalities.

The CNB exercises supervision of credit unions in a similar manner.

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. These bodies are responsible for regulation and supervision of non-banking financial services.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2011

The methodology of the process of CNB supervision was slightly modified in 2011 to make it compatible as much as possible to European supervisory guidances. The previously used CAMELS methodology was thus replaced by a new Methodology for the risk assessment of credit institutions. Under this methodology, each credit institution is assigned a risk profile assessment that is based on an assessment of the following components of the business of credit institutions: credit risk, market risk, operational risk, liquidity risk, interest rate risk in the non-trading book, earnings, capital, balance sheet developments, risk assumption and strategy and corporate management. The basic added value of the new methodology (in addition to risk assessment introduced by new subordinate legislation, most notably the operational risk and interest rate risk in the non-trading book) lies in the division of assessment to the quantitative and the qualitative component for each individual segment covered by this methodology, i.e. in the determination of the effect of the level of exposure to an individual risk on the one hand and the quality of management of the relevant risk on the other hand, on total risk assessment.

Over the past few years, the CNB was active in the adjustment of the prudential reporting system for the purposes of supervision, including financial reporting of credit institutions (FINREP, Consolidated Financial Reporting Framework) and reporting on the capital adequacy of credit institutions (COREP, Common Reporting Framework). Though lower in volume since most of the adjustment had been completed in 2010, the adjustment of the system of reporting of the CNB on the business of credit institutions with EU directives and guidelines continued into 2011. The bulk of new reporting had been implemented in 2010 so that in 2011 only system improvements were made, mainly those relating to the introduction of reporting on currency risk on a daily basis and IT development and testing of reporting records whose implementation is expected in 2012.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

Based on changes in European legislation and plans for the necessary changes to the domestic legal framework regulating the operation of credit institutions, in 2011, the CNB implemented the provisions of CRD III into the domestic legal framework. In the last quarter of 2011, the CNB took the necessary steps and organised working groups for the implementation and use of CRD IV, which was submitted into legislative procedure by the European Commission in 2011. This Directive will be implemented in the Croatian regulations and the Regulation will be directly applicable in the banking system of Croatia from the moment of its accession to the EU. The authorities of the newly-established European Banking Authority (EBA) will fully enter into force with the accession to the EU. Following the signing of the Accession Treaty with the EU, CNB Prudential Regulation and Bank Supervision Area staff actively joined in the work of EBA as observers.

In 2011, the CNB stepped up its activities in the field of consumer protection policy and set up a Consumer Protection and Market Competition Department within the Prudential Regulation and Bank Supervision Area. In addition to the internal activities associated with the organisational set up and recruitment of new staff, great efforts were also exerted in dealing with consumer complaints in the field of banking and financial services. These activities are planned to assist the CNB in collecting sufficient information that will, together with information obtained from individual consumer complaints, be used to amend the existing and draft new legislation, bearing in mind the role of the CNB in the activities related to the implementation of EU legislation.

In 2011, the CNB continued its activities on the analysis of data on due but unpaid receivables and credit risk quality. Monthly data on due but unpaid receivables of credit institutions and data on rolled over and restructured placements were analysed in 2011. Special attention in the area of prudential analysis was paid to internal capital adequacy assessment reports (ICAAP reports), submitted to the CNB for the first time by credit institutions in accordance with subordinate legislation.

All the tasks planned under the CNB strategic guidelines relating to on-site examination were completed in 2011. The emphasis was placed on core tasks that include on-site examination of credit institutions, with a particular focus on asset quality control and credit risk management and value adjustments and provisions for bad placements. In addition, on-site examinations in 2011 focused on the process of granting of placements, including the assessment of the methodology of client creditworthiness analysis and internal scoring/rating systems used in the process of placement granting. Special attention was also paid to the process of subsequent placement monitoring with a particular emphasis on early warning indicators of increased credit risk and their integration in the framework of placement distribution process.

Until the date of accession of the Republic of Croatia to the EU, the CNB is responsible for the protection of market competition in the market of banking and financial services provided by credit institutions. Since CNB's responsibility in the area of market competition will be transferred to the Croatian Competition Agency as of the date of accession, further steps were undertaken towards drafting a memorandum of understanding with this Agency.

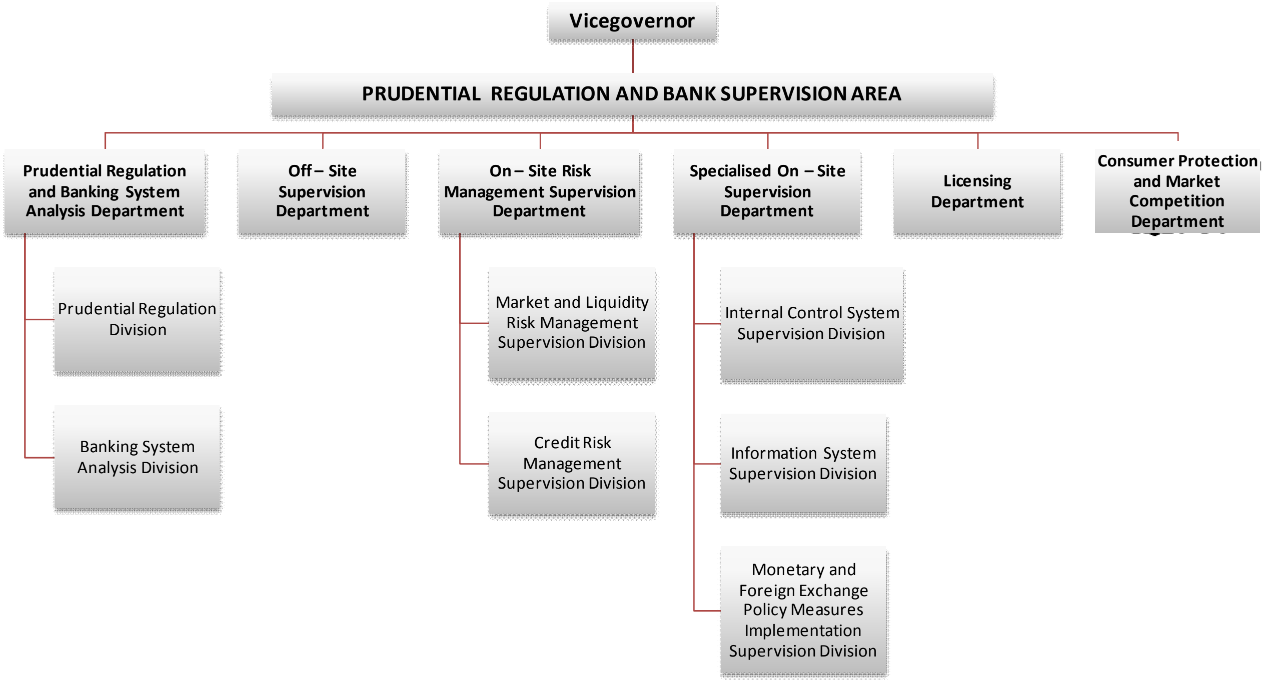
In the area of licensing, a number of applications were processed and different decisions and approvals were given to the banks. One bank, for which also a decision to initiate compulsory winding up proceedings was issued, had its authorisation withdrawn.

Under the Act on Amendments to the Credit Unions Act that was enacted in 2011, credit unions are also allowed to conduct payment transactions for their members and to receive monetary deposits from unions and chambers of trades and crafts and non-refundable funds from international institutions. At the end of 2011, there were 22 credit unions operating in the Republic of Croatia.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

The activities of supervision of credit institutions are organised within the Prudential Regulation and Bank Supervision Area. At the end of 2011, the Prudential Regulation and Bank Supervision Area numbered 120 employees.

Organizational chart of the Prudential Regulation and Bank Supervision Area:



INTERNATIONAL ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

The guidelines and instructions of the European Banking Authority place an even bigger emphasis on the strengthening of the role of the college of supervisors on the European level, thus prompting enhanced CNB cooperation with foreign supervisors, particularly as regards joint assessments of the risk of business operations of banking groups and the adequacy of the allocated amounts of capital for individual group members.

In 2011, the CNB signed a memorandum of understanding in the field of supervision of the group of credit institutions with the Turkish supervisory authority, and memoranda of understanding in the field of supervision of housing savings banks, where the activities of the college of supervisors had already begun, with the Austrian supervisory authorities. Based on signed memoranda of understanding and for the purpose of improving cooperation with foreign supervisors, in 2011 CNB representatives participated in workshops and/or colleges of supervisors relating to the supervision of banking groups that include domestic credit institutions.

In 2011, 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 drafting of the Supervisory Risk Report, i.e. the annual risk assessment of the domestic credit institution, which serves as an element for making the final Joint Risk Assessment decision and for a joint decision on the required amount of capital of a banking group. In 2011, the CNB continued to co-operate with the Austrian supervisory authority on the preparation of a Supervisory Newsletter that deals with the business of domestic banks in majority ownership of Austrian banks.

COOPERATION WITH OTHER SUPERVISORY BODIES IN CROATIA

Under the provisions of the Act on the Croatian National Bank and the Credit Institutions Act, the CNB enters into memoranda of understanding in the field of banking supervision with domestic and foreign supervisory bodies.

The CNB entered into the following agreements with other supervisory bodies in the Republic of Croatia:

- Agreement on co-operation between the Croatian National Bank and the Croatian Financial Services Supervisory Agency.
- Agreement on co-operation and exchange of information in the area of anti-money laundering and combating of terrorism financing.
- Agreement on co-operation in the area of protection of market competition in the banking and financial services market with the Croatian Competition Agency.
- Agreement on co-operation with the Office for Money Laundering.
- Memorandum of understanding regarding financial crisis management with the Ministry of Finance and the Croatian Financial Services Supervisory Agency.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

For further information on CNB supervision activities and regulations governing CNB supervision, please visit CNB website at www.hnb.hr.

STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
Banks	32	32	31
Savings banks	2	1	1
Housing savings banks	5	5	5
Banking sector, total:	**39**	**38**	**37**

*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	2009	2010	2011
Public sector ownership	4,1	4,3	4,5
Other domestic ownership	4,9	5,4	4,9
Domestic ownership total	9,0	9,7	9,4
Foreign ownership	91,0	90,3	90,6
Financial institutions, total	**100,0**	**100,0**	**100,0**

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

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Banks*	56,3	76,0	1 400,4
Housing savings banks	57,5	100,0	2 400,4
Banking sector, total:	55,3	74,5	1 348,8

*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	2009	2010	2011
Banks	6,4	6,5	6,9
Housing savings banks	13,5	3,9	2,2
Banking sector, total:	6,4	3,9	6,9

*ROAE

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Banks	98,3	98,3	98,1
Housing savings banks	1,7	1,7	1,9
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2009	2010	2011
Financial sector	n/a	13,5	14,6
Nonfinancial sector	n/a	59,4	59,9
Government sector	n/a	12,7	13,9
Other*	n/a	14,5	11,5
Liabilities	**2009**	**2010**	**2011**
Financial sector	n/a	10,2	9,4
Nonfinancial sector	n/a	52,5	52,4
Government sector	n/a	1,9	2,0
Capital	n/a	13,8	13,4
Other*	n/a	21,6	22,7

* includes non-residents

Capital adequacy ratio of banks

Type of financial institution	2009*	2010**	2011**
Banks	16,4	18,8	19,6
Housing savings banks	16,3	20,3	19,9
Banking sector, total:	**16,4**	**18,8**	**19,6**

* 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	2009	2010	2011
Non financial sector			
- households	**5,8**	**7,8**	**8,6**
- corporate	**12,9**	**18,1**	**20,1**

*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	56,6	43,9
Government sector	1,8	10,8
Corporate	15,8	42,1
Other (excluding banks)*	25,8	3,2
Total	**100.0**	**100.0**

*excluding domestic banks, including non-residents

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

P&L account	2009	2010	2011
Interest income	22 830	21 215	21 779
Interest expenses	13 279	10 251	10 184
Net interest income	9 551	10 964	11 595
Net fee and commission income	2 983	3 209	3 008
Other (not specified above) operating income (net)	2 761	1 479	1 472
Gross income	15 295	15 652	16 075
Administration costs	6 643	6 643	6 810
Depreciation	940	940	887
Provisions	61	-75	10
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	3 454	3 841	3 689
Profit (loss) before tax	4 196	4 303	4 680
Net profit (loss)	3 278	3 451	3 804

*in million HRK

Total own funds in 2011 (in EUR*)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Banks	7 285,9	6 669,0	616,9	0,0
Housing savings banks	74,1	61,3	12,8	0,0
Banking sector, total:	7 360,0	6 730,3	629,7	0,0

*HRK/EUR 7,53042

2011 DEVELOPMENTS IN THE CZECH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Economic growth in the Czech Republic continued in 2011, following its renewal in 2010, but the growth rate was slower. Real economic growth for the year as a whole was 1.7%. This was mostly due to net exports, whereas the other components ceased to be the drivers of domestic economic growth in the second half of the year.

Economic growth was fostered by improved export opportunities as world trade gradually emerged from the recession and financial crisis. The economy maintained its previous year's growth in 2011 Q1, but Q2 already saw a slowdown in economic growth due also to a deeper decline in household and government consumption. Following a temporary improvement in spring 2011, the tensions in the global financial markets again started to grow.

Inflation rose slightly for the second consecutive year. The average inflation rate in 2011 was 1.9%, up by 0.4 percentage point on a year earlier. The pick-up in inflation was chiefly due to rising global commodity and food prices and domestic administered prices. At the year-end, food prices reflected in advance the increase in the reduced VAT rate, which took place at the start of 2012.

The appreciation trend of the koruna's exchange rate against the euro and the dollar continued into 2011. The average CZK/EUR exchange rate appreciated from 25.3 in 2010 to 24.6 in 2011. The average CZK/USD exchange rate appreciated as well, from 19.1 in 2010 to 17.7 in 2011. At the end of the year, however, the exchange rate depreciated owing to the escalation of the euro area debt crisis.

The current account deficit decreased moderately during 2011, to 2.9% of GDP. In absolute terms it reached CZK 109.1 billion. The current account deficit reflected mainly the trade balance where the surplus increased in 2011. As in previous years, the financial account showed a surplus in 2011. The surplus reached CZK 87.9 billion, which was, however, CZK 86.4 billion less than a year earlier.

The improvement in the labour market came to an end at the end of 2011, due to a slowing economic growth. The average registered unemployment rate decreased by 0.4 percentage point compared to 2010, to 8.6%. Growth in the average nominal wage in the economy was modest in 2011, slowing to 2% in Q4. The end of the year saw a convergence of wage growth in the private and public sectors. The average real wage rose by a mere 0.3% for the entire 2011. Aggregate labour productivity has been rising for the second year, although its growth rate is slowing. It was up by 1.4% compared to a rise of 4.5% a year earlier.

The measures taken to reduce the public finance deficit led to a decrease to CZK 117.9 (3.1% of GDP) under ESA95 methodology. The government debt-to-GDP ratio increased again in 2011, totalling 41.2% at the end of the year.

The Czech National Bank had responded to both the current and expected economic developments by maintaining its key interest rates at the level set in May 2010. The two-week repo rate remained at 0.75% throughout 2011, the discount rate was also unchanged at 0.25% since August 2009, and the Lombard rate was flat at 1.75%.

DEVELOPMENT IN THE BANKING SYSTEM

As of 31 December 2011, the Czech banking sector consisted of 44 banks and foreign bank branches. The structure of the banking sector is stable.

The Czech banking sector was sound, well capitalised and had enough liquid funds in 2011. The sector continued to generate profit.

The sector was growing, the assets of the banking sector increased by 6.9% to CZK 4,476.5 billion in this period.

The rate of growth of the banking sector was higher compared to the previous year. This was reflected in a larger volume of the banking sector's receivables, which account for a substantial part of its balance-sheet assets. The dynamic development was recorded in lending to individuals, although its annual growth rate decreased to 5.0% at the end of 2011, and the total value of such loans exceeded CZK 1,009 billion. Loans for house purchase, which rose by 6.1% year on year and amounted to more than CZK 773 billion, accounted for nearly 78% of all loans provided to individuals. Of this, mortgage loans for housing recorded an annual increase of 9.0% at the end of 2011, accounting for more than 65% of all loans to individuals. Consumer credit amounted to CZK 196.1 billion and decreased by 1.6% y-o-y. Loans to resident non-financial corporations started to grow in 2011, up by 6.1% y-o-y to CZK 828.2 billion.

The banking sector was profitable in 2011. It generated net profit of CZK 53.5 billion, which was, however, 3.2% lower than a year earlier. Profit from financial activities of CZK 162.1 billion, particularly from interest profit, which increased by 4.4% year on year and accounted for nearly 68% of profit from financial activities, was the main source of net profit. Profit from fees and commissions which rose by 1.4% to CZK 39.0 billion was another source. Total administrative expenses grew by 6.0% to CZK 66.1 billion. At CZK 10.1 billion, aggregate income tax increased by 0.7% year on year.

Credit risk has recently been the most significant risk in the Czech banking sector. Non-default loans accounted for 94.8% of the investment portfolio at the end of 2011. The value of all default receivables increased by CZK 2.8 billion (2.1%) to CZK 145.5 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 5.2% and falling at the end of 2011.

In 2011, domestic banks' activities continued to focus mostly on domestic clients. The share of transactions with non-residents and the share of foreign currency activities were relatively low. The exposure of the banking sector to territorial and foreign exchange risk was assessed as limited in 2011, 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.

The Czech banking sector had enough liquid funds and the liquidity sub-indicators were stable during 2010 as usual. Quick assets were up by 10.0% year on year, reaching CZK 1,202.9 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 2011. The capital adequacy ratio slightly decreased to 15.26% as a result of a rise of 4.9% in the regulatory capital of the banking sector to CZK 303.5 billion. Tier 1 increased to CZK 282.0 billion, thanks mainly to retained earnings. In 2011, a partial repayment of subordinated debt in several banks again led to a decrease in additional capital (Tier 2). Tier 1 traditionally has a dominant position within the banking sector's capital, accounting for nearly 93% of total regulatory capital. The capital requirements of the banking sector were CZK 159.1 billion at the end of 2011, showing annual growth of 6.7%, or CZK 10.0 billion.

All banks were compliant with the set minimum capital ratio of 8% during 2011.

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 117.5% at the end of 2011, 3.3 percentage points higher than in the same period 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 THE CZECH REPUBLIC

In accordance with Act No. 6/1993 Coll., on the Czech National Bank, the Czech National Bank is the integrated supervisor 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 2011

In 2011, 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's activities included mainly cooperation with the Ministry of Finance and other state administration bodies in the preparation of new legislation. The CNB 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.

2011 brought a major change in the institutional environment for financial market supervision in the EU, as the European System of Financial Supervision (ESFS) commenced its activities on 1 January 2011. The CNB made an active contribution to cooperation between supervisory authorities within this system and sought support for its visions of financial market supervision among other members.

In 2011 the CNB was very active within the new EU supervisory framework. At the beginning of 2011, the three new European Supervisory Authorities (ESAs) – the EBA, ESMA and EIOPA – and the European Systemic Risk Board (ESRB) launched their activities. The CNB does not regard the gradual transfer of more powers from national supervisors to the new European authorities as sound, mainly because of concerns of separation of powers and final responsibility for the functioning and stability of the domestic financial market. The CNB's priorities also include limiting the increase in excessive European regulation and reducing the administrative burden on national supervisors and financial institutions. The CNB promoted its goals by actively participating in the ESRB and the ESAs and as part of cooperation with the Ministry of Finance in the EU policy committees and with the supervisory authorities of EU Member States.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

The conduct of financial market supervision involves a range of activities encompassing licensing and approval proceedings, fulfilment 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.

Supervision of credit institutions involves supervision of banks, foreign bank branches, building societies and credit unions. The main analytical instrument employed in off-site surveillance is regular comprehensive analyses of the financial condition of individual entities and the sector as a whole. An analysis of the credit institutions sector is produced quarterly. The observance of prudential limits is monitored on a monthly basis for all credit institutions.

Early warning information is assessed every month, which helps to identify potential negative tendencies in the financial indicators. Branches of foreign banks from EU countries are assessed under a simple regime[16].

Ratings dividing banks into five categories according to their financial condition and management quality are prepared for internal CNB supervisory purposes twice a year.

Banking supervision was performed under the standard regime in 2011. The CNB concentrated – in connection with the persisting problems in the world economy – mainly on the quality of credit portfolios, provisioning, and sufficiency of banks' capital to cover potential losses, and banks' liquidity and overall performance. An extraordinary daily reporting duty, covering quick assets and exposure to entities within the group, was re-introduced for selected entities. Extraordinary monitoring of the situation of building societies continued in connection with changing conditions for building savings.

Supervision of the credit union sector proceeded in 2011 in compliance with the approved plan of activity under the standard regime. It focused in particular on assessing the current situation and developments in individual credit unions and on resolving their regulatory problems.

16 Primary responsibility for supervision of foreign bank branches lies with home country supervisors. In the case of branches of foreign banks from EU Member States, the CNB monitors their liquidity and compliance with the obligations in the Act on Banks.

The on-site examination work is based on an annual plan of activity building primarily on outputs from the internal analytical system of risk assessment of supervised entities, information obtained during continuous off-site surveillance and on-site examinations and last but not least on the requirements of foreign regulators. In addition to on-site examinations, the supervisory work includes approving advanced methods for calculating capital requirements. Because of linkages between financial markets, cooperation with foreign regulators is systematically being stepped up. The managers of the examined entities are notified of the findings of examinations by means a report, on the basis of which remedial measures are imposed. The implementation and observance of such measures is systematically monitored. In justified cases, the CNB opens administrative proceedings with the relevant entities based on the examination results.

Both comprehensive and partial examinations as well as information-gathering visits were conducted in the credit institutions sector in 2011.

Five on-site examinations were launched or conducted in banks in 2011. In addition to two comprehensive examinations in large banks, one of which was launched in 2010, partial examinations were conducted. Moreover, six examinations in credit unions were conducted in 2011.

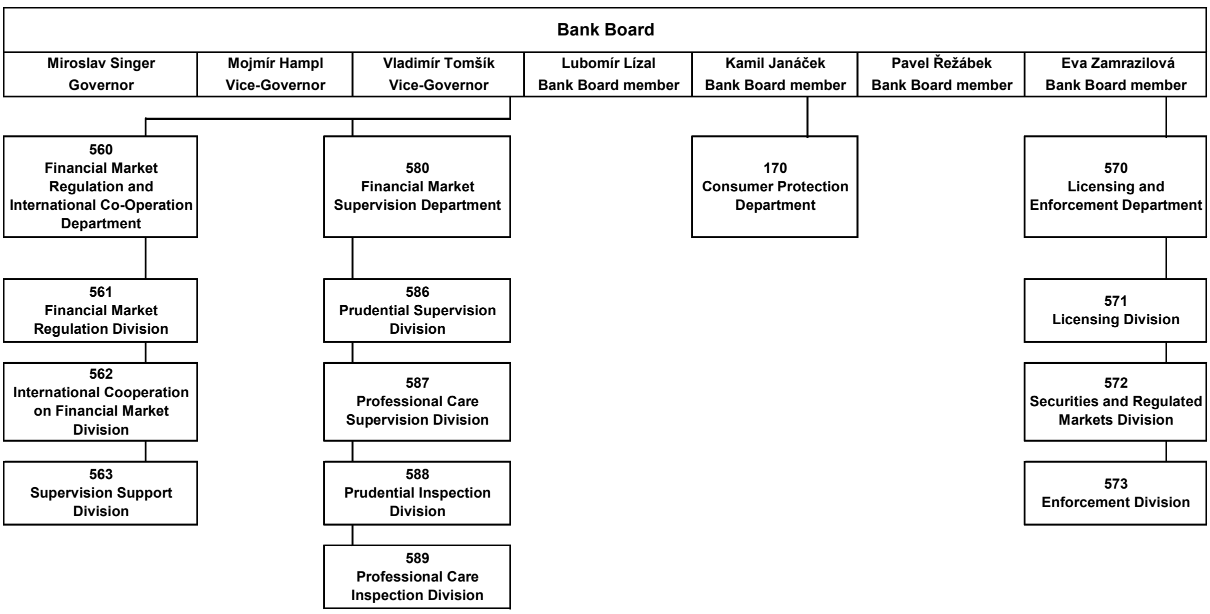
Number of on-site examinations by type

	ICAAP	Credit risk	Market risks liquidity risk	Operational risk	IS/IT risk	AML/CFT
Banks	2	3	2	3	2	3
Credit unio	2	4	3	0	0	6

ORGANIZATIONAL CHART OF BANKING AUTHORITY

The organisational chart of financial market supervision in the Czech National Bank

as of 31 December 2011



INTERNATIONAL ACTIVITIES OF THE CZECH NATIONAL BANK

The Czech National Bank is very active in the area of international cooperation.

- Cooperation between European financial market supervisory authorities focuses mainly on activities in the new supervisory authorities. One of the ESAs is the European Banking Authority (EBA). CNB representatives were actively involved in EBA activities at the level of the Board of Supervisors, the Management Board, standing committees and working groups. A CNB representative was also appointed a member of the EBA Management Board and Chairman of the Standing Committee on Regulation and Policy. The ESAs also include the European Securities and Markets Authority (ESMA). CNB representatives were involved in ESMA’s activities at the level of the Board of Supervisors, standing committees and groups, actively contributing to ESMA’s outputs. The third ESA is the European Insurance and Occupational Pensions Authority (EIOPA), in which CNB representatives were actively involved at the level of the Board of Supervisors, standing committees and working groups. The CNB’s activities in the Joint Committee of European Supervisory Authorities (JC) focus mainly on the individual sub-committees.
- In 2011 CNB representatives were actively involved in the activities of the new European Systemic Risk Board (ESRB) at the level of both the General Board (where the CNB Governor and another Bank Board member participated) and the Advisory Technical Committee (ATC) and its permanent sub-structures – the Analysis Working Group (AWG) and the Instruments Working Group (IWG).
- Within the European Central Bank structures, the CNB participates in the Financial Stability Committee (FSC). It actively contributes to the works of many groups and the Payment and Settlement Systems Committee (PSSC).
- Cooperation with the EU Council and its structures consists mainly in proposals and opinions for Czech representatives (the ECOFIN Council, the Economic and Financial Committee – EFC, the Financial Services Committee – FSC). Anti-money laundering measures are debated in the Moneyval Committee. CNB proposals are discussed in the Working Party on Financial Services (SAPA).
- As regards other international institutions and associations, the CNB was involved in the IMF’s Financial Sector Assessment Program (FSAP); a CNB representative participates in the work of the Committee on Financial Markets (CFM – OECD); the CNB is represented in the Basel Consultative Group of the Basel Committee on Banking supervision, which mainly discussed liquidity issues; the Czech National Bank is a member of the IAIS, IOPS and IOSCO (the International Association of Insurance Supervisors, the International Organization of Pension Supervisors, the International Organization of Securities Commissions) and attends their meetings and participates in their activities.
- The CNB is also very active in cooperation with partner supervisory authorities. In 2011, CNB representatives regularly participated in meetings of eight supervisory colleges for the most important banking groups in the Czech banking sector. The CNB also took part in meetings

concerning potential future cooperation between relevant national supervisors as regards the financial stability of the banking groups Erste, Raiffeisenbank, Volksbank and Société Générale.

- The CNB participated in meetings of coordination committees for the supervision of insurance companies in groups, which focused above all on preliminary approval of internal models under Solvency II. It signed a memorandum of understanding within a supervisory college for the French insurance group AXA.

In the capital market, the CNB continued to work in partnership with other supervisory authorities on the basis of IOSCO and ESMA (CESR) multilateral memoranda of understanding.

The CNB also cooperated closely with financial market supervisors from Central and Eastern Europe. This cooperation involved exchange of information and coordination of opinions between national supervisory authorities in the region, especially from the perspective of host supervisors of subsidiaries of foreign financial groups.

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 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

In 2011, the CNB performed its regular half-yearly stress-testing of banks' loan portfolios. The stress-testing methodology is gradually being refined on the basis of experience gained since 2009. Two rounds of stress tests (the other is prepared in cooperation with the Ministry of Finance) assessed banks' resilience to adverse economic developments using data as of 31 December 2010 and 30 June 2011. Eight and nine selected banks respectively which have received approval to use the special IRB approach for calculating the capital requirement for credit risk, or which are in the process of IRB pre-validation by the CNB, took part in the testing. The loan portfolio stress-testing project consists in assessing the impact of pre-defined economic scenarios on the loan portfolios, P&L and liquidity of sector-important banks. In the two rounds, a baseline scenario was prepared, identical to the official CNB's macroeconomic forecast, and one or two adverse scenarios simulating economic slowdowns of various strength. These scenarios were transformed into average percentage increases in probability of default, exposure at default and loss given default in the most important segments of the loan portfolio. The aggregate results of the two rounds of stress testing confirmed good resilience of domestic banks.

In addition to these bottom-up tests, the CNB conducts quarterly stress tests of the banking sector (top-down tests). The results are regularly published on the CNB website.

The latest update was prepared in May 2012; the results were published on 16 June 2012, using data as on 31 March 2012.

STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
Commercial banks	87.6	88.3	88.0
Branches of foreign credit institutions	12.1	11.2	11.4
Credit unions	0.3	0.5	0.6
Other	n.a.	n.a.	n.a.
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Type of financial institution	2009	2010	2011
Public sector ownership	2.7	2.9	3.0
Other domestic ownership	0.2	0.6	0.9
Domestic ownership total	2.9	3.5	3.9
Foreign ownership	97.1	96.5	96.1
Financial institutions, total	**100.0**	**100.0**	**100.0**

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

Type of financial institution	2009	2010	2011
Commercial banks	25.9	21.8	19.3
Branches of foreign credit institutions	n.a.	n.a.	n.a.
Credit unions	- 0.01	- 2.27	5.38
Banking sector, total:	25.0	21.0	18.8

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	87.6	88.3	88.0
Branches of foreign banks	12.1	11.2	11.4
Credit unions	0.3	0.5	0.6
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	2009	2010	2011
Financial sector (loans and advances)	10.5	11.3	10.4
Nonfinancial sector (loans and advances)	48.6	48.9	48.8
Government sector (loans and advances)	1.7	1.7	1.7
Other	39.2	38.1	39.1
Liabilities	**2009**	**2010**	**2011**
Financial sector (deposits)	10.5	10.7	11.2
Nonfinancial sector (deposits)	59.0	60.3	58.9
Government sector (deposits)	7.6	7.0	7.0
Capital	7.8	8.2	8.1
Other	15.1	13.8	14.8

Note: Banking sector = commercial banks + bank foreign branches

Capital adequacy ratio of banks

Type of financial institution	2009	2010	2011
Commercial banks	14.11	15.52	15.27
Credit unions	14.80	12.21	12.07
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	2009	2010	2011
Non financial sector	5.9	7.0	6.6
- households	4.1	5.2	5.0
- corporate	7.9	9.0	8.2

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	61.2	50.1
Government sector	10.9	2.9
Corporate	24.1	37.9
Other (excluding banks)	3.8	9.1
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	2009	2010	2011
1. Financial & operating income and expenses	168 409	157 376	162 090
1.1 Interest income	174 434	166 962	172 316
1.2 Interest expenses	71 161	61 655	62 391
1.3 Dividend income	9 623	5 859	7 578
1.4 Fee and commission income	46 756	48 369	50 011
1.5 Fee and commission expenses	10 314	9 876	10 950
1.6 Realised gains (losses) on financial assets and liabilities not measured at FV through profit or loss, net	6 327	-1 451	-1 112
1.7 Gains (losses) on financial assets and liabilities held for trading, net	4 399	11 016	1 149
1.8 Gains (losses) on financial assets and liabilities designated at fair value through profit or loss, net	1 683	2 398	- 1 868
1.9 Gains (losses) from hedge accounting, net	-330	-208	51
1.10 Exchange differences, net	7 480	-3 097	8 388
1.11 Gains (losses) on derecognition of assets other than held for sale, net	580	18	233
1.12 Other operating income	2 880	3 339	3 044
1.13 Other operating expenses	3 949	4 324	4 359
2. Administration costs	60 455	62 381	66 047
2.1 Staff expenses	31 103	31 603	33 776
2.2 General and administrative expenses	29 352	30 777	32 271
3. Depreciation	7 442	6 926	6 826
4. Provisions	4	-258	706
5. Impairment	29 792	22 535	25 506
5.1 Impairment on financial assets not measured at fair value through profit or loss	26 573	22 317	25 250
5.2 Impairment on non-financial assets	3 219	218	255
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	3
8. Profit or loss from noncurrent assets and disposal groups	61	-157	405
Total profit or loss before tax from continuing operations (1 - 8)	70 778	65 636	63 413
9. Tax expense	11 038	9 980	10 092
10. Profit (loss) after taxation, total	59 740	55 656	53 321
10.1 Profit (loss) from continuing operations after taxation	59 740	55 656	53 321
10.2 Profit (loss) from discontinued operations after taxation	0	0	0

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	11 763 551	10 929 522	1 188 648	0
Credit unions	107 175	100 958	6 217	0
Banking sector, total:	11 870 726	11 030 480	1 194 865	0

Note: Banking sector = commercial banks + credit unions.
Note: EUR = 25.80 CZK as at 30 December 2011

2011 DEVELOPMENTS IN THE ESTONIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Growth prospective of the world economy deteriorated and global risks increased in 2011 as a whole. The confidence of both consumers and producers started to drop in the European Union since the end-summer of 2011, having an affect also on the exporting industry of Estonia. According to the data of Statistics Estonia, the GDP of Estonia increased by 7.6% in 2011 compared to the previous year, but the slowdown in economic growth in the last quarter 2011 is an important factor worth mentioning. Economic growth slowed abruptly in the year-end due to the deterioration of external environment: the GDP increased 4.5% in the last quarter 2011 compared to the same period 2010 (economic growth of 2.3% in 2010). The growth perspective of Estonia's most important trading partners worsened significantly in the second half of 2011. The last quarter witnessed thus the slowdown in export growth of processing industry goods, especially due to the drop in export of computers and electronic equipment and optical appliances. In 2011, export of goods and services increased by 25% and import by 27%. The rapid growth in the export of computers and electronic equipment and optical appliances in the first 3 months affected external trade the most. The ratio of net exports to GDP was 4.9%. This ratio was positive for the 3rd year in a row, though in experienced a decline in comparison with 2010 (6.7% in 2010). Due to the recovery of import of goods and services, the surplus of the current account balance was smaller in 2011 as a whole than in previous year, accounting for 3.2% of GDP (3.6% of GDP in 2010). In 2011, the consumer price index increased in comparison with the last year's average by 5%, driven by the increase in prices of food and non-alcoholic beverages, energy, thermal energy and heating, and motor fuel (the average consumer price index increased by 3% in 2010). The average unemployment rate was 12.5% in 2011 (16.9% in 2010). In 2011, the average number of active persons was 609,000, being 38,000 (6.7%) more than a year ago.

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

As at 31 December 2011, there were 7 locally authorized credit institutions and 10 branches of foreign credit institutions operating in Estonia. The ratio of banking sector's total assets to GDP was 116%.

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 92%. The market share of foreign credit institutions increased on the account of major credit institutions – Swedbank AS, AS SEB Pank and Danske Bank A/S Estonian Branch. The aggregate market share of Swedbank AS, AS SEB Pank and Danske Bank A/S Estonian Branch decreased in total by 2.27% by the end of 2011 (the drop of 2.44% in 2010). Writing off of substantial problematic loans in 2011 contributed to the decrease in the volume of loan portfolios.

Total assets of credit institutions decreased by 6% in 2011 and totalled 18.5 billion euro as at 31 December 2011. 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% also in 2010). The combined loan portfolio of credit institutions amounted to 14.2 billion euro at the end of 2011, accounting for 77% of total assets. This share remained virtually unchanged compared to 2010.

Similarly to 2010, the quality of loan portfolios of credit institutions improved in the end of 2011 and the total volume of overdue loans decreased, both in absolute figures and as a share of the whole loan portfolio. The decrease was especially remarkable in case of long-term loans overdue, i.e. loans overdue for more than 90 days. Loans overdue for more than 90 days formed 4.6% of the combined loan portfolio of credit institutions at the end of 2011 (6.1% of the combined loan portfolio at the end of 2010). The volume of long-term loans overdue dropped due to write-offs, restructuring and the selection of better risk classes. In 2011, credit institutions decreased their valuation reserves; this occurred generally in conformity with changes in quality parameters of loan portfolio. The drop in valuation reserves was mostly driven by the improved quality of companies' loan portfolios due to better ratings and the write-off of problematic loans. The coverage with valuation reserves of long-term loans overdue reached 86% (85% coverage of loans overdue for more than 90 days as at 31 December 2010).

At the end of 2011, the total volume of resources of credit institutions totalled 16.4 billion euro, decreasing by 6% in a year. 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 significantly by the end of 2011. While these loans accounted for 39% of total resources at the end of 2010, their share decreased to 29% by the end of 2011. Funds received from foreign credit institutions, primarily from parent companies of Estonian credit institutions, decreased due to the fact that loan demand in Estonia was low in 2011 and the increase in client deposits continued to be strong. The share of client deposits increased and accounted for 71% of total resources of credit institutions at the end of 2011 (60% at the end of 2010). 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 2011: from 141% at the end of 2010 to 122% at the end of 2011.

While credit institutions earned significant losses in 2009 due to high cost of valuation reserves, then both 2010 and 2011 ended with profits both on solo and consolidated basis. Credit institutions earned the profit of 657.6 million euro on solo basis and 534.2 million euro on consolidated basis (56.3 million euro and 93 million euro respectively in 2010).

As at 31 December 2011, the composite capital adequacy of credit institutions on solo basis was 18.61% (22.07% in 2010). Consolidated capital adequacy of banking groups was 19.56% at the end of 2011 (16.25% in 2010). The capital structure of the banking sector is relatively simple and primarily based on Tier 1 capital. Tier 1 capital remained on an adequate level both on solo and consolidated basis throughout the year: Tier 1 capital was on solo basis 17.66% and on consolidated basis 18.70% at the end of 2011 (16,43% and 12,66% respectively at the end of 2010). 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 2011.

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 FSA in developing the regulative 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 FSA must approve draft legislation regulating supervised entities or the activities of the FSA or having otherwise an effect on the achievement of objectives of financial supervision. In 2011, the legislative activities of the FSA were focused inter alia on the supplementary regulation of activities of financial mediation companies, including those supervised by the FSA. The contribution of the FSA depended on the importance of regulated area and on its potential effects on the development and smooth functioning of the financial sector.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2011

The approval of the new strategy for financial supervision (2011–2015) by the Supervisory Board was an important milestone for the FSA. This new strategy outlines three main operational goals for the coming years: to increase the supervisory capacities of the FSA; to foster cooperation partnerships; and to increase the role of the FSA in providing advice and guidance to consumers of financial services.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

One of the most important supervisory actions that the FSA performed in 2011 in the banking sector was the assessments made under the capital adequacy framework Pillar 2 – one of the elements of the Basel II framework of prudential norms – in respect of capital adequacy procedures of banks and of their capital needs. We analysed the reports on Internal Capital Adequacy Assessment Process (ICAAP) submitted by banks and issued supervisory assessments. We presented our assessments to all credit institutions operating in Estonia; as to cross-border banking groups, we presented our assessments to supervisory authorities of parent banks, so that they could prepare their supervisory assessments of groups. In 2011, the FSA's supervisory assessments focused mostly on such qualitative issues as corporate governance, intra-group outsourcing of operations, quality of internal audit and other internal control mechanisms, as well as strategy and issues related to stockholders. The capitalization level of Estonian credit institutions is adequate pursuant to the assessments and sufficient for meeting regulative standards. The performance of stress testing in credit risk area continued to be high on the agenda in the supervision of banking sector, in order to evaluate the resistance of banks and the adequacy of their capital base in case of potential exposure to credit risk under prudential scenarios.

In the supervision of investment services offered by credit institutions, the FSA focused on controlling the implementation of the Securities Market Act in 2011. The supervision focused especially on the evaluation of the adequacy of organizational solutions in providing investment services. The control covered also the question how the obligations accompanying the evaluation of service adequacy were performed when offering investment services to customers. The presentation in financial services adverts of obligatory information to customers was also evaluated.

In 2011, the FSA continued to focus on the quality assessment of depository services provided by credit institutions to investment and pension funds. On-site inspections evaluated the compliance of credit institutions with legislation as well as assessed the solutions that should ensure that a credit institution is independent from the fund management company and acts only in the interests of its unit holders.

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

Estonia as an EU member state is a part of the common financial services market and its financial stability depends directly on its cooperation with other EU member states, especially with Nordic countries. The FSA can influence the development of European supervisory practices and policy primarily through its participation in the work of European financial supervisory authorities.

In 2011, representatives of the FSA were members of 51 different committees or working groups and participated in 78 meetings of these committees or working groups. Participation of officials of the FSA in various working groups is based on the principle of feasibility, i.e. on the extent to which the working group is related to the Estonian market and on the importance of various issues in the context of the European Union.

In addition, the FSA participates in the work of supervisory colleges. In 2011, the FSA took part in supervisory colleges of credit institutions groups Citadele, Danske, DNB, Marfin, Nordea, SEB, Snoras and Swedbank where the cooperation is pursued by regular meetings between related supervisors. The work in colleges includes regular information exchange, development of common supervisory evaluation, performance of common on-site inspections and adoption of joint decisions in various group-based cases.

STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
Commercial banks	7	7	7
Branches of foreign credit institutions	12	11	10
Banking sector, total:	**19**	**18**	**17**

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

Type of financial institution	2009	2010	2011
Public sector ownership	0.0	0.0	0.0
Other domestic ownership	1.8	2.0	2.9
Domestic ownership total	1.8	2.0	2.9
Foreign ownership	98.2	98.0	97.1
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2011 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Banks	77.4	90.3	2,589.9

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

Type of financial institution	2009	2010	2011
Banks	-31.7	2.1	37.5

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	73.1	71.1	69.9
Branches of foreign credit institutions	26.9	28.9	30.1
Banking sector, total:	**100.0**	**100.0**	**100.0**

Capital adequacy ratio of banks

Type of financial institution	2009	2010	2011
Commercial banks	22.2 **	22.1 **	18.6 **
Cooperative banks			
Banking sector, total:	**22.2 ****	**22.1 ****	**18.6 ****

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

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

Asset classification	2009	2010	2011
Non financial sector	5.5	6.1	4.6
- households	**4.4**	**5.0**	**4.3**
- corporate	**7.7**	**8.5**	**5.9**

The structure of deposits and loans of the banking sector in 2011 (%) (at year-end)

	Deposits	Loans
Households	40.4	50.1
Government sector	6.2	3.0
Corporate	46.8	43.1
Other (excluding banks)	6.6	3.8
Total	**100.0**	**100.0**

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

P&L account	2009	2010	2011
Interest income	827	583	627
Interest expenses	557	260	232
Net interest income	270	323	395
Net fee and commission income	125	133	130
Other (not specified above) operating income (net)	131	101	407
Gross income	**1 132**	**866**	**1 213**
Administration costs	246	249	269
Depreciation	12	11	11
Provisions	-24	-8	4
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-798	-223	10
Profit (loss) before tax	-579	56	660
Net profit (loss)	**-579**	**56**	**657**

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	1 573 987 143	1 494 024 345	79 962 798	0
Cooperative banks				
Banking sector, total:	**1 573 987 143**	**1 494 024 345**	**79 962 798**	**0**

2011 DEVELOPMENTS IN THE HUNGARIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2011, Hungarian economy experienced a slight recovery, as real GDP grew by 1.7%, mainly pulled by manufacturing and agriculture on supply side, while particularly pushed by exports on demand side. Sectors influenced by practically stagnating consumption and negative investment activities remained sluggish. Unemployment rate was 10.9% in average and 10.6% in Q4 2011, markedly falling during the year, backed mainly by more flexible labour market regulation, while activity rate increased. Corporate bankruptcy ratio continued to grow, partially due to administrative measures. (Companies which didn't meet the reporting requirements were deleted from company register.) Some segments of car and house markets have shown moderate signs of temporary recovery due to administrative measures (taxation, final repayment). However, second half faded in serious global fears on financial markets and growth prospects globally, and supplemented with sovereign debt problem in the eurozone. These developments influenced negatively the Hungarian macroeconomic situation and the future prospects at the end of the year.

2011 has shown further fiscal consolidation efforts, as the fiscal balance was +4.3% (surplus) of GDP by ESA-95 standards after -4.2% in 2010, mainly due to reform of the pension system. General government debt decreased by 0.8 percentage points to 80.6%, while much more in volume terms, as HUF depreciated in Q4 2011 significantly pushing higher the foreign currency denominated debt. Debt financing conditions (bond spreads, country risk and downgrading to non-investment grade) have been stressed by rather external and partially domestic factors that have already pushed to initiate negotiations with IMF/EU on a Precautionary Credit Line or a Stand-By Arrangement. External balances improved in 2011, as the external financing capacity surplus peaked at 3.6% of GDP, foreign reserves of Magyar Nemzeti Bank (National Bank of Hungary, hereinafter MNB) reached 37.7 billion EUR by end-year more than 10% increase year on year. Monetary policy is highly restricted by financial stability aspects, less by inflation trends, thus the MNB had to raise its official base rate to 7% from 6.5% as of 21 December 2011.

DEVELOPMENTS IN THE BANKING SYSTEM

The unfavourable trends in banking sector continued in 2011. Due to low demand for credit and still tightening credit standards the loan stock contracted by more than 10% in real terms. Banking sector's total assets slightly increased in nominal terms because of the HUF weakening, but the total assets/-GDP ratio fell from 105.2% to 102.4%. The CHF, in which the 42% of loans were denominated, appreciated 14.9% during 2011. The EUR, which had 28% share in outstanding loan volume appreciated by 11.6%. FX volatility had a considerable impact on credit quality, inasmuch the share of loans with more than 90 days arrears increased up to 11.5%.

The banking sector increased the share of local funding. The deposits grew by 5%, and the loan to deposit ratio decreased from 165% to 157% during 2011. The opposite trend of loans and deposits allowed the banks to pay back a part of their foreign liabilities.

During 2011 there were some legal actions which affected the banking sector. At the end of June the eviction moratorium was substituted with a quota system, which allowed the banks to clear to some extent their balance sheet without putting significant pressure on the property market. In the final repayment scheme the households had the opportunity from September 2011 to February 2012 to repay their outstanding FX loans at a preferential foreign exchange rate. The 30% of the losses, stemming from the difference between the actual and the preferential exchange rate, was deductable from bank tax, but the rest caused significant losses to the lenders.

The banking sector met notable losses in 2011. The primary reason of this fact was the high proportion of non-performing loans and impairment necessity. The final repayment scheme also caused losses for the sector.. The distribution of the losses was unequal, thus banks with massive losses needed capital injections. Owners provided sufficient amount and good quality capital, and this with the supplementary effect of the reduction in risk weighted assets left the sector’s capital adequacy ratio unchanged at 13%.

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

Change of the HFSA’s constitutional status

An important step before assigning decree-issuing rights to the HFSA was the elevation of its status to constitutional organ. By modification of the relevant pieces of legislation, the HFSA’s president is entitled to issue decrees in a specific range of topics. A decree issued by the HFSA president is at the same level as a ministerial decree in the hierarchy of laws. Based on this mandate, 28 decrees were issued in 2011.

The new European Financial Supervisory System and the HFSA

In November 2010, the European Union established the European System of Financial Supervisors (ESFS). Having entered into effect on 1 January 2011, the new European financial supervision system encompasses a two-pillar structure comprising a micro-prudential and a macro-prudential supervision part.

Micro-prudential supervision is the responsibility of the three newly established European Supervisory Authorities (European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA), European Securities and Markets Authority (ESMA)) and the national supervisory authorities of Member States.

Macro-prudential supervision is directed by the European Systemic Risk Board (hereinafter ESRB), a body established simultaneously to the organizations discussed above.

As an integrated supervisory authority, the HFSA participates in the work of all three European Supervisory Authorities (hereinafter ESAs) and the ESRB. This puts significant additional workload on the HFSA and required the transformation of its activities accordingly.

Both the HFSA and MNB actively joined the new European system of micro-level and macro-level supervision. This is both an opportunity and a responsibility, as it requires the HFSA to participate in European regulatory efforts. One task of national authorities is to have the specific features of the domestic financial system manifested in European-level analysis, proposed regulations and supervisory guidelines. Second, national authorities also exercise control over the operation of European institutions and bodies of micro and macro-supervision. What adds additional importance to this is that the principal objective of the new European supervisory structure is to establish harmonized regulatory requirements and supervisory practices at EU level implemented by national authorities. In order to enable national authorities to represent a common standpoint in their messages to the European authorities of micro and macro-supervision, they must address the risks of the Hungarian financial system regularly and comprehensively within the domestic Financial Stability Board.

In 2011, the HFSA cooperated with EBA in the EU-level stress test and recapitalization exercise. The OTP Bank – leading bank of the Hungarian credit institution's sector – passed the stress test, achieving good results. As the bank fulfilled the capital requirement determined by the EBA recommendation, no measures were necessary for capital increase.

MAIN STRATEGIC OBJECTIVES OF THE HFSA IN 2011

The HFSA's strategy

The objective of the Hungarian Financial Supervisory Authority's activities and its fundamental responsibilities are specified in the HFSA Act. Its responsibilities and the statutory mandates assigned to the HFSA are detailed in sector-specific laws that regulate financial institutions and markets. All these are presented in a concise form in the HFSA's Mission Statement. For the sake of transparency, the HFSA published its key medium-term objectives in a document titled "The HFSA's Strategy". These objectives serve the efficient, targeted and consistent fulfilment of the HFSA's tasks set out in laws and prescribed directions for its actions.

The HFSA's strategic objectives

The HFSA prepares theme-specific strategies for each area of operation (e.g. consumer protection) and assigns priority to the fulfilment of strategic objectives when elaborating its work plan.

1. Expansion and targeted application of the HFSA's regulatory role, establishment of a transparent, rapidly responding prudential regulatory system that benefits the public.
2. Active Hungarian participation in European regulation and supervision. This is an interest and basic responsibility of the HFSA as the Hungarian financial intermediation system is highly open and embedded into the European environment.

3. Strengthening the role of proactive, risk-based supervision; monitoring the risks, risk management and stress resistance of supervised institutions in addition to compliance.
4. To ensure that the domestic implementation of new risk-based international regulatory systems is carried out in a well-prepared, efficient and timely manner, regarding Basel III in banking, and Solvency II in the insurance sector.
5. Cooperation in the ongoing development of the framework and means of macro supervision and in the timely identification of financial systemic risks in order to mitigate or eliminate factors that are often interrelated and convey systemic risks, and to improve the efficiency of financial supervision.
6. Further reinforcement and powerful representation of financial consumer protection, and in order to restore consumer confidence shaken by the financial crisis, using new means of handling violations of consumer interests such as the Financial Arbitration Board or the financial consumer protection consulting network.
7. Improvement of the HFSA's efficiency, performing its tasks as an independent, strong and integrated supervisory authority.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

Risks treated as priorities for banking supervision in 2011

Credit risk

The HFSA assigned priority to project loans, small and medium enterprise loans and lending to construction industry and property development firms in 2011. Regarding the management of credit risks, the HFSA's comprehensive inspections mainly scrutinized the recording and evaluation of collaterals held by institutions, the management and monitoring of restructured portfolios and the inspection of collection processes.

Profitability and capital risk

In the course of ongoing supervision, the HFSA paid special attention to the proper choice of business strategy for 2011, 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.

Liquidity

HFSA continuously monitors the liquidity of credit institutions. Based on the last year liquidity position of the banks and to prepare the banking system for the new Basel and CRD liquidity requirements, the HFSA and the MNB commonly initiated to set up new regulatory measures and liquidity minimum requirements, which has been introduced in 2012 in a Governement decree.

Protection of financial consumers

The financial crisis had a negative impact on a number of consumers and households. Therefore, in 2011 managing the legal and informational asymmetry between consumers and service providers became an even more urgent task for the HFSA. The HFSA identified it as an additional risk that the payment willingness of certain groups of consumers was decreased by news in the media suggesting the launch of government-backed debtor rescue programs. The limited financial literacy of Hungarian retail customers is a significant problem, thus the HFSA's consumer protection role had also to be extended to financial literacy improvement.

There were 683 consumer protection measures taken by the HFSA in the banking sector last year.

The Financial Arbitration Board

Established on the HFSA management's initiative, the Financial Arbitration Board (hereinafter FAB) began to operate in July 2011 and has fulfilled all expectations so far. During the six months of its operation last year, the FAB acted upon 1200 claims pertaining to financial consumer disputes, which far exceeds the total number of cases managed annually by the former national arbitration network of commercial chambers. With the FAB's help, consumers can settle their disputes with service providers quickly, efficiently and free of charge. Several significant financial organizations already issued a general declaration of submission at the FAB, committing to subordinating themselves to FAB proceedings and, if no agreement is reached in the process, to the FAB's resolution. The binding resolutions, recommendations and agreements published on the FAB's website provide guidance to financial institutions regarding their cooperation with consumers.

Methodological development

In 2011, methodology developments were carried out regarding both on-site and off-site supervision and changes were made to the organization of work.

In 2011, new, modern inspection manuals were drafted for the on-site inspection of credit cooperatives, investment enterprises, banks and banking groups. The new manuals are in line with current legal provisions.

As a permanent task, the risk indicators of our risk assessment system used by the supervisors were modified in order to better reflect the risks of the supervised institutions.

On-site and off-site supervision

The HFSA performs prudential supervision, market supervision and employs the toolsets of consumer protection (off-site and on-site) to monitor on an ongoing basis the activities and processes of money and capital market institutions, pension, healthcare and voluntary self-support funds, insurers (financial institutions), and the so-called financial infrastructure institutions (regulated market, central counterparty, central repository). The purpose of continual supervision is to detect risks in a timely manner and to manage them appropriately.

The HFSA is required to carry out on-site inspections at the supervised institutions regularly, Depending on type and operational form of the given entity the frequency of on-site inspections vary from 1 to 5 years. During 2011, 6 on-site inspections at large banking groups, 11 at small- and medium-sized banks, 31 at credit cooperatives were carried out by the authority.

Law enforcement measures

The HFSA took 513 law enforcement measures regarding banks in 2011 (there were 201 resolutions concluding supervisory inspections, from which 22 finished with imposing fines).

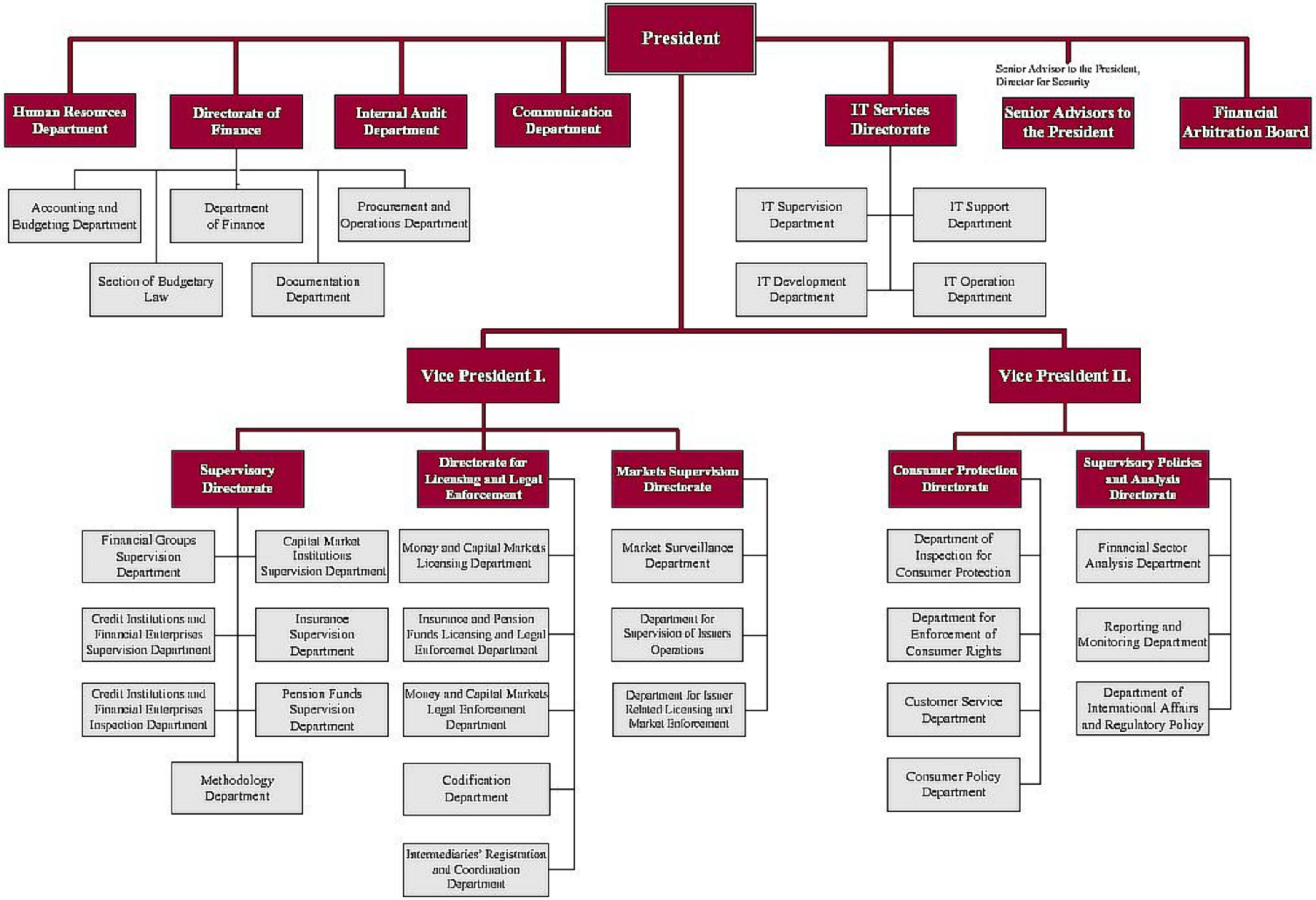
Money market licensing

In 2011, one new specialized credit institutionand one new payment institution entered the market. One merger took place in the banking sector and four mergers were completed in the savings cooperative sector. The 2011 saw only one cross-border merger, the result of which sees one institution continue operations in Hungary through a branch office. Furthermore, two payment branch offices launched operation in Hungary in 2011.

For savings cooperatives, the employment of pawnbrokers remained an important source of revenue. The unusually high number of licensing requests received by the HFSA in relation to pawnbroker contracts and contract modifications is a clear sign that many savings cooperatives use such arrangements.

In 2011, fewer intermediation licensing requests were submitted to the HFSA than in the previous year. It is apparent that many of the companies licensed since October 2010 deemed their operations unprofitable and returned their operating license for independent intermediation to the HFSA. However, the number of companies possessing a licence for independent intermediation did not decrease significantly. Currently 755 such companies are in business in Hungary.

ORGANIZATIONAL CHART OF THE HFSA



INTERNATIONAL ACTIVITY OF THE HFSA

Cooperation at EU level

The HFSA's participation in the new European financial supervisory structure

The HFSA made a series of strategic decisions in 2011 in order to use the resources available to it as efficiently as possible in any joint effort with the European System of Financial Supervisors (ESFS). After thorough internal surveys and harmonization, standing committees and working groups were selected where the HFSA's participation are the most effective regarding both the international effort on a specific matter and the HFSA's own operation. The HFSA is represented by its senior managers and employees in the decision-making bodies, committees, subcommittees and working groups of the ESAs and of the ESRB.

Actually, the HFSA is represented in 26 different committees and working groups operating in the framework of the EBA.

Moreover, HFSA takes part in the work of 21 banking supervisory colleges. As home supervisor of the OTP Bank, the authority organized 2 college meetings in the last year.

EU presidency

In the first half of 2011, Hungary held the rotating presidency of the EU Council. In order to provide maximum support to the Hungarian EU presidency in the preparation of financial legislation, the HFSA established the topic owner system in 2010, under which it assigned an expert to each of the 22 topics i.e. to draft financial regulations specified by the Ministry for the National Economy. During the Hungarian presidency, significant progress was made with five financial topics:

- short-selling,
- single euro payment area (SEPA),
- deposit insurance directive,
- regulation of derivatives and
- the Omnibus II directive.

International cooperation outside the European Union

OECD (Organisation for Economic Co-operation and Development)

In respect of financial markets related activities of the international organization, the HFSA is represented on the Committee on Financial Markets.

CBSG (Cross-Border Stability Group)

The CBSG is the joint platform of Austria, Bulgaria, the Czech Republic, Hungary, Slovakia and Slovenia and consists of Finance Ministers, Central Banks and Financial Supervisory Authorities, with the objective to enhance preparedness in normal times and facilitate the management and resolution of a cross-border financial crisis.

V6 Financial Stability Meeting

The leaders of central banks and supervisory authorities of the V6 countries (Austria, Czech Republic, Poland, Hungary, Slovakia and Slovenia) meet every year to discuss the current issues of financial stability and related supervisory matters. The 2011 meeting was held in Vienna and was attended by the heads of the MNB and HFSA.

Financial Stability Board European Regional Consultative Group for Europe

In November 2010, the FSB announced its intention to establish official ties with the authorities of non-member countries. Hungary was among the countries invited to the European group. As a member of the FSB's European regional consultation group, the HFSA president attended the group's kick-off meeting held in Luxembourg on 6 December 2011.

Other events of international relevance

The representatives of large global banks, securities traders and credit rating agencies are also regular visitors to the HFSA, seeking information on financial trends in Hungary, regulatory changes in Hungary and the EU and the HFSA's opinion on market trends. The quality of supervision also has an impact on Hungary's credit rating. Finally, research institutes requesting consultations, an opinion or data often approach the HFSA, and the HFSA tries to help their work wherever possible.

COOPERATION WITH OTHER SUPERVISORY BODIES

The HFSA is an integrated regulatory authority responsible for the supervision of banking, insurance, capital market and pension sectors. Therefore there is no other supervisory body in the field of financial supervision at national level to cooperate with.

STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
Commercial banks	35	35	35
Branches of foreign credit institutions	11	10	**10**
Cooperative banks	140	138	132
Banking sector, total:	**186**	**183**	**177**

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

Type of financial institution	2009	2010	2011
Public sector ownership	3,66	3,94	4,57
Other domestic ownership	13,91	13,24	12,96
Domestic ownership total	17,57	17,18	17,54
Foreign ownership	82,43	82,82	82,46
Banking sector, total:	**100**	**100**	**100.0**

Concentration of asset by the type of financial institutions in 2011 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	44,6	62,6	11,0
Branches of foreign credit institutions	69,2	92,1	20,7
Cooperative banks	11,3	17,0	1,4
Banking sector, total:	**38,9**	**54,6**	**8,5**

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

Type of financial institution	2009	2010	2011
Commercial banks	8,7	0,5	-9,5
Branches of foreign credit institutions	30,6	7,2	9,6
Cooperative banks	6,5	4,9	4,2
Banking sector, total:	**9,6**	**1,1**	**-8,9**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	85	83,5	83,0
Branches of foreign credit institutions	6	7,0	7,1
Cooperative banks	5	5,1	5,0
Other	4	4,4	4,9
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2009	2010	2011
Financial sector	26,0	22,2	26,5
Nonfinancial sector	45,7	47,5	43,4
Government sector	12,6	13,8	13,4
Other	15,8	16,6	16,7
Liabilities	**2009**	**2010**	**2011**
Financial sector	13,4	12,9	14,0
Nonfinancial sector	36,1	36,8	38,3
Government sector	2,2	2,0	1,9
Capital	8,1	8,1	7,7
Other	40,2	40,2	38,1

Capital adequacy ratio of banks

Type of financial institution	2009	2010	2011
Commercial banks	13,1	13,0	13,0
Cooperative banks	14,8	15,6	15,4
Banking sector, total:	**13,2**	**13,1**	**13,1**

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

Asset classification	2009	2010	2011
Non financial sector	23,3	27,3	34,8
- households	**15,2**	**22,7**	**32,8**
- corporate	**31,9**	**32,7**	**37,0**

The structure of deposits and loans of the banking sector in 2011 (%) (at year-end)

	Deposits	Loans
Households	52,5	36,8
Government sector	3,5	3,3
Corporate	30,1	33,6
Other (excluding banks)	13,9	26,3
Total	**100.0**	**100.0**

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

P&L account *(in EUR)*	2009	2010	2011
Interest income	2 787 702	2 319 324	2 307 956
Interest expenses	1 883 180	1 306 105	1 304 316
Net interest income	904 522	1 013 219	1 003 640
Net fee and commission income	293 680	296 858	268 646
Other (not specified above) operating income (net)	282 060	-127 953	-46 998
Gross income	1 480 262	1 182 124	1 225 288
Administration costs	641 651	657 178	634 032
Depreciation	60 585	57 085	56 323
Provisions	-474 955	-410 867	-741 839
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	0	0	0
Profit (loss) before tax	303 072	56 993	-206 906
Net profit (loss)	216 433	18 232	-239 260

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	8 134 136 315	7 074 295 191	1 046 715 595	13 125 530
Cooperative banks	478 943 548	426 847 322	52 096 226	0
Banking sector, total:	**8 613 079 863**	**7 501 142 513**	**1 098 811 821**	**13 125 530**

2011 DEVELOPMENTS IN THE LATVIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2011, the economic growth in Latvia was among most buoyant in Europe. GDP increased by 5.5% in Latvia in comparison with 1.5% in the EU countries overall.

In 2011, real export of goods and services were the primary drivers of economic progress. Despite adverse developments in the global economy, especially in Europe, Latvian exports posted a very dynamic growth of 12.6%. This expansion in exports was supported by regained competitiveness in manufacturing sector and solid advance in investment-making.

Even though the external demand was more solid than the domestic one, strengthening of the latter was quite dynamic as well. Private consumption, the largest component of domestic demand, picked up 4.4% in 2011; however, due to the low base and a much steeper increase in other components of the GDP expenditure, this pickup could be assessed as moderate for Latvia. The revival of private consumption was encumbered by weak purchasing power and high household debt level.

Imports of goods and services picked up 20.7% in 2011, primarily on account of imports of intermediate goods for export production. Steeply rising investment contributed substantially to the expansion of capital goods imports as well. As imports grew faster than exports, the contribution of net exports was negative (-5.2 percentage points).

In 2011, the price dynamics was affected by both internal and external factors. A rise in indirect taxes in particular the raised VAT tax rate and raised excise tax rate, domestically led to higher inflation in 2011 as compared to 2010. At the same time, external factors made raw material prices go up – global energy and food prices increased notably in 2011. The effect from the domestic demand and labour market on consumer prices was limited. For 2011 on the whole, the average consumer price level was 4.4% above that of 2010.

Contrary to 2010, consumer price core inflation was positive during 2011. Due to an increase in indirect taxes as well as due to the impact of rising energy and food prices, core inflation rose from 1.1% in January to 4.4% in August (decreasing afterwards), and in the year on average stood at 3.1%.

Labour market situation continued to improve in 2011. Based on competitiveness restoration (closing wage-productivity gap) export-oriented sectors were first to rebound, followed by the domestic demand-oriented sectors including construction and trade. Wage growth was moderate and in line with the labour productivity growth, thus, not exerting a pressure on inflation. According to the Central Statistical Bureau labour force survey, jobseekers constituted 15.0% of economically active population at the end of 2011 and according to State Employment Agency the registered unemployment rate stood at 11.5% at the end of the year.

DEVELOPMENT IN BANKING SYSTEM

Banks dominate the financial sector in Latvia, accounting for about 92 per cent of its total assets. At the end-2011, 30 banks, including eight branches of EU banks were operating in Latvia. Total banking assets to GDP ratio reached 147.8% (20 926 mln lats (assets)/14 161 mln lats (GDP)) at the end-2011.

As at end-2011, 64% of the Latvian banks' share capital was owned by foreign investors. Four subsidiaries and eight branches of EU banks accounted for approximately 54% of total Latvian bank assets and around 68% of total loan portfolio. All other banks in Latvia are privately owned, except for 3 government-controlled banks. The market share of State-owned banks in total banking sector assets made up 14.7%.

All banks comply with the regulatory requirements[17]. Liquidity ratio of the banking sector remains high – 63.9% at end-2011 and is well above the minimum requirement[18]. Banking sector is well capitalized – following the on-going capital strengthening and reduction in risk weighted assets (due to subdued lending), capital adequacy ratio (regulatory minimum – 8%) reached historically high level of 17.4% at end-2011. Tier I ratio predominantly consisting of top quality own funds is high - 14.2%.

Securities portfolio predominantly consists of central government securities. The Latvian banking sector does not have any significant investments in euro zone countries which are currently considered to be with higher risk, thus investments in the securities of Greece, Italy, Ireland, Portugal and Spain comprise less than 0.2% of total banking sector assets.

Funding sources of Latvian banks have been dominated by deposits which accounted for 52.9% of total assets and borrowings from parent banks which stood at 22.1% of total assets at end-2011 (constituting 90% of liabilities to MFI). Funding from the parent banks decreased in 2011 (by 1.2 billion lats or 20.5%). Overall, the deposit base remained stable, with deposits by resident non-financial corporations and households growing by 0.5%; nevertheless, the aggregate resident deposits contracted by 9.9% (influenced by conversion of State aid in Parex bank, into debt securities in Dec-2011). Non-resident deposits continued to expand (by 13.0%).

In 2011, lending resumed gradually in line with positive macroeconomic developments. Banks more actively engaged in financing resident companies focusing on export-oriented industries. In 2011, banks granted new loans at the total amount of 1.5 bln lats, incl. 920 mln lats to residents (companies - 664 mln lats, financial institutions – 87 mln lats, households – 168 mln lats) and 621 mln lats – to non-residents.

The quality of loan portfolio has stabilized. The share of non-performing loans (loans with more than 90 days overdue payments) in total loans started to decline (decreased from its peak of 19.4% in July-2010 to 17.3% at end-2011), influenced by write-offs (312 mln lats in 2011) and regaining of performing status. However, still slow improvement in the labour market situation and rising inflation continued exerting pressure on household loan repayment capacity.

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17 Data of two banks are not included in the calculation of total liquidity and capital adequacy ratios as after restructuring JSC *Parex bank* no longer offers financial services but has been engaged in asset recovery (credit institution operating licence was withdrawn on 15.03.2012), while operations of the *JSC Latvijas Krājbanka* were halted as of 21.11.2011 after encumbrance on the bank funds for the third parties was established (credit institution operating licence was withdrawn on 10.05.2012).

18 Banks have to maintain liquid assets in amount not less than 30% of current liabilities (i.e. with maturity up to 30 days).

Loan restructuring continued but at a much slower pace. By end-2011, restructured loans constituted 17.5% of the total banking sector loan portfolio (19.9% at end-2010), loans in work-out process reached 14.2% of the total banking loan portfolio (15.3% at end-2010).

Upon stabilization of loan portfolio quality, the total amount of loan loss provisions has been gradually decreasing since the second half of 2010. By the end of 2011 banks had made provisions at the total amount of 1.5 billion lats, comprising 11.5% of the banking sector loan portfolio.

With the national economy undergoing recovery, the banking sector profit also improved. Although most Latvian banks operated with profit in 2011, overall the banking sector finished the year with losses (178.7 mln lats) which were half as large as in the previous year (360.6 mln lats) and mainly related to developments with JSC Latvijas Krājbanka and JSC Parex banka. Losses of both banks excluded, all in all, the banking sector in 2011 operated with a profit of 97 million lats. For the third year in a row, the banking sector profitability has been affected by the still considerably high charges for loan loss provisions, accounting for 794 million lats, or 48.9% of total expenses. Whereas reversal of the recognized impairments took more significant place in the bank income profile – growing by 86% over the year and amounting to 28.4% of the total income.

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

The Financial and Capital Market Commission (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, electronic money institutions, payment services providers 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 any of regulatory requirements are violated.

MAIN STRATEGIC OBJECTIVES OF FCMC IN 2011

Main strategic objectives of the FCMC in 2011 were:

- to develop an effective regulatory framework that will promote development and competitiveness, ensure high standards of risk management and better quality and security of financial services;
- to ensure that the financial system is sound and regulation-compliant and promotes development;
- to ensure information and education measures to the general public to promote both confidence in the sector and ability to comprehensively assess the risks associated with financial services as well as take informed decisions;
- to improve constantly its own operating processes and increase efficiency and productivity of its operations.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

Regulatory developments

Amendments to the **Credit Institution Law** were adopted in order to transpose Omnibus I Directive regarding the powers of European Banking Authority.

The FCMC adopted a number of regulations at the end of 2011. Amendments to **Regulations on Development of Internal Capital Adequacy Assessment Process** set minimum requirements for stress tests performed within the internal capital adequacy assessment process, and prescribe that stress tests must be performed by any bank whose credit risk, operational risk, market risks and concentration risk are material and the results of stress tests are to be taken into account in determining the amount of capital required to cover relevant risk. In addition, every bank must conduct stress testing to determine the amount of capital buffer, considering several macroeconomic scenarios – a baseline scenario and at least one materially adverse scenario. Amendments also introduce additional requirements for market risk assessment, subordinated capital planning and additional information that banks must include in their reports on the capital adequacy assessment process for submission to the FCMC.

Amendments to **Regulations for Calculating the Minimum Capital Requirements** provide that capital requirements for settlement risk shall be calculated for all exposures not only to those of the trading book, set higher capital requirements for equities, securitisation and re-securitisation positions in the trading book, as well as stricter provisions with regard to using internal model standards for calculating capital requirements of market risks and specify the elements of own funds.

Amendments to **Regulations on the Compliance with Restrictions on Exposures** allow banks to exempt from the large exposure limits more asset items constituting claims on central banks in the form of minimum reserve requirements, which are denominated in national currencies.

Supervision

In 2011, the following priorities were determined in banking supervision, namely:

- to assess adequacy of the capital basis of Latvian banks;
- to assess sufficiency and quality of liquidity maintenance and management;
- to assess sufficiency of banks' work with problem loans and recognition of loan impairment losses in their statements;
- to assess the potential impact of banks' activity strategy on the structure and volume of risks.

In performing 23 on-site inspections and analyzing financial statements of banks the FCMC continued monitoring the measures taken by banks for ensuring efficient credit risk management in loan restructuring. Apart from individual bank on-site inspections, also horizontal reviews were carried out to assess the credit restructuring process and market risk management in these banks, as well as enforcement of policies under the FCMC regulations. Internal capital adequacy assessment processes were thoroughly evaluated in the banks to clarify whether minimum capital adequacy requirements were sufficient to cover credit risk, market risks and operational risk inherent in the bank activities and if there were no other material risks arising from the bank activities (for instance, concentration risk, interest rate shift risk in a banking book and other) where capital add-on would be required to cover risks. Based on the banking capital assessment, the FCMC requested a bank to provide for capital add-on, if it was necessary.

The FCMC has entered into the cooperation and information exchange agreements with all foreign supervisory authorities regarding bank group supervision, if subsidiaries of their banks operate in Latvia or Latvian banks have subsidiaries in their countries. The FCMC representatives participated in the colleges of supervisors on a regular basis. The FCMC continued regular supervision of parent bank exposures in Latvia which are registered in the EU Member States to all type of debt instruments and capital, as well as net deposits granted to banks in Latvia.

The FCMC performed information integrity reviews regarding credit institution guaranteed deposits. Upon the occurrence of JSC "Latvijas Krājbanka" insolvency at end-2011, the FCMC immediately started pay-outs of the State-guaranteed compensations successfully launching the State Guarantee Fund.

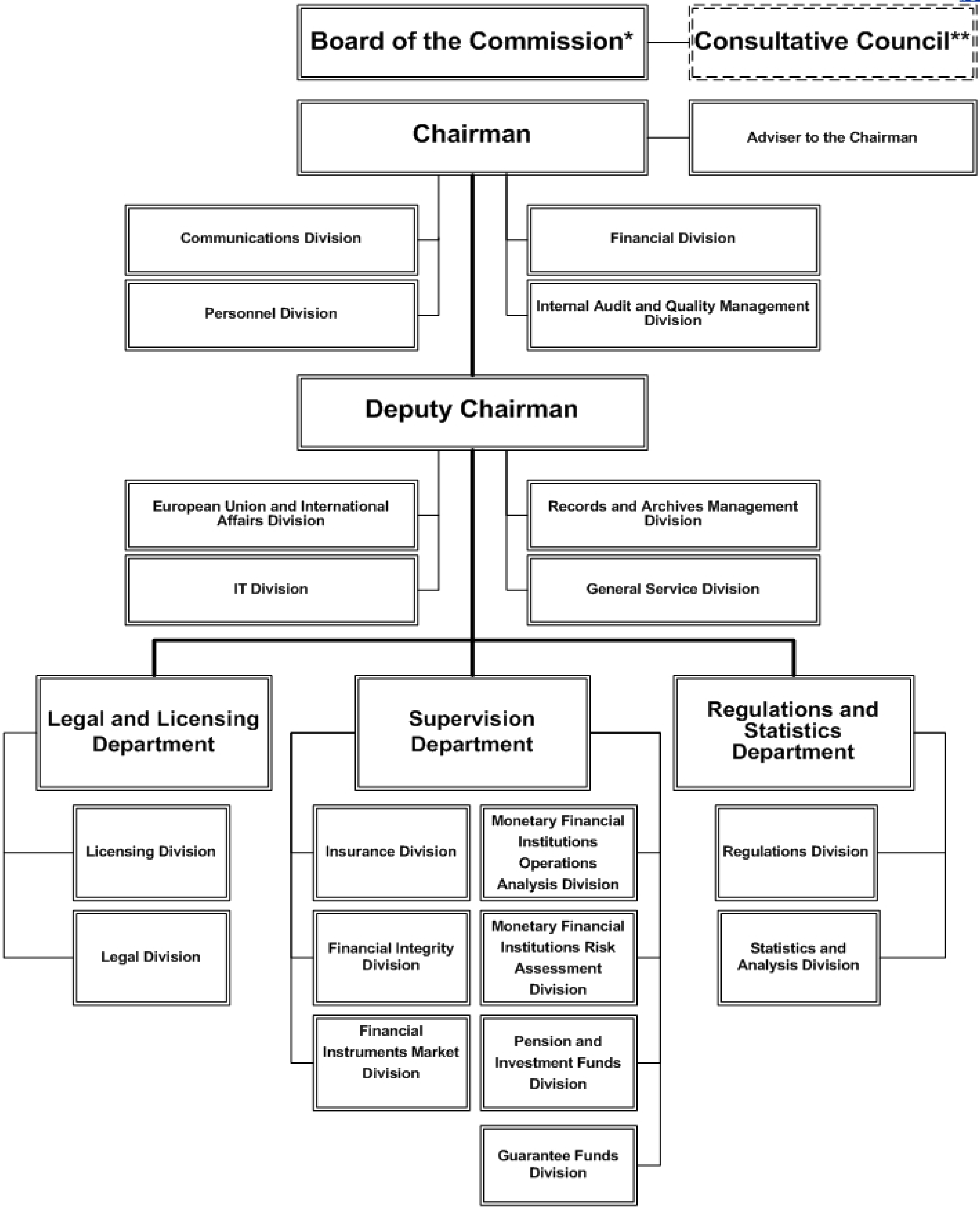
Consumer education

The FCMC focus on consumer protection and education has been intensified. The FCMC launched a new website CLIENT SCHOOL on 1 March 2011, where current and potential financial and capital market clients can obtain more detailed information and description of the financial products. The new site CLIENT SCHOOL is designed so that to provide basic information on new financial services to all the clients allowing them to assess potential future risks that may arise and to evaluate their readiness to assume the risks. In an easily perceptible manner, the core principles for financial sector supervision are explained there as well as essential qualities of deposit guarantee scheme.

More information regarding main activities is available in the Annual Report of the FCMC for 2011 http://www.fktk.lv/en/publications/annual_reports.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

In 2011, significant structural changes were made in the Supervision Department. As a result of the reorganising of the Banking and Institutional Investors Division, three separate structural units were established: Monetary Financial Institutions Operations Analysis Division that is responsible for carrying out off-site supervision, Monetary Financial Institutions Risk Assessment Division that is responsible for carrying out on-site inspections, and Pension and Investment Funds Division. Moreover, a new function — supervision methodology — was established to ensure that the techniques used in supervision were improved on an ongoing basis and complied with EU requirements.



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

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

INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In 2011, the EC made a number of legislative proposals concerning the banking sector: new capital requirements framework for credit institutions CRD IV/CRR, directive on credit agreements relating to residential property and the proposals disclosed in 2010 (amendments to deposit guarantee scheme directive and financial conglomerate directive) were further discussed in the Council of the EU. The FCMC's experts were involved in developing the national positions and discussing proposals in the Financial Services Working Group of the Council of the EU. As a national supervisory authority the FCMC regularly participated in the work of European Banking Authority and European Systemic Risk Board, their committees and working groups, providing contributions to the documents elaborated and negotiated by EBA and ESRB.

As regards bilateral cooperation with other supervisory authorities separate agreements for cooperation and information exchange were concluded for cross-border supervision of banking groups if subsidiaries of banks of Member States operated in Latvia or subsidiaries of Latvian banks operated in Member States, and they governed the operation of those colleges of supervisors of banking groups in which the FCMC's representatives participated.

COOPERATION WITH OTHER SUPERVISORY BODIES IN LATVIA

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

STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
Commercial banks	21	21	22
Branches of foreign credit institutions	6	8	8
Cooperative banks	0	0	0
Banking sector, total:	**27**	**29**	**30**

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

Type of financial institution	2009	2010	2011
Public sector ownership	17.1	15.5	14.7
Other domestic ownership	13.7	15.5	20.3
Domestic ownership total	30.7	31.0	35.0
Foreign ownership	69.3	69.0	65.0
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2011 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	39.5	54.9	0.103
Branches of foreign credit institutions	11.8	12.1	0.727
Cooperative banks	-	-	-
Banking sector, total:	**41.0**	**58.4**	**0.090**

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

Type of financial institution	2009	2010	2011
Commercial banks	-41.6	-20.4	-11.2
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	-	-	-
Banking sector, total:	**-41.6**	**-20.4**	**-11.2**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	88.0	87.9	87.7
Branches of foreign credit institutions	12.0	12.1	12.3
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	2009	2010	2011
Financial sector	21.0	25.2	25.0
Nonfinancial sector	70.3	64.9	64.6
Government sector	3.4	4.2	3.9
Other	5.2	5.7	6.5
Liabilities	**2009**	**2010**	**2011**
Financial sector	40.8	35.1	27.3
Nonfinancial sector	36.2	42.4	48.1
Government sector	3.6	4.4	2.1
Capital	7.4	7.3	7.5
Other	12.0	10.8	15.1

Capital adequacy ratio of banks

Type of financial institution	2009**	2010**	2011**
Commercial banks	14.56	14.64	17.40
Cooperative banks	-	-	-
Banking sector, total:	**14.56**	**14.64**	**17.40**

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

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

Asset classification	2009	2010	2011
Non financial sector	17.2	19.8	18.1
- households	16.7	18.7	19.6
- corporate	18.0	21.0	17.2

The structure of deposits and loans of the banking sector in 2011 (%) (at year-end)

	Deposits	Loans
Households	32.3	41.2
Government sector	3.9	0.6
Corporate	58.1	54.5
Other (excluding banks)	5.8	3.7
Total	**100.0**	**100.0**

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

P&L account	2009	2010	2011
Interest income	1 442 905	973 758	910 850
Interest expenses	932 473	633 532	478 464
Net interest income	510 432	340 226	432 386
Net fee and commission income	187 085	200 263	235 252
Other (not specified above) operating income (net)	307 279	188 507	187 959
Gross income	1 004 796	728 996	855 598
Administration costs	493 503	472 000	480 851
Depreciation	53 415	52 923	36 442
Provisions	1 707 075	721 905	542 400
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	1 707 075	721 905	542 400
Profit (loss) before tax	-1 249 197	-517 832	-204 095
Net profit (loss)	-1 100 479	-513 229	-254 211

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	2 713 270	2 214 980	498 291	0
Cooperative banks	0	0	0	0
Banking sector, total:	**2 713 270**	**2 214 980**	**498 291**	**0**

2011 DEVELOPMENTS IN THE LITHUANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Recovering domestic demand supported a rapid growth of Lithuania's economy in 2011. At the end of the year, in the environment of a declining global economy and therefore deteriorating expectations of enterprises in our country, the economic growth slowed down. The effect of slower foreign demand growth was mitigated by a particularly buoyant growth of private consumption in the fourth quarter (8.1 % per annum).

After being positive in 2009-2010, the current account balance turned again to negative in 2011, with deficit amounting to LTL 1.7 billion or 1.6 per cent of GDP.

Recovering Lithuania's economy determined an improvement in the labour market situation as well. The rate of unemployment increased somewhat in the first quarter, while from the second quarter it was dropping. The average annual unemployment rate was 15.4 per cent (in 2010 – 17.8%).

Average gross wage was rising in the economy at a slow rate. With the exception of the beginning of the year, it was increasing in the public sector more intensively than in the private sector.

In 2011, the average annual HICP inflation made up 4.1 per cent. Approximately a half of this inflation was driven by more expensive food. Increasing prices of fuels and administered prices determined one-fifth of inflation each.

DEVELOPMENT OF THE BANKING SYSTEM

On 31 December 2011, there were 8 commercial banks holding the licence issued by the Bank of Lithuania, one bank undergoing bankruptcy proceedings, 12 foreign bank branches and two representative offices of foreign banks. The Bank of Lithuania had received 258 notifications from the supervisory authorities of the EEA countries regarding intentions of the banks licensed by them to provide services without establishing branches.

Total assets of the banking system were nearly LTL 79 billion and comprised 75 per cent of GDP. As banks continued to accumulate liquid assets, the share of loans granted decreased in 2011 by 3 percentage points to 68.4 per cent of total assets.

Deposits attracted in the country comprise the main source of financing for the banking sector. They account for almost 60 per cent of bank liabilities. Deposits of the banking sector decreased due to the bankruptcy of AB bankas SNORAS, but at the end of the year former depositors of the bankrupt bank appeared in some other banks. Lending remained at low level, and cash flows from repaid loans were accumulated by banks largely in parent banks. Therefore, the net debt to parent banks (a difference between the debt to parent banks and funds held with them) decreased by LTL 3.2 billion to LTL 15.2 billion.

In 2011, the Lithuanian banking sector became less reliant on the financing from other countries. Funds received from non-residents made up 38.3 per cent of the banking sector's liabilities at the end of the year, of which, debts to parent banks accounted for more than 30 per cent.

In 2011, banks earned the profit of LTL 1.1 billion, after incurring losses in 2009 and 2010. It was almost similar to the profit earned by the banking sector during the economic upswing in 2007.

On 31 December 2011, the foreign investors' share in the authorised capital of banks made up 87.7 per cent. The capital of investors from the Northern European countries continued to dominate the Lithuanian banking system.

In Lithuania, the established capital adequacy ratio is 8 per cent, but for some banks, owing to the specific nature of their operations and risk, a higher ratio of 10 per cent has been set. Several local capital banks increased their capital in 2011.

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

To avoid financial shocks in the future, the international community has agreed to strengthen banking supervision by setting higher requirements for banks. Banks operating in Lithuania will have to observe much stricter requirements in the future.

In order to encourage responsible lending practices of credit institutions, protect consumers against excessive burden of financial liabilities and form responsible borrowing habits, as well as to reduce the systemic risk of the credit institutions sector and unbalanced changes of real estate prices, the Bank of Lithuania approved the Responsible Lending Regulations. They establish the maximum loan-to-value ratio, which should not exceed 85 per cent, the maximum loan term, which should not exceed 40 years, and the debt-to-income ratio, which should not exceed 40 per cent.

To receive sufficient information for monitoring the bank bankruptcy proceedings, the Bank of Lithuania prepared new requirements for information provided by administrators of banks in bankruptcy.

To improve the conditions for operation of electronic money institutions and encourage the development of electronic money in the Lithuanian financial sector, experts of the Bank of Lithuania, in cooperation with the work group formed by the Ministry of Finance of the Republic of Lithuania, worked out a draft law of the Republic of Lithuania on Electronic Money and Electronic Money Institutions. The Law was adopted at the end of 2011 and the package of by-laws necessary for electronic money institutions to apply for operational licences and start activities was finalised.

The Bank of Lithuania started the supervision of payment institutions at the end of 2011. A legal framework for the supervision of these institutions was built, which regulates licensing, prudential requirements, internal control and risk management, accountability and other issues. Technical measures for receiving supervisory and financial reports and conducting supervision were implemented.

To further improve liquidity risk management in banks, the General Provisions for Internal Capital Adequacy Assessment Process and Supervisory Review and Evaluation Process were supplemented. A requirement was set for banks to implement the mechanism for the allocation of liquidity costs, benefits and risks to ensure proper functioning of the liquidity risk management systems and processes. The Bank of Lithuania adopted new requirements and will monitor the preparation and implementation by banks of the liquidity cost-benefit allocation mechanism by means of a regular and detailed assessment of the liquidity risk management in banks.

MAIN STRATEGIC OBJECTIVES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

The global financial crisis exposed gaps in the regulation of credit institutions and revealed the need for the systemic regulation of their activities. At the same time, a need emerged to implement new instruments for boosting the banking sector's capacity to withstand shocks, improve risk management and governance in banks and raise transparency of their activities.

Experts of the Bank of Lithuania participated in working (expert) groups of EU institutions, which were discussing the CRD VI, the Capital Requirements Regulation and provisions of the technical standards to be issued by the European Banking Authority. Information was prepared along with the country's position on the main changes in the regulation of credit institution activities to be made in accordance with the CRD IV and CRR requirements, with a major focus on liquidity, leverage indicator, the structure of own funds, the cooperation between home and host countries, enforcement measures, credit risk and counterparty credit risk.

To assess resilience of the financial sector, all banks conducted stress testing exercises in accordance with uniform and quite severe scenarios prepared by the Bank of Lithuania. The findings of the testing on 1 January and 1 July 2011 showed that the Lithuanian banking system is capable to withstand potential financial shocks.

Constructive communication with managing bodies of banks operating in the country was also prioritized.

THE ACTIVITIES OF BANKING SUPERVISORY AUTHORITY IN 2011

The prevention of risks associated with banking activities remained the Bank of Lithuania's priority in performing the supervision of credit institutions in 2011, with the major focus on ensuring adequate control of significant risks undertaken by credit institutions, strengthening their capital, which is the main source for absorbing risk-related losses, and improving its quality.

Credit risk continues to be among the most significant risks, as it has a direct effect on banks' operating results. Loan quality was a key determinant of banks' operating results and their prospects; therefore the issue of strengthening the capital base remained a priority in performing the supervision of credit institutions.

In 2011, banks continued implementing the Internal Capital Adequacy Assessment Process (ICAAP) and Supervisory Review and Evaluation Process (SREP).Along with that, the central bank continued to organise yearly full-scope and target on-site inspections. During these on-site inspections, a special focus was given to the management of certain types of risks, huge attention was paid to the management of credit and liquidity risks as well as the quality of internal governance.

The management of the Bank of Lithuania had regular meetings with heads of banks and credit unions operating in the country. These meetings were held to find out about operational prospects of credit institutions, present to their management the Bank of Lithuania's position on issues it considers the most urgent, discuss on-site inspection results and other problems related to banks' activities. Much attention was also paid to the elimination of the shortcomings in the activities of credit institutions, which were revealed during on-site inspections, and the implementation of the instructions prescribed by the Board of the Bank of Lithuania.

INTERNATIONAL ACTIVITIES OF THE AUTHORITY

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.

The Banks governed by parent banks from abroad and foreign bank branches are the most important players in the Lithuanian banking sector. Therefore, the Bank of Lithuania, when conducting the supervision of banks within different bank groups, regularly cooperates with the financial supervisory authorities of other countries. It also actively cooperates at supervisory colleges whose activities involve participation of representatives of the financial supervisory authorities of all countries a certain bank group operates in. The Bank of Lithuania has signed seven multilateral agreements on the supervision of international groups whose branches are operating in our country.

In 2011, representatives of the Bank of Lithuania were involved in the activities of colleges established by the Danish, Latvian, Norwegian and Swedish Financial Supervisory Authorities. At the meetings of supervisory colleges, significant attention was paid to the process of assessment by individual countries of the risk related to the operation of individual banks within the bank group subject to their supervision, adoption of decisions on capital adequacy, problems of individual bank groups and the processes taking place within the groups were discussed.

While conducting on-site inspections or on–the-spot verifications of foreign bank subsidiaries and branches, the Bank of Lithuania cooperates with foreign financial supervisory authorities by informing them about pending inspections or verifications and, afterwards - on the results and other important information. Foreign financial supervisory authorities are advised of the results of inspections of parent banks carried out by them. Such cooperation is very important, as the units of foreign banks operating in Lithuania belong to groups of large banks which recently have been increasingly centralising the management of different risks and application of advanced methods for risk assessment to calculate their capital requirement.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

In 2011 the supervision in the financial sector in Lithuania was still performed by three separate supervisory authorities: the Bank of Lithuania, the Securities Commission and the Insurance Supervisory Commission. All three authorities cooperated and exchanged information under the terms of MoU. The political support for merger of three supervisory institutions into one under the Bank of Lithuania was taken in the middle of the year and the new structural unit, Supervision Service, began functioning at the Bank of Lithuania on 1 January 2012. All functions carried out by Lithuanian Securities Commission and Insurance Supervisory Commission have been transmitted to the Bank of Lithuania and these individual institutions as such were liquidated. The Supervision Service under the Bank of Lithuania was delegated to undertake the functions of banking, insurance and securities market supervisors.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS IN THE COURSE OF LAST YEAR

A significant event occurred in the banking sector in the fourth quarter of 2011: bankruptcy proceedings have been instituted against AB bankas SNORAS, 5th largest bank of the country with 10 per cent of the domestic banking market share.

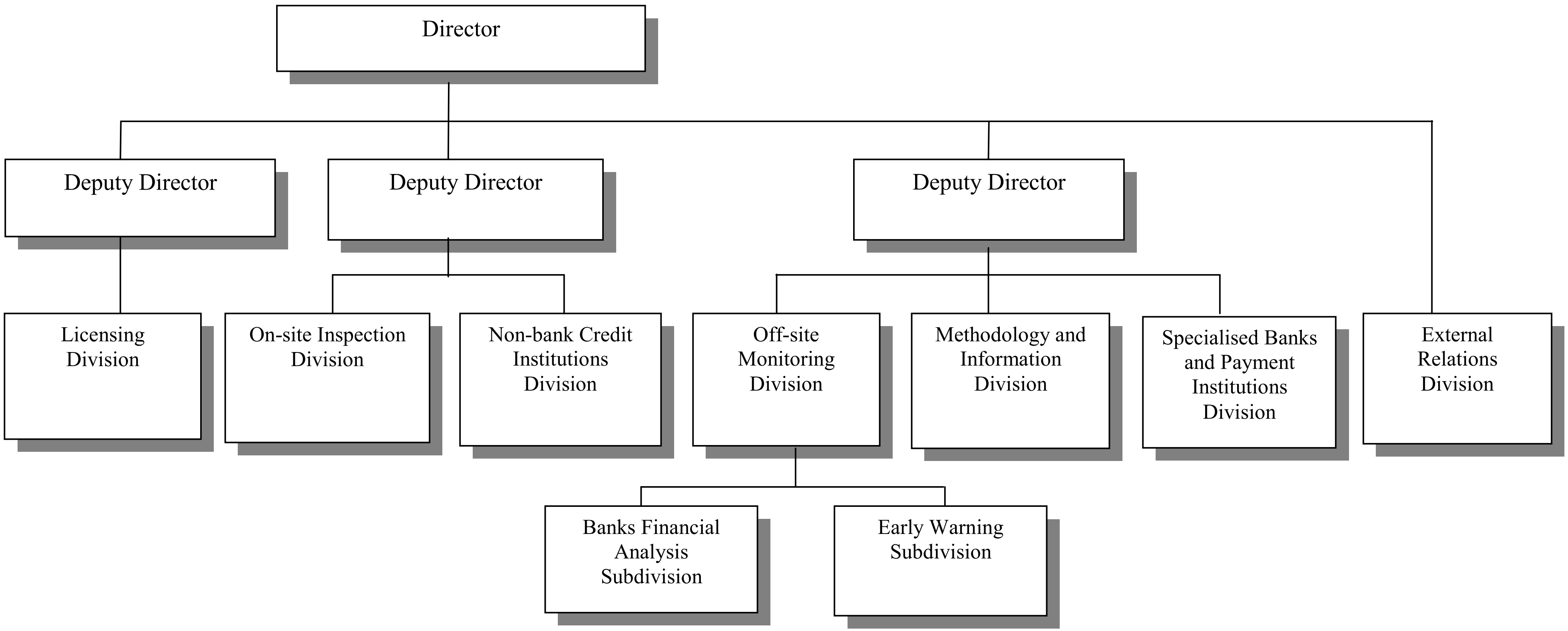
The Board of the Bank of Lithuania took the decision on 16 November to declare the suspension of activities (a moratorium) of AB bankas SNORAS and appoint a temporary administrator. This decision was also prompted by suspicions of potential criminal activities at this bank (embezzlement of especially large amounts, fraudulent accounting, etc.), potential insolvency, as well as that the fact that all this can harm the interests of the bank's depositors, other creditors, customers and the general public. To minimise the negative impact on the financial sector stability and eventual government costs, the Government of the Republic of Lithuania, following the proposal of the central bank, imposed a measure provided for in the Law of the Republic of Lithuania on Financial Stability. The shares of AB bankas SNORAS were taken over for public needs. However, on 24 November, the Bank of Lithuania received a report by the temporary administrator, according to which the financial situation in AB bankas SNORAS was worse than expected, as the bank's assets made up LTL 4.4 billion, i.e. they were lower by LTL 3.4 billion than the value estimated by the bank. Consequently, the bank's liabilities actually exceeded its assets by LTL 2.8 billion. It became clear that further activities of AB bankas SNORAS had no future, therefore the bankruptcy proceedings were instituted against the bank.

It should be noted that the case of AB bankas SNORAS was exceptional in the banking sector. Serious deficiencies in its activities are not typical to other banks operating in Lithuania. The domestic banking sector proved it was ready and capable to withstand serious challenges and became even safer and more reliable after AB bankas SNORAS bankruptcy. The banking supervision and decision making system functioning in the Bank of Lithuania ensured the timely identification and quick, professional and effective elimination of the threat posed by AB bankas SNORAS.

Public confidence in the financial sector is the key condition for maintaining its stability. By withstanding the shock of such magnitude, the financial sector revealed not only the competence of banks, but also the society's maturity. A smooth deposit compensation process had a significant effect on maintaining stability and building up confidence of the population. The message was clear: the government is capable to meet its obligations.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY

THE STRUCTURE OF CREDIT INSTITUTIONS SUPERVISION DEPARTMENT OF THE BANK OF LITHUANIA AT THE END OF 2011



STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
Commercial banks	9	9	8
Branches of foreign credit institutions	8	11	12
Cooperative banks*	68	69	75
Banking sector, total:	**85**	**89**	**95**

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

Type of financial institution	2009	2010	2011
Public sector ownership	-	-	-
Other domestic ownership	-	-	-
Domestic ownership total	17.1	21.1	12.3
Foreign ownership	82.9	78.9	87.7
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	85.7	96.6	1725
Branches of foreign credit institutions	97.7	99.2	165
Cooperative banks	27.8	35.8	0
Banking sector, total:	**67.7**	**85.0**	**1890**

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

Type of financial institution	2009	2010	2011
Commercial banks	-48.42	-4.72	15.23
Branches of foreign credit institutions	-	-	-
Cooperative banks*	-5.2	-4.3	-9.3
Banking sector, total:	-	-	-

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	80.9	79.9	78.8
Branches of foreign credit institutions	17.8	18.2	19.1
Cooperative banks	1.3	1.9	2.1
Other	-	-	-
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Assets	2009	2010	2011
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	**2009**	**2010**	**2011**
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	2009**	2010**	2011**
Commercial banks**	14.15	15.64	13.92
Cooperative banks	18.61	20.16	19.76
Banking sector, total:	14,21	15,71	14,04

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

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

Asset classification	2009	2010	2011
Non-financial sector	19.30	19.50	16.27
- households	x	x	x
- corporate*			

*Information not available for this type of breakdown

The structure of deposits and loans in 2011 (%)
(at year-end)

	Deposits	Loans
Households	58.2	43.5
Government sector	5.9	6.0
Corporate	33.0	46.5
Other (excluding banks)	2.9	4.0
Total	**100.0**	**100.0**

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

P&L account	2009	2010	2011 (without credit unions)
Interest income	1215.7	939.8	593.1
Interest expenses	838.0	593.6	283.0
Net interest income	377.7	346.2	310.1
Net fee and commission income	188.7	195.8	151.0
Other (not specified above) operating income (net)	-27.7	-22.3	-
Gross income	646.4	576.6	470,7
Administration costs	320.7	316.7	252
Depreciation	28.5	26.5	21.4
Provisions	40.4	-18.0	-4.5
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	1154.8	209.9	-51.9
Profit (loss) before tax	-1165.9	-92.5	322.2
Net profit (loss)	-1064.1	-81.1	288.3

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	1765.5	1519.2	246.3	-
Cooperative banks	52.8	45.4	7.4	-
Banking sector, total:	**1818.3**	**1564.6**	**253.7**	

2011 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF MACEDONIA

MACROECONOMIC ENVIRONMENT

In 2011, the Macedonian economy continued the recovery that began during the previous year. GDP grew by 3.1%, which arose mainly from the developments in the first half of the year. The gradual increase in the global economic growth, the favorable conjunction on the world market for our export products and more optimistic expectations of the economic entities had positive impact on the domestic economic activity. The stimulus of the government capital investments also contributed to the positive performances. In line with the mainly favorable environment, domestic entities increased the propensity to consume, supported by the somewhat intensified credit activity and moderate increase in employment. These factors resulted in high average growth of the domestic economy of 5.9% in the first half of the year. However, in the second half, the macroeconomic trends worsened. The reemergence of the debt crisis in the Euro area stirred new wave of uncertainty, new tensions on the financial markets and resulted in constant downward revisions of the growth rates of the most important trading partners of the domestic economy. The fall in the foreign demand had negative impact on both the domestic industry and the export sector. The elevated uncertainty reflected also on the expectations of the domestic entities and resulted in higher propensity for saving and restrain from consumption. As a result, economic growth decelerated to only 0.7%, on average, in the second half of the year.

Despite the sustained economic recovery (especially in the first half of the year), in 2011 the domestic economy was below the potential and pointed to absence of inflationary pressures through the demand channel. However, the inflation in 2011 accelerated moderately and equaled 3.9%, on average. The increase in the price level was led by supply side factors, i.e. by the further surge of the world food and energy prices, as well as by the rise in the domestic regulated prices.

In 2011, the external position of the Macedonian economy remained relatively favorable despite the increased risks in the global economy. The current account deficit increased moderately (by 0.5 p.p. of GDP on annual basis) and it equaled 2.7% of GDP. This slight worsening was mostly due to the larger trade deficit. Higher energy needs, accompanied by higher energy prices worsened the energy trade balance, which was the main factor for the trade deficit widening. Private transfers continued to mount, especially at the end of the year, allowing for a high 85% coverage of the trade deficit. Net-inflows on the capital and financial account (excluding official reserves), were three times higher compared to 2010. Their level was sufficient to fully finance the relatively low current account deficit and enable additional foreign currency inflows in the domestic economy. Substantial part of the inflows came from foreign investments in the country, which exceeded the current account deficit almost by double. The inflows contributed for foreign reserves to reach their historically highest level of Euro 2,069 million at the end of 2011. This level of FX reserves is relatively favorable in terms of coverage of over 4 months of imports.

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

In 2011, no significant changes occurred within the banks’ ownership structure. Financial institutions, with share of 65.9% in the total equity, remained the dominant owners of banks. The share of foreign capital in total banks' capital increased slightly and as of December 31, 2011 it equaled 74.7% (72.9% as of December 31, 2010).

In 2011, the degree of financial intermediation registered an upward movement compared to the end of 2010. The ratio of total banking system assets to GDP increased to 71.5% at the end of 2011 (from 70.3% at the end of 2010). The increased level of financial intermediation is also evident through the continuous growth of the ratio of total deposits to GDP (from 49.1% at the end of 2010 to 50.5% at the end of 2011), and the ratio of total loans to GDP (from 43.0% at the end of 2010 to 43.7% at the end of 2011).

Credit risk is the dominant risk in the banking activities. As of 31.12.2011, the non-performing loans (NPLs) to non-financial entities equaled Denar 20,089 million, and registered an annual rise of Denar 2,800 million or by 16.2% (in 2010 was Denar 1.512 million or 9.6%). That led to a rise in the NPL ratio for non-financial entities from 9.3% at the end of 2010 to 9.9% at the end of 2011. From the sector perspective, the increase in non-performing loans to non-financial entities was mainly due to the increase of these loans to enterprises, while the non-performing loans to households and other clients decreased. There is a full coverage of NPLs with allocated loan loss provisions (impairment for credit risk).

The banks use only 3.5% of their own funds for currency risk. The ratio of the exposure of banks to currency risk, expressed through the gap between assets and liabilities with currency component to the banks' own funds, was 21.3% at the end of 2011.

The main reason for the low interest rate risk in the banking book is the application of so called adjustable interest rates by the banks (interest rates can be changed by a bank's body decision and not based on the movements of some referent market rate or index). As of December 2011, 63.1% of total loans are with adjustable interest rates (62.1% in December 2010). The exposure of banks to interest rate risk expressed as a ratio between the total weighted value of the banking book and the banks' own fund is low and equals to 1.3% at the end of 2011.

The banks maintain relatively high level of liquid assets and stable liquidity indicators. At the end of 2011 total liquid assets of the banking system were Denar 100,361 million and registered an annual growth of 8.8%. Thus, as of December 31, 2011, the share of liquid asset in total assets was 31.3% and compared to December 31, 2010 increased by 0.5 percentage points. At the end of 2011, liquid assets covered 48.9% and 60.7% of banks' short term liabilities and household deposits, respectively. At the end of February 2012, all banks fulfilled the prescribed minimum liquidity ratios of 1 up to 30 days and up to 180 days. Stress-test analyses show satisfactory resilience of the banking system to liquidity shocks. The banking system has sufficient liquid assets to deal with shocks related to the possible instability of the deposits as the most important source of financing.

The Macedonian banking system has stable and high solvency and capitalization ratios, which have further improved over 2011. The capital adequacy ratio is more than twice over the prescribed minimum of 8%. As of December 2011, the capital adequacy ratio and the Tier 1 ratio equaled 16.8% and 14.1%, respectively. As of December 31, 2011, the conducted stress test simulations on the resilience to hypothetical shocks showed that the banking system and the individual banks are relatively resistant to the influence of these shocks. The implementation of several hypothetical simulations[19] showed that none of the banks register fall of the capital adequacy ratio below 8%.

The 2011 profit in amount of Denar 1,183 million was lower by 48.7% compared to the profit realized in 2010. The lower profitability of the banking system is mostly a result of the higher impairment, as well as the further increase in the operating expenses evident in the last few years, despite the higher level of the operating income. The return on assets equaled 0.4% (0.8% in 2010), while the return on equity equaled 3.4% (7.3% in 2010). The worsening of the operational efficiency is evident through the increase of the part of the total regular income used for covering the operating expenses (cost-to-income ratio) from 66.4% in 2010 to 67.8 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 MACEDONIA

The National Bank of the Republic of Macedonia (NBRM) is Banking Supervisory Authority responsible for licensing and supervision of banks and savings houses in the Republic of Macedonia. Within the National Bank of the Republic of Macedonia, the Supervision, Banking Regulations and Financial Stability Division (Three Departments: Off-site Supervision and Licensing, On-site Supervision and Financial Stability and Banking Regulations) performs the supervisory function.

These competences of the NBRM are 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.

In order to achieve further enhancement of the banking regulatory framework, in 2011 the following acts were prepared and adopted:

- Decision on the risk management, which replaced the previous risk management regulation, enhancing the existing regulation with more precise definitions of the term "outsourcing", as well as of the

19 (a) isolated credit shock (increase in C, D and E credit exposure of 10%, 30% and 50%), (b) combination of the credit and interest rate shock (increase in C, D and E credit exposure of 30% and increase in the interest rates by 1 to 5 percentage points), (c) combination of credit and foreign exchange shock (increase in C, D and E credit exposure of 50% and depreciation in the Denar exchange rate of 20%), (d) combination of credit risk, foreign exchange risk and interest rate risk shocks (increase in C, D and E credit exposure of 50%, depreciation of the Denar exchange rate of 20% and increase in the interest rates by 1 to 5 percentage points), (e) appreciation of the Denar exchange rate of 20%, (f) simultaneous reclassification of the five largest credit exposures to non-financial entities (including their connected entities) in the risk category C.

components of the internal capital adequacy assessment process (ICAAP);
- Decision on banks' liquidity risk management that also supersedes the old Decision. The New Decision requires integrated monitoring of the minimal liquidity ratios irrespective of the currency of claims and liabilities (unlike before when liquidity ratios for the positions in domestic and in foreign currencies were monitored separately). Additionally, a certain stability of term deposits was presumed, so they are included in the calculation of the liquidity ratios (as an outflow) with 20% haircut (unlike before when they were treated as 100% outflow with their maturity). These provisions are closely related with the new Basel III liquidity requirement and represent a basis for further harmonization;
- Few by laws in the domain of consumer protection.

In addition to this, during 2011 National Bank has developed a new capital adequacy methodology which will be enforced from the second half of 2012. The new methodology enables full implementation of Pillar 1 standardized approaches of Basel II[20].

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2011

Maintenance of a safe and sound banking system is one of the Central bank's key goals. That is the main precondition for the financial stability of the country and its sustainable economic growth.

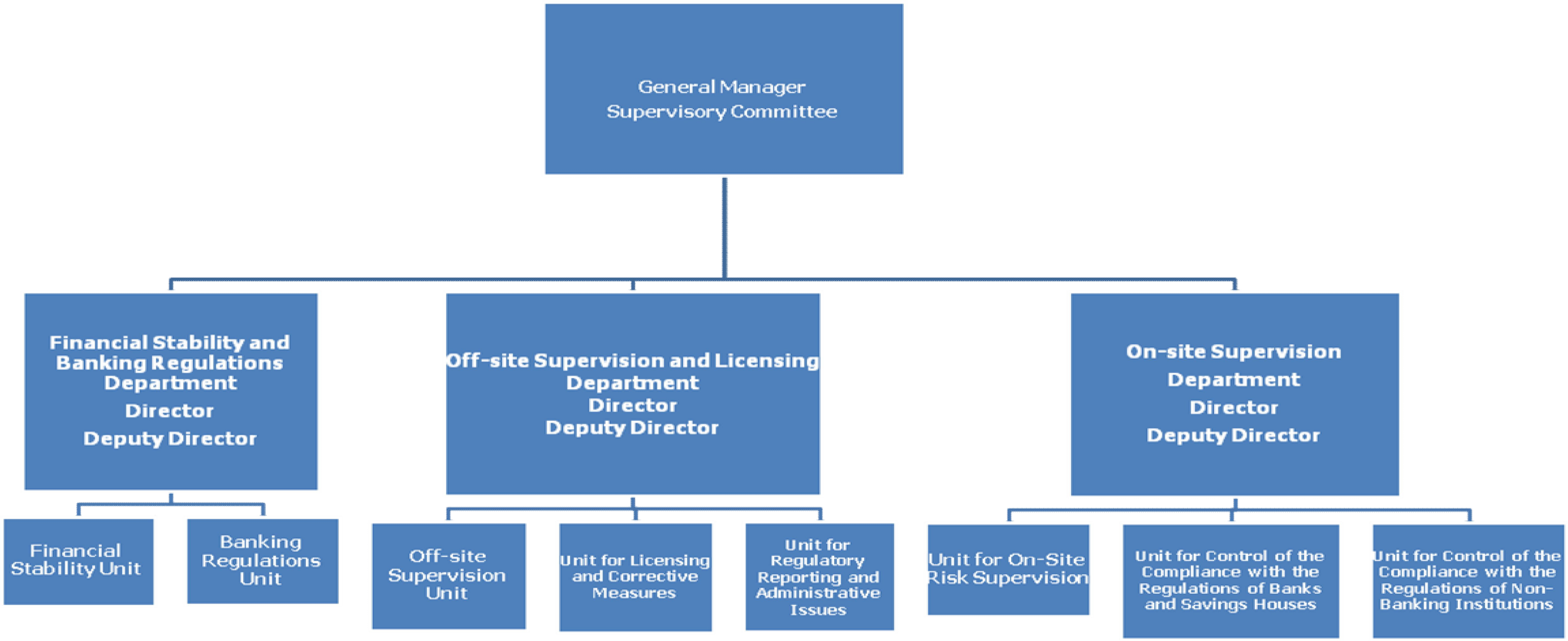
The main strategic focus of the National Bank of the Republic of Macedonia supervision is:
- Further development of risk-based supervision by determining the aggregate risk profile of each bank, applying quantitative and qualitative indicators;
- Determining the level of capital requirement according to the bank's aggregate risk profile;
- Further strengthening of the Supervisory department's capacity for assessment and licensing of banks' internal models for risk management. This mainly refers to the usage of advanced approaches for determining the capital requirements for credit and operational risk coverage that should be licensed by the Supervisory authority.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

The banking supervision department, continued to perform regular full scope and focused on site examination and off site surveliance of banks in the Republic of Macedonia.

20 Pillar 2 and Pillar 3 requirements were introduced with a set of regulations developed from 2007 till 2009.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

International activities consist of cooperation with other supervisory bodies under the signed MoUs.

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

The collaboration of the domestic supervisory authorities in 2011 continued on a regular basis. In the second quarter of 1012, on the NBRM initiative, the periodical meetings beteween the authorized financial supervisor in the Republic of Macedonia were reactivated.

OTHER RELEVANT INFORMATION AND DEVELOPMENTS

At the beginning of 2011, initial steps were made towards developing an econometric model for Macedonian banks' exposure to credit risk, which, inter alia, could be used for the needs of stress testing, as part of the broad macro stress test framework. The main purpose was to indentify the macroeconomic determinants of non-performing loans by conducting a panel data analysis. The dependent variable in the model is the ratio of non-performing to total loans of nonfinancial entities. The empirical results point to an existence of certain interconnectedness between non-performing loans and phases of economic cycle (via GDP movement) and between non-performing loans and external sector variables. Variables with highest explanatory power are the inflation rate and the real effective exchange rate.

Several extensions of this research work are planned in the future: to enrich the explanation of NPLs movements by adding bank-specific variables, which could capture the differences between individual banks related with management quality and their behavior on credit market, to develope separate equations for different segments of the credit portfolio, etc. Also, it was ascertained that several other accompanying econometric equations could be constructed (for the credit growth, anticipation of interest income, determination of the amount of unexpected losses, calculation of the effects of the risk of spillover of adverse effects etc.).

STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
Commercial banks	18	18	17
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	**18**	**18**	**17**

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

Type of financial institution	2009	2010	2011
Public sector ownership	1.4%	2.3%	3.1%
Other domestic ownership	5.3%	4.8%	4.5%
Domestic ownership total	6.7%	7.1%	7.6%
Foreign ownership	93.3%	92.9%	92.4%
Banking sector, total:	**100.0%**	**100.0%**	**100.0%**

Concentration of asset by the type of financial institutions in 2011
(at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	64.0%	76.6%	1,524
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	**64.0%**	**76.6%**	**1,524**

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

Type of financial institution	2009	2010	2011
Commercial banks	5.6%	7.3%	3.4%
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total:	**5.6%**	**7.3%**	**3.4%**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	98.8	99.0	99.1
Branches of foreign credit institutions	1.2	1.0	0.9
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	2009 (%)	2010 (%)	2011 (%)
Cash and balance with NBRM	12.0	11.4	11.5
Nbrm bills	5.9	8.5	9.7
Debt securities	5.2	6.1	5.0
Placements to other banks	0.4	0.3	0.3
Placements to clients	12.6	13.3	13.1
Accrued interest and other assets	58.5	55.1	54.7
Securities investments	3.2	2.7	2.5
Fixed assets	2.3	2.6	3.1
Non allocated reserves for potential losses	12.0	11.4	11.5
TOTAL ASSETS	**100,0**	**100,0**	**100,0**
Liabilities	**2009 (%)**	**2010 (%)**	**2011 (%)**
Deposits of financial institutions	6.7	6.0	4.2
Sight deposits of nonfinancial entities	25.2	24.2	23.0
Short-term deposits up to one year of nonfinancial entities	36.2	34.9	35.3
Short-term borrowings up to one year	1.2	1.2	1.1
Long-term deposits over one year of nonfinancial entities	8.6	10.8	12.4
Long-term borrowings over one year	7.7	9.5	10.5
Provisions for off-balance sheet liabilities and other provisions	0.3	0.2	0.2
Equity and reserves	11.4	10.6	11.0
Other liabilities	2.7	2.6	2.2
TOTAL LIABILITIES	**100,0**	**100,0**	**100,0**

Capital adequacy ratio of banks

Type of financial institution	2009	2010	2011
Commercial banks*	16.4%	16.1%	16.8%
Cooperative banks	/	/	/
Banking sector, total:	**16.4%**	**16.1%**	**16.8%**

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

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

Asset classification	2009	2010	2011
Non financial sector	9.1%	9.3%	9.9%
- households	**8.2%**	**8.1%**	**7.5%**
- corporate	**9.6%**	**10.0%**	**11.4%**

The structure of deposits and loans of the banking sector in 2011 (%) (at year-end)

	Deposits	Loans
Households	66.7	36.5
Government sector	0.5	0.1
Corporate	24.4	58.2
Domestic Banks	0.4	4.4
Foreign banks*	3.4	0.3
Other (excluding banks)	4.6	0.5
Total	**100.0**	**100.0**

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

P&L account	2009	2010	2011
Interest income	19,130,949	19,535,305	19,521,536
Interest expenses	-8,436,029	-9,138,386	-9,120,391
Net interest income	10,694,920	10,396,919	10,401,145
Net fee and commission income	3,112,669	3,382,828	3,482,426
Other (not specified above) operating income (net)	1,787,269	1,585,994	2,356,136
Gross income	15,594,859	15,365,741	16,239,707
Administration costs**	-8,617,087	-8,926,424	-9,318,122
Depreciation	-1,053,081	-1,150,002	-1,144,730
Provisions***	54,979	-93,090	-675,774
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)****	-4,254,278	-2,855,938	-3,883,358
Profit (loss) before tax	1,725,392	2,340,288	1,217,723
Net profit (loss)	1,675,660	2,306,926	1,183,455
Interest income	19,130,949	19,535,305	19,521,536

* 1 EUR = 61.5050 MKD, as of 31.12.2011.
** Administration costs include all operating expenses.
*** Provision items include: impairment losses of non-financial assets, provisions for off-balance sheet items and other provisions.
**** Presented on net basis.

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	683,950,739	575,051,211	108,899,528	0
Cooperative banks	/	/	/	/
Banking sector, total:	683,950,739	575,051,211	108,899,528	0

2011 DEVELOPMENTS IN THE BANKING SYSTEM OF THE REPUBLIC OF MOLDOVA

MACROECONOMIC ENVIRONMENT

According to the NBS data, in 2011 the GDP increased in real terms by 6.4 percent compared with 2010. It's worth mentioning that Moldova's growth model has undergone significant changes in 2011.

The main factors that have favored the GDP growth were the increased external demand for domestic products and the augmented disposable income of the population. Thus, the economic recovery of Moldova's main trade partners determined the upward evolution of exports, which increased by 28.6 percent, generating the maximum positive contribution to the GDP growth. Household consumption rose by 8.5 percent, while the government final consumption registered a 1.6 percent decrease. The increased domestic demand has generated a 19.3 percent rise in the imports annual growth rate. By categories of resources, positive developments were recorded in all sectors. Similar to 2010, the increase in gross value added of services-related branches had the largest contribution to GDP growth. The industry recorded a growth rate below the 2010 level, and constructions, despite the positive developments for the last two years, have not yet reached the level recorded before the economic crisis.

The labor market situation has stabilized during 2011. Thus, the economically active population increased by 1.8 percent, and the number of employed people rose by 2.6 percent compared to 2010.

In December 2011, the annual inflation rate was of 7.8 percent. The prices increment was mainly caused by increases in tariffs for utilities, in international oil prices, by higher domestic demand and higher remittances from abroad, being partially offset by the national currency appreciation against the U.S. dollar, by the significant increase in the production of certain agricultural crops and by reduced world food prices.

In 2011, Moldova's macroeconomic environment continued to be strongly influenced by developments in the external economic setting, given the considerable share of remittances in the household consumption funding sources and the large share of imports (especially of energy resources, oil and foodstuff products).

During 2011 the official nominal exchange rate of the national currency against the U.S. dollar appreciated by 3.6 percent and against the EUR – by 6.4 percent.

At the same time, the real effective exchange rate of the national currency (calculated as compared to December 2000) appreciated by 10.3 percent compared to the end of 2010. This change was driven by the effect of consumer prices developments and by the impact of the significant nominal depreciation of foreign trading partners' national currencies against the U.S. dollar (among the most significant being the devaluation of the Belarusian Ruble by 181.1 percent, Turkish Lira - by 22.8 percent, Polish Zloty- by 12.0 percent, Hungarian Forint – by 9.7 percent and the Russian Ruble – by 1.9 percent).

The exchange rate dynamics of the Moldovan Leu against the U.S. dollar in 2011 was mainly influenced by the shifts in the amount of liquidities on the domestic foreign exchange market, determined by incoming and outgoing foreign exchange flows, evolution of foreign currencies on external markets.”

DEVELOPMENT IN THE BANKING SYSTEM

During 2011 Tier I Capital reached the level of 7483.8 million lei and was increased by 756.9 million lei (11.3 percent) as compared to 2010. On December 31, 2011, Tier I capital of all banks was in compliance with the established minimum capital requirements, except BC "Universalbank" SA, which held Tier I capital at 39.2 million lei due to the registered losses.

Tier I capital increase was due to the income obtained during 2011 and performance of the share’s issuing by four banks in the amount of 147.0 million lei from the account of additional funds contributions of the underwriters of shares (B.C. "ProCredit Bank" S.A. –16.0 million lei, BC „Universalbank” SA - 10 million lei, BC "Moldindconbank" S.A. – 56.2 million lei and BCR Chişinău SA. have carried out the share’s issuing of the subordinated debt account in sum of 64.8 million lei).

However, 2 banks issued shares at the account of undistributed profit in sum of 479.6 million lei. (B.C. "VICTORIABANK" S.A. - 150.0 million lei, BC "Moldindconbank" S.A. - 329.6 million lei).

The average risk weighted capital adequacy shall be further maintained at a high level - 30.4 percent, which is higher by 0.1 percents in comparison with the last year.

Total assets of the banking system on December 31, 2011 were 47651.7 million lei, increasing by 5382.1 million lei (12.7 percent) as compared to December 31, 2010 from the account of liabilities increasing with 4620.4 million lei (13.2 percent) and equity capital by 761.7 million lei (10.5 percent).

Gross credit portfolio, during 2011 was increased by 4315.6 million lei (16.9 percent) and constituted 29813.5 million lei on December 31, 2011.

For the analyzed period, the absolute value of nonperformed credits was diminished by 201.2 million lei (5.9 percents) due to the account of expired credits, of classification more favorable of the granted credits and a higher reimbursement level. The share of nonperformed credits (substandard, doubtful and compromise) in total loans was diminished by 2.6 percentage points and constituted 10.7 percent on December 31, 2011, compared to the end of 2010. The share of nonperformed credits in total regulatory capital was diminished by 7.2 percents compared to the end of the last year and constituted 42.5 percents.

The largest share of loans from the total amount of the portfolio as for 31.12.2012 is for the industry in proportion of 55.6 percents, it is followed by loans offered to agriculture and food instustry in proportion of 13.5 percents, mortgage loans with 12.2 percents and loans for consumption with 6.7 percents. The structure of the loans portfolio has not changed in correspondande with the last month.

For 2011, the net income of the banking sector was 805.7 million lei. This is an increase with 617.8 million lei comparing to the period of 2010. This increase is due to the amount of the income related to interest with 489.8 million lei.

Assets return and equity capital return on December 31, 2011 reached the value of 1.8 percent and 10.6 percent, increasing with 1.3 percetage points and 7.9 percetage points.

The value of long term liquidity indicator (1st principle of liquidity) (assets with the term of reimbursment higher than 2 years over financial resources with potential of withdrawal higher than 2 years has to be lower or equal to 1) has constituted 0.7. This rule has been met by all the banks, exept BC „Universalbank" S.A.[21],which indicator had the value of 1.52.

The value of the current liquidity indicator as for the system (the 2nd principle of liquidity) (liquid assets in cash, deposist at the NBM, securities, interbanking loans with maturity of a month over total assets * 100% has to be higher or at least equal to 20 percents) constituted 33.2 percents. The proper level for this indicator has been met by the entire banking system, exept BC „Universalbank" with a level of 9.1 percents.

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

On December 31, 2011, the banking system in the Republic of Moldova was formed by National Bank of Moldova and 15 licensed banks.

Law No.548-XII as of July 21, 1995 establishes the composition of the National Bank, primary objective, its basic tasks, cooperation with state bodies and international cooperation.

The National Bank is exclusively responsible for the licensing, supervision and regulation of the financial institutions activity. For this purpose, the National Bank shall have the right to issue normative acts and undertake certain measures in order to perform powers and duties regulated by the acting legislation, to perform controls to financial institutions, to examine books, documents and their accounts and conditions in which the activity is carried out and to prescribe remedial measures or to apply sanctions, if the financial institution violated the national legislation or engaged in unsafe or unsound operations of the financial institution or any of its subsidiaries.

During the 2011 were operated certain amendments to the Law on Financial Institutions No.550-XII as of July 21, 1995 related to the ownership and participation shares in the bank's capital. Thus, was improved the legal framework which regulates the legislative relations to perform the transactions on the securities market with bank's shares.

In this respect, were stipulated expressly cases in the event that the transfer of a share from the bank's capital shall be performed with the written preliminary permission of the National Bank. Simultaneously, according to the modifications, was determined a more detailed procedure of the transfer of ownership of banking shares, being expressly provided transfers performed under a court decision. Also, the modifications provided explicit the invalidity of the banking shares' transfers performed without their preliminary approval by the National Bank of Moldova.

The National Bank of Moldova still perfected its normative acts with the purpose of bringing them in accordance with the new provisions of the acting legislation, recommendations of the Basel Committee on Banking Supervision,

21 As for February 15, 2012, National Bank of Moldova has withdrawn the license of BC „Universalbank" S.A

as well as the approximation with the Directives of the European Union. Prudential normative acts issued by the National Bank of Moldova are available on the official web site in English language in the compartment Legislation/Normative acts (www.bnm.md).

MAIN STRATEGIC OBJECTIVES OF THE BANKING AUTHORITY IN 2011

During 2011, the main objectives pursued by the National Bank of Moldova for the purpose of further development of the banking sector were: increasing the promotion of consolidation level of the banks which will be based on careful development of their activities, increasing the market discipline and the competitiveness level.

Strengthening the banking system was achieved by maintaining the requirements on absolute and relative size of the capital, as well as its capacity to cover risks related to each bank's activity. The implementation of the improved standards on capital assessment was promoted.

Prudent development of banking activities was supported by maintaining stringent criteria to bank's administrators and by increasing the capacity of the internal control systems of banks to determine and manage risks.

Increasing the market discipline and the competitiveness level was achieved by imposing sufficient disclosure of ownership structure of each bank, as well as strict compliance with the International Financial Reporting Standards related to the banking accounting operations and the accurate reflection of the balance sheet values' size.

National Bank of Moldova systematically assessed all development trends and changes taking place in the banking sector, aiming to prevent the emergence and development of system crisis in the situation of the country's macroeconomic, as well as the events that will be carried out within the economies of other countries and can affect the domestic banks, due reacting by the regulatory and supervisory methods for the purpose of promoting financial stability.

ACTIVITY OF THE BANKING SUPERVISORY AUTHORITY IN 2011

During 2011, a number of actions were undertaken to improve the strengthening of the domestic banking system. Thus, was continued the improving of the regulation and supervision of the banking activity.

According to the new amendments of the Accounting Law, starting with January 1, 2012, the licensed banks passed to the book-keeping in accordance with the requirements of International Financial Reporting Standards (IFRS). Thus, to provide a single reporting framework when applying the IFRS by the bank was analyzed the new FINREP, which the licensed banks will be obliged to submit to the National Bank of Moldova.

However, were modified prudential reports submitted to the National Bank of Moldova by the banks, taking into account the new requirements of the IFRS, as well as practice in the field of supervision the banks' activities.

In order to eliminate some discrepancies between financial and prudential reporting in the banking system, the Regulation on assets and conditional commitments classification expressed in a new wording, new provisions will encourage further development of a strict regulatory approach to credit risk assessment.

In order to comply with the amendments made to the Law on Financial Institutions in 2010, were improved the normative acts applied to banks. Thus, were established conditions for outsourcing the bank's activities/operations, requirements and procedure for obtaining permission for outsourcing the activities of material importance, the minimum content of the outsourcing contract, as well as requirements on the risk management and the control of outsourced activities/operations.

At the same time, was developed the new conditions for opening of branches, representatives and secondary offices of licensed banks from the Republic of Moldova, the procedure for preliminary approval for opening branches and representatives, for the notification of opening the secondary offices and the procedure for closing the respective subdivisions.

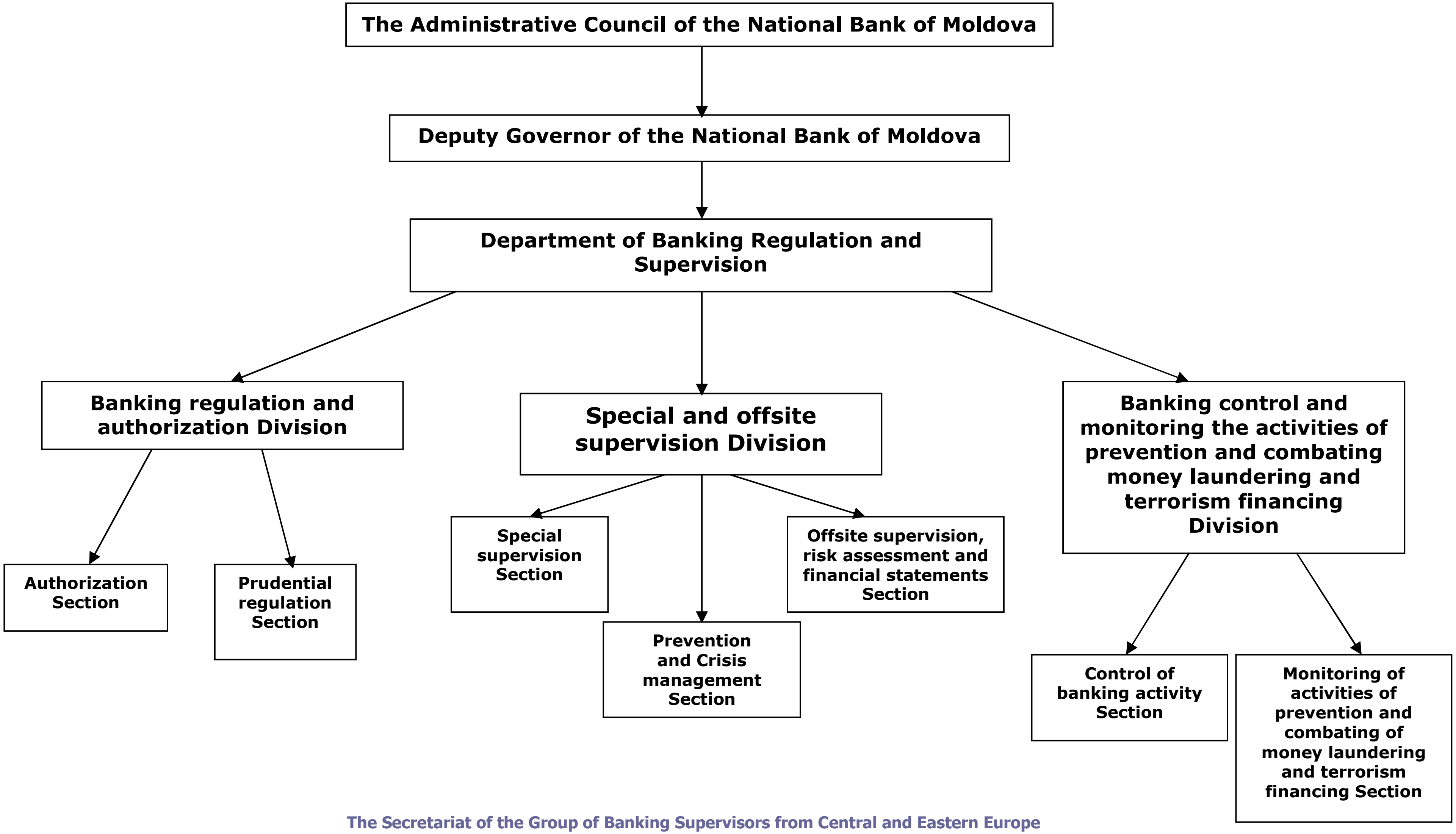
Were established requirements related to the possession and reflection in the banks' balance sheet of tangible assets transmitted into possession or acquired for credits reimbursement. These changes shall be related to the value at which such assets are to be reflected in the banks' balance sheets, their merchantability characteristics and the issuing of permission for holding the tangible assets transmitted into possession or acquired for credits reimbursement more than a year and other characteristics in accordance with the International Financial Reporting Standard 5.

For avoiding the bank involvement in excessive risks related to foreign currency-linked loans was established the limits on the size of bank's exposures to individuals, including individuals performing an entrepreneurial activity or other type of activity, in the amount of 30.0% of total regulatory capital, of which the total amount of net exposures, other than mortgage, shall not exceed 10.0%.

In order to minimize the risks related to the bank's exposures to its affiliated persons and taking into account these persons' possibility to influence the bank, were made modifications related to the establishment of tighter limits on bank exposures to its affiliated persons. Thus, the total amount of bank's exposures to its affiliated persons and/or groups of persons acting jointly with affiliated persons shall not exceed 20% of the size of the bank's Tier I capital.

Taking into account the specific of the domestic banking market, it was increased gradually the risk weighted capital adequacy ratio, starting with June 30, 2012, the ratio shall be at least 16.0%, starting with June 30, 2013 - at least 18.0% and starting with June 30, 2014 - at least 20.0%.

ORGANIZATIONAL STRUCTURE OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL COOPERATION OF THE BANKING SUPERVISORY AUTHORITY

During 2011, the National Bank of Moldova collaborated with a number of international authorities, such as the World Bank, the International Monetary Fund, the European the Bank for Reconstruction and Development and the Banking Supervisors from Central and Eastern Europe in order to provide information related to development of the domestic banking system.

Internationally, the National Bank of Moldova has concluded agreements with the banking supervisory bodies from 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, National Bank of Moldova negotiates the concluding of new agreements with the supervisory authorities from Germany, Italy, France and Austria.

During 2011, for the supervision and authorization purpose of the licensed banks, the National Bank of Moldova 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 various supervisory bodies in Moldova.

Internally, the National Bank of Moldova 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 field of preventing and combating money laundering and terrorist financing, the National Bank of Moldova cooperates with various state bodies in this field by informing and presenting the respective information to the enforcement bodies.

OTHER INFORMATION AND RELEVANT TRENDS IN 2011

During 2011, the National Bank of Moldova received technical assistance from the World Bank, the International Monetary Fund, the European Bank for Reconstruction and Development, Department of the Treasury of the United States of America related to the development of the domestic banking system.

During 2011 International Monetary Fund’s mission were on a working visit in the context of examining and improving the legal framework related to the ownership structure of financial market, with the final goal to increase transparency of the banking system by amending the legislation aimed to the bank shareholders.

Technical assistance from the International Monetary Fund in the field of legal framework' development for crises preparedness helped the National Bank of Moldova in becoming a signatory of the Memorandum of Understanding on Maintenance of Financial Stability.

As a result of technical assistance from World Bank related to performance and perception of the stress testing macroprudential model of the credit risk, the National Bank initiated the creation and implementation of the new stress testing model to adapt it to current macroeconomic conditions.

Department of the Treasury of the United States of America granted assistance to the National Bank of Moldova in the field on implementation the International Financial Reporting Standards, elaboration of the guidelines on the banking intervention process, techniques for performing on-site controls, modification to the manual regarding to on-site controls, special banking supervision and assessment nonperforming loans, determination of the systemically important financial institutions and early warning system.

With the support of the European Bank for Reconstruction and Development, the National Bank of Moldova received technical assistance from KPMG Czech Republic related to the assessment of the regulations to requirements on ownerships and substantial shares hold in the bank's capital, comparison of the existing procedures with the relevant EU legislation, with similar regulations used by central banks in the EU and USA

STATISTICAL TABLES

Number of financial institutions (at year-ends)

Type of financial institution	2009	2010	2011
Commercial banks	12	12	12
Branches of foreign credit institutions	3	3	3
Cooperative banks	-	-	-
Commercial banks	**15**	**15**	**15**

Ownership structure of banks on the basis of assets total (at year-ends)

Type of financial institution	2009	2010	2011
Public sector ownership	7.3	7.2	7.1
Other domestic ownership	47.9	50.3	42.7
Domestic ownership total	55.2	57.5	49.8
Foreign ownership	44.7	42.5	50.2
Financial institutions, total	**100.0**	**100.0**	**100.0**

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

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	50.30	70.12	0.1106
Branches of foreign credit institutions	16.35	16.35	0.89
Cooperative banks	-	-	

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

Type of financial institution	2009	2010	2011
Commercial banks	3.75	7.65	10.71
Branches of foreign credit institutions	-22.17	-19.45	14.67
Cooperative banks	-	-	-
Banking sector, total:	**-2.51**	**2.61**	**10.55**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	77.83	82.19	83.65
Branches of foreign credit institutions	22.17	17.81	16.35
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	2009	2010	2011
Cash	5.46	4.72	4.18
Due from banks and NBM, net	18.55	15.47	16.47
Net loans and financial leasing	50.69	55.17	58.21
Total securities, net	15.16	15.74	13.47
Other, net	10.14	8.90	7.67
Total assets	100	100	100
Liabilities	**2009**	**2010**	**2011**
Deposits by natural persons	41.23	43.00	43.39
Deposits by legal persons	20.06	23.07	22.06
Others	21.37	16.76	17.72
Shareholder capital	17.34	17.17	16.83
Total liabilities and shareholder capital	**100**	**100**	**100**

Capital adequacy ratio of banks

Type of financial institution	2009	2010	2011
Commercial banks	32.10*	30.00*	30.11*
Cooperative banks	-	-	-
Banking sector, total:**	12.8	13.2	13.6

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

Asset portfolio quality of the banking system (%)

Loan classification	2009	2010	2011
Standard	45.21	44.21	49.78
Supervised	38.41	42.47	39.49
Substandard	9.66	8.89	7.97
Doubtful	6.41	3.56	2.29
Bad	0.31	0.87	0.46
Classified total	**100**	**100**	**100**
Specific Reserves/Total Loans	9.73	8.55	6.96

The structure of deposits and loans in 2011 (%) (at year-end)

	Deposits		Loans
Households	63.36	Credits for agriculture / food industry	13.51
Government sector	0	Credits for real estate, construction and development	12.90
Corporate	32.21	Consumer credits	6.71
Other	4.43	Credits for energy and fuel industry	3.86
		Credits to banks	0.15
		Credits to Government	0.04
		Credits for industry / trade	53.90
		Credits for road construction and transportation	2.80
		Other credits	6.13
Total	**100.0**		**100.0**

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

P&L account	2009	2010	2011
Total interest income, inclusive:	223.34	220.50	268.67
interest income on credits and financial leasing	201.06	190.98	223.99
interest income from securities	16.22	26.37	37.32
interest income from other assets	6.06	3.15	7.05
Total non-interest income	87.58	97.39	114.92
Expenditures	**2009**	**2010**	**2011**
Total interest expenditure	147.70	97.96	116.17
Total non-interest expenditure	109.99	146.63	149.50
Provision for Loan Losses	63.58	61.63	64.47
Total profit (loss) before taxes and extraordinary gain (losses)	-10.36	11.69	53.46
Total net income	-9.79	11.67	53.44

As of December 31, 2011 1 EUR = 15.0737 lei

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	499.57	496.48	3.09	-
Cooperative banks	-	-	-	-
Banking sector, total:	**499.57**	**496.48**	**3.09**	**-**

As of December 31, 2011 1 EUR = 15.0737 lei

2011 DEVELOPMENTS IN THE MONTENEGRIN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Following negative trends throughout most of the economic sectors and a 5.7% decline in GDP in 2009, in 2010 Montenegro's economy recovered as predicted. Most of the available statistic indicators show that the trend in 2011 is similar to that of 2010. Growth of GDP in 2011 was mostly a result of the growth of tourism, trade, forestry, manufacturing industry and mining and quarrying.

Montenegro's economy remains vulnerable, in particular due to liquidity problems in the real economy, insufficient credit support and the increasing number of natural and legal persons with frozen accounts. Problems in metal industry are deepening and additionally complicating the situation in the industrial sector, threatening to affect the level of total economic activities in the following period.

The annual CPI **inflation** amounted to 2.8% in December 2011, while the average annual rate amounted to 3.1%. Inflation was levelled with that recorded in the euro area, while it was lower than the inflation in the EU. Annual **core inflation** rate in December 2011 amounted to 0.95%, being by 1.86 percentage points lower than total annual inflation. Throughout 2011, core inflation was lower than total inflation, being negative in the first two months.

Total revenues of the Budget and State Funds, as per preliminary data of the Ministry of Finance, amounted to EUR 1,342.7 million in 2011. In relation to 2010, budget revenues were lower by 2.3%, yet by 0.5% above the plan. Total Budget expenditures in 2011 amounted to EUR 1.429,8 million or 43.7% of the estimated GDP. In comparison with 2010, the Budget expenditures were lower by 0.6% and 2.1% above the plan. The Budget of Montenegro recorded a EUR 136.9 million deficit in 2011, or 4.2% of GDP.

The public debt of Montenegro at 2011 year-end, as per the Ministry of Finance's data, amounted to EUR 1,483.5 million or 45.3% of the estimated GDP for 2011. In relation to end-2010, public debt increased by 16.7%. This brings us to the conclusion that during the past period, the public debt growth trend was the major concern, while currently the most worrying are the level of the debt and the costs of borrowing, bearing in mind that further increase of public debt is expected in 2012. Total issued guarantees as at 2011 year-end amounted to EUR 380.8 million, so the total public debt amounted to 57.0% of GDP. Certain guarantees carry a high risk of being called or converted into public debt.

The number of **employed persons** in 2011 amounted to 163,082, thus being 0.8% higher than the average number of employees in the previous year. As per the Employment Agency's records, the number of registered **unemployed** persons averaged at 30,869 in 2011, which is 3.1% less than in the same period of the previous year. The unemployment rate, announced by the Employment Agency of Montenegro, in December 2011, amounted to 11.57%, which is 0.59 percentage points lower than in December 2010.

Monstat data show that an **average salary** in Montenegro in 2011 amounted to EUR 722, being 1% higher than in the previous year. An average salary without taxes and contributions totalled EUR 484, also showing the year-on-year increase of 1%.

In 2011, the downward trend in **current account** deficit, characteristic from the beginning of the crisis, continued. Current account deficit amounted to EUR 633.8 million or 19.4% of GDP or by 17% lower than in 2010. Therefore, in 2011, the export of goods increased by 33.6%, while at the same time import recorded a decelerated growth of 9.8%. Simultaneously, as a result of the travel-tourism revenues increase of 12%, the services account shows the increase in surplus of 29.3%, amounting to EUR 530.4 million (16.2% of GDP. The coverage of foreign trade deficit with surplus recorded in other accounts amounted to 51.5% showing an increase of 11.8 percentage points in relation to 2010.

Preliminary data show that the net **inflow of FDI** in 2011 amounted to EUR 389.1 million or 11.9%, which is by 29.5% lower than in 2010. In total FDI inflow, the share of equity investments was 69%, while the share of debt investments amounted to 26.8%. Unfavourable structure and the lack of greenfield investments in the production sector remain a major problem.

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

The banking system relatively stabilized in 2011. Banking operations were characterised by restrictive loan policy, as well as the sale or displacement of a part of loan portfolio to factoring companies or parent banks. These activities had a positive effect on the improvement of the quality of banks' loan portfolio also leading to significant changes of certain banks' market share in the structure of the banking sector. Decrease in the amount of non-performing assets was more intense in relation to the decrease in capital, leading to the increase in the solvency ratio from 15.85% at 2010 year-end to 16.51% or by 0.66 percentage points at 2011 year-end. At end-2011, total own funds of banks amounted to EUR 334.9 million and total risk weighted assets amounted to EUR 2,028.7 million.

Banks' total capital amounted to EUR 305.2 million as at 2011 year-end, but total capital declined as a result of incurred losses of EUR 5.7 million or 1.8% as compared to the previous year. Despite the fact that eight banks reported profit, high levels of loss in three banks led to the reported loss of EUR 3.2 million at the entire banking system level at 2011 year-end. Main reasons for such a high loss should be sought in the high costs of loan loss and high operating expenses of banks. Attention should be paid also to the fact that the loss is considerably lower in relation to 2010 (-EUR 81.7 million) and 2009 (-EUR 21.6 million).

Liquidity of the banking system was satisfactory in 2011.Due to the decline in the liquid assets of banks, the key liquidity indicators recorded a slight annual decline however they can be rated as satisfactory. Daily and ten-day liquidity indicators were above the prescribed minimum.

Total loans amounted to EUR 1,955.8 million at 2011 year- end, showing the year-on-year decline of 11.1%.[22]Observed by banks, three banks reported a decline, while eight banks reported growth in lending activity in 2011. The main reasons for the decline in lending activity were: sale and transferring of parts of loan portfolios of some systemic banks, defaults in payment of previously

22 If we were to exclude the displacement of loans into parent banks' and factoring companies' balance sheets, than the real decline in loans would amount between 2% and 3%.

granted loans, high dispersion of illiquidity in the real sector, inadequate maturity match of sources and placement of funds, high interest rates, still present high operating risk and, consequently precaution of banks.

With regard to the maturity structure of total loans, long-term loans accounted for 79.7% and short-term loans made up 20.3% thus continuing the increasing trend of long-term loans' share in total loans which were increased by 1.25 percentage points. The most important loan beneficiaries were private companies and natural persons (with credit cards) with the share of 90% in total loans granted in 2011 year-end. Loans granted to private companies amounted to EUR 926.1 million at 2011 year-end (47.3% of total loans), and loans granted to natural persons amounted to EUR 833.7 million (42.6% of total loans). Loans granted in foreign currency amounted to mere 2.3% of total loans.

Banks' total deposits amounted to EUR 1,817.7 million at 2011 year-end and they showed the year-on-year increase of 1.5%. Natural persons' deposits increased by almost 8.6%, confirming that the crisis of confidence is generally over. Corporate deposits increased by 6.2%, while the decline was recorded in the deposits of general government (33.7%), financial institutions (25.2%), non-profit organisations (4.3%) and in the deposits of the category "other" (19.0%). The most important banks' depositors were natural persons with the share of 56.9% and private companies with the share of 24.5%. Maturity structure of deposits was improved, since the share of demand deposits decreased from 40.9% (2010 year-end) to 39%. Deposits in EUR were dominant in currency structure, while deposits in other currencies made up 3.5% of total deposits.

Loan to deposit ratio at the system level was negative, amounting to EUR 138.7 million. The most evident negative relationship of loans and deposits was in trade, construction and services sectors, as well as in tourism and hotel management industries. Beside households, the most important net lenders at the aggregate level were financial and energy sectors.

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

Regulatory activities in the banking area were dominantly focused on further improvement of the secondary legislation in the banking area and their harmonisation with relevant EU regulations.

Within the Twinning Project: "Strengthening the Regulatory and Supervisory Capacity of the Financial Regulators", with the assistance of the Bulgarian National bank, the most important legal act which was passed was the Capital Adequacy Decision (OGM, 38/11) which includes guidelines for internal capital adequacy assessment process (ICAAP) and guidelines for supervisory review and evaluation process (SREP). The decision was passed in July 2011, and will come into force on 1st January 2012.

In October 2011, the Central bank passed:

1) General guidelines for cooperation with supervisors of other countries within the supervisory colleges;

2) General guidelines for supervisory review and evaluation process (SREP),
3) General guidelines for recognition of external credit assessment institutions (ECAI);

By passing the Capital Adequacy Decision and General guidelines for supervisory review and evaluation process (SREP), the CBCG's legislation is fully in compliance with Pillars I and II of the Basel Capital Accord, except regarding advanced approaches for calculating necessary capital for credit and operational risk.

In November 2011, the CBCG passed the Decision Amending the Decision on Minimum Standards for Bank Investment in Immovable Property and Fixed Assets (OGM 2/12), which exceeded the deadline for alienating assets that banks acquired as settling a debt deom debtors with problems in loan repayment.

In December 2011, the Central bank passed:

1) Decision on Public Disclosure of Information and Data by Banks (OGM 2/12), which harmonized CBCG's regulations with the Directive 2006/48/EC (Annex XII - Technical Criteria on Disclosure), thus implementing Pillar III of the Basel Capital Accord,
2) Decision Amending the Decision on Bank Reporting to the Central Bank pursuant to the Banking Law (OGM 2/12), which complied reporting forms on bank's own funds and on capital needed for risks with new Capital Adequacy Decision. This decision shall come into force as of 1 April 2012.
3) Decision Supplementing the Decision on Temporary Measures for Credit Risk Management in Banks (OGM 2/12), which established preventive supervision of banks' purchase or sell loan receivables by the Central Bank.
4) Decision Amending the Decision on Banking Ombudsman (OGM 2/12).

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2011

As key objectives of the Central Bank, supervision and regulation of the banking system aimed at fostering and maintaining sound banking system have been impleented in 2011 though the process of ongoing strenghtening of the prudential supervision and supervisory capacitiesm as well as through improving regulatory framework with a view to its compliance to operations at the international financial market through the implementation of Basel standards.

Through the integrated system of on-site and off-site inspections provided ongoing oversight and analysis of the banking sector and consequently, adequate correction measures were performed.

In carrying out its supervisory activities, special focus was put on comprehensiveness of risk assessment in banks, especially of credit risk which is dominating, as well as on the supervisory oversight of the capital adequacy assessment process in banks. Moreover, mechanisms and procedures necessary for successful implementation of prevention of money laudering and terrorism financing process have been intensified.

Intensive cooperation with regulatory and supervisory bodies of the remaining part of the financial system in Montenegro continued in 2011, as well as that with home supervisors of parent banks operating in Montenegro.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

Due to noticeable instability at external financial markets and risks recognized at the Montenegrin banking sector, the on-site inpections of banks and MFIs were intensified as well as ongoing monitoring of their operations on the basis of reports submitted to Central Bank.

In 2011, thirteen on-site inspections were performed, as well as two on-site inspections of MFIs. The inspections included all banks, paying special attention to systemic banks, some of which were subject to several on-site inspections of individual risk areas of operations.

Pursuant to Article 115 paragraph 2 of the Banking Law (OGM nos. 17/08 and 44/10), the irregularities in a bank's operations shall be considered:

1) inadequate managing of risks to which the bank is exposed in its operations;
2) bank's action (and/or failure to act) which is not in accordance with the law and regulations passed on the basis of the law;
3) applying unsafe or unsound banking practices.

The analysis of measures imposed agains banks and MFIs during the reporting period shows that the most common reasons for imposing measures to abovementioned financial institutions were inadequate managing of risks to which the bank is exposed in its operations, as well as a bank's action (and/or failure to act) which is not in accordance with the law and regulations passed on the basis of the law. Application of unsafe or unsound practices in banks' and MFIs operations was a basis for imposing measures only in several cases.

In most of measures imposed as orders, the Central Bank committed banks to classify assets into more risky group on the basis of exposures to credit risk. In many banks it was disclosed that the operations reffering to assuming credit risk were not separated from credit risk management operations.

Inadequate operational risk management was also the irregularity evident in banks' and MFI operations, and this irregularity was also materialized in many cases in the indaequte IT systems management. Inadequate management of other risks was not disclosed or it was at the neglectable level, which did not require imposing of measures.

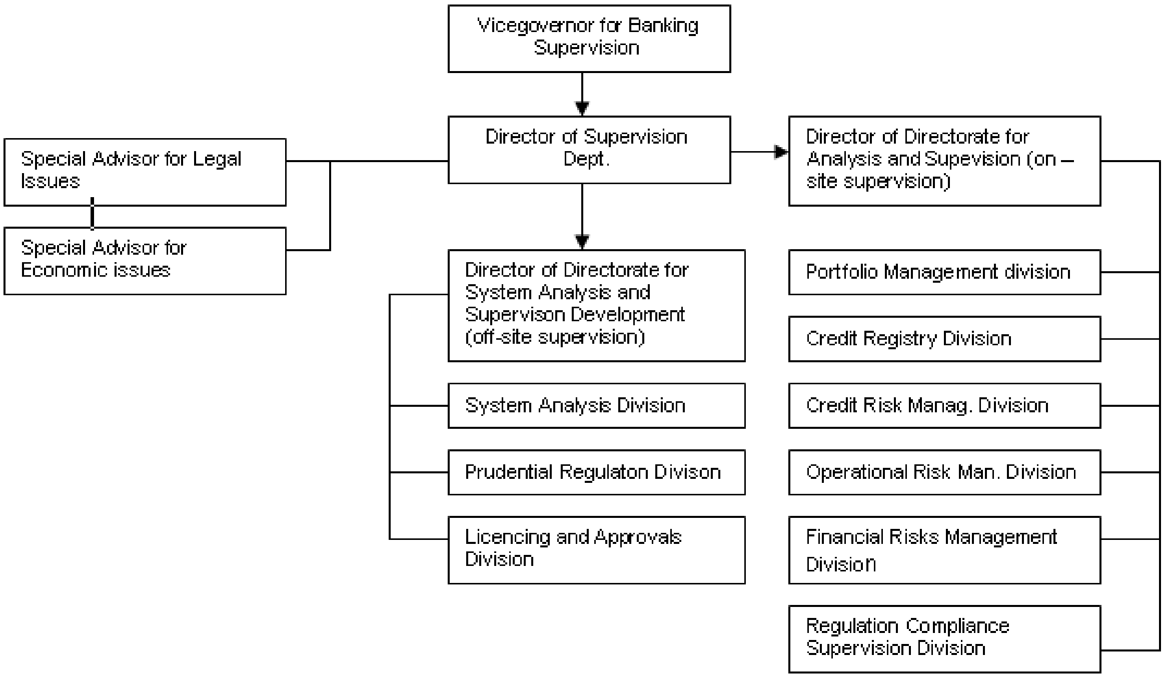
The analysis of banks' or MFI's action (and/or failure to act), which is not in accordance with the law and regulations passed on the basis of the law, has shown that these actions were dominantly materialized as: incorrect reporting to the Central Bank by banks and MFIs, incompliance of bank's and MFI's genreal acts to the law and the Central Bank's bylaws, inadequate functioning of internal control and internal audit systems and breaching regulations violating the rights of bank's and MFI' clients.

During 2011, as as result of findings from inspections and banks' exposures to risks, the CBCG introduced the following supervisory measures:

- **four written warnings**, of which one was directed to a MFI and three to banks;
- **A written agreement** bounding a bank to remove the irregularities in operation;
- **Four** orders imposing measures to banks to remove the irregularities found in its operations and
- **One resolution** on cancelling measures to a bank;

During 2011, one decision was issued for approval of issuing license to a MFI.

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

By continuing the Twinning project "Strengthening the Regulatory and Supervisory Capacities of the Financial Regulators" in the Central Bank of Montenegro, year 2011 was marked by intense activities related to the drafting and adopting the regulations aimed at strengthening the regulatory frame of banking supervision and capacities of CBCG. As a result of this programme, which officially ended in November 2011, CBCG made significant progress in the advancement of its legal frame and harmonisation of its regulations with the EU requirements, which was also confirmed through the European Commission Progress Reports.

The strategy of the **European Bank for Reconstruction and Development** for Montenegro, i.e. for the region in the near future, was discussed with its representatives on several occasions and regular contact was maintained with the representatives of the European Fund for Southeast Europe (EFSE), as well as with the representatives of rating agencies Moody's and Standard&Poor's.

CBCG also hosted one international meeting. Regional meeting of governors of five central banks of the Western Balkans: "Cooperation of Central Banks in the Region and Financial Stability" was held in Budva, 8-10 September 2011. Governors of CBCG, central banks of Albania, Bosnia and Herzegovina, Macedonia and Serbia, and their colleagues, discussed the economic situation in the region.

COOPERATION WITH OTHER SUPERVISORY BODIES IN MONTENEGRO

In addition to aforementioned Twinning project "Strengthening the Regulatory and Supervisory Capacities of the Financial Regulators", the project itself reinforced the collaboration among the financial sector supervision authorities through the signing of MoU on Cooperation and the Exchange of Information in the area of the Prevention on Money Laundering and Terrorist Financing between CBCG, Ministry of Finance, Administration for the Prevention of Money Laundering and Terrorist Financing, Securities and Exchange Commission and the Insurance Supervision Agency.

STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
Commercial banks	11	11	11
Branches of foreign credit institutions			
Cooperative banks			
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	2009	2010	2011
Public sector ownership	-	-	-
Other domestic ownership	13	12	10
Domestic ownership total	13	12	10
Foreign ownership	87	88	90
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2011
(at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	54	74	1,431
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total	**54**	**74**	**1,431**

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

Type of financial institution	2009	2010	2011
Commercial banks	-7.77	-27.27	-1.08
Branches of foreign credit institutions	-	-	-
Cooperative banks	-7.77	-27.27	-1.08
Banking sector, total:	**-7.77**	**-27.27**	**-1.08**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	97.57	98.04	98.45
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Other*	2.43	1.96	1.55
Banking sector, total	**100.0**	**100.0**	**100.0**

*MFIs

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

Assets	2009	2010	2011
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	**2009**	**2010**	**2011**
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)

Solvency ratio of financial institutions

Type of financial institution	2009	2010	2011
Banks	15.04	15.75	15.85
Cooperative banks	-	-	-
Banking sector, total	**15.04**	**15.75**	**15.85**

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

Asset classification	2009	2010	2011
Non financial sector			
- households	**n.a.**	**n.a.**	**n.a.**
- corporate	**n.a.**	**n.a.**	**n.a.**

The structure of deposits and loans of the banking sector in 2011 (%) (at year-end)

	Deposits	Loans
Households	56.87	42.6
Government sector	9.07	8.2
Corporate	25.17	47.7
Other (excluding banks)	8.89	1.5
Total	**100.0**	**100.0**

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

P&L account	2009	2010	2011
Interest income	236833	213892	195960
Interest expenses	-116465	-100191	-89797
Net interest income	120368	113701	106169
Net fee and commission income	32706	34431	30384
Other (not specified above) operating income (net)	9725	8972	84402
Gross income			
Administration costs	-101108	-101675	-106447
Depreciation			
Provisions	-80725	-136280	-116300
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	-19033	-80850	-1792
Net profit (loss)	**-21569**	**-81677**	**-3219**

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	334.9	284.2	61.5	0
Cooperative banks	-	-	-	-
Banking sector, total:	**334.9**	**284.2**	**61.5**	**0**

2011 DEVELOPMENTS IN THE POLISH BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2011 the Polish economy grew by 4.3%, which represents a higher rate than in 2010, i.e. 3.8%, but still lower than during the boom period of 2006-2007. The development was mainly stimulated by gross capital formation (mainly due to investments) and individual consumption, where the contribution to the economic growth totalled 2.0 pp. and 1.9 pp. respectively. The contribution of the net exports was also positive (0.7 pp.). In spite of the next wave of the debt crisis in the euro zone, the Polish economy performed quite well and in comparison to other European countries Poland turned out to be one of the leaders in terms of the economic growth.

A relatively high GDP dynamics did not positively affect the labour market. In the end of 2011 the unemployment rate totalled 10.0% (according to the Eurostat), which corresponds to 9.6% as for the end of 2010. The figure also remained higher 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 2011 wages in the national economy grew at a moderate rate of 5.4% in nominal terms, which gives 1.2% in real terms.

The Monetary Policy Council (RPP) originated a tightening cycle in 2011 and the NBP interest rates were increased 4 times, altogether by 100 bps (in January, April, May and June). As a consequence, the main refinancing rate was raised from its historic low of 3.5% to 4.5%. Nevertheless, the reserve requirement stayed at 3.5%. Consumer inflation in 2011 totalled 4.3%, which is much above the inflation target of the National Bank of Poland, i.e. 2.5%.

What still poses non-negligible problems to the Polish economy is the performance of the public finance. On the one hand, the government deficit as a percentage of the GDP (according to the Eurostat) in 2011 dropped to 5.1% of vs. 7.8% the year before. But on the other hand, the government debt in 2011 totalled 56.3% of the GDP, compared to 54.8% in 2010. 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 2011 the situation of the banking sector remained stable.

- The situation with respect to the capital base was good. The adverse impact of the market risk on the capital adequacy was effectively mitigated by solid capital buffers.
- The situation as regards the liquidity was stable, except for certain banks with significant currency mismatch in the balance sheet.

- It was market risk that proved to be most significant. It predominantly refers to high volatility of exchange rates that badly affected liquidity and profitability of certain banks.
- The level of non-performing loans increased valuably in 2009-2010 and still poses risks to the banking sector.
- In spite of the lasting recovery in the Polish economy, high volatility in the financial markets together with uncertainty regarding the performance of the euro represent major risk to the Polish banking sector. It is necessary that banks keep on monitoring potential threats and strengthen their liquidity and capital positions.

The importance of banking sector in Polish economy rises systematically and in 2011 relation of its banking sector assets to GDP amounted to 84.9% compared with 81.9% in 2010.

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

The Polish Financial Supervision Authority (the KNF) commenced its activities on September 19th 2006, i.e. the date when the Act on Financial Market Supervision of 21 July 2006 came into force. The KNF therefore supervises the banking sector, the capital market, the insurance industry, and pension funds. The KNF lays down rules safeguarding the stability of the entire financial sector. It systematically regulates, supervises and, where appropriate, issues penalties for non-compliance with these rules.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2011

One of the statutory objectives behind financial market supervision is to ensure protection of interests of market participants. The KNF's supervisory activities in this respect involve monitoring of market practices on an ongoing basis and intervention measures, focusing in particular on those areas of the regulated entities' operations which are exposed to the risk of law infringement or abuse of rights of non-professional market participants.

The KNF Office monitors market practices by exercising its supervisory powers, which allow it to demand information and clarifications directly from the regulated entities, and by obtaining relevant data on its own. The supervisory activities are undertaken as a reaction to problems identified on the market, and in response to requests for intervention, queries and complaints filed with the KNF.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

In 2011 the KNF continued bank monitoring, in particular, of their capitalisation and liquidity positions. As a result of these efforts risk of loss of liquidity did not arise at any bank. The supervisory authority reacted promptly to any signs of problems being experienced by international banking groups which could affect the condition of their subsidiaries operating in Poland, focusing on meetings with banks' management boards and contacts with their home country supervisory authorities. The KNF also monitored the possible impact of obligations imposed by the European Commission on banking groups in receipt of state aid. The Authority paid particular attention to transactions that could be rocognised as an unjustified transfers of funds to parent companies. In its cyclical monitoring activities no such transactions were identified. At the same time banks were recommended to retain profits as a measure of strengthening their capital positions.

In 2011, the Polish Financial Supervision Authority adopted resolutions: on detailed procedures for determining capital requirements for particular risks; on the requirements concerning identification, monitoring and control of concentration of exposures, including large exposures; on detailed rules and conditions for considering exposure when determining the observance of the exposure concentration limit and the large exposure limit.

In 2011, the Polish Financial Supervision Authority adopted the following amended recommendations:

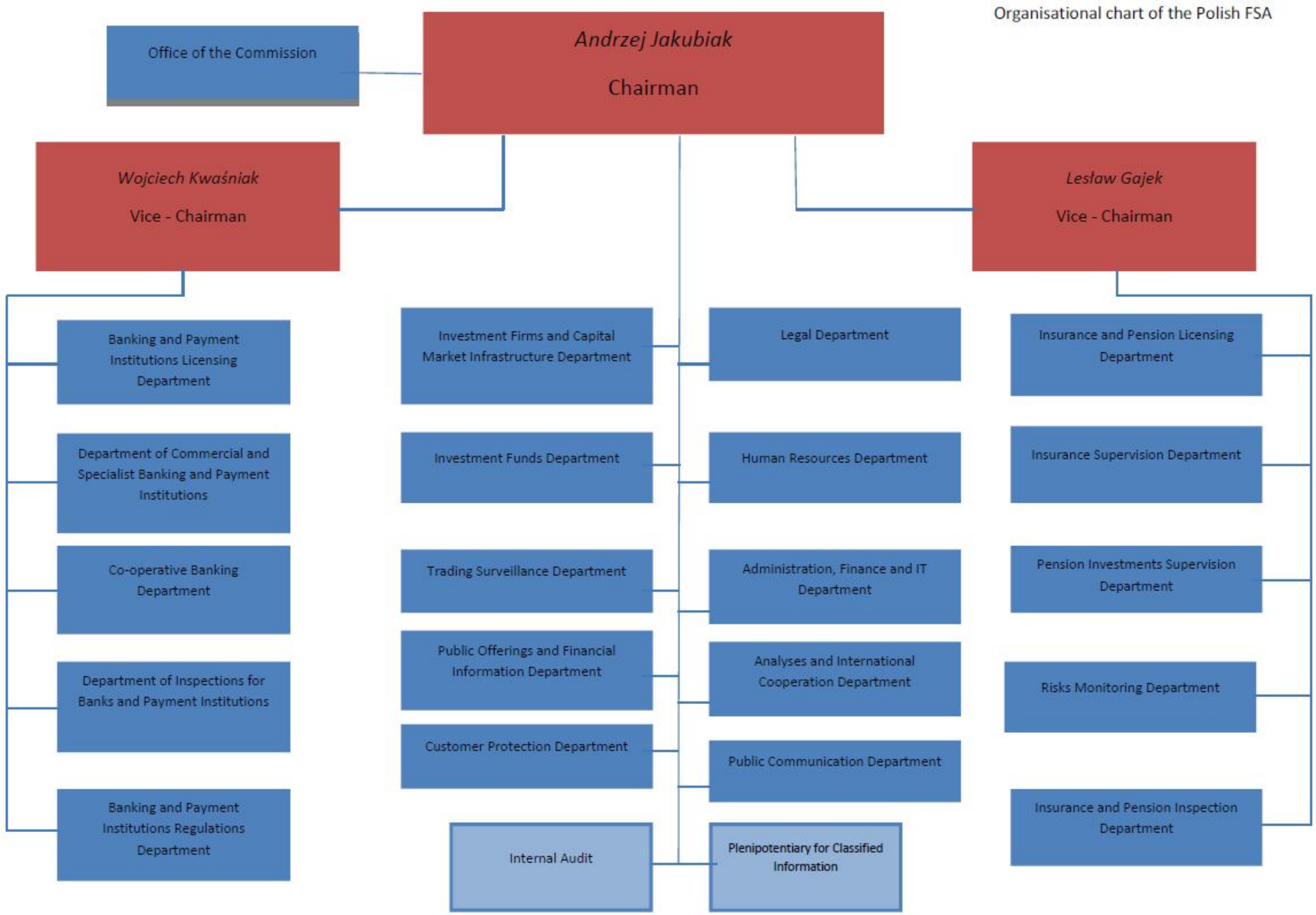
- Recommendation H concerning internal control at banks
  The need to amend Recommendation H resulted from implementing provisions concerning internal control at banks in the Banking Law. The amendment was also necessary because of the introduction of an obligation to create audit committees at domestic banks (excluding co-operative banks) in the Act on Qualified Auditors, Their Self-Government, Entities Qualified to Audit Financial Statements and on Public Supervision of 7 May 2009. The amended Recommendation H introduced regulations which would limit the number of cases where personal links exist between members of a bank's governing bodies.
- Recommendation S on good practices in the management of credit exposures financing real estate and secured by a mortgage
  The reasons listed for amending the recommendation included: the risk associated with a growing share of mortgage exposures, harmonisation of Recommendation S (II) and T concerning best practices in managing of credit risk arising from exposures to households, the need to protect the Polish banking sector against disruptions such as those suffered by a number of other economies in the CEE region, which were caused by unrestricted foreign-currency lending to households.
- Recommendation R concerning the rules for identification of impaired balance-sheet credit exposures, calculation of impairment losses on balance-sheet credit exposures and provisions for off-balance-sheet credit exposures
  Recommendation R is addressed to banks operating in Poland that prepare consolidated or separate financial statements in accordance with the IAS/IFRS. The guidelines contained in Recommendation R also apply to branches of a domestic bank and the bank's subsidiaries located outside of Poland, taking into account the legal environment of local markets and the

feasibility of ensuring compliance with the good practices set forth in the recommendation.

In 2011 the KNF carried out 64 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.

One of the important activities of the KNF in 2011 was banking sector stresstesting, based on bottom-up approach. The KNF also took part in EBA stress-test exercise.

ORGANIZATIONAL CHART OF THE SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AURHORITY

European Banking Authority (EBA)

2011 was the first year of operation of the European Banking Authority, which superseded the Committee of European Banking Supervisors (CEBS).

In 2011, six meetings of the Board of Supervisory Authorities of the EBA, composed of representatives of national supervisory authorities, were held. The KNF was represented during each meeting and participated in written procedures.

The EBA performs a wide range of tasks concerning the banking sector, payment institutions and electronic payments, as well as corporate governance, audits and financial reporting. The key decisions adopted by the Board of Supervisory Authorities of the EBA in 2011 concerned:

- stress-testing a sample of 90 European banks, including Poland’s PKO BP,
- preparing the EBA’s positions regarding documents setting out the framework of crisis management in the financial sector and a draft CRD IV package,
- adopting a recommendation concerning the establishment by banks of a temporary capital buffer with regard to the risk involved in government securities,
- drafting an implementing draft of the technical standard concerning supervisory reporting and presenting it for public review.

Cooperation in Supervisory Colleges

In 2011, the KNF Office participated in 32 meetings of supervisory colleges established by home-country regulators of banking groups which established subsidiaries in Poland (including one bank from outside the EU). As a result of the participation in the meetings, the KNF Office was able to:

- obtain information on the economic and financial assessment performed by the home-country regulators of particular financial groups,
- obtain information on the completed and planned supervisory measures towards particular financial groups,
- obtain information on plans relating to the improvement of the process of information exchange between the regulators,
- participate in the discussion on the manner of organisation and proceedings of supervisory college meetings and their role in the SREP process,
- perform a joint risk assessment of the supervised groups (assessment by the home-country and host-country regulator),
- obtain information on the role and scope of cooperation with the European Banking Authority (EBA).

Regular exchange of information on the financial situation of the parent bank and all other members of the group helps to precisely identify potential risks connected with the group's individual business areas, which may have an effect on the undertakings operating in Poland. Exchange of information and views between the host-country regulators helps to ensure constant monitoring of the quality of assets and the liquidity position, as well as the capital needs of banks forming part of a group.

COOPERATION WITH OTHER SUPERVISORY BODIES IN POLAND

The statutory tasks of the Polish Financial Supervision Authority include participation in drafting laws regulating supervision over the financial market. In this process, the KNF acts as an advisor and gives opinions to authorities and agencies which, under separate legal regulations, initiate and conduct legislative work. The KNF's activity includes in particular cooperation with the Minister of Finance as the minister competent for financial institutions, and the Minister of Labour and Social Policy as the minister competent for social security. In 2011, the Polish Financial Supervision Authority's experts were involved in drafting and advising on several dozen draft acts, acts assumptions and regulations.

The KNF 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	2009	2010	2011
Commercial banks	49	49	47
Branches of foreign credit institutions	18	21	19
Cooperative banks	576	576	574
Banking sector, total:	**643**	**646**	**640**

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

Type of financial institution	2009	2010	2011
Public sector ownership	20.8	21.5	22.2
Other domestic ownership	11.1	12.3	12.8
Domestic ownership total	31.9	33.8	35.0
Foreign ownership	68.1	66.2	65.0
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2011 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	32.97	44.31	684
Branches of foreign credit institutions	1.48	1.85	1 770
Cooperative banks	0.32	0.58	48
Banking sector, total:	**32.97**	**44.31**	**577**

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

Type of financial institution	2009	2010	2011
Commercial banks	8,58	10.19	12.87
Branches of foreign credit institutions			
Cooperative banks	9,31	10.46	11.81
Banking sector, total:	**8,62**	**10.21**	**12.80**

The Secretariat of the Group of Banking Supervisors from Central and Eastern Europe
1 Plac Powstańców Warszawy, 00-950 Warsaw, Poland
tel : +48 22 262 5650 fax: +48 22 262 5158
bscee@knf.gov.pl www.bscee.org

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	88.9	89.2	91.7
Branches of foreign credit institutions	5.3	4.7	2.2
Cooperative banks	5.8	6.1	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	2009	2010	2011
Financial sector	11,9	14,3	14.8
Nonfinancial sector	58,3	57,6	59.4
Government sector	18,7	18,0	16.8
Other	11,1	10,0	9.0
Liabilities	**2009**	**2010**	**2011**
Financial sector	25.5	27.4	28.0
Nonfinancial sector	54.8	54.5	55.1
Government sector	5.3	5.2	4.0
Capital	9.8	10.0	10.0
Other	14.4	13.0	13.0

Capital adequacy ratio of banks

Type of financial institution	2009	2010	2011
Commercial banks	13,3	13,9	13,1
Cooperative banks	13,4	13,2	13,4
Banking sector, total:	13,3	13,8	13,1

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

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

Asset classification	2009	2010	2011
Non financial sector	7.9	8.8	8.2
- households	**6.0**	**7.2**	**7.2**
- corporate	**11.6**	**12.4**	**10.3**

The structure of deposits and loans of the banking sector in 2011 (%) (at year-end)

	Deposits	Loans
Households	60.0	58.4
Government sector	6.2	9.3
Corporate	25.9	29.0
Other (excluding banks)	8.0	3.3
Total	**100.0**	**100.0**

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

P&L account	2009	2010	2011
Interest income	55 585	57 268	64 777
Interest expenses	29 209	26 368	29 812
Net interest income	26 376	30 899	34 966
Net fee and commission income	12 459	13 754	14 295
Other (not specified above) operating income (net)	11 466	8 799	8 489
Gross income	50 301	53 452	57 749
Administration costs	24 815	25 477	26 784
Depreciation	2 544	2 534	2 587
Provisions	1 275	690	1 354
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	11 556	10 545	7 479
Profit (loss) before tax	10 170	14 217	19 557
Net profit (loss)	8 278	11 420	15 665

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	23 348	20 799	2 472	76
Cooperative banks	1 756	1 646	109	0
Banking sector, total:	**25 103**	**22 445**	**2 582**	**76**

2011 DEVELOPMENTS IN THE ROMANIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Although economic growth was again in positive territory in 2011, GDP has remained below its potential. The annual inflation rate reached a historic low level at the end of 2011 (3.14%). Resumption and consolidation of disinflation trend were due to the prudent macroeconomic policies and gradual dissipation of the influence of adverse shocks. Real GDP growth returning in positive territory (2.5%), after two years of decline, was supported mainly by industry, whose gross added value increased by 5% due to reinvigorate domestic supply (more particular in terms of capital goods) and further to extension of the offer for export, albeit at a slower pace compared with 2010. General government deficit fell from 6.8% of GDP in 2010 to 5.2% of GDP in 2011. Public debt to GDP increased in 2011 by about 3 percentage points, reflecting not only the need for financing the budget deficit, but the State Treasury liquidity needs. Romania's commercial transactions showed a similar trend to the previous year - both exports and imports of goods are placed on an upward trajectory leading to improvement of the openness of the economy, up to 71.5% of GDP.

The new precautionary Stand-by Agreement signed in 2011 with the EU, the IMF and the World Bank, together with the commitments undertaken by the Romanian authorities under the national programmes, are seen as anchors for maintaining financial stability and furthering structural reforms in order to boost the economic growth potential.

DEVELOPMENT IN THE BANKING SYSTEM

The Romanian banking sector didn't experienced significant structural changes during 2011. Thus, the number of the domestically incorporated credit institutions remained unchanged, 33 entities, while the foreign banks branches number decreased from 9 to 8 entities. 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 (83%, including foreign banks branches).

The size of the balance sheet accounted for 82 billion euro at the end of December 2011, the largest concentration being in the five top banks (55% in term of assets, 52% of loans, 58% of deposits and 60% of government securities). The banking system assets in GDP amounted to 61% at December-end 2011 and non-government loans to 38% in GDP. Balance sheet composition is largely dominated by loans on the assets side but the exposure on government securities increased significantly due to changes in the banks investment orientation toward the less risky instruments. On the liabilities side, banks financial sources considerably rely on deposits attracted from customers and credit institutions.

Notwithstanding the developments in 2011, the Romanian banking system is still sound, with solvency and liquidity ratios well above domestic prudential requirements. The good level of leverage ratio pointed out an adequate capitalization relative to the size of the banks balance sheet. Moreover, the tier 1 ratio reveals the same good capitalization relative to risk-weighted assets against the background of banks aversion to risk, and good quality of capital.

Also, the trend of these ratios was supported by the growing capitalization through new cash contribution of the shareholders. At the end of 2011, the capital adequacy ratio stood at 14.87%, well above the regulatory threshold of 8%. Moreover, 31 from 33 banks, Romanian legal entities have solvency ratios above 10%. In this field, NBR took measures to strength the monitoring process: 20 banks report solvency ratio monthly instead of quarterly as rules provide; 15 has to reach and maintain a solvency ratio above the minimum regulatory level (10% instead 8%).

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 2011 and reached roughly 14.33% at December-end 2011. 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. The Romanian banking system reported losses at the end of December 2011, generated to a large extent by the increased credit risk provisions, and cost and availability of financial resources. ROA and ROE recorded negative values: - 0.2% and -2.6%.

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

One of the key objectives of the regulatory activity is to continue the harmonization process of national regulations with the guidelines and standards issued by CEBS/EBA.

As a result of the implementation of a variety of regulations and amendments to their provisions, the current prudential regulatory framework ensures:

(i) harmonisation with Basel II framework (Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions, as amended by, among others, Directive 2009/111/EC, Directive 2009/83/EC and Directive 2009/27/EC). The prudential regulatory framework was also amended in order to transpose Directive 2010/76/EU amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies (CRD III);

(ii) harmonisation with guidelines issued by the Committee of European Banking Supervisors (the "CEBS"), including in the field of prudential reporting system harmonised with COREP and FINREP requirements. As of 1 January 2011, CEBS responsibilities have been taken over by the European Banking

Authority (the "EBA") established by Regulation (EC) No. 1093/2010). Other areas in which the CEBS guidelines/Basel Committee documents were transposed into Romanian regulations refer to governance arrangements, remuneration policies, internal capital adequacy assessment process and management of significant risks, conditions for outsourcing of activities, assessment and validation of using advanced approaches for calculating capital requirements for credit and operational risks.

At the beginning of 2012, the Romanian banking system implemented IFRS as accounting basis and for the drawing up of individual financial statements. Also for the purpose of implementing IFRS, the NBR has issued the necessary notification of the change to banks along with a timetable and ensured the compliance with the regulation on bookkeeping rules in accordance with IFRS. NBR rules includes the main objectives regarding IFRS implementation to be observed by credit institutions and which stipulates credit institutions' obligation to: (i) shift to accounting record-keeping and to the preparation of individual financial statements in compliance with the IFRS, starting with financial year 2012; (ii) develop their own action plans regarding IFRS implementation; and (iii) inform the NBR periodically on the implementation of the measures set out under their action plans.

The financial reporting framework for prudential supervision purposes — FINREP — was updated considering both the effective implementation of IFRS starting with financial year 2012 and the compliance with CEBS revised guidelines. In the context of IFRS implementation as accounting basis at individual level, the prudential regulatory framework establishing the treatment of prudential filters that would preserve prudent bank solvency, provisions and reserves was finalised.

As regards the implementation of Basel III and CRD IV Directive (Capital Requirements Directive IV), Romania will follow the implementation timetable to be adopted after the negotiation of the CRD IV Directive and implementing regulation proposals at EU level. Currently, the forecasted date for entering into force of the CRD IV Directive and implementing regulation is 1 January 2013, with the same timetable for transitory provisions as Basel III.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2011

The difficult external environment poses a challenge to financial stability in Romania. Thus, 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 2011 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 harmonization process of national regulations with the guidelines and standards issued by CEBS/EBA was also one of the main directions of activity.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

Romania has continued to enjoy financial stability, despite the difficult global and domestic economic conditions manifest since the beginning of the international financial crisis. Risks to the banking sector were countered by the own efforts of credit institutions such as consolidation of solvency, provisioning and liquidity levels and NBR's measures addressing prudential regulation, supervision and adequate management of risks faced by the banking system. 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 the period from October 2008 - when the global financial crisis was deemed to become manifest in Romania – there were no bank failures in Romania and no need for support or bail-out measures from the central Government. The factors that ensured the stability of the Romanian banking system include (i) the measures taken by the NBR with a view to enhancing credit institutions' capacity to withstand economic shocks, (ii) the fulfilment of commitments taken by the parent banks of the nine leading subsidiaries in Romania aimed at providing ex ante additional capital and (iii) increased caution with respect to lending.

A beneficial contribution to safeguarding financial stability was the European Bank Coordination Initiative, under which the nine participating banks have fulfilled their aggregate commitments to maintain their exposure and ensure a capital adequacy ratio above 10% for their subsidiary in Romania.

According to the National Reform Programme for 2011-2013, one of the actions taken last year referred to the proper implementation of the relevant Financial Reporting Standards (IFRS) by the banking sector from 2012. In 2011, apart from the aspects specific to off-site supervision (assessment of banks’ financial standing and the risks they assume in pursuit of their business, monitoring the observance of prudential limits and regulations on a continuous basis), particular importance was attached to the monitoring of capital adequacy, liquidity and loan portfolio quality.

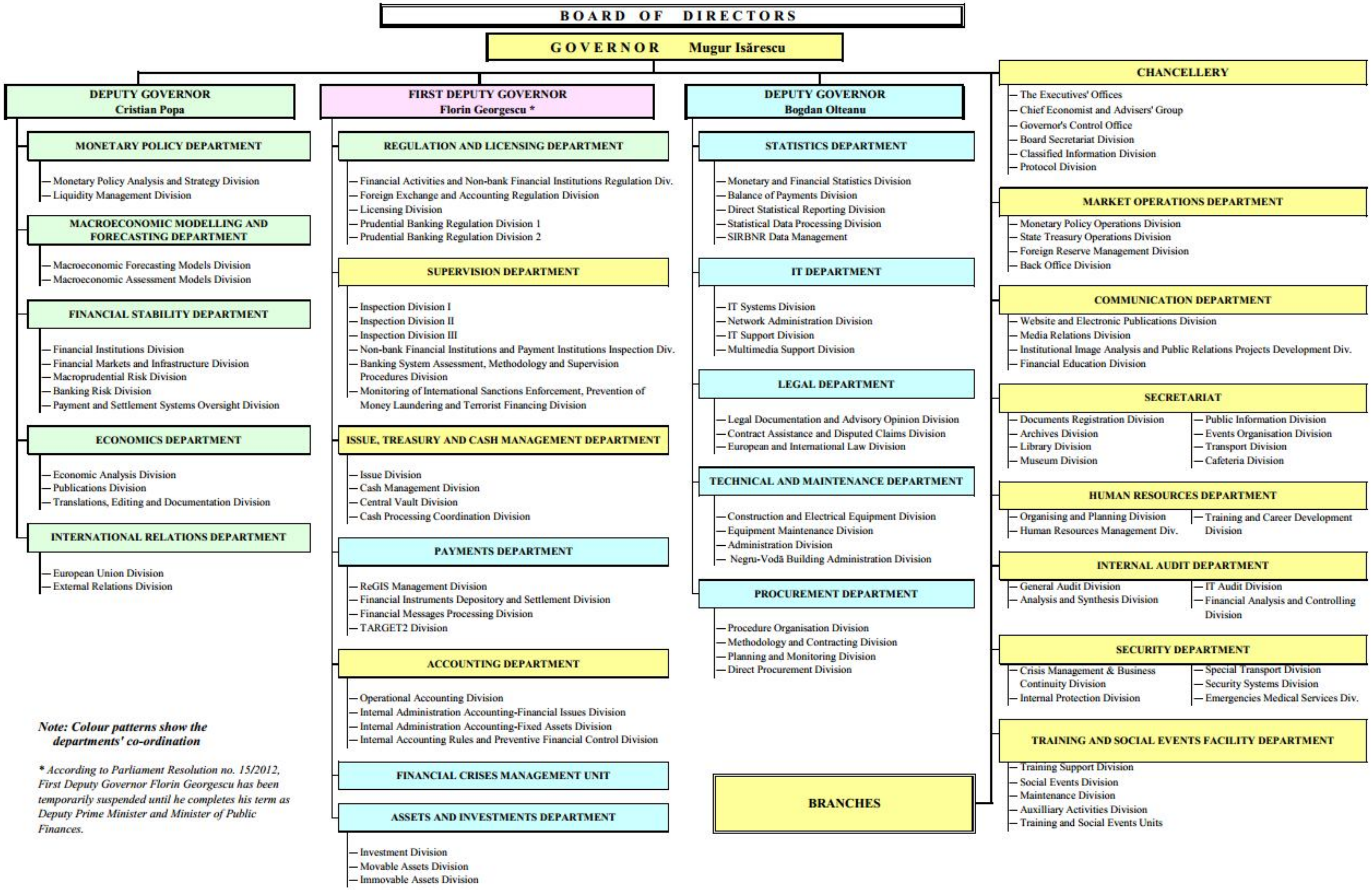
In the off-site monitoring process, during 2011 were carried out 55 actions to 20 banks and 6 branches of foreign banks, among them 5 having full objectives and other 50 with specific topic. On-site supervision consisted in the performance of 39 inspection actions on 28 banks and foreign bank branch, of which 28 were performed as overall assessment and other 11 were held on specific topic.

Liquidity on the interbank market was monitored on a daily basis so as to identify or prevent any deterioration. In prudential terms, credit institutions were required to have alternative financing plans, to provide regular analyses of liquidity under extreme market conditions, to maintain a certain level of reserves in the form of highly liquid assets or to diversify the resources attracted.

Furthermore, in order to prevent the worsening of capital adequacy ratio, as a result of larger losses due to non-performing loans, the supervisory authority stepped in to preserve a comfortable solvency level, by requesting that the structure and the level of capital are adequate to the risk profile specific to each credit institution, as well as to the context of the crisis. In this regard, a number of credit institutions supplemented own funds by raising share capital in cash, retaining the prior year's profit or by resorting to subordinate loans.

The changes to the supervisory process were in line with the latest developments in the regulatory framework and were aimed at limiting the impact of the crisis on the banking system and at maintaining its stability. The changes focused on strengthening the NBR's prerogatives in crisis management, especially as regards the special administration procedure, so as to ensure a fast and efficient intervention in the case of troubled banks.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF NBR

NBR signed 19 multilateral cooperation agreements for the supervision of international banking groups, i.e. EFG Eurobank (for the supervision of Bancpost), Piraeus Bank (Piraeus Bank România), Bayerische Landesbank (MKB Romexterra Bank), Crédit Agricole (Emporiki Bank), Unicredit SPA (UniCredit Ţiriac), Intesa SanPaolo (Intesa SanPaolo România), Erste Bank Group (Banca Comercială Română), Raiffeisen Zentralbank (Raiffeisen Bank), Volksbank (Volksbank România), Société Générale (BRD-Groupe Société Générale), ING (ING Bank), Banco Comercial Portugues (Millennium Bank), OTP (OTP Bank), Alpha Bank AE (Alpha Bank), Royal Bank of Scotland (RBS Bank România), National Bank of Greece (Banca Românească Grupul National Bank of Greece), Marfin Popular Bank (Marfin Bank), Bank of Cyprus (Bank of Cyprus), Porsche Bank AG (Porsche Bank România).

The presence and cooperation within supervisory colleges became of high importance for the activity of the National Bank of Romania as regards the analysis and assessment of risks at individual level, the more so as the decisions on the capital of banking groups and their entities has to be jointly approved by the supervisors. Discussions at the meetings held within these structures regarded the financial standing of the group and its subsidiaries, the risk profile of the group, its plans and strategy, the main findings of the supervisory activity, the coordination of supervision plans

The assessment has to take into consideration the financial standing and the risk profile, as well as the minimum capital requirements for each entity in the group, following the EBA guidelines on the manner in which cooperation should be achieved in the process of assessing risk and implementing the provisions of the Capital Requirement Directive concerning ICAAP (Internal Capital Adequacy Assessment Process) and SREP (Supervisory Review and Evaluation Process).

COOPERATION WITH OTHER SUPERVISORY BODIES IN ROMANIA

Ministry of Public Finance, National Securities Commission, National Bank of Romania, Insurance Supervisory Commission, Private Pension Supervision Commission agreed to co-operate in view to exchange and disseminate the information among them on financial stability and financial crisis management. As a result, the National Committee for Financial Stability was established (NCFS). During 2011, the members of the National Committee for Financial Stability examined the developments in the Romanian financial sector and the external environment, as well as the conclusions of the European Summit of 26 October 2011 and of the G20 meeting of 3-4 November 2011, including the main provisions of the draft directive on a common system of financial transaction tax in the European Union.

During the discussions, the participants underscored that stability of the Romanian financial sector was preserved, in spite of the escalating sovereign debt crisis in the euro area and the mixed signals on global economic recovery.

The Romanian authorities continued to strengthen action mechanisms, in line with the commitments under the agreements signed with international financial institutions, with a view to maintaining financial stability.

STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
Commercial banks	31	32	32
Branches of foreign credit institutions	10	9	8
Cooperative banks	1	1	1
Banking sector, total:	**42**	**42**	**41**

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

Type of financial institution	2009	2010	2011
Public sector ownership	7.3	7.4	8.2
Other domestic ownership	7.4	7.5	8.8
Domestic ownership total	14.7	14.9	17.0
Foreign ownership	85.3	85.1	83.0
Banking sector, total:	**100.0**	**100.0**	**100.0**

Concentration of asset by the type of financial institutions in 2011 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	44.6	59.5	1018
Branches of foreign credit institutions	86.3	96.6	3322
Cooperative banks	-	-	-
Banking sector, total:	**40.9**	**54.6**	**878**

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

Type of financial institution	2009	2010	2011
Commercial banks	3.01	-2.44	-3.79
Branches of foreign credit institutions	0.90	15.02	24.84
Cooperative banks	0.75	2.19	3.33
Banking sector, total:	**2.89**	**-1.73**	**-2.56**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	92.4	92.8	91.8
Branches of foreign credit institutions	7.4	7.0	8.0
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	2009	2010	2011
Financial sector	25.2	22.5	20.6
Nonfinancial sector	57.1	55.8	56.7
Government sector	14.1	18.1	19.0
Other	3.6	3.6	3.7
Liabilities	**2009**	**2010**	**2011**
Financial sector	25.2	22.5	20.6
Nonfinancial sector	57.1	55.8	56.7
Government sector	14.1	18.1	19.0
Capital	3.6	3.6	3.7
Other	25.2	22.5	20.6

Capital adequacy ratio of banks

Type of financial institution	2009**	2010**	2011**
Commercial banks	14.6	15.0	14.8
Cooperative banks	31.4	32.4	32.8
Banking sector, total:	**14.7**	**15.0**	**14.9**

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

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

Asset classification	2009	2010	2011
Non financial sector	7.9	11.9	14.3
- households	**7.7**	**10.0**	**11.3**
- corporate	**8.0**	**13.6**	**16.9**

The structure of deposits and loans of the banking sector in 2011 (%) (at year-end)

	Deposits	Loans
Households	60.2	35.5
Government sector	0.0	24.1
Corporate	33.3	39.2
Other (excluding banks)	6.5	1.2
Total	**100.0**	**100.0**

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

P&L account	2009	2010	2011
Interest income	30,542.2	26,723.7	26,142.1
Interest expenses	19,721.5	12,154.7	11,869.8
Net interest income	10,820.7	14,569.0	14,272.3
Net fee and commission income	5,112.9	3,965.3	4,117.3
Other (not specified above) operating income (net)	8,604.4	5,504.5	4,634.2
Gross income	**24,538.0**	**24,038.8**	**23,023.8**
Administration costs	14,675.9	14,535.0	14,491.7
Depreciation	1,000.5	1,054.5	1,114.2
Provisions	7,610.7	8,616.1	7,827.5
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	**1,250.9**	**-166.8**	**-409.6**
Net profit (loss)	**815.9**	**-516.4**	**-777.3**

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	7,155.3	5,764.8	1,390.5	-
Cooperative banks	54.7	42.5	12.2	-
Banking sector, total:	**7,210.0**	**5,807.3**	**1,402.7**	-

Rate of exchange: 4.3197 RON/EUR

2011 DEVELOPMENTS IN THE RUSSIAN BANKING SYSTEM

MACROECONOMIC SITUATION IN RUSSIA

In 2011, the Russian economy developed under favorable external conditions and increased internal demand. Production of the goods and services reached the level of 2008. The Federal budget in 2011 was balanced with surplus, and the inflation rate was record low (6.1%) in the recent Russian history. However considerable net private capital outflow ($80.5 billion) slowed down development of positive tendencies in the Russian economy.

Russia's international reserves grew by $19.3 billion to $498.6 billion as of January 1, 2012. Foreign debt rose by $56.2 billion in 2010 and totalled $545.2 billion in early 2012. The debt burden on the country was not critical according to internationally recognised criteria: foreign debt amounted to 29.4% of GDP in 2011 (32.9% of GDP in 2010).

In 2011, GDP growth was 4.3% (the same as in 2010).

In 2011, employment rose in comparison with 2010 and virtually reached the 2008 level. Unemployment reduced markedly (from 7.2% of the economically active population at the end of December, 2010 to 6.1% at the end of December, 2011).

Over 2011 gross fixed capital formation grew by 6.1%.

The real wage growth improved the labour market and expanded the consumer lending contributed to high consumer demand. In 2011, household final consumption rose by 6.8%.

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

Stable situation in the Russian economy predetermined positive dynamics of banking sector in 2011. The ratio of banking sector assets to GDP grew from 74.8 to 76.3% over the year. The ratio of banking sector capital to GDP fell by 0.9 percentage points to 9.6%.

As in the previous years, the principal source of funding for credit institutions in 2011 was household deposits: their share remained unchanged in the relation to GDP (21,7%). The ratio of deposits raised from non-financial organisations to GDP increased by 2.0 percentage points to 15.3%.

In 2011, as the year before, loans prevailed in the structure of banking sector assets. The total loans to GDP ratio rose by 3.6 percentage points to 52.6%. The ratio of loans to non-financial organisations and individuals to GDP was up by 2.4 percentage points to 42.6%.

LEGISLATIVE AND INSTITUTIONAL FRAMEWORKS FOR THE ACTIVITY OF CREDIT INSTITUTIONS AND BANKING SUPERVISION, MAIN CHANGES. SUPERVISORY AUTHORITY'S LEGAL COMPETENCE

According to the 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 to protect the interests of creditors and depositors. To this end the Bank of Russia supervises, on a permanent base, compliance by credit institutions and banking groups with banking legislation, laws on counteraction of money laundering and terrorist financing, Bank of Russia's regulations and required prudential ratios.

Pursuant to the Bank of Russia Law, to ensure the soundness of credit institutions, the Bank of Russia may establish the following prudential standards (also for the banking groups):

- maximum amount of property (nonmonetary) contributions to a credit institution's charter capital, as well as the list of types of property in nonmonetary form that may be contributed to a bank's capital;
- maximum risk per borrower or group of connected borrowers;
- maximum amount of major credit risks;
- lending institutions' liquidity standards;
- capital adequacy standards;
- amounts of currency, interest-rate and other financial risks;
- minimum amount of provisions;
- standards for a lending institution's use of its capital to acquire shares (interest) in other legal entities;
- the maximum amount of loans, bank guarantees and sureties granted by a credit institution (banking group) to its participants (shareholders).

The Bank of Russia establishes the methodology for determining a credit institution's capital, assets, liabilities and amount of risk on assets for each standard, taking into account international standards and consultations with credit institutions and banking associations. The Bank of Russia is empowered to differentiate standards and methods for calculating respective indicators according to types of credit institutions.

In order to exercise its regulatory and supervisory functions, the Bank of Russia conducts examinations of credit institutions (their branches), sends them binding orders to eliminate violations that have been revealed in their operations, and applies the sanctions specified in the Bank of Russia Law.

In cases of a credit institution's violation of federal laws or the Bank of Russia's regulations and orders, failure to provide information, or provision of incomplete or inaccurate information, the Bank of Russia has the power to demand that a credit institution eliminates the identified violations, to impose a fine of up to 0.1 percent of minimum charter capital, or to bar the credit institution from engaging in certain operations for a period of up to six months.

The Bank of Russia has the power to revoke a credit institution's banking license on grounds stipulated in the Federal Law on Banks and Banking Activities. The procedures for revoking a banking license are established in the Bank of Russia regulations.

Also, 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.

The Russian Federation banking legislation (including the Bank of Russia's regulations) in the area of banking supervision is being changed in order to maintain its effectiveness in light of the development of the national banking system and regulatory practices, taking into account international banking supervision practice. Pursuant to Article 77 of the Bank of Russia Law, the Bank of Russia cooperates with credit institutions and their associations, and holds consultations with them prior to adopting the most important regulatory decisions. To ensure the orderly development of the legislative base, the Russian Federation Government and the Bank of Russia approved the Strategy of Development of the Russian Federation Banking Sector for 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[23] 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 disclosure 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).

In 2011, the Bank of Russia started setting out methodical recommendations on implementing in supervisory purposes the internal ratings-based approach to evaluate borrowers' credit risks (the IRB-approach within the framework of Pillar I «Minimum Capital Requirements», Basel II).

Within the framework of implementing the Pillar II «Supervisory Review Process», Basel II the Bank of Russia issued the document on development and application of internal capital adequacy assessment procedures at credit institutions.

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 2011

In 2011, principal efforts to improve banking supervision focused on developing risk-based approaches to evaluate credit institutions' soundness and supervisory arrangements for protecting the interests of depositors and creditors and maintaining the stability of the banking sector.

From the viewpoint of risk-based approaches the Bank of Russia analyzed all substantial aspects of credit institutions' activity, including the economic

23 "International Convergence of Capital Measurement and Capital Standards. A Revised Framework. Comprehensive Version", Basel Committee on Banking Supervision, Basel, June 2006.

nature of bank's operations, risk exposure, liquidity position and quality of risk management and internal controls.

Efforts were taken to intensify the supervision of the largest banks of federal and regional importance entering in the so-called «second line» of supervision.

Special attention was paid to increased transparency of credit institutions, the adequate recording of risk exposure in their financial statements.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

In 2011, 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.

The important lines of supervision were early identification of negative trends in bank operations and assessment of prospects for their resolving by bank owners and managers. The area of pricing concern was evaluation of the quality of bank assets, essentially credit portfolios.

Another line of supervisory activity was monitoring the securities transactions of banks. The supervisors studied the consequences of potential securities depreciation, the quality of market risk management and stress-tests performed by banks.

In order to improve banking supervision taking into account lessons of the world financial crisis the Bank of Russia made decisions based on more conservative risk assessment, higher requirements on capital adequacy and transparency of Russian banks. Since October 01, 2011 raised requirements on banks' risks coverage came into force, these requirements were related to nontransparent transactions, nontransparent counteragents and transactions with nontransparent financial results.

According to the Strategy of Development of the Russian Federation Banking Sector for the period up to 2015 year one of the goals of the Bank of Russia is implementation in banking supervision of approaches of Basel Committee on Banking Supervision "International Convergence of Capital Measurement and Capital Standards" (Basel II). Within the scope of Basel II the corresponding work on development of methodological recommendations on advanced approaches in credit risks assessment based on interbank ratings was made (IRB approach, Pillar 1 "Minimum Capital Requirements" of Basel II).

Within implementation of Pillar 2 "Supervisory Review Process" of Basel II the document on development and implementation of internal procedures on assessment of capital adequacy ratio was developed and brought to credit institutions' notice. This document contains recommendations on banking risks management and organization of control procedures performed by management of banks on capital adequacy and risk exposures. The Bank of Russia recommended that credit institutions, particularly largest ones, should voluntarily develop and implement internal procedures on capital adequacy.

In order to bring Russian practice of consolidated supervision closer to international practice the Bank of Russia prepared special regulations related to issues of consolidated supervision arrangement.

For wider use of IFRS by credit institutions and banking groups the Bank of Russia issued new requirement on solo and consolidated reporting prepared according to IFRS.

ORGANIZATIONAL STRUCTURE OF BANKING REGULATION AND SUPERVISION IN RUSSIA

The Supervisory Authority of the Bank of Russia head office includes the Banking Supervision Department, Banking Regulation 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 supervision within the framework of the entire supervisory cycle: from the licensing of credit institutions, establishment of regulatory requirements, the exercise of on-going supervision of their activities and the conduct of on-site inspections to financial rehabilitation of credit institutions and implementation of measures, if necessary, to liquidate financially unviable credit institutions.

The supervisory divisions are 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 supervision policies.

The Bank of Russia carries out its banking supervision policies through its regional offices in the constituent entities of the Russian Federation (national banks or regional branches). As of January 1, 2012, there were 20 national banks and 59 regional branches operating in the Bank of Russia system.

INTERNATIONAL ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

In 2011, the Bank of Russia continued to take part in the activities of the Basel Committee on Banking Supervision (BCBS) and its working groups and sub-groups on the Core Principles, Macroprudential Supervision, Standards Implementation (on operational risk, validation and supervisory practices), Policy Development (on capital definition and capital monitoring, securitisation and external ratings, risk management and risk modelling, liquidity risk and trading portfolio risk), and also the Accounting Task Force.

Since the second quarter of 2011, the Bank of Russia has been participating in calculating capital adequacy, leverage and liquidity indicators stipulated in the BCBS documents (Basel III)[24] as part of Quantitative Impact Study conducted by the BCBS working group (on a six-month basis), first of all, within the framework of interaction with Russian credit institutions, which make respective calculations. Building on its experience, the Bank of Russia is engaged

[24] Basel III: International Framework for Liquidity Risk Measurement, Standards and Monitoring" and "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems".

in developing approaches towards the determination of indicators, drafting reporting forms and procedures to monitor a broader range of credit institutions.

In 2011, the Bank of Russia continued cooperation as part of BCBS regional groups. In particular, jointly with the Financial Stability Institute of the Bank for International Settlements (Switzerland), the Bank of Russia arranged a high-level meeting in May 2011 in St Petersburg with the participation of the heads of central banks and banking supervisors of the BCBS Group of Banking Supervisors from Central and Eastern Europe and the Regional Group on Banking Supervision of Trans-Caucasia, Central Asia and the Russian Federation to discuss the topical issues of enhancing banking regulation and strengthening financial stability.

Meetings were also held at the Bank of Russia with World Bank representatives as part of a World Bank study of the impact of banking regulation on mitigating/exacerbating of the consequences of the global financial crisis (June 2011).

With regard to protecting financial service users and raising financial literacy, the Bank of Russia is participating in the project of the Ministry of Finance of the Russian Federation and the International Bank for Reconstruction and Development on Enhancing Household Financial Literacy and Developing Financial Education in Russia.

In March 2011, the Bank of Russia completed, jointly with the Eurosystem comprising the European Central Bank and national (central banks) of European countries, the implementation of the Programme of Cooperation in Banking Supervision and Internal Audit for 2008-2011, which had been financed by the European Union. The Bank of Russia held a wrap-up workshop involving representatives of ministries and agencies, the banking community, the European Commission, the European Central Bank and the Eurosystem (March 2011, Moscow).

In November 2011, the Bank of Russia purchased an annual subscription for 300 employees of its head office and regional offices for the FSI Connect distance learning programme whose 53 courses were translated into Russian and integrated into the computer-based learning programme as part of the Memorandum of Understanding between the Bank for International Settlements and the Bank of Russia.

The Bank of Russia attaches great importance to interaction and data exchange with foreign banking supervisors. It has signed 34 agreements of cooperation (memoranda of understanding) with the banking supervisory authorities of foreign states. In 2011, the Bank of Russia signed memoranda of understanding with the Commission de Surveillance du Secteur Financier of Luxembourg and the Financial Market Supervisory Authority of Liechtenstein.

In 2011, the Bank of Russia held meetings on the current issues of banking regulation and supervision with the supervisory authorities of Austria, Great Britain, Germany, Italy and China.

In particular, the Bank of Russia organised the fourth joint workshop with the National Bank and the Financial Market Authority of Austria on "Banking Supervision and Financial Stability" (April 2011, Moscow). The workshop assessed and studied the stability of the Russian and Austrian banking systems.

High-level meetings were held in January, July and October 2011 as part of cooperation between the Bank of Russia and the Federal Financial Supervisory Authority of Germany (BaFin) to discuss the pressing problems of bilateral cooperation in banking regulation and supervision.

To coordinate the activities of authorities supervising banking groups' cross-border establishments, the Bank of Russia cooperates with foreign supervisors in multilateral colleges. In 2011, Bank of Russia representatives took part in the supervisory colleges for the OTP banking group (Hungary) and the HSBC banking group (Great Britain).

In 2011, the Bank of Russia had discussions with the European Banking Authority, and with the EU banking supervisors on the consistency of Russian legislation and the European confidentiality standards relating to treatment of information received from foreign banking supervisors, to see if the Bank of Russia had a role to play in supervisory colleges organised by the EU supervisors.

In 2011, the Subgroup on Banks and Financial Services continued its work under the aegis of the German-Russian Strategic Working Group on Economy and Finance. It discussed the financing of energy-efficiency and energy-saving projects, the Basel III implementation and the development of payment systems (June 2011, Nizhny Novgorod), and also a draft law on the central depository, legislation on insider information in Russia and Germany, the development of national payment systems and the National Payment Council (November 2011, Bonn, Germany).

In compliance with the programme of professional training for the personnel of central (national) banks of the EurAsEC member states, in 2011 the Bank of Russia provided in-house training for the National Bank of Belarus and the National Bank of Kazakhstan on "Financial Stability Indicators" (September 2011) and the National Bank of Belarus on "Off-site Supervisory Practices. Analysing a Bank's Financial Standing" (December 2011).

COOPERATION WITH OTHER SUPERVISORY BODIES

In 2011, 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 Anti-Monopoly Service, the Federal Tax Service, the Federal Customs Service, Federal Treasury, Pension Fund of Russia and other federal agencies.

STATISTICAL TABLES

Number of financial institutions (at year-ends, %)

Type of financial institution	2009	2010	2011
Banks	1007	955	922
Non-bank credit institutions	51	57	56
Banking sector total	**1058**	**1012**	**978**

Share in Aggregate Banking Sector Registered Authorized Capital (%) (at year-ends)

Type of financial institution	2009	2010	2011
Russian credit institutions including:	78,8	75,9	77,1
- public sector ownership	32,8	29,5	28,7
- other domestic ownership	46,0	46,4	48,4
Foreign-controlled banks (banks with non-resident interest in excess of 50%)	21,2	24,1	22,9
Banking sector total	**100,0**	**100,0**	**100,0**

Share in Aggregate Banking Sector Assets (at year-ends, %)

Type of financial institution	2009	2010	2011
Russian credit institutions including:	81,7	82,0	83,1
- credit institutions controlled by state	40,4	41,0	42,6
- credit institutions controlled by residents	41,4	41,0	40,5
Foreign-controlled banks (banks with non-resident interest in excess of 50 %)	18,3	18,0	16,9
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)		
	2009	2010	2011	2009	2010	2011
Banks	41,9	41,8	43,3	48,1	47,9	41,9
Non-bank credit institutions	87,3	86,2	85,7	90,1	89,9	87,3
Banking sector total	41,7	41,6	43,2	47,9	47,7	41,7

Return on Assets (ROA) of credit institutions
(at year-ends, %)

Type of financial institution	2009	2010	2011
Banks	0,7	1,9	2,4
Non-bank credit institutions	2,2	2,2	3,1
Banking sector total	**0,7**	**1,9**	**2,4**

Return on Capital (ROE) of credit institutions*
(at year-ends, %)

Type of financial institution	2009	2010	2011
Banks	4,8	12,5	17,6
Non-bank credit institutions	50,8	31,2	48,7
Banking sector total	4,9	12,5	17,6

*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	2009	2010	2011
Banks	99,64	99,61	99,57
Non-bank credit institutions	0,36	0,39	0,43
Banking sector total	**100,00**	**100,00**	**100,00**

Structure of Credit Institutions' Assets
(at year-ends, %)

	Type of financial institution	2009	2010	2011
1.	Money, precious metals and gemstones	2,7	2,7	2,9
2.	Account with the Bank of Russia	6,0	5,4	4,2
3.	Correspondent accounts with banks	2,9	2,5	2,4
4.	Securities acquired by banks	14,6	17,2	14,9
	of which:			
4.1.	Russian Federation sovereign debt securities	2,6	3,5	3,6
5.	Loans	67,5	65,6	69,0
6.	Other assets	6,3	6,6	6,5
	Total assets	**100,0**	**100,0**	**100,0**

Structure of Credit Institutions' Liabilities
(at year-ends, %)

	Type of financial institution	2009	2010	2011
1.	Banks' funds and profits	12,8	12,8	11,9
2.	Loans received by banks from the Bank of Russia	4,8	1,0	2,9
3.	Bank accounts	0,9	0,8	0,8
4.	Loans, deposits and other funds received from other banks - total	10,6	11,1	11,0
5.	Clients funds	58,2	62,4	62,7
	of which:			
5.1.	Deposits of legal entities	32,5	32,9	33,6
5.2.	Individuals deposits	25,4	29,0	28,5
6.	Debt obligations issued	3,9	3,9	3,7
7.	Other liabilities	8,7	8,0	7,1
	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	2009	2010	2011
Banks	17,96	18,41	21,63
Non-bank credit institutions	0,00	0,00	4,30
Banking sector total	**17,90**	**18,34**	**21,56**

Capital Adequacy Indicator
(at year-ends, %)

Type of financial institution	2009	2010	2011
Banks	20,9	18,8	14,6
Non-bank credit institutions	103,8	85,4	38,2
Banking sector total	**20,9**	**18,8**	**14,7**

Quality of Banking Sector Loan Portfolio
(at year-ends, as % of total loans)

Type of financial institution	2009	2010	2011
Standard loans	42,5	45,5	53,4
Non-standard loans	38,0	34,7	29,4
Doubtful loans	9,8	11,4	10,4
Problem loans	3,5	2,9	2,7
Bad loans	6,2	5,4	4,1
Loan loss provisions	**9,3**	**8,8**	**7,2**

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 2011
(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*	7,9	1,3
Legal entities	24,5	58,6
Individuals	43,7	19,6
Banks	7,9	5,8
Non-residents **	16,0	14,7
Total	100,0	100,0

* Including the Bank of Russia
** Including banks and other legal entities and individuals

Deposit and loan structure in 2011*
(at year-ends, %)

Loans, deposits and other funds raised by credit institution		Loans, deposits and other funds provided by credit institutions	
On demand	1,4	Long-term (over 3 years)	42,2
Less than 1 year	40,2	Mid-term (1-3 years)	25,2
Over 1 year	58,5	Short-term (less than 1 year)	32,6
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		
	2009	2010	2011	2009	2010	2011
Banks	27,7	24,2	23,3	25,3	22,8	21,6
Non-bank credit institutions	4,3	6,3	10,0	4,2	6,2	5,7
Banking sector total	27,6	24,1	23,3	25,3	22,7	21,5

Structure of Incomes and Expenses of Operating Credit Institutions (at year-ends, %)

	2009	2010	2011
1. Incomes, total	100,0	100,0	100,0
1.1. Interest income on funds provided to legal entities (without income on securities)	6,0	7,1	6,0
1.2. Interest income on loans to individuals	1,9	2,7	2,8
1.3. Incomes on securities	3,3	3,3	2,9
1.4. Incomes on operations with foreign exchange	72,0	62,5	65,4
1.5. Commissions received	1,5	2,3	2,1
1.6. Loss provisions recovery	11,5	18,2	14,5
1.7. Other incomes	3,9	3,9	6,2
of which:			
1.7.1. penalties, fines, forfeits	0,17	0,45	0,3
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)	3,0	2,8	2,4
2.2. Interest paid to individuals	1,5	2,6	2,0
2.3. Expenses on operations with securities	2,2	1,8	1,9
2.4. Expenses on operations with foreign exchange	71,9	64,0	67,2
2.5. Commissions paid	0,2	0,3	0,3
2.6. Expenses on loss provisions	14,9	19,7	15,3
2.7. Management expenses (including personnel expenses)	2,0	3,3	3,4
2.8. Other expenses	4,4	5,7	7,5
of which:			
2.8.1. Penalties, fines, forfeits	0,00	0,01	0,00

Structure of the Registered Authorized Capital and Equity Capital of Credit Institutions in 2011

Type of credit institution	Registered capital	/Total assets	Own funds	/Total liab.
	Mill. EUR	%	Mill. EUR	%
Banks	29 046,1	2,9	125 500,9	12,6
Non-bank credit institutions	94,8	2,2	294,0	6,9
Banking sector total	29 140,9	2,9	125 794,9	12,6

2011 DEVELOPMENTS IN THE SERBIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

In 2011, the Republic of Serbia recorded a moderate real growth of total economic activity compared to the previous years. According to official statistics, real gross domestic product (GDP) growth was 1.6% in 2011. After relatively strong growth in the first half of 2011, GDP growth was significantly slowed down in the second half of the year, due to a backlash of economic activity in Eurozone and southeastern Europe countries who are Serbia's largest foreign trade partners. Modest GDP growth of 0.5% is expected in 2012.

In 2011, The National Bank of Serbia (NBS) continued the implementation of Inflation Targeting Regime as its official monetary policy strategy. This monetary policy model applies since 1 January 2009 on the basis of the Agreement on Inflation Targeting, which was concluded between the NBS and the Government of the Republic of Serbia.

The inflation rate was reduced in 2011 compared to 2010. The consumer prices growth for 2011 was 7% compared to 10.3% in 2010. The inflation rate was further reduced in the first half of 2012, so in May 2012 it was 3.9% compared to May 2011.

In 2011, the NBS continued to implement a managed floating exchange rate regime. In terms of the analytical basket of currencies, according to the NBS data, in 2011 the dinar has appreciated by 10.3% in nominal terms and 4.4% in real terms.

The average wages were on the increase in 2011. According to official statistics, the average gross wage was 61,116 RSD and the average net wage (net of taxes and contributions) was 43,887 RSD in December 2011. The average nominal growth of net wages in December 2011 (y-o-y) was 10.9% while real growth was 3.6%.

Due to economic crisis influence, the unemployment rate increased from 19.2%, which was the average rate in 2010, to 23.0% in 2011.

In 2011, the Republic of Serbia recorded consolidated public revenues of 1,302.5 bl RSD and public sector expenditures of 1,460.9 bl RSD, which resulted in fiscal deficit of 158.4 bl RSD (5.0% of GDP). Basically, the fiscal deficit was financed by the issuance of debt securities.

The public debt was 14.5 bl EUR at the end of 2011 and its share in GDP, according to the NBS' methodology, increased to 47.7%. Total external debt was 24.1 bl EUR at the end of 2011, compared to 23.8 bl EUR at the end of 2010.

Current account deficit in Serbia was EUR 2.97 billion in 2011, which was reflected in current account deficit to GDP ratio of 9.5%, compared to EUR 2.08 billion in 2010.

Year-end 2011, total foreign exchange reserves stood at EUR 12.06 billion, 2.06 billion more than in 2010. This level of foreign exchange reserves ensured 8.6 months coverage of goods and services import.

Dinar reserve money reached RSD 227.1 billion by end-2011, up by RSD 38.9 billion from end-2010.

Money Supply M1 at the end of 2011 reached RSD 293.7 billion, compared to RSD 253.3 billion at the end of 2010.

Money Supply M2 at the end of 2011 reached RSD 487.9 billion, compared to RSD 410.5 billion at the end of 2010.

Short-term dinar and dinar-indexed bank claims were RSD 496.6 billion at the end of 2011 (RSD 559.3 billion in 2010), of which claims from companies were RSD 398.4 billion, from households RSD 68.4 billion and from public enterprises RSD 20.6 billion.

Long-term dinar and dinar-indexed bank claims were RSD 1,141.3 billion at the end of 2011, of which claims from companies were RSD 497.6 billion, from households RSD 527.3 billion and from public enterprises RSD 69.1 billion.

Key policy rate of NBS was 12% p.a. in January 2011. It was raised to 12.25% in March, to 12.50% in April, and afterwards gradually decreased to 9.75% in December 2011.

Average weighted interest rate on loans to households (for new loans) was 20.51% in December 2011 and on loans to non-financial sector 10.80% p.a.

Household savings with banks were RSD 794.99 billion or EUR 7.6 billion.

The main challenges in 2012 relate to fiscal and foreign trade deficit and unemployment.

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

The banking sector of Serbia was well protected and not dramatically affected by disturbances caused by the euro area debt crisis. All banks in Serbia are operating as independent legal entities, no branching is allowed. Banking sector is adequately capitalized and liquid as measured by international standards and local regulation, and reliant predominantly on domestic sources of funding (primarily foreign currency savings of citizens).

At the end of 2011, 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. Foreign-owned banks are members of banking groups from 11 countries and the most significant foreign banks are from Italy and Austria (22% and 19%, respectively), followed by banks from Greece (15%), France (10%) and other countries (8% share in total). During 2011, there were no changes in banking sector's ownership structure.

With a large number of banks holding small shares in total assets, lending, deposits and income, the Serbian banking sector is fragmented. The market share of the top five banks in Serbia is 47% for assets, 50% for lending and 48% for deposits.

Banking sector total balance sheet assets reached 25.2 bln EUR with growth rate of 4.1% in 2011.

The nominal growth of banks' total net loans was 8,9%, and reduced compare to 2010 (19.0% nominal growth), because of huge write-off by one bank. To a significant extent, the growth of lending activity is a result of the growth of loans to households (6,6% nominal growth) and repo transactions with NBS (155,5%).

At the end of 2011, the share of NPL's in total loans granted was 19.03% gross (10,47% net), while in absolute terms, their level reached 3.3 bln EUR gross.

Deposits recorded growth of 1.4% in 2011, mostly because of a growth in private companies' deposits (17.5% in 2011). Households' deposits had growth of 7.5% and share in the total bank funding sources amounts to 54.9% at the end of 2011. At the end of 2011 total FX household saving reached 7.6 bln EUR (0.5 bill EUR more than in 2010).

Also, banks recorded growth in own funding sources (7.2% in 2011), which resulted in equity of 5.1 bln EUR and still high proportion of own fund to total liabilities side of balance sheet (20.2%). The capital adequacy ratio is 19,1% (regulatory minimum is 12%).

The average regulatory liquidity ratio for the Serbian banking sector as at 31 December 2011 was 2.2, indicating that liquid assets (core and receivables maturing in the next 30 days) are twice as large as liabilities without maturity and liability maturity within 30 days. Liquid assets comprised 37.8% of total assets and amounted to 62.8% of total short-term liabilities.

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

The National Bank of Serbia published in 2011 new decisions aiming to bring secondary legislation into line with the Law on Amendments and Supplements to the Law on Banks and the Law on Amendments and Supplements to the Law on the National Bank of Serbia:

- Decision on Detailed Conditions and Manner of Conducting Bank Supervision
- Decision on the Contents of Documents and Evidence Submitted Along with the Application to Issue an Operating License to a Bridge Bank
- Decision on Implementing the Provisions of the Law on Banks Relating to Granting of a Preliminary Bank Founding Permit, Bank Operating License and Consents by the National Bank of Serbia, as well as the Provisions Relating to the Establishment of Criteria for Defining a First-Class Bank

During 2011, National Bank of Serbia has continued to amend and improve regulatory framework for banks in order to implement Basel II standards. Finalizing of preparation for full implementation of Basel II standards was a strategically important activity for the Banking Supervision Department and the whole NBS in 2011. The new regulation is aimed at further strengthening banking sector stability and safety, upgrade of the supervisory function by developing the risk-based supervision concept and harmonization with EU Directives that incorporate Basel 2 standards.

In June 2011, the Executive Board of the NBS adopted a set of six decisions introducing Basel II standards - the new capital adequacy framework was fully set:

- Decision on Bank Capital Adequacy, which implements Pillar 1 of Basel II;
- Decision on Reporting on Bank Capital Adequacy, which prescribes frequent reporting requirements for banks to the National Bank in connection with capital adequacy, bringing Serbia in line with the COREP (Common Reporting) regime implemented by all EU member countries;

- Decision on Risk Management by Banks, which implements Pillar 2 of Basel II standards and prescribes the obligations of banks to manage all risks to which they are exposed or may be exposed to in their operations, as well as requiring banks to maintain their capital reserves at a level that covers such risks. The key changes introduced by decision include: (i) establishing a comprehensive and reliable risk management system for banks; (ii) prescribing a strategy for risk management, strategy, policy and procedure for banks; (iii) imposing an obligation on banks to implement the internal capital adequacy assessment process (ICAAP), precisely defined requirements regarding maintaining business continuity of the bank (a Business Continuity Plan and Disaster Recovery Plan) and the responsibilities of bank management in the process; (iv) setting out criteria relating to risk management arising from outsourcing activities; and (v) introducing remuneration policies governing wages and bonuses;
- Decision on Disclosure of Data and Information by Banks, which promotes market transparency by imposing an obligation on banks to disclose data and information relating to their capital and risk exposures, in accordance with Pillar 3 of Basel II standards;
- Decision on Consolidated Supervision of Banking Group, which enables the implementation of new regulation based on Basel II, on a consolidated level; and
- Decision on Bank Reporting Requirements.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2011

The main strategic objective in 2011 was, as mentioned, the implementation of Basel II standards.

The first effects of new regulations were analyzed after the receipt of quarterly reports as of December 31, 2011. Banking sector capital adequacy ratio decreased from 19.7% as it was in the third quarter of 2011 to 19.1% in the fourth quarter of 2011. The drop in capital adequacy ratio was caused primarily by decrease of regulatory capital. Total regulatory capital in the fourth quarter of 2011 was 322.4 bn RSD which is a 20.7% decrease compared to 406.5 bn RSD in the third quarter of 2011. Tier I capital was 444.9 bn RSD in the fourth quarter of 2011, which is 6% lower than in the third quarter of 2011. Apart from the effect of 32.1 bn RSD increase in current year losses, the fall in Tier I capital was caused primarily by different methodology for applying prudential filters in the calculation of total regulatory capital. Also, more strict conditions for inclusion of subordinated debt in regulatory capital also contributed to the decrease in regulatory capital.

On the other hand, total capital requirements decreased, the main reason being lower capital requirement for credit risk (decreased from 245.4 bn RSD in the third quarter of 2011 to 175.2 bn RSD in the fourth quarter of 2011) resulting from significant changes in the methodology for calculation of credit risk-weighted assets (from Basel I to Basel II). It is important to mention that, by cancellation of risk weights 75% and 125% for debtors whose regular monthly income does not fully cover their obligations denominated and/or indexed in foreign currencies, foreign currency-induced credit risk is no longer captured by minimal capital requirements – rather, it is being monitored and managed within Pillar 2 of Basel II.

The introduction of Basel II also led to a change in total capital requirements structure. The share of capital requirement for credit risk is still dominant, but decreased in relative terms (86.6% in the fourth quarter of 2011 compared to 98.9% in the third quarter of 2011) due to introduction of capital requirement for operational risk (11.2% of total capital requirements in the fourth quarter of 2011). The capital requirement for market risks participated with cca 1% in total capital requirements before introduction of Basel II-based regulations, whereas the share of this capital requirement rose to cca 2% of total capital requirements after new regulations came into force.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

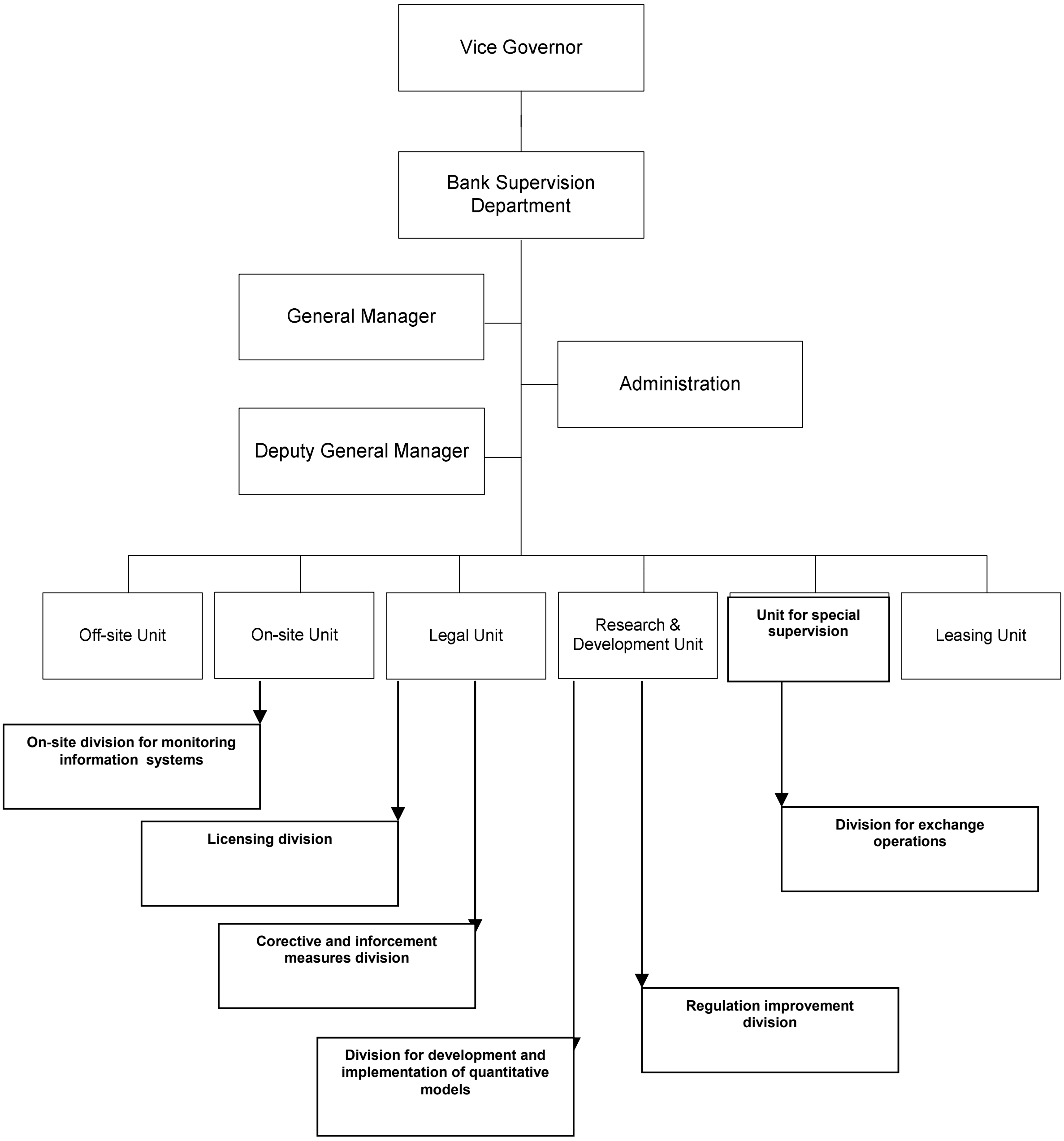
Activities of National Bank of Serbia, as banking supervisor, were primarily aimed to safeguarding stability of banks and banking sector and supplementing existing regulatory framework according to macroeconomic developments and international standards of supervision. In line with that, the National Bank of Serbia continued to implement countercyclical measures in order to achieve and maintain stability of banking sector and whole financial system.

The Decision on Measures for Safeguarding and Strengthening Stability of the Financial System was enacted in June 2011 aiming at safeguarding and strengthening stability of the financial system by decreasing systemic risk arising from the high share of foreign currency denominated loans and indexed loans. The main stipulations of this regulation are:

- Banks may approve to natural persons loans that are indexed to a foreign currency (currency of indexation can only be euro).
- If loans are granted in foreign currency mandatory down payment or deposit of no less than 30 percent of the loan amount (except mortgages and credit cards) is required.
- Maximum LTV ratio for mortgage loans of 80 percent unless mortgage loans are in local currency where no such requirement exist.

It is also important to mention changes in the Decision on the Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items which, as countercyclical measure, relate primarily to the relaxation of existing regulatory provisions (lowering of the provisioning percentages for categories B, C and D).

ORGANIZATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY



INTERNATIONAL ACTIVITIES OF THE AUTHORITY

In the field of banking supervision, the National Bank of Serbia, signed Memorandums of Understanding with foreign supervisory authorities from 11 countries and two multilateral agreements in previous period, and is in the process of negotiating MoU-s with FMA (Austrian supervisory authority) and the Autorité de Contrôle Prudentiel (France). It is importantn to mention, that the National bank of Serbia has already established very successful cooperation with those two supervisory authorities, since those authorities supervise parent banks that have its subsidiaries in Serbia.

Beyond signing Memorandums of Understandings, cooperation is extended through active participation at Supervisory Colleges organized by competent authorities in Italy, Austria, Slovenia, Hungary, Greece and Belgium. Although more often as host supervisor, the National bank of Serbia was active as home supervisor, as well: relevant supervisory college was organized in Belgrade.

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

Employees in Banking Supervision Department were participants of two-year program of the European Central Bank „Strengthening Macro and Micro-prudential Supervision" (in 2010 and 2011) – 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	2009	2010	2011
Commercial banks	34	33	33
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**34**	**33**	**33**

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

Type of financial institution	2009	2010	2011
Public sector ownership	17.5	17.9	17.9
Other domestic ownership	8.2	8.6	8.0
Domestic ownership total	25.7	26.5	25.9
Foreign ownership	74.3	73.5	74.1
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	32.7	47.2	664
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**32.7**	**47.2**	**664**

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

Type of financial institution	2009	2010	2011
Commercial banks	4.6	5.4	6.0*
Branches of foreign credit institutions			
Cooperative banks			
Banking sector, total:	**4.6**	**5.4**	**6.0***

Without one bank with huge loss in 2011

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
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	2009	2010	2011
Financial sector	13,1	10,8	9,6
Nonfinancial sector	50,7	54,1	52,5
Government sector	7,8	11,0	12,1
Other	28,4	24,1	25,8
Liabilities	**2009**	**2010**	**2011**
Financial sector	18,0	17,9	13,6
Nonfinancial sector	43,4	44,0	47,1
Government sector	3,8	3,1	3,3
Capital	20,7	19,7	20,6
Other	14,1	15,3	15,5

Capital adequacy ratio of banks

Type of financial institution	2009	2010	2011
Commercial banks	21.4	19.9	19.1
Cooperative banks			
Banking sector, total:	**21.4**	**19.9**	**19.1**

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

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

Asset classification	2009	2010	2011
Non financial sector			
- households	8,12	7,85	7,93
- corporate	20,88	21,85	24,62

The structure of deposits and loans of the banking sector in 2011 (%) (at year-end)

	Deposits	Loans
Households	57.6	33.4
Government sector	4.9	9.5
Corporate	24.3	46.0
Other (excluding banks)	13.2	11.1
Total	**100.0**	**100.0**

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

P&L account	2009	2010	2011
Interest income	168,918	179,702	201,234
Interest expenses	68,393	71,315	82,558
Net interest income	100,525	108,387	118,676
Net fee and commission income	31,594	32,985	35,335
Other (not specified above) operating income (net)	17,947	17,439	10,818
Gross income	150,065	158,811	164,829
Administration costs	85,610	92,229	93,535
Depreciation	8,320	8,588	8,353
Provisions	0	0	0
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	36,110	32,596	61,689
Profit (loss) before tax	20,025	25,398	1,252
Net profit (loss)	17,696	22,622	- 1,877

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	3,081,100	2,916,954	164,146	-
Cooperative banks				
Banking sector, total:	**3,081,100**	**2,916,954**	**164,146**	**-**

2011 DEVELOPMENTS IN THE SLOVAKIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

Economic developments in 2011 showed some signs of recovery in the Slovak Republic. In the second half of the year, the mood on the markets deteriorated due to the escalated European debt crisis as well as fears of renewed recession.

The outlook for 2012 is exceptionally uncertain. Several Euro-zone countries are sliding into recession, which will weigh heavily on the export-dependent Slovak economy. It appears that our key trading partner, Germany, may sustain positive growth; this could help to maintain a positive real GDP growth in Slovakia also, although at a slower 1% rate. At this forecast growth rate, though, the unemployment rate is expected to continue increase, which might impact negatively on household confidence and lower demand for financial products.

Indicator	2010	2011	2012e	2013e
GDP (nominal) in %	4,20%	3,30%	1,10%	2,70%
Unemployment rate in %	14,40%	13,50%	13,80%	13,70%
Inflation (nominal) in %	1,00%	3,90%	2,80%	2,30%
National debt to GDP in %	41,10%	44,40%	48,20%	45,30%
Fiscal deficit to GDP in %	-7,70%	-4,90%	-4,60%	-2,90%

DEVELOPMENT IN THE BANKING SECTOR[25]

The year 2011 saw several conflicting trends in the housing loan market. After growing at an accelerating pace over the first six months, housing loans showed weakening dynamics in the second half-year period in most of the banks. The slower growth in housing loans in that period was influenced largely by subdued demand on the part of households. The falling household demand for new loans was caused by several factors, including a loss of confidence among households regarding the further trend in their financial situation, continuing fall in residential property prices, and the large amount of loans provided in the first half of 2011. Despite the weakening demand, there was still relatively strong competition among banks. Consumer loans experienced a revival over the course of 2011. Their absolute increase in the second half-year period reached the level of 2008. However, the marked increase in the amount of loans was concentrated in several banks only.

25 Overall analysis of the Slovak Financial sector can be find on the following link: http://www.nbs.sk/en/publications-issued-by-the-nbs/nbs-publications/analysis-of-the-slovak-financial-sector

The above-average competitive pressure in the market for household deposits persisted in 2011. The strongest competition was recorded in the area of deposits with longer maturities. In the middle of the year, both demand and supply were influenced by increased redemptions in collective investment funds. The last quarter also saw a revival in the area of term deposits with an agreed maturity of up to one year, mainly to the detriment of sight deposits.

Lending to enterprises grew throughout the whole year of 2011. The year-on-year rate of growth slowed somewhat in the second half of the year. After June 2011, however, lending activity was more balanced in terms of its sectoral distribution, as well as in terms of the number of banks involved in corporate financing. The overall financial position of the non-financial institution sector improved slightly during 2011, mainly as a result of growth in external trade and its positive influence on the revenues of domestic enterprises. This factor, together with the relatively favourable interest rate developments, created room for an increase in demand for loans. On the other hand, demand was adversely affected by the low level of business confidence in both Slovakia and its main trading partners, and by an increase in funds inflows from abroad. Credit standards for new loans to enterprises remained relatively strict in 2011.

Investments in securities, mostly in Slovak government bonds, continued to account for a significant part of banks' assets in 2011. The total amount of securities held in the portfolios of individual banks remained virtually unchanged in 2011.

The largest changes in the structure of interbank assets and liabilities took place at the end of the year, as a result of the ECB's non-standard three-year refinancing operations. Banks used the funds so obtained as a replacement for interbank deposits and deposits from non-residents. The significance of interbank operations, except for daily liquidity management, was relatively small in 2011 for the majority of banks.

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

The National Bank of Slovakia performs supervision of the financial market.

As part of its supervision of the financial market, the National Bank of Slovakia shall perform supervision of banks, branch offices of foreign banks, securities dealers, branch offices of foreign securities dealers, stock exchanges, central depositories, asset management companies, branch offices of foreign asset management companies, mutual funds, foreign collective investment undertakings, insurance companies, reinsurance companies, branch offices of foreign insurance companies, branch offices of foreign reinsurance companies, branch offices of insurance companies from another state, branch offices of reinsurance companies from another state, pension asset management companies, pension funds, supplementary pension insurance companies, supplementary pension companies, supplementary pension funds, payment institutions, branch offices of foreign payment institutions, rating agencies, electronic money institutions, branch offices of foreign electronic money institutions, independent financial agents, financial advisers, the Deposit Protection Fund, the Investment Guarantee Fund, the Slovak Bureau of Insurers, consolidated groups, sub-consolidated groups, financial holding institutions, mixed financial holding companies, financial conglomerates, also over other persons, other property associations with a designated purpose and over groups of persons and property associations with a designated purpose.

No major changes in the area of legal competence of the National Bank of Slovakia were applied during the year 2011.

MAIN STRATEGIC OBJECTIVES IN 2011

Role and objectives of the Financial Market Supervision Division is defined by relevant legal rules. The objective of the integrated financial market supervision is to contribute to the stability of the financial market as a whole, as well as to the secure and sound operation of the financial market in the interest of maintaining credibility of the financial market, protecting clients, and respecting the competition rules.

There were no detailed strategic objectives in a formalised form defined for 2011.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY IN 2011

The activities of the Financial Market Supervision Division could by divided into the following 3 categories:

a. **Regulation and methodological activities**
   A significant part of the regulatory process in the banking sector in 2011 consisted of the preparation of the Law no. 520/2011 of 30 November 2011, which amends the Securities Act, and it includes a provision changing the Banking Act. The aim of the change was to implement the European Directive 2010/734, Omnibus I and CRD III, particularly as regards capital requirements for trading book, re-securitization and review of remuneration policies.
b. **Licensing**
   In 2011, the Division of banking and payment services issued 87 administrative decisions in the area of banking sector. The largest part of the proceedings (54 decisions) was based on the granting of permission for changes of members in the Board of Directors, Board of Supervisors and managers.
   The most important decisions (prior approvals) were taken in the following areas:
   - changes in the ownership structure in 2 banks
   - changes in the IRB models in 2 banks
   - changes in the AMA models

c. Banking Supervision

i. On-site

Eleven on-site examinations started in 2011 (10 in banks and 1 in branch of foreign bank). Seven examinations were formally completed in 2011, while other was formally completed in the first quarter of the year 2012.

The main topics of on-site supervision of banks were checking the quality of the risk management system, particularly credit risk, liquidity risk, market and operational risks and the related issues of capital requirements reporting for individual risks.

In addition the provisioning, credit receivables, investment services and the prevention of money laundering were examined.

ii. Off-site

Off-site supervision of banks and branches of foreign banks includes regular analyzing of reports, monitoring of prudential indicators, analytical work, and communication with the supervised entities and with home supervisory authorities.

In the 2011 Department of the banking supervision and payment services prepared monthly assessment of banks and branches of foreign banks, semi-annual analysis of individual banks and annual reports of each bank containing a detailed assessment of each bank, including an assessment of capital adequacy under Pillar II. Detailed reports were provided for home supervisors for the Joint Risk Assessment purposes.

ORGANISATIONAL CHART OF THE BANKING SUPERVISORY AUTHORITY[26]

- Executive Director of the 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

26 Organizational structure of the National Bank of Slovakia can be find on the following link http://www.nbs.sk/en/about-the-bank/organisational-structure

INTERNATIONAL ACTIVITIES

Financial Market Supervision Division covers the activities within the ESRB and participates in two working groups: Analysis Working Group and Instruments Working Group. Financial Market Supervision Division actively participates on the work of the European Banking Authority. Several employees have been nominated as members of different working groups the four Standing Committees of the European Banking Authority. An NBS representative chairs the Sub-group on Home-Host and Colleges under the European Banking Authority.

During the 36th plenary meeting of the European Council Committee MONEYVAL an evaluation report of the Slovak Republic has been discussed and approved. The report will be updated in 2013.

Ten CEE countries (Slovakia included) established an informal initiative called CEE10 Forum to exchange information and to prepare common stances regarding the new European legislation (CRD 4).

The employees of the Department participate on the international IPA Project to help Serbia face the challenges of the European integration and also on a technical assistance for the National Bank of Belarus.

An essential part of the banking supervision constitutes the cooperation with supervisory bodies which supervise parent institutions of subsidiaries based in Slovakia. This cooperation is realized mainly through the colleges of supervisors for the respective banking group. The Department participates in 9 colleges (8 banks and 1 branch of a foreign bank).

COOPERATION WITH OTHER SUPERVISORY BODIES IN THE COUNTRY

Financial Market Supervision Division communicates with all relevant sector associations, especially within the processes of preparation of regulation, recommendations and guidelines. There is a close cooperation among the NBS, the Ministry of Interior and the Police Headquarters. In 2011 the cooperation between the NBS and Financial Police has been strengthened (AML, terrorism financing).

STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
Commercial banks	16	15	14
Branches of foreign credit institutions	13	14	17
Cooperative banks	0	0	0
Banking sector, total:	26	29	31

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

Type of financial institution	2009	2010	2011
Public sector ownership	0,9%	0,9%	0,9%
Other domestic ownership	0,3%	0,3%	0,3%
Domestic ownership total	1,2%	1,2%	1,2%
Foreign ownership	98,8%	98,8%	98,8%
Financial Institutions, total	100,0%	100,0%	100,0%

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

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	55,7%	71,8%	n/a
Branches of foreign credit institutions	3,9%	5,2%	n/a
Cooperative banks	0,0%	0,0%	n/a
Banking sector, total:	100,0%	100,0%	n/a

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

Type of financial institution	2009	2010	2011
Commercial banks	5,4%	10,5%	12,0%
Branches of foreign credit institutions	n/a	n/a	n/a
Cooperative banks	0,0%	0,0%	0,0%
Banking sector, total:	n/a	n/a	n/a

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	94,4%	93,1%	92,8%
Branches of foreign credit institutions	5,6%	6,9%	7,2%
Cooperative banks	0,0%	0,0%	0,0%
Other	0,0%	0,0%	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	2009	2010	2011
Financial sector	13,7%	11,0%	8,1%
Nonfinancial sector*	57,3%	58,1%	61,7%
Government sector	23,9%	26,3%	24,8%
Other	5,1%	4,7%	5,3%
Liabilities	**2009**	**2010**	**2011**
Financial sector	17,4%	16,0%	14,5%
Nonfinancial sector	67,4%	69,4%	71,1%
Government sector	3,7%	2,8%	1,6%
Capital	9,6%	10,0%	10,7%
Other	1,9%	2,0%	2,1%

Capital adequacy ratio of banks (%)

Type of financial institution	2009	2010	2011
Commercial banks	12,6%	12,7%	13,4%
Cooperative banks	n/a	n/a	n/a

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

Asset Classification	2009	2010	2011
Non financial sector	1,34	1,15	1,15
- households	**n/a**	**n/a**	**n/a**
- corporate	**n/a**	**n/a**	**n/a**

The structure of deposits and loans in 2011 (%) (at year-end)

	Deposits	Loans
Household	59,3%	45,0%
Government sector	1,7%	3,0%
Corporate	34,7%	47,9%
Other (excluding banks)	4,3%	4,1%
Total	**100,0%**	**100,0%**

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

P&L account	2009	2010	2011
Interest income	2 338 752	2 264 837	2 508 783
Interest expenses	776 377	575 829	701 819
Net interest income	1 562 375	1 689 008	1 806 964
Net fee and commission income	403 798	439 419	465 936
Other (not specified above) operating income (net)	-55 927	-63 415	36 273
Gross income	1 910 246	2 065 012	2 309 173
Administration costs	984 065	977 263	1 007 813
Depreciation	159 078	150 976	134 221
Provisions	-23 041	-21 440	3 214
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	-403 481	-268 752	-347 986
Profit (loss) before tax	340 581	646 581	822 367
Net profit (loss)	250 131	503 820	671 483

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	4 487 847 000	4 146 312 000	341 535 000	0
Cooperative banks	0	0	0	0
Banking sector, total:	4 487 847 000	4 146 312 000	341 535 000	0

The Secretariat of the Group of Banking Supervisors from Central and Eastern Europe
1 Plac Powstańców Warszawy, 00-950 Warsaw, Poland
tel : +48 22 262 5650 fax: +48 22 262 5158
bscee@knf.gov.pl www.bscee.org

2011 DEVELOPMENTS IN THE SLOVENIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

According to the figures adjusted for the season and the number of working days, economic growth in Slovenia was significantly below the euro area average in 2011 at 0.2%. Before the number of working days was allowed for, GDP actually recorded a decline of the same magnitude. The deteriorating economic situation is for the most part the result of a decline in domestic demand, which was particularly pronounced in the second half of the year. Value-added in manufacturing increased by 3.0% in 2011, 3.5 percentage points less than in 2010. Construction investment declined by 25%, and remained the main brake on economic activity. Final household consumption recorded a gradual decline for the third consecutive year, as unemployment continued to rise and consumer purchasing power continued to decline. The majority of forecasts for 2012 envisage a stagnation of economic activity in the EU. At the same time there is little possibility of growth in domestic consumption, in the context of a continuing cost adjustment in the private sector and the urgency of fiscal consolidation. The economic situation will therefore remain poor in 2012.

Employment continued to fall in 2011 because of unfavourable economic situation. Employment was down 1.7%, considerably less than in the previous year. At the end of 2011 employment approached its level of 2006, while real value-added was also at that level. The number of registered unemployed rose by around 10% in 2011, to pass 112,000 by the end of the year.

Average inflation as measured by the harmonised index of consumer prices stood at 2.1% in 2011, unchanged from 2010, although its structure altered somewhat. The most notable increase was in the contribution made by food prices. Average annual inflation in Slovenia was significantly below the euro area average of 2.7%.

The current account deficit widened in 2011. It amounted to EUR 385 million or 1.1% of GDP, 0.3 GDP percentage points more than in the previous year. The merchandise trade deficit remained the main factor in the current account deficit. Growth in merchandise trade slowed sharply last year as a result of the rapid decline in growth in foreign demand in the second half of the year and the decline in domestic consumption.

Last year's net outflow of funds from the private sector stood at more than EUR 2 billion, which means that the private sector financed the rest of the world. The private sector's claims against the rest of the world increased by EUR 971 million overall in 2011, primarily as a result of increases in claims from currency and deposits and in capital transfers. Corporates last year recorded net borrowing in the rest of the world for the first time since 2009, as the banks made debt repayments in the rest of the world and the European Banking Authority (EBA) issued requirements to raise original own funds. The gross external debt increased by EUR 858 million last year to stand at EUR 41.6 billion at the end of the year. Gross external claims stood at EUR 30.1 billion at the end of the year, up EUR 436 million on the end of 2010.

The general government deficit widened by 0.4 GDP percentage points in 2011 to 6.4% of GDP. This was the third consecutive year with a large general government deficit. The general government debt stood at EUR 16,954 million at the end of 2011, or 47.6% of GDP.

Slovenia approved EUR 140.6 million in loans in 2011 as part of the financial assistance for Greece, while the stock of government guarantees had reached EUR 118.5 million by the end of the year on the basis of the Republic of Slovenia Guarantee for Maintaining Financial Stability in the Euro Area Act. Government sureties and guarantees amounted to EUR 6,996 million at the end of the year, or 19.6% of GDP.

The spreads of Slovenian 10-year government bonds over the benchmark German bonds have primarily risen since the middle of 2011. Having mostly fluctuated around 120 basis points in the first half of the year, the spread of Slovenian bonds had reached almost 500 basis points by the end of the year. Standard & Poor's, Moody's and Fitch all downgraded Slovenia's long-term sovereign debt in November and all maintained a negative outlook, which means the possibility of further downgrading.

Slovenia has been undergoing an excessive deficit procedure since December 2009. Fiscal consolidation is vital to Slovenia, and is a priority of the government. The preparation and implementation of appropriate structural reforms will also be vital to achieving long-term sustainable economic growth.

DEVELOPMENTS IN THE BANKING SYSTEM

There was no change in the number of credit institutions in Slovenia in 2011. At the end of the year the Slovenian banking system comprised 19 banks (including eight subsidiary banks), three branches of foreign banks and three savings banks. In terms of ownership structure, the banking system comprises eight banks under majority domestic ownership, three banks under 100% domestic ownership and eight banks under majority foreign ownership. The banking system's total assets amounted to EUR 48.8 billion at the end of 2011, having declined by EUR 1.5 billion or 3.1% during the year.

There was a notable decline in year-on-year growth in loans to non-banking sectors in 2011 at all the bank groups. The stock of loans to non-banking sectors had declined by 4.3% by the end of the year, the domestic banks recording the largest decline. Lending to non-financial corporations was down 5.9%, the domestic banks again recording the largest decline.

The stock of loans to households increased by EUR 198 million in 2011, mostly as a result of the banks under majority foreign ownership. Growth in loans to households stood at 2.3%, but was lower than in 2010 at all the bank groups. Variable interest rates on housing loans rose to 3.9% in 2011, 0.4 percentage points higher than in the euro area at the end of the year. Interest rates on consumer loans rose, but remained below the euro area average.

Refinancing risk has also increased since the middle of 2011, in line with the situation on international financial markets, Slovenia's downgrading and the rising cost of funding on the market. The banking system's liabilities to the Eurosystem increased by EUR 1.1 billion in 2001 to EUR 1.7 billion. The banks partly used the long-term loans raised to reduce debt to the rest of the world (reduction by EUR 2.2 billion in 2011).

Deposits by non-banking sectors remain the most important element of bank funding. The proportion of the banking system's total funding that they account for stood at 49.6% at the end of 2011, up 2.9 percentage points on a year earlier. Year-on-year growth in deposits by non-banking sectors averaged 3.1% on a monthly basis in 2011, down slightly from 2010. Interest rates on household deposits of up to 1 year again remained below the euro area average in 2011, and rose at a much slower pace, while household deposits of more than 1 year increased significantly faster than in the euro area overall as a result of the higher interest rates caused by the banks' need for stable long-term funding.

The Slovenian banking system was exposed to significant credit risk and income risk in 2011. Net interest in 2011 was down 2.9% on the previous year, primarily as a result of the increase in interest expenses outpacing that of interest income. With the number of bankruptcies rising and the situation in the sector of non-financial corporations deteriorating, growth in impairment and provisioning costs remained above-average last year. The banking system's performance thus worsened significantly, as it recorded a loss after taxation of EUR 411 million, according to unaudited and unconsolidated figures. The deterioration in the quality of the credit portfolio continued in 2011. The proportion of all classified claims classed as bad claims increased by 2.5 percentage points to 6.2%. The proportion of firms more than 90 days in arrears in settling their liabilities to banks increased by 2.0 percentage points to 14.7%. The proportion of classified corporate assets more than 90 days in arrears increased by 6.2 percentage points to 18.5%. The most prominent sectors are construction (49.6% of the total) and information and communication activities (25.5%).

The liquidity of the banking system as measured by the liquidity ratio remained at a satisfactory level last year. The decline in funding via securities issues and borrowing in the rest of the world exposed the banks to refinancing risk, which they partly mitigated by borrowing from the Eurosystem. Interest rate risk increased slightly last year. The solvency of the banking system remains the key issue for their owners from the point of view of improving performance. From the point of view of regulatory requirements, the banking system maintained a satisfactory capital adequacy in 2011. The capital adequacy ratio stood at 11.7% in December 2011, up 0.4 percentage points on a year earlier. The Tier 1 capital ratio increased by 0.6 percentage points over the same period to stand at 9.6%.

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 capital market is supervised by the Securities Market Agency, and
- the insurance sector with pension savings is supervised by the Insurance Supervision Agency.

According to the Bank of 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.

CHANGES TO THE BANKING REGULATION

Most of the changes to banking regulations in 2011 were related to the transposition of Directive 2010/76/EU of 24 November 2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for resecuritisations, and the supervisory review of remuneration policies (the CRD III). Some of the provisions of this directive were transposed into the Slovenian legal system by the amendment of the Banking Act, the ZBan-1G (Official Gazette of the Republic of Slovenia, No. 59/11), while the remaining provisions were transposed by the amendment ZBan-1H (Official Gazette of the Republic of Slovenia, No. 85/11). The majority of the Bank of Slovenia regulations cited below were also adopted on the basis of these two amendments of the Banking Act. Certain regulations adopted last year arose on the basis of the amendment ZBan-1F (Official Gazette of the Republic of Slovenia, No. 35/11), which intervenes in the area of ethics of governance, and other changes in legislation or findings from supervisory practice.

The *Regulation on the documentation for demonstrating fulfilment of the conditions for performing the function of a member of the management board of a bank or savings bank* was amended in February. The amendment requires the submission of a photocopy of evidence of the candidate's professional qualifications and notification of the Bank of Slovenia of any proceedings for an economic offence or misdemeanour that could be initiated against the candidate, while a broader description of the bank management strategy is also required.

A new *Regulation on the amounts of annual fees for supervision and fees for decisions regarding requests for the granting of authorisation* was adopted in April. All provisions relating to electronic money institutions have been removed from the regulation, because as of the end of April 2011 a change of definition means that these institutions are no longer regulated by the Banking Act (they are no longer defined as credit institutions).

The *Regulation on large exposures of banks and savings banks* was updated in May. In the determination of maximum allowable exposure banks are now granted more favourable treatment for their exposures to other banks established in the EU that are members of the same banking group as the bank and are included in supervision on a consolidated basis.

The new ZBan-1F, published in May 2011, instructed the Bank of Slovenia to prescribe detailed rules for the conduct of members of management boards and supervisory boards in performing their functions in accordance with the relevant standards of professional diligence and the highest ethics of governance, with regard to conflicts of interest and the criteria for defining a significant business contact. The aforementioned rules and criteria were the subject of August's updated *Regulation on the diligence of members of the management and supervisory boards of banks and savings banks*. The ZBan-1F also expands the range of disclosures to be made by banks, who must now also disclose information on all significant business contacts that members of their management boards and supervisory boards and their immediate family members have had with the bank or a subsidiary of the bank. In addition, banks must disclose information on compliance with regulations, other rules as well as internal rules that govern conflicts of interest involving the members of the management and supervisory bodies of subsidiary financial corporations established outside Slovenia. It was necessary to revise the *Regulation on disclosures by banks and savings banks* to define the aforementioned disclosures in greater detail.

The two aforementioned regulations also had to be updated for reason of the new ZBan-1G published in July. The important new features brought by the ZBan-1G included new powers and duties for members of a bank's supervisory board in connection with remuneration policy, the obligation to appoint a remuneration committee at systemically important banks of the Slovenian banking system, and additional disclosures on the remuneration system and the earnings of employees with jobs of a specific nature (i.e. employees whose duties allow them to have a significant impact on the bank's risk profile).

In accordance with the CRD III, the ZBan-1G introduces a remuneration system as a mandatory component of the governance system at each bank. The remuneration system, which should encourage adequate and effective risk management, includes remuneration policy and practice, in respect of which the Bank of Slovenia must prescribe detailed rules. These rules are set out in the new *Regulation on risk management and implementation of the internal capital adequacy assessment process for banks and savings banks* published in August. The new regulation also defined terms in the area of remuneration, the internal audit department's obligations in respect of the remuneration system, the application of the principle of proportionality and the conditions for exemption of certain rules, and the general and specific requirements regarding the adjustment of remuneration to risk. It was also necessary to revise the *Regulation on the reporting of individual facts and circumstances of banks and savings banks* on the basis of the ZBan-1G to provide a more detailed definition of the information to be reported to the Bank of Slovenia in relation to employee remuneration.

Two other regulations were issued in August, namely the *Regulation on the calculation of capital requirements for credit risk under the standardised approach for banks and savings banks* and the *Regulation on the calculation of capital requirements for credit risk under the internal ratings-based approach for banks and savings banks*, which brought minor changes for Slovenian banks deriving from the CRD III.

The *Regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks* was amended in September. The amendment improved the treatment of sight deposits of households and non-financial corporations in the calculation of the liquidity ratios in accordance with their intended treatment within the LCR (*liquidity coverage ratio*) standard.

In November the *Regulation on the documentation for the granting of authorisations to provide banking and financial services and for status transformations* was amended. The new ZBan-1G introduced the remuneration system as a mandatory component of the governance system of each bank, as a result of which it was necessary to amend the aforementioned regulation, which includes documentation about the governance system in the documentation to be enclosed with the application for an authorisation to provide banking services.

A broad package of regulations was adopted in December to transpose the remaining provisions of the CRD III into the Slovenian legal system. These comprised updates to the Regulation on the calculation of the own funds of banks and savings banks, the Regulation on the calculation of capital requirements for credit risk in securitisation and the rules on the exposure of banks and savings banks to transferred credit risk, the Regulation on the calculation of capital requirements for market risks for banks and savings banks and the Regulation on disclosures by banks and savings banks. The major changes to the aforementioned regulations are described below.

The *Regulation on the calculation of the own funds of banks and savings banks* was primarily amended in the part relating to deductions in the calculation of own funds. The main change relates to the requirement for the prudential valuation of all financial assets measured at fair value, irrespective of whether they are in the banking book or the trading book.

The most significant change brought in accordance with the CRD III by the new *Regulation on the calculation of capital requirements for credit risk in securitisation and the rules on the exposure of banks and savings banks to transferred credit risk* is the stricter treatment of re-securitisation positions relative to "ordinary" securitisation positions via a higher risk weight for the purpose of calculating capital requirements. The CRD III now requires the calculation of capital requirements for securitisation positions in the trading book, which equalises the treatment of positions with regard to the banking book.

The *Regulation on the calculation of capital requirements for market risk for banks and savings banks* was primarily amended in the part relating to the calculation of capital requirements for position risk, currency risk and commodity risk using an internal approach. Banks will therefore have to comply with stricter quantitative and qualitative standards in the calculation of value-at-risk, and calculate additional capital requirements based on the calculation of value-at-risk for stress situations.

The main changes to the *Regulation on disclosures by banks and savings banks* relate to the expansion of disclosures in the area of securitisation and the use of internal approaches for calculating capital requirements for position risk, currency risk and commodity risk.

Given the amendments to the regulations governing the calculation of own funds and capital requirements, it was also necessary by the end of the year to amend the *Regulation on the reporting of the own funds and capital requirements of banks and savings banks*, and the *Guidelines for the electronic submission of reports on own funds and capital requirements*, which regulates the form and method of electronic reporting.

The Regulation (EC) on credit rating agencies (No 1060/2009/EC) primarily governs the pursuit of the activities of credit rating agencies in the EU, but also affects the use of credit assessments by credit institutions and recognition of the eligibility of external credit assessment institutions by banking supervisors. As a result of the amendment of this regulation, which transferred all duties and responsibilities in connection with decisions on the registration and supervision of credit rating agencies, and in connection with decisions on the use of their credit assessments to the European Securities and Markets Authority (ESMA), it was necessary to also amend the *Regulation on the recognition of external credit assessment institutions* and the *Regulation on the calculation of capital requirements for credit risk under the standardised approach for banks and savings banks*. The two regulations were published in December.

In December the *Regulation on the reporting of individual facts and circumstances of banks and savings banks* was amended, by virtue of which the Bank of Slovenia prescribed the reporting of exposures of banks and savings banks to members of their management boards and supervisory boards and their immediate family members, and exposures to other persons in a special relationship with the bank. The purpose of the new half-yearly report solely covering exposures in excess of EUR 20,000 is the uniform of data on the actual stock of exposures to which particular attention must be given by banks, in addition to large exposures.

MAIN STRATEGIC OBJECTIVES OF THE SUPERVISORY AUTHORITY IN 2011

The main strategic orientation of banking supervision, coming out of the Bank of Slovenia's strategic plan for the period 2009 – 2012 is to design and introduce conditions for a stable and efficient banking system and for the security of deposits at banks and savings banks.

In the frame of this strategic objective and considering the current situation of the macroeconomic environment the main focus of banking supervision in 2011 were:

- evaluation of increasing credit risk in banks as a consequence of economic and financial crisis,
- carefully monitoring of overall liquidity in the banking system as well as the position of individual banks,
- emphasising the attention to the capital position of banks and required increase of Tier I capital with the goal to increase robustness of banks,
- adoption of the national legislation according to the latest changes of EU legislation,
- further intensifying of cross-boarder cooperation with foreign supervisory authorities at IRB and AMA approval processes and supervisory colleges.

THE ACTIVITIES OF THE BANKING SUPERVISORY AUTHORITY

Licensing

The Bank of Slovenia issued a total of 14 authorisations in 2011, and suspended the authorisation procedure for two applications. Nine of the authorisations issued in 2011 were to hold office as a member of a bank’s management board, four were to provide ancillary financial services, and one was to merge a legal entity with a bank. The Bank of Slovenia revoked one authorisation to acquire a qualifying holding in a bank in 2011, because the holder no longer satisfied the conditions defined by regulations that owners of a significant holding should permanently satisfy.

The Bank of Slovenia received 22 notifications of the direct provision of banking and other mutually recognised financial services in 2011, the same as in the previous year. 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.

Examinations of banks and savings banks

The Banking Supervision Department conducted regular prudential examinations of banks and savings banks in 2011, based on an assessment of risks and the quality of the control environment for risk management. Examinations of specific areas were prevalent among the examinations and reviews conducted, practice having shown that shorter and thus more frequent and more detailed examinations of specific areas are more significant and thus more needed than comprehensive reviews (examinations of all areas of operations). Due to the development of the macroeconomic situation, the greatest emphasis was placed on credit risk, liquidity risk and capital risk. In accordance with the Basel core principles for effective banking supervision, the Banking Supervision Department consistently monitors the implementation of all measures via specific follow-up reviews. It also maintains continuous contacts with banks and savings banks at a number of hierarchical levels, primarily via shorter visits and/or regular annual meetings at the completion of a review or otherwise. These meetings focus on assessing the capital adequacy, performance and current financial position of the banks and savings banks in question, and learning about their strategy for the bank's future development. The regular exchange of opinions and information between supervisors and the management of banks or savings banks is also a prerequisite for timely and appropriate action with the aim to prevent operating difficulties.

On the basis of the powers of the Governor of the Bank of Slovenia, there were 32 supervisory review procedures initiated in 2011. In the procedures initiated in the current year and the procedures initiated in previous years, the Banking Supervision Department carried out:

- 10 prudential examinations which covered 27 specific risk areas and the control environment,
- 26 follow-up examinations to review the implementation of measures.

In addition to the above, the Banking Supervision Department also conducted thematic examinations of compliance with legislation on the prevention of money laundering and terrorist financing, banks’ ability to provide information about guaranteed deposits, banks’ readiness to use bank loans as collateral for Eurosystem claims and other narrower areas of banking operations. There were 23 such examinations.

Based on the findings of examinations and reviews at banks and savings banks, the Bank of Slovenia may issue recommendations, admonishments or orders, or another measure in accordance with the Banking Act. There were 14 orders to eliminate violations in 52 points issued in 2011, along with 100 admonishments and 121 additional reporting requirements, recommendations to improve operations and conditions for the granting of authorisations. The majority of measures were issued in the area of credit risk, followed by liquidity risk, capital risk and interest rate risk. Numerous measures were also issued because of breaches of legislation on the prevention of money laundering and terrorist financing. All of the measures in respect of banks were discussed and approved by the Governing Board of the Bank of Slovenia.

Another very important element of banking supervision is the regular annual review of the calculation of capital requirements, which banks draw up during the internal capital adequacy assessment process (ICAAP) in accordance with the rules and procedures set out in the European Directive and the ZBan-1. Intensive communication was undertaken with certain banks to this end, while specific reviews were also conducted. The main result of the SREP is that the supervisor determines a minimum level of capital adequacy for each bank with regard to the scope and level of the risks that it is exposed to. The Bank of Slovenia expects banks to maintain this level of capital adequacy at all times in their operations.

For the banks under majority foreign ownership, frequent and ongoing cooperation with foreign supervisors has been established within supervisory colleges, which have recently assumed an increasingly important role in the exchange of information of relevance to supervisors of an individual banking group, and in the coordination of supervisory activities. Managing supervisors and examiners responsible for individual banks regularly participate in supervisory colleges for individual international banking groups. The Bank of Slovenia participates in six colleges for banking groups that also operate in Slovenia. For the operational functioning of these colleges the Bank of Slovenia has signed the relevant multilateral agreements with all other supervisors involved in supervision of the group. In accordance with a European directive, procedures to assess the overall capital adequacy of the banking group were conducted for the first time in the supervisory colleges, headed by the supervisors of the parent bank in the banking group. In these cases the Bank of Slovenia participates as a host supervisor responsible for a subsidiary bank. A joint decision on capital adequacy was reached by all supervisors for all six foreign banking groups.

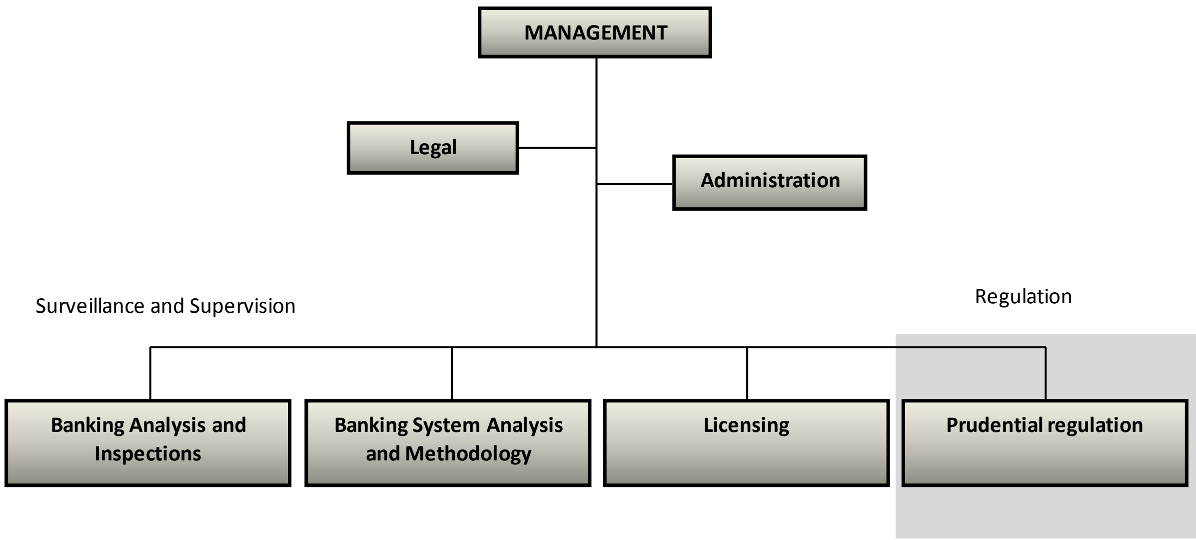
The Bank of Slovenia is responsible for the organisation and chairing of the supervisory colleges for the Slovenian banking groups of Nova Ljubljanska banka and Nova kreditna banka Maribor. The meetings of the colleges in November involved representatives of the supervisory institutions from all the countries where the two banks have subsidiaries. The Bank of Slovenia also conducted the capital adequacy assessment process for the two banking groups. A joint decision on capital adequacy was reached and signed by all the competent supervisors. In addition to cooperating with supervisors from other countries within the framework of the supervisory colleges, the Banking Supervision Department also maintained bilateral contacts with certain supervisors on the basis of bilateral memorandums of understanding (the Bank of Slovenia has 12 MoUs with foreign supervisory institutions) and participated in two supervisory reviews of a subsidiary bank.

The Bank of Slovenia approved seven requests in 2011 for authorisations relating to elements in the calculation of own funds, in particular the repayment of subordinated debt classified as additional capital, the inclusion of subordinated debt in additional capital, the redemption of a hybrid instrument, and the inclusion of a hybrid instrument in Tier 1 capital.

Supervisory process

Certain changes were made to the operation of the Banking Supervision Department in 2011 with the aim of ensuring the most proactive and effective possible supervisory process in the altered economic circumstances and in the business climate faced by the banks. The changes provide for more in-depth and systematic preparations for examinations and reviews, based on monitoring and consideration of the impact of macroeconomic and systemic developments on the risk exposure of the individual bank, the distinctive nature of each bank's business model being taken into account. This has ensured faster, more effective detection of changes in the risk exposure of the banking system, and has strengthened the preventive and counter-cyclical work of the supervisor. The demarcation of competencies at all levels of supervisory activity has also been made clearer, while inter-departmental and inter-sectoral cooperation has been enhanced with the aim of better horizontal transparency, objectivity and efficiency.

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.

Bank of Slovenia is in the position of being home supervisor for NLB group and NKBM group. In 2011 Bank of Slovenia organized two colleges, one for each aforementioned group. Between the college meetings information is exchanged directly: on bilateral meetings, via participation of Bank of Slovenia on exit meetings in subsidiaries abroad, on meetings with host supervisors and also joint inspections with host supervisors and via supervisory reports (based on common templates). In 2011 we also concluded JRAD process for both groups ending with signed Joint Decision on capital adequacy. The multilateral memoranda of understanding (MMoU) were prepared and discussed for both colleges.

On the other hand, Bank of Slovenia is in role of the host supervisor of seven foreign owned banks: UniCredit Banka Slovenije d. d. (UniCredit Group), Banka Koper d. d. (Intesa SanPaolo Group), Hypo Alpe-Adria-Bank d. d. (Hypo Group Alpe-Adria), Banka Volksbank d. d. (Volksbank International), Raiffeisen banka d. d. (Raiffeisen Bank International), SKB d. d. (Societe Generale Group), BAWAG (BAWAG). This means that the Bank of Slovenia has to cooperate with three different home authorities: Italian (BdI), Austrian (FMA) and French (ACP). Over the last years the cooperation of home and host supervisors increased. The large part of this increase is due to the processes of the adoption of Joint Decisions on either advanced models or capital adequacy. The home supervisor for each banking group usually organizes two college meetings per year. Bank of Slovenia has also signed the MMoUs for every above mentioned banking group. Supplementary cooperation among relevant supervisors is conducted via usual communication channels (restricted internet web site, e-mail, fax, phone). There were 29 colleges in which Bank of Slovenia participated as host authority in the last three years (2009 -2011).

Bank of Slovenia is actively participating at numerous expert groups and task forces operating under European Banking Authority and European System of Central Banks.

In 2011, Bank of Slovenia provided technical assistance in the area of banking supervision to central banks of Kosovo, Macedonia, Montenegro and Serbia.

COOPERATION WITH OTHER DOMESTIC SUPERVISORY AUTHORITIES

Cooperation with the other two Slovenian supervisory institutions for financial services (the Securities Market Agency and the Insurance Supervision Agency) proceeded on the basis of the Rules on mutual cooperation by supervisory authorities, and took the form of regular meetings, exchanges of information between the aforementioned institutions, and examinations and reviews of banks and related parties coordinated in terms of theme and timing. The Banking Supervision Department participated in three joint reviews in 2011.

Under the rules, the supervisory institutions are required to inform one another when they identify any irregularities that fall under the auspices of another supervisory institution.

STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
Commercial banks[1]	22	22	22
Branches of foreign credit institutions	3	3	3
Cooperative banks	0	0	0
Banking sector, total	**25**	**25**	**25**

[1] including 3 savings banks

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

Type of financial institution	2009	2010	2011
Public sector ownership	20,5	21,7	24,2
Other domestic ownership	40,1	40,1	37,7
Domestic ownership total	60,6	61,8	61,9
Foreign ownership	39,4	38,2	38,1
Banking sector, total	**100,0**	**100,0**	**100,0**

Concentration of asset by the type of financial institutions in 2011 (at year-end)

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	45,3	59,6	0,0887
Branches of foreign credit institutions	100,0	/	0,7662
Cooperative banks	/	/	/
Banking sector, total	**44,7**	**58,9**	**0,1110**

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

Type of financial institution	2009	2010	2011
Commercial banks	3,9	-2,4	-12,7
Branches of foreign credit institutions	/	/	/
Cooperative banks	/	/	/
Banking sector, total	**3,9**	**-2,3**	**-12,5**

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
Commercial banks	99,0	99,0	98,7
Branches of foreign credit institutions	1,0	1,0	1,3
Cooperative banks	/	/	/
Banking sector, total	**100,0**	**100,0**	**100,0**

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

Assets*	2009	2010	2011
Financial sector[1]	15,1	14,4	13,8
Nonfinancial sector[2]	64,2	66,1	64,8
Government sector[3]	11,3	11,1	12,8
Other	9,4	8,4	8,6
Liabilities*	**2009**	**2010**	**2011**
Financial sector[1]	30,7	29,8	26,2
Nonfinancial sector[2]	38,2	41,0	42,9
Government sector	7,7	6,0	7,0
Capital	8,3	8,2	8,0
Other[4]	15,1	15,0	15,9

[1] banking sector
[2] non-banking sector
[3] included government debt securities
[4] included funding from ECB

Capital adequacy ratio of banks

Type of financial institution	2009	2010	2011
Commercial banks**	11,6	11,5	12,1
Cooperative banks	/	/	/
Banking sector, total**	**11,6**	**11,5**	**12,1**

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

Asset portfolio quality of the banking sector (share of impaired receivables / share of non-preforming loans[1])

Asset classification	2009	2010	2011
Non financial sector	3,6 / 2,2	4,8 / 3,7	6,5 / 6,2
- households[2]	**3,6 / 2,8**	**3,4 / 2,9**	**3,0 / 3,4**
- corporate	**4,6 / 2,6**	**6,5 / 4,6**	**9,3 / 8,9**

[1] Non-preforming loans include all classified claims (financial assets at amortisied cost and some risky-bearing off-balance sheet items) from groups D and E (with impairments or provisions higher than 40 percent)
[2] Just citizens without small entrepreneurs

The structure of deposits and loans of the banking sector in 2011 (%) (at year-end)

	Deposits	Loans
Households	60,5	27,3
Government sector	14,1	3,7
Corporate	15,8	55,3
Other (excluding banks)	9,6	13,7
Total	**100,0**	**100,0**

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

P&L account	2009	2010	2011
	EUR thousands	EUR thousands	EUR thousands
Interest income	2 114 747	2 075 028	2 207 430
Interest expenses	1 175 134	1 027 718	1 189 886
Net interest income	939 613	1 047 310	1 017 540
Net fee and commission income	342 737	349 798	346 460
Other (not specified above) operating income (net)	157 812	93 933	82 842
Gross income	1 440 162	1 491 041	1 446 842
Administration costs	688 565	691 422	687 096
Depreciation	88 426	87 248	89 502
Provisions	9 755	20 047	62 227
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)	491 284	791 231	1 144 536
Profit (loss) before tax	162 132	-98 907	-536 521
Net profit (loss)	123 035	-96 289	-441 998

Total own funds in 2011 (in EUR)

Type of financial institution	Total Capital	Tier 1	Tier 2	Tier 3
Commercial banks	4 360 799	3 606 309	754 491	/
Cooperative banks	/	/	/	/
Banking sector, total	**4 360 799**	**3 606 309**	**754 491**	**/**

2011 DEVELOPMENTS IN THE UKRAINIAN BANKING SYSTEM

MACROECONOMIC ENVIRONMENT

The 2011 macroeconomic situation in Ukraine was characterized by improved key macroeconomic indicators.

Thus, growth of real GDP of Ukraine in 2011 was 5.2%, which was 1.1 p.p. higher than in 2010. In 2011 nominal GDP was UAH 1,316.6 billion, by 21.6% higher than in the previous year. Industrial output grew by 7.6%; growth was registered for almost all main types of industrial activity.

The real available household income growth rates grew by 6.1% in 2011.

Consumer inflation was the lowest in the last 9 years amd made 104.6% (109.1% in 2010). The Producer Price Index stood at 114.2%.

The core inflation rate for 2011 made up 6.9% (in 2010: 7.9%).

In 2011, net inflow of direct foreign investments went up to USD 7 billion compared with USD 5.8 billion in 2010. By the end of 2011, accumulated foreign investments reached USD 64.5 billion.

DEVELOPMENT IN THE BANKING SYSTEM

As of January 1, 2012, 176 banks had the National Bank of Ukraine banking license.

In 2011, the number of banks with foreign capital went down from 55 to 53 entities (30.1% of the total number of banks operating in Ukraine), while that of banks with 100% foreign capital increased from 20 to 22 entities (12.5%).

The foreign capital in the registered authorized capital of Ukrainian banks augmented by 21% in 2011, amounting to UAH 72 billion as of January 01, 2012. The portion of foreign capital in the registered authorized capital of Ukrainian banks grew from 40.6% to 42%.

Foreign capital in Ukraine is represented by 25 countries. The largest shares within the total foreign capital fall on capital from Russia (21/9%), Cyprus (17.1%), Austria (11.9%), France (10.7%), Germany (8.7%), Sweden (8.5%) and Hungary (4.0%).

The banking system of Ukraine has completed the year 2011 with the following positive trends secured:

- In a year, total assets grew by 11% up to UAH 1211.5 billion or EUR 118 billion (by 9% in 2010).
- Lending operations that make almost 70% of the assets grew by 9% up to UAH 825 billion or EUR 80 billion (by 1% in 2010).
- Loans to economic entities grew by 14.3%(by 7% in 2010) up to UAH 581 billion or EUR 56 billion .
- The liabilities of banks grew almost by 12% up to UAH 899 billion or EUR 87 billion (by 5% in 2010).
- In 2011, funds of individuals grew by 13% up to UAH 306 billion or EUR 30 billion.

- Funds of economic entities grew by 29% up to UAH 186 billion or EUR 18 billion.
- Regulatory capital grew by 11% up to UAH 178.5 billion or EUR 17 billion.
- Regulatory capital adequacy of the Ukrainian banking system made 18,90% as of January 1, 2012.

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 2011

In 2011, the National Bank of Ukraine took steps to further stabilize the banking system of Ukraine, improve the loan portfolio quality and lending procedures, facilitate bank loan paybacks, reduce debts on loans classified as negative, raise 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 2011

In 2011, the national bank of Ukraine activities were aimed at further improvement of banking legal framework.

On the initiative and with the direct participation of the National Bank experts, the Verkhovna Rada has passed the following laws:

- ***On Beneficial Owners***, provisions whereof allow to increase transparency of banks through streamlining procedures for revealing banks' beneficial owners and setting higher requirements for them, to raise their responsibility for the bank standing, and to warrant higher public awareness about banks' activities. The law has raised the minimum requirement to the authorized capital to the level of UAH 120 million 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;

- ***On Consolidated Banking Supervision*** that allows more comprehensive and higher quality supervision through introduction of consolidated supervision over groups comprising financial institutions, including banks, as well as through limiting risks to a financial institution arising from its belonging to such a group, and provides for the procedure of cooperation and coordination of activities of the financial market state regulatory authorities in the area of consolidated supervision;
- ***On settling legal issues between creditors and consumers of financial services***, that is aimed at maintaining the balance and equally high levels of rights protection for all participants of financial services market, solving topical issues in the course of exercising the rights set by the law both for creditors and consumers of financial services.

Verkhovna Rada (Parliament) has passed in the first reading the draft law ***On Corporate Governance in Banks*** that will assist in improving corporate management in banks, in particular, through developing an efficient mechanism for distribution of authority between banks' managing and controlling bodies, raising responsibility of managers and owners of a bank for the results of their activities, establishing efficient risk management framework and improving the internal control systems in banks.

Following the new legislative requirements, the National Bank of Ukraine has approved:

- Regulation ***On the Procedure for Banks Registration and Licensing***, opening of separate substructures and Regulation ***On the Procedure for Submitting Data on the Ownership Structure;***
- Regulation ***On the Procedure for Granting General Licences for Foreign Exchange Transactions to Banks and Foreign Banks' Branches****;*
- amendments to the ***Regulation On peculiarities of bank's reorganization upon decision of the bank owners***;
- Regulation O***n the Procedure for Maintaining the Register of Auditors*** entitled to audit the banks;
- amendments to Regulation on Planning and Carrying out Inspections related to ***improvement of the approaches to inspections effected by the National bank of Ukraine***;
- amendments to Instruction on the Procedure for Regulation of Bank Activities in Ukraine in what concerns ***improvement of the approaches to calculation of regulatory capital and liquidity ratios, as well as investment ratios***.

Significant effort has been put into ***reducing bad loans in the banking system***:

- legal prerequisites have been formed for the operation of the bad assets market;
- the Procedure has been approved for banks of Ukraine to cover bad debts with reserves, which provides more opportunities for banks to write off bad debts at the expense of reserves, this being settled with the State Tax Administration.

Besides, the National Bank of Ukraine has approved the Regulation ***On the Procedure of Registration, License Issuance, Regulation of a Bridge Bank***

and its Supervision, which defines the procedure for establishing a bridge bank, particularities of regulation and supervision of its activities.

ORGANIZATIONAL STRUCTURE OF THE BANKING SUPERVISORY AUTHORITY

In 2011, the following structural subdivisions within the National Bank of Ukraine were responsible for banking supervision:

- General Department of Banking Supervision;
- Department of Banking Regulation and Supervision Legal and Methodological Support;
- Department for Registration, Licensing and Reorganization of Banks;
- Department for Financial Monitoring.

General management of the said subdivisions was effected by the NBU Deputy Governor in charge of banking supervision.

INTERNATIONAL ACTIVITIES OF THE BANKING SUPERVISION SERVICE

During 2011, the National Bank of Ukraine continued to work on improving and deepening cooperation in the area of banking supervision with foreign supervisory authorities.

In 2011, the National Bank of Ukraine signed the Bilateral Memorandum of Understanding on cooperation in supervision over credit institutions with the Swedish Financial Supervisory Authority (Finansinspektionen).

Overall, by the end of 2011, the National Bank of Ukraine had entered into respective bilateral Memoranda on cooperation with supervisory authorities of 13 countries, namely: Cyprus, Latvia, Kyrgyz Republic, Republic of Armenia, Lithuania, the People's Republic of China, Poland, the Republic of Belarus, the Russian Federation, Luxemburg, Hungary, Turkey and Sweden, as well as two multilateral agreements on cooperation and coordination of supervision over OTP Group and Cyprus Popular Bank.

COOPERATION WITH OTHER SUPERVISORY AUTHORITIES

The National Bank of Ukraine, performing the function of banking supervision, coordinates its activities and exchange of information with other supervisory authorities of the country, in particular, the State Commission for Regulation of Financial Services Markets and the State Commission for Securities And Stock Market.

STATISTICAL TABLES

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

Type of financial institution	2009	2010	2011
Commercial banks	182	176	176
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	**182**	**176**	**176**

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

Type of financial institution	2009	2010	2011
Public sector ownership	13.3	14.0	14.1
Other domestic ownership	35.9	39.0	47.9
Domestic ownership total	49.2	53.0	62.0
Foreign ownership	50.8	47.0	38.0
Banking sector, total:	**100.0**	**100.0**	**100.0**

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

Type of the financial institutions	The first three largest (%)	The first five largest (%)	HHI
Commercial banks	27.9	36.6	0.0426
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	27.9	36.6	0.0426

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

Type of financial institution	2009	2010	2011
Commercial banks	-32.52	-10.19	-5.27
Branches of foreign credit institutions	-	-	-
Cooperative banks	-	-	-
Banking sector, total:	-32.52	-10.19	-5.27

Distribution of market shares in balance sheet total (%)

Type of financial institution	2009	2010	2011
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 (In EUR million) (at year-end)

Assets	2009	2010	2011
Cash and bank metals	1,898	2,530	2,623
Funds at the NBU	2,038	2,477	3,040
Correspondent accounts with other banks	4,483	6,393	7,613
Loans	65,277	71,410	80,143
Investments in securities	3,436	7,903	8,518
Accounts receivable	2,336	1,955	4,004
Fixed and intangible assets	4,005	4,729	5,383
Accrued income	3,339	4,751	5,171
Other assets	0.7	1,000	1,153
Total Assets	**87,487**	**103,115**	**117,647**
Liabilities	**2009**	**2010**	**2011**
Funds of the NBU	7,378	6,689	6,805
Correspondent accounts of banks	0.8	1,210	1,334
Interbank loans and deposits	16,936	16,345	16,169
Funds of legal entities	10,062	13,623	18,082
Funds of individuals	18,343	25,606	29,734
Funds of non-bank financial institutions	1,076	1,492	1,724
Budget and off-budget funds	0.7	0.4	0.4
Credits from international and other financial organizations	3,657	3,698	3,531
Own debt securities	0.4	0.3	0.7
Subordinated debt	2,639	3,376	3,318
Accrued expenses	1,000	0.9	1,098
Accounts payable	2,881	2,122	4,058
Other liabilities	0.9	0.3	0.4
Total Liabilities	**66,830**	**76,076**	**87,278**

Capital adequacy ratio of banks

Type of financial institution	2009	2010	2011
Commercial banks	18.08*	20.83*	18.90*
Cooperative banks	-	-	-
Banking sector, total:	18.08*	20.83*	18.90*

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

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

Asset classification	2009	2010	2011
Non financial sector	12.9	14.6	13.8
- households	**3.9**	**4.3**	**4.3**
- corporate	**9.0**	**10.3**	**9.5**

The structure of deposits and loans of the banking sector in 2011 (%)
(at year-end)

	Deposits	Loans
Households	63.1	25.1
Government sector	0.8	1.1
Corporate	31.1	71.8
Other (excluding banks)	5.0	2.0
Total	**100.0**	**100.0**

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

P&L account	2009	2010	2011
Interest income	10,578	10,719	11,007
Interest expenses	5,816	5,808	5,778
Net interest income	4,761	4,911	5,229
Net fee and commission income	5,915	6,104	1,496
Other (not specified above) operating income (net)	-0,519	-0,432	-984
Gross income	12,490	12,943	13,865
Administration costs	2,465	2,748	3,333
Depreciation	0,271	0,302	343
Provisions	6,590	4,367	3,545
Impairment on financial assets not measured at fair value through profit and loss / Provisions on financial assets (loans, ...)			
Profit (loss) before tax	-3,417	-1,244	-631
Net profit (loss)	-3,358	-1,232	-749

Total own funds in 2011 (in EUR million)

Type of financial institution	Total own funds (for CAR)	Tier 1	Tier 2	Tier 3
Commercial banks	17,329[27]	12,834	4,780	-
Cooperative banks	-	-	-	-
Banking sector, total:	17,329	12,834	4,780	-

27 After supervisory deductions

MAIN GROUP EVENTS OF THE YEAR 2011

24th Annual BSCEE Members' Conference

Tirana, Albania, April 12 – 14, 2011

The Chairmanship of the BSCEE Group in 2011 was held by the Bank of Albania and Mr. Indrit Banka, Director of the Supervision Department, was entrusted the position of the Chairman. Therefore, the 24th Annual BSCEE Members' Conference was hosted by the Bank of the Albania on April 12 - 14, 2011 in Tirana.

The first day of the two days' conference was devoted to *The role of the banking system and the supervisor in the financial stability.*

Presentations were made by the representatives of the following institutions:

- Bank of Albania, *The role of the banking system and the supervisor in the financial stability – the Albanian point of view.*
- Austrian Financial Market Authority, *The role of the banking system and the supervisor in the financial stability – the Austrian point of view.*
- Bank of Slovenia, *The role of the banking system and the supervisor in the financial stability – the Slovenian point of view.*
- Polish Financial Supervision Authority, *The role of the banking system and the supervisor in the financial stability – the Polish point of view.*
- Basel Committee on Banking Supervision, *The role of the banking system and the supervisor in the financial stability.*

The second day focused on the topic of *Basel III*.

Presentations were made by the representatives of the following institutions:

- Banca D'Italia, *The overall background and reasons behind introducing the reforms of Basel III.*
- Basel Committee on Banking Supervision, *Basel III.*
- EBRD, *Beyond the crisis: rebuilding sound banks.*
- Bank of Albania, *Financial System Stability Issues.*
- BSCEE Secretariat, *Report of the Secretariat.*

The Austrian Financial Market Authority volunteered to hold the 2012 BSCEE Chairmanship as well as host the 25th Annual Conference and the Member countries accepted this candidature by acclamation.

FSI – BSCEE Regional Seminar

Vienna, Austria, May 2 – 4, 2011

The Austrian Financial Market Authority in cooperation with the Financial Stability Institute and the BSCEE Secretariat organized a regional seminar for BSCEE member countries on *Basel III Application.*

BSCEE High-Level Meeting in St. Petersburg, Russia, May 24 – 25, 2011

On May 24 - 25, 2011 the High-Level Meeting on the New Framework to Strengthen Financial Stability and Regulatory Priorities was hosted by the Central Bank of the Russian Federation and co-organized by the Financial Stability Institute and the BSCEE Group.

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
Central Bank of Armenia	*6, Vazgen Sargsyan str.* *PO Box 0010, Yerevan* *Republic of Armenia*	*www.cba.am*
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
Banking Agency of Federation of Bosnia and Herzegovina	*Kosevo 3, Sarajevo 4000* *Bosnia and Herzegovina*	www.fba.ba
Banking Agency of Republika Srpska, 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* *Tallinn 15030, Estonia*	www.fi.ee
Hungarian Financial Supervisory Authority	*Krisztina krt. 39* *1013 Budapest, Hungary*	www.pszaf.hu
Financial and Capital Market Commission	*Kungu iela 1* *Riga, LV-1050, Latvia*	www.fktk.lv
Bank of Lithuania	*Zirmunu St 151* *Vilnius, LT-09128 Lithuania*	www.lbank.lt

National Bank of Macedonia	*Kuzman Josifovski Pitu Blvd 1 Skopje, 1000 Macedonia*	www.nbrm.mk
National Bank of Moldova	*1 Grigore Vieru Ave. Chisinau, MD-2005 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. 103016 Moscow, 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	*Institutska str. 9. 01601 Kiev, Ukraine*	www.bank.gov.ua
BSCEE Secretariat	*Plac Powstańców Warszawy 1 00-950 Warsaw, Poland*	www.bscee.org